CEAPRO
Nature Enhancing Life®

# Management's Discussion & Analysis

2011

The MD&A provides commentary on the results of operations for the years ended December 31, 2011 and 2010, the financial position as at December 31, 2011 and the outlook of Ceapro Inc. ("Ceapro") based on information available as at April 27, 2012. The following information should be read in conjunction with the audited consolidated financial statements as at December 31, 2011, and related notes thereto, which are prepared in accordance with International Financial Reporting Standards (IFRS), as well as the audited consolidated financial statements for the year ended December 31, 2010 prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP) and the Management Discussion and Analysis (MD&A) for the year ended December 31, 2010. All comparative percentages are between the periods ended December 31, 2011 and 2010 and all dollar amounts are expressed in Canadian currency, unless otherwise noted. Additional information about Ceapro can be found on SEDAR at www.sedar.com.

## Forward-looking Statements

This MD&A offers our assessment of Ceapro's future plans and operations as at April 27, 2012, and contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, including those discussed below. You are cautioned that the assumptions used in the preparation of forward-looking information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. No assurance can be given that any of the events anticipated will transpire or occur, or if any of them do so, what benefits Ceapro will derive from them. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise unless required by law.

## Vision, Core Business, and Strategy

Ceapro Inc. (Ceapro) is incorporated under the Canada Business Corporations Act, and its wholly-owned subsidiaries, Ceapro Technology Inc., Ceapro Veterinary Products Inc., Ceapro Active Ingredients Inc., and Ceapro BioEnergy Inc. are incorporated under the Alberta Business Corporations Act. Ceapro (P.E.I.) Inc. is a wholly owned subsidiary incorporated in Prince Edward Island. Ceapro USA Inc. is a wholly-owned subsidiary incorporated in the state of Nevada. Ceapro is a growth stage biotechnology Company. Our primary business activities relate to the development and commercialization of natural products for personal care, cosmetic, medical and animal health industries using proprietary technology and natural, renewable resources.

Our products include:

- A commercial line of natural active ingredients, including *beta glucan, avenanthramides (colloidal oat extract*), *oat powder, oat oil*, *oat peptides* and *lupin peptides* which are marketed to the personal care, cosmetic, medical and animal health industries through our distribution partners and direct sales; and

- Veterinary therapeutic products, including an *oat shampoo*, an *ear cleanser,* and a *dermal complex/conditioner*, which are manufactured and marketed to veterinarians in Japan and Asia, through agreements with Daisen Sangyo Co. Ltd.

Other products and technologies are currently in the research and development or pre-commercial stage. These technologies include:

- *CeaProve*®, a diabetes test meal to screen pre-diabetes and to determine dosage levels for diabetes oral therapy, and to monitor the condition of pre-diabetics;

- *A drug delivery* platform using our *beta glucan* technology to deliver compounds for uses ranging from wound care and therapy, to skin care treatments that reduce the signs of aging;

- An extension t*o the active ingredients* product range offering, through new plant extract products including products from unique varieties of spearmint and rosehips; and

- A variety of novel manufacturing technologies including “Pressurized Green Solvent” drying technology which is currently being tested on oat beta glucan but may have application for multiple classes of compounds.

Our vision is to be a global leader in developing and commercializing products for the human and animal health markets through the use of proprietary technology and renewable resources. We act as innovator, advanced processor and formulator in the development of new products. We deliver our technology to the market through distribution partnerships and direct sales efforts. Our strategic focus is in:

- Identifying unique plant sources and technologies capable of generating novel natural products;
- Increasing sales and expanding markets for our current active ingredients;
- Developing and marketing additional high-value proprietary therapeutic natural products;
- Developing and improving manufacturing technologies to ensure efficiencies; and
- Advancing new partnerships and strategic alliances to develop new commercial active ingredients and manufacturing technologies.

As a knowledge-based enterprise, we will also expand and strengthen our patent portfolio and build the necessary manufacturing infrastructure to become a global technology Company.

Our business growth depends on our ability to access global markets through distribution partnerships and direct sales. Our marketing strategy emphasizes providing technical support to our distributors and their customers and generating direct sales to maximize the value of our technology and product utilization. Our vision and business strategy are supported by our commitment to the following core values:

- Adding value to all aspects of our business;
- Enhancing the health of humans and animals;
- Discovering, extracting, and commercializing new, therapeutic natural ingredients;
- Producing the highest quality work possible in products, science, and business; and
- Developing personnel through guidance, opportunities, and encouragement.

To support these objectives, we believe we have strong intellectual and human capital resources and we are developing a strong base of partnerships and strategic alliances to exploit our technology. The current economic environment provides challenges in obtaining financial resources to fully exploit opportunities. To fund our operations, Ceapro relies upon revenues primarily generated from the sale of active ingredients, and the proceeds of public and private offerings of equity securities, debentures, government grants and loans and other investment offerings.

## Risks and Uncertainties

Biotechnology companies are subject to a number of risks and uncertainties inherent in the development of any new technology. General business risks include: uncertainty in product development and related clinical trials and validation studies; the regulatory environment, for example, delays or denial of approvals to market our products; the impact of technological change and competing technologies; the ability to protect and enforce our patent portfolio and intellectual property assets; the availability of capital to finance continued and new product development; and the ability to secure strategic partners for late stage development, marketing, and distribution of our products. To the extent possible, we pursue and implement strategies to reduce or mitigate the risks associated with our business.

The Company has exposure to credit, liquidity and market risk as follows:

a) Credit risk:

Accounts receivable
The Company makes sales to customers that are well-established and well-financed within their respective industries. Based on previous experience the counterparties had zero default rates and management views this risk as minimal. Approximately 81% of accounts receivable are due from two customers at December 31, 2011 and all accounts receivable are current. These main customers present good credit quality and historically have a high quality credit rating.

Cash and cash equivalents
The Company has cash and cash equivalents in the amount of $592,259 at December 31, 2011 and mitigates its exposure to credit risk on its cash balances by maintaining its bank accounts with Canadian Chartered Banks and investing in low risk, high liquidity investments.

The Company received $750,000 under a capital expenditure grant agreement and has presented this amount as deferred revenue and considers it restricted cash as it can be spent only for qualified expenditures.

There are no past due or impaired financial assets. The maximum exposure to credit risk is the carrying amount of the Company's accounts receivable, cash and cash equivalents and restricted cash and cash equivalents. The company does not hold any collateral as security.

b) Liquidity risk:

Liquidity risk relates to the risk that the Company will encounter difficulty in meeting its financial obligations. The long-term debt matures in January 2013. It is the intention of the Company that refinancing will be negotiated at that time should it be required. The Company may be exposed to liquidity risks if it is unable to collect its trade accounts receivable balances in a timely manner, which could in turn impact the Company's long-term ability to meet commitments under its current facilities. In order to manage this liquidity risk, the Company regularly reviews its aged accounts receivable listing to ensure prompt collections. The Company regularly reviews its cash availability and whenever conditions permit; the excess cash is deposited in short-term interest bearing instruments to generate revenue while maintaining liquidity. There is no assurance that the Company will obtain sufficient funding to execute its strategic business plan.

The following are the contractual maturities of the Company's financial liabilities and obligations.

| | 0 - 1 year<br>$ | 1 - 3 years<br>$ | 4 - 7 years<br>$ | Total<br>$ |
|---|---|---|---|---|
| Accounts payable and accrued liabilities | 624,154 | - | - | 624,154 |
| Long-term debt, including interest | 208,613 | 1,006,951 | - | 1,215,564 |
| Royalties interest payable | 33,366 | - | - | 33,366 |
| Royalty financial liability | 74,057 | 189,566 | - | 263,623 |
| Repayable research funding | 52,133 | 32,500 | - | 84,633 |
| Repayable CAAP funding | - | 30,770 | 92,311 | 123,081 |
| Total | 992,323 | 1,259,787 | 92,311 | 2,344,421 |

c) Market risk

Market risk is comprised of interest rate risk, foreign currency risk and other price risk. The Company's exposure to market risk is as follows:

1. Foreign currency risk

Foreign currency risk arises from the fluctuations in foreign exchange rates and the degree of volatility of these rates relative to the Canadian dollar.

The following table summarizes the impact of a 1% change in the foreign exchange rates of the Canadian dollar against the US dollar (USD) on the financial assets and liabilities of the Company.

| | Foreign Exchange Risk (USD) | | |
|---|---|---|---|
| | Carrying Amount (USD) | -1% Earnings & Equity | +1% Earnings & Equity |
| **Financial assets** | | | |
| Accounts receivable | 424,807 | 4,248 | (4,248) |
| **Financial Liabilities** | | | |
| Accounts payable and accrued liabilities | 177,783 | (1,778) | 1,778 |
| **Total increase (decrease)** | | 2,470 | (2,470) |

The carrying amount of accounts receivable and accounts payable and accrued liabilities in USD represents the Company's exposure at December 31, 2011.

2. Interest rate risk.

The Company has minimal interest risk because its long-term debt is a fixed rate of 5.49%. However, in the event of a default, the rate would increase to 7.49% and result in an increase in the required monthly principal and interest payment by $1,541.

Management believes that changes in interest rates will not have a material impact on the Company as the Company's long-term debt is due in January, 2013.

3. Share price risk.

a) Ceapro's share price is subject to equity market price risk, which may result in significant speculation and volatility of trading due to the uncertainty inherent in the Company's business and the technology industry.

b) There is a risk that future issuance of common shares may result in material dilution of share value, which may lead to further decline in share price. The expectations of securities analysts and major investors about our financial or scientific results, the timing of such results and future prospects, could also have a significant effect on the future trading price of Ceapro's shares.

4. People and process risk.

A variety of factors will affect Ceapro's future growth and operating results, including the strength and demand for the Company's products, the extent of competition in our markets, the ability to recruit and retain qualified personnel, and the ability to raise capital.

Ceapro's consolidated financial statements are prepared within a framework of IFRS selected by management and approved by the Board of Directors. The assets, liabilities, revenues, and expenses reported in the consolidated financial statements depend to varying degrees on estimates made by management. An estimate is considered a critical accounting estimate if it requires management to make assumptions about matters that are highly uncertain; and if different estimates that could have been used would have a material impact. The significant areas requiring the use of management estimates relate to provisions made for inventory valuation, amortization of property and equipment, the assumptions used in determining share-based compensation, the interest rates used in determining the employee future benefits obligation, the liability portion of convertible debentures, the liability on the license agreement, and the estimated sales projections to value the royalty financial liability. These estimates are based on historical experience and reflect certain assumptions about the future that we believe to be both reasonable and conservative. Actual results could differ from those estimates. Ceapro continually evaluates the estimates and assumptions.

i) Loss of key personnel

Ceapro relies on certain key employees whose skills and knowledge are critical to maintaining the Company's success. Ceapro has procedures in place to identify and retain key employees and always attempts to be competitive with compensation and working conditions.

ii) Interruption of raw material supply:

Interruption of key raw materials could significantly impact operations and our financial position. Interruption of supply could arise from weather related crop failures, or from market shortages. Ceapro attempts to purchase key raw materials well in advance of their anticipated use.

iii) Environmental issues:

Violations of safety, health and environmental regulations could limit operations and expose the Company to liability, cost and reputational impact. In addition to maintaining compliance with national and provincial standards, Ceapro maintains internal safety and health programs.

iv) Regulatory compliance:

As a natural extract producer, Ceapro is subject to various regulations and violation of these could limit markets into which we can sell. Ceapro has introduced a range of procedures which will ensure that Ceapro is well prepared for new regulations, and obligations that may be required.

## Adoption of International Financial Reporting Standards

The consolidated financial statements included in this annual MD&A reflect the adoption of IFRS that are in effect on December 31, 2011. Periods prior to January 1, 2010 have not been restated and were in accordance with Canadian GAAP which was applied during the periods prior to the effective date of the company's adoption of IFRS. Our consolidated financial statements subsequent to this report will be prepared in accordance with IFRS.

Note 3 to the consolidated financial statements gives further information with regards to the conversion to IFRS, including a reconciliation of key components of our financial statements previously prepared under Canadian GAAP to those under IFRS as at and for the year ended December 31, 2010 and as at January 1, 2010.

## Future Accounting Pronouncements

Financial instruments disclosure

In October 2010, the IASB issued amendments to IFRS 7 – Financial Instruments: Disclosures that enhance the disclosure requirements in relation to transferred financial assets. The amendments are effective for annual periods beginning on or after July 1, 2011, with earlier application permitted. The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

Financial instruments

The IASB intends to replace IAS 39 - Financial Instruments: Recognition and Measurement ("IAS 39") in its entirety with IFRS 9 - Financial Instruments ("IFRS 9") in three main phases. IFRS 9 will be the new standard for the financial reporting of financial instruments that is principles-based and less complex than IAS 39. In November 2009 and October 2010, phase 1 of IFRS 9 was issued and amended, respectively, which addressed the classification and measurement of financial assets and financial liabilities. IFRS 9 requires that all financial assets be classified as subsequently measured at amortized cost or at fair value based on the company's business model for managing financial assets and the contractual cash flow characteristics of the financial assets. Financial liabilities are classified as subsequently measured at amortized cost except for financial liabilities classified as at fair value through profit or loss, financial guarantees and certain other exceptions. On August 4, 2011, the IASB published for comments an exposure draft proposing to defer the mandatory effective date of IFRS 9 from annual periods beginning on or after January 1, 2013 (with earlier application permitted) to annual periods beginning on or after January 1, 2015 (with earlier application permitted).

Consolidation

In May 2011, the IASB issued IFRS 10 – Consolidated Financial Statements ("IFRS 10"), which supersedes SIC 12 and the requirements relating to consolidated financial statements in IAS 27 – Consolidated and Separate Financial Statements. IFRS 10 is effective for annual periods beginning on of after January 1, 2013, with earlier application permitted under certain circumstances.

IFRS 10 establishes control as the basis for an investor to consolidate its investees; and defines control as an investor's power over an investee with exposure, or rights, to variable returns from the investee and the ability to affect the investor's returns through its power over the investee.

In addition, the IASB issued IFRS 12 – Disclosure of Interest in Other Entities ("IFRS 12") which combines and enhances the disclosure requirements for the Company's subsidiaries, joint arrangements, associates and unconsolidated structured entities. The requirements of IFRS 12 include reporting of the nature of risks associated with the Company's interests in other entities and the effect of those interests on the Company's consolidated financial statements.

Concurrently with the issuance of IFRS 10, IAS 27 and IAS 28 – Investments in Associates ("IAS 28") were revised and reissued as IAS 27 – Separate Financial Statements and IAS 28 – Investments in Associates and Joint Ventures to align with the new consolidation guidance. The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

Joint ventures

In May 2011, the IASB issued IFRS 11 – Joint Arrangements ("IFRS 11"), which supersedes IAS 31 – Interest in Joint Ventures and SIC-13 – Jointly Controlled Entities – Non-Monetary Contributions by Venturers. IFRS 11 is effective for annual periods beginning on of after January 1, 2013, with earlier application permitted under certain circumstances. Under IFRS 11, joint arrangements are classified as joint operations or joint ventures based on the rights and obligations of the parties to the joint arrangements. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement ("joint operators") have rights to the assets and obligations for the liabilities relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement ("joint ventures") have rights to the net assets of the arrangement. IFRS 11 requires that a joint operator recognizes its portion of assets, liabilities, revenues and expenses of a joint arrangement, while a joint venturer recognizes its investment in a joint arrangement using the equity method. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

Income taxes

In December 2010, the IASB issued an amendment to IAS 12 – Income Taxes that provide a practical solution to determining the recovery of investment properties as it relates to the accounting for deferred income taxes. The amendment is effective for annual periods beginning on or after January 1, 2012 with earlier application permitted. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

Fair value measurement

In May 2011, as a result of convergence project undertaken by the IASB and the US Financial Accounting Standards Board, to develop common requirements for measuring fair value and for disclosing information about fair value measurements, the IASB issued IFRS 13 – Fair value Measurement ("IFRS 13"). IFRS 13 is effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. IFRS 13 defines fair value and sets out a single framework for measuring fair value which is applicable to all IFRSs that require or permit fair value measurements or disclosures about fair value measurements. IFRS 13 requires that when using a valuation technique to measure fair value, the use of relevant observable inputs should be maximized while unobservable inputs should be minimized. The Company does not anticipate the application of IFRS 13 to have a significant impact on its consolidated financial statements.

Financial statements presentation

In June 2011, the IASB issued amendments to IAS 1 – Presentation of Financial Statements ("IAS 1") that require an entity to group items presented in the Statement of Comprehensive Income on the basis of whether they may be reclassified to earnings subsequent to initial recognition. For those items presented before taxes, the amendments to IAS 1 also require that the taxes related to the two separate groups be presented separately. The amendments are effective for annual periods beginning on or after July 1, 2012 with earlier adoption permitted. The Company does not anticipate the application of the amendments to IAS 1 to have a material impact on its consolidated financial statements.

Employee Benefits

In June 2011, the IASB issued amendments to IAS 19 – Employee Benefits ("IAS 19") that introduced changes to the accounting for the defined benefit plans and other employee benefits. The amendments include elimination of the options to defer, or recognize in full in earnings, actuarial gains and losses and instead mandates the immediate recognition of all actuarial gains and losses in other comprehensive income and requires use of the same discount rate for both the defined benefit obligation and the expected asset return when calculating interest cost. Other changes include modification of the accounting for termination benefits and classification of other employee benefits. The amendments to IAS 19 are effective for annual periods beginning on or after January 1, 2013. The Company does not anticipate the application of the amendments to IAS19 to have a material impact on its consolidated financial statements.

## Results of Operations

## Years Ended December 31, 2011, 2010 and 2009

### CONSOLIDATED INCOME STATEMENT

| $000s except per share data | 2011 IFRS | % | 2010 IFRS | % | 2009 GAAP | % |
|---|---|---|---|---|---|---|
| Total revenues | 5,786 | 100% | 5,577 | 100% | 4,370 | 100% |
| Cost of goods sold | 2,538 | 44% | 3,061 | 55% | 2,252 | 52% |
| Gross margin | 3,248 | 56% | 2,516 | 45% | 2,118 | 48% |
| Research and product development | 997 | 17% | 774 | 14% | 577 | 13% |
| General and administration | 1,374 | 24% | 1,279 | 23% | 1,469 | 34% |
| Selling and marketing | 111 | 2% | 69 | 1% | 184 | 4% |
| Finance costs | 181 | 3% | 203 | 4% | 328 | 8% |
| Income (loss) from operations | 585 | 10% | 191 | 3% | (440) | -10% |
| Other operating loss | (7) | 0% | (30) | -1% | (55) | -1% |
| Write off of property and equipment | - | 0% | (12) | 0% | - | 0% |
| SGGF legal fees | - | 0% | 315 | 6% | 426 | 10% |
| Net income (loss) | 578 | 10% | 464 | 8% | (69) | -2% |
| Basic net income (loss) per common share | 0.009 | | 0.009 | | (0.000) | |
| Diluted net income (loss) per common share | 0.009 | | 0.009 | | (0.000) | |
| Total assets | 4,171 | | 2,820 | | 2,771 | |
| Long-term financial liabilities | 1,206 | | 1,384 | | 1,997 | |

The Company’s revenue increased by 4% or $209,000 to $5,786,000 from $5,577,000 while cost of goods sold decreased by 17% or $523,000 to $2,538,000 from $3,061,000.

These positive changes resulted in a significant increase in gross margin by 29% or $732,000 to $3,248,000 from $2,516,000.

Income from operations has increased by $394,000 to $585,000 from $191,000.

Net income increased 10% in 2011 in comparison with 2010.
There were significantly higher research and development expenditures in 2011 due to a large increase in product development and research activities.

The fourth quarter of 2011 revenue has been decreased by $144,000 or 8% to $1,552,000 from $1,696,000 in 2010. Cost of goods sold decreased by $219,000 or 26% from $853,000 to $634,000 in the fourth quarter. Gross margin increased by $75,000 or 9% in the fourth quarter of 2011 in comparison with the same period of 2010.

## Revenue

| $000s | Year Ended December 31, 2011 | 2010 | Change | Quarter Ended December 31, 2011 | 2010 | Change |
|---|---|---|---|---|---|---|
| Total revenues | 5,786 | 5,577 | 4% | 1,552 | 1,696 | -8% |

**PRODUCT SALES**

The sales to the personal care industry in 2011 rose $209,000 or 4% primarily as a result of higher sales volumes of avenanthramides and beta glucan, the Company's main products.

The sales in the fourth quarter of 2011 decreased by $144,000 or 8% to $1,552,000 from $1,696,000 in comparison with the fourth quarter of 2010 primarily as a result of decreased sales in volumes of beta glucan and oat oil partially compensated by increased sales in avenanthramides.

## Expenses

**COST OF GOODS SOLD AND GROSS MARGIN**

| $000s | Year Ended December 31, 2011 | 2010 | Change | Quarter Ended December 31, 2011 | 2010 | Change |
|---|---|---|---|---|---|---|
| Sales | 5,786 | 5,577 | 4% | 1,552 | 1,696 | -8% |
| Cost of goods sold | 2,538 | 3,061 | -17% | 634 | 853 | -26% |
| Gross margin | 3,248 | 2,516 | 29% | 918 | 843 | 9% |
| Gross margin % | 56% | 45% | | 59% | 50% | |

Cost of goods sold is comprised of the direct raw materials required for the specific formulation of products, as well as direct labour, quality assurance and control, packaging, transportation costs, plant costs, and amortization on plant and equipment assets. Aside from labour, rent, quality control related expenses, overhead and property plant and equipment amortization the majority of costs are variable in relation to the volume of product produced or shipped.

The cost of goods sold fell by $523,000 or 17%, from $3,061,000 in 2010 to $2,538,000 in 2011. The gross margin in 2011 is higher by 29% due to higher sales of 4% and lower cost of goods sold of 17%. The gross margin have been positively impacted in 2011 through greater manufacturing output from operating efficiencies implemented and the use of higher quality feedstock. The gross margin percentage increased by 11% from 45% in 2010 to 56% in 2011.

The cost of goods sold decreased by $219,000 or 26% from $853,000 in the fourth quarter of 2010 to $634,000 in the same period of 2011. The gross margin increased in the fourth quarter of 2011 in comparison with the fourth quarter of 2010 by 9% or $75,000 from $843,000 to $918,000 and the gross margin percentage increased in the fourth quarter of 2011 in comparison with the fourth quarter of 2010 by 9% from 50% to 59% mostly due to significant decreased cost of goods sold of 26% partially offset by decreased sales of 8%.

**RESEARCH AND PRODUCT DEVELOPMENT**

| $000s | Year Ended December 31, 2011 | Year Ended December 31, 2010 | Change | Quarter Ended December 31, 2011 | Quarter Ended December 31, 2010 | Change |
|---|---|---|---|---|---|---|
| Salaries and benefits | 603 | 381 | | 172 | 143 | |
| Regulatory and patents | 118 | 128 | | 42 | 23 | |
| Other | 120 | 159 | | 69 | 68 | |
| | 841 | 668 | 26% | 283 | 234 | 21% |
| Product development - Ceaprove® | 156 | 106 | 47% | 29 | 27 | 7% |
| Total research and product development expenditures | 997 | 774 | 29% | 312 | 261 | 20% |

During 2011 research and development expenses before Ceaprove development have increased by 26% due to a large increase in product development and research activities. Ceaprove costs have increased by 47% from $106,000 to $156,000 as a result of increased patent and contract manufacturing costs.

The same trends were responsible for an overall 20% increase in expenditures for 2011 during the fourth quarter of 2011 over the same period of 2010 from $261,000 to $312,000 with Ceaprove expenditures increasing 7% from $27,000 to $29,000.

**GENERAL AND ADMINISTRATION**

| $000s | Year Ended December 31, 2011 | Year Ended December 31, 2010 | Change | Quarter Ended December 31, 2011 | Quarter Ended December 31, 2010 | Change |
|---|---|---|---|---|---|---|
| Salaries and benefits | 390 | 361 | | 110 | 104 | |
| Consulting | 211 | 188 | | 62 | 47 | |
| Board of Directors compensation | 174 | 168 | | 41 | 30 | |
| Insurance | 121 | 114 | | 32 | 29 | |
| Accounting and Audit fees | 113 | 90 | | 35 | 24 | |
| Rent | 90 | 87 | | 28 | 23 | |
| Public Company Costs | 53 | 44 | | 2 | 6 | |
| Travel | 83 | 65 | | 29 | 19 | |
| Depreciation | 36 | 37 | | 12 | 11 | |
| Legal | 16 | 54 | | 10 | 1 | |
| Other | 87 | 71 | | 20 | 24 | |
| Total general and administration expenses | 1,374 | 1,279 | 7% | 381 | 318 | 20% |

General and administration expense for 2011 increased by $95,000 or 7% from $1,279 to $1,374 as a result of increased expenses for salaries and benefits of $29,000; consulting of $23,000; directors' compensation of $6,000; insurance of $7,000; accounting and audit fees of $23,000; rent of $3,000; public company costs of $9,000; travel of $18,000 and other expenses of $16,000 offset by decreased depreciation of $1,000 and legal expenses of $38,000. Legal expenses declined by $38,000 due to lessened requirements for legal services and recoveries of previously accrued amounts.

General and administration expense for the fourth quarter of 2011 increased by $63,000 or 20% from $318,000 to $381,000 as a result of increased expenses for salaries and benefits of $6,000; consulting of $15,000; board of directors compensation of $11,000; insurance of $3,000; accounting and audit fees of $11,000; rent of $5,000; travel of $10,000; legal of $9,000 and depreciation of $1,000; there was a decrease of public company costs of $4,000 and other expenses of $4,000.

**SALES AND MARKETING**

| $000s | Year Ended December 31, 2011 | 2010 | Change | Quarter Ended December 31, 2011 | 2010 | Change |
|---|---|---|---|---|---|---|
| Travel | 45 | 30 | | 10 | 15 | |
| Consulting | 36 | 29 | | 9 | 2 | |
| Advertising | 12 | - | | 3 | - | |
| Courses & Conferences | 9 | 5 | | 1 | 1 | |
| Other | 9 | 5 | | 3 | 2 | |
| Total sales and marketing | 111 | 69 | 59% | 26 | 20 | 30% |

Sales and marketing expenses in 2011 increased by $42,000 or 59% and the fourth quarter of 2011 showed an increased in expenditures of $6,000 or 30% versus 2010 due to targeted expansion activities.

The Company is currently reviewing new marketing initiatives for 2012 and anticipates continued participation at major personal care and cosmetic conferences, and travel to visit current and potential customers, as well as increased consulting fees to assist in identifying and implementing new marketing initiatives.

**OTHER OPERATING LOSS (INCOME)**

| $000s | Year Ended December 31, 2011 | 2010 | Change | Quarter Ended December 31, 2011 | 2010 | Change |
|---|---|---|---|---|---|---|
| Foreign exchange losses | 32 | 28 | | (1) | 24 | |
| Other losses (gains) | (25) | 2 | | (24) | 2 | |
| | 7 | 30 | -77% | (25) | 26 | -196% |

Foreign exchange losses in 2011 were greater versus 2010 by $4,000 as a result of a steady decline of the U.S. dollar versus Canadian dollar in the first six months of the year. There were other gains in 2011 of $25,000 mostly comprised of revenue in the fourth quarter of 2011 from non-core activities in the amount of $20,000 which were not present in 2010.

Other operating losses in the fourth quarter of 2011 are comprised of foreign exchange gains of $1,000 and other gains of $24,000 compared to foreign exchange loss of $24,000 and other loss of $2,000 in the same period of 2010. Losses were lower in the fourth quarter of 2011 versus 2010 as the U.S. dollar strengthened against the Canadian dollar.

**FINANCE COSTS**

| $000s | Year Ended December 31, 2011 | 2010 | Change | Quarter Ended December 31, 2011 | 2010 | Change |
|---|---|---|---|---|---|---|
| Interest on royalty financial liability | 44 | 64 | | 5 | 17 | |
| Interest on long-term loan | 60 | 70 | | 13 | 17 | |
| Interest on convertible debentures | 40 | 41 | | 10 | 10 | |
| Accretion of convertible debentures | 32 | 28 | | 9 | 7 | |
| Accretion of CAAP loan | 4 | - | | 2 | - | |
| Bank charges | 1 | - | | - | - | |
| | 181 | 203 | -11% | 39 | 51 | -24% |

As at December 31, 2011, royalty investors received royalties equal to 2.285% (2010 – 2.285%) of revenues from product sales and royalty, license, and product development fees of active ingredients and veterinary therapeutic products and *CeaProve*®, to a maximum of two times the amount invested. AVAC Ltd. receives royalties of up to 2.5% to 5% of revenues from eligible product sales, to a maximum of one and a half to twice the amount invested. Royalty expense will vary directly with fluctuations in eligible product sales, royalty, license and product development fees, product sales mix, and any new royalty interest offerings that may be completed.

Finance costs decreased in 2011 in comparison with 2010 due to decreasing interest expenses on royalty financial liabilities of $20,000 and interest on long-term loan of $10,000 as a result of lower principal due to repayments.

On December 31, 2009, the Company issued secured convertible debentures for cash of $500,000. The debentures incurred interest at 8% per annum, matured on December 31, 2011, and were convertible at any time at a price of $0.10 per common share at the option of the holder. In 2011 the Company recorded interest expense on convertible debentures in the amount of $40,000 and accretion of $32,000, a decrease of $1,000 in interest compared to 2010 and an increase of $4,000 for accretion as the liability moved closer to convertible debentures' maturity date.

In the fourth quarter of 2011 finance costs were $39,000 in comparison with $51,000 in the same period of 2010 due to decrease of interest on royalty financial liability of $8,000 and interest on long-term loan of $4,000; accretion on convertible debentures increased of $2,000 and accretion of CAAP loan of $2,000.

**DEPRECIATION AND AMORTIZATION EXPENSES**

In 2011 the total depreciation of $297,000 (2010 - $291,000) was allocated as follows: $35,000 to general and administration expense (2010 - $37,000), $35,000 to inventory (2010 - $4,000), and $227,000 (2010 - $250,000) to cost of goods sold. Depreciation expenses were increased mostly due to new property and equipment.

**QUARTERLY INFORMATION**

The following selected financial information is derived from Ceapro's unaudited quarterly financial statements for each of the last eight quarters, all of which cover periods of three months. All amounts shown are in Canadian currency.

| $000s except per share data | 2011 (IFRS) | | | | 2010 (IFRS) | | | |
|---|---|---|---|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Total revenues | 1,552 | 1,515 | 1,185 | 1,534 | 1,696 | 1,708 | 1,018 | 1,155 |
| Net income (loss) | 256 | (108) | 105 | 325 | 173 | 97 | 240 | (46) |
| Basic net income (loss) per common share | 0.005 | (0.002) | 0.002 | 0.006 | 0.003 | 0.002 | 0.005 | (0.001) |
| Diluted net income (loss) per common share | 0.005 | (0.002) | 0.002 | 0.006 | 0.003 | 0.002 | 0.005 | (0.001) |

Ceapro's quarterly sales and results primarily fluctuate due to variations in the timing of customer orders, different product mixes, and the capacity to manufacture products.

## Liquidity and Capital Resources

**CAPITAL EMPLOYED**

| *$000s* | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Non-current assets | 2,307 | 1,713 |
| Current assets | 1,864 | 1,107 |
| Current liabilities | (1,510) | (1,930) |
| Total assets less current liabilities | 2,661 | 890 |
| | | |
| Non-current liabilities | 2,143 | 1,545 |
| Shareholders' equity (deficiency) | 518 | (655) |
| Total capital employed | 2,661 | 890 |

Non-current assets increased by $594,000 due to a depreciation provision of $297,000 offset by the acquisition of $126,000 of property and equipment, $15,000 paid under the amended license agreement and receiving restricted cash of $750,000.

Current assets increased by $757,000 and cash increased over 2010 by $405,000. Inventories were higher by $412,000; accounts receivables and prepaid expenses were lower $60,000.

Current liabilities totaling $1,510,000 decreased by the net amount of $420,000 due to decreased trade payables and accrued liabilities of $238,000; a net royalty interest payable decreased of $345,000 and convertible debentures principal repayment of $467,000 offset by $561,000 for sales orders prepayments and research grant advanced of $10,000; current portion of repayable research funding increased of $40,000; current portion of long-term debt increased of $8,000 and royalty financial liability increased of $11,000.

Non-current liabilities totaling $2,143,000 increased by the net amount of $598,000 due to restricted cash received in the amount of $750,000 under a capital expenditure grant agreement and recorded as deferred revenue; additional accrued employee future benefit obligation of $27,000 and discounted CAAP loan recognized in the amount of $57,000 offset by principal repayment of long-term debt in the amount of $155,000; decreased royalty financial liability in the amount of $76,000 and repayable research funding decrease of $5,000.

Shareholders' equity of $518,000 at December 31, 2011 improved by $1,173,000 from a shareholders' deficiency of $655,000 at December 31, 2010 due to increased share capital of $545,000 including $175,000 from the conversion of debt and $370,000 from the conversion of the principal amount of matured convertible debentures, the recognition of share-based compensation in contributed surplus of $50,000 and net income for 2011 of $578,000.

**NET DEBT**

| *$000s* | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Cash and restricted cash | 592 | 187 |
| Current financial liabilities | 938 | 1,930 |
| Non-current financial liabilities | 1,206 | 1,385 |
| Total financial liabilities | 2,144 | 3,315 |
| NET DEBT | 1,552 | 3,128 |

**Current and non-current financial liabilities include accounts payable and accrued liabilities, long-term debt, current portion of long term debt, convertible debentures, royalty interest payable, repayable research funding, current portion of repayable research funding, royalty financial liability, current portion of royalty financial liability; CAAP loan.*

The Company's net debt decreased by $,576,000 mostly due to increase cash and cash equivalents in the amount of $405,000; repayment of matured convertible debentures in the amount of $468,000; royalty interest repayment in the amount of $345,000, long-term debt repayment in the amount of $146,000, accounts payable and accrued liabilities decreased of $238,000 and royalty financial liability decreasing by $66,000; net debt discounted amount of CAAP loan of $57,000; repayable research funding of $35,000.

**SOURCES AND USES OF CASH**

The following table outlines our sources and uses of funds during 2011 and 2010.

| | Year Ended December 31, | | Quarter Ended December 31, | |
|---|---|---|---|---|
| *$000s* | 2011 | 2010 | 2011 | 2010 |
| Sources of funds: | | | | |
| Funds generated from operations (cash flow) | 1,063 | 1,054 | 316 | 274 |
| Changes in non-cash working capital items | 157 | (505) | 49 | (206) |
| Deferred revenue | 750 | - | 750 | - |
| Repayable CAAP Funding | 123 | - | - | - |
| Repayable research funding | 50 | 50 | - | - |
| | 2,143 | 599 | 1,115 | 68 |
| Uses of funds: | | | | |
| Purchase of property and equipment | (126) | (91) | (38) | (54) |
| Purchase of license | (15) | - | (15) | - |
| Restricted cash received | (750) | - | (750) | - |
| Interest paid | (411) | (70) | (61) | (17) |
| Repayment of financial liability | (143) | (228) | (11) | - |
| Convertible debentures settlement | (130) | - | (130) | - |
| Repayable research funding repayment | (15) | - | (15) | - |
| Repayment of long term debt | (146) | (139) | (37) | (36) |
| | (1,737) | (528) | (1,057) | (107) |
| Net change in cash flows | 406 | 71 | 58 | (39) |

**Cash flows provided by operating activities comprise the cash generated by operating activities less adjustments for items not affecting cash.*

Net change in cash flow increased $335,000 in 2011 in comparison with 2010. For the three months ended December 31, 2011, the net change in cash flow increased $97,000 in comparison with the same period in 2010.

The Company estimates that the cash flows generated by its operating activities as well as cash available through other sources will be sufficient to finance its operating expenses, maintain capital investment and service debt needs.

The Company relies upon revenues generated from the sale of active ingredients, the proceeds of public and private offerings of equity securities and debentures, and income offerings to support the Company's operations.

Total common shares issued and outstanding as at April 27, 2012 were 60,278,948 (April 18, 2011 – 56,578,948). In addition, 3,170,000 stock options as at April 27, 2012 (April 18, 2011 – 3,105,000) were outstanding that are potentially convertible into an equal number of common shares at various prices.

Ceapro's working capital position was $354,000 at December 31, 2011, is an improvement of $1,177,000 from ($823,000) at December 31, 2010.

To meet future requirements, Ceapro intends to raise additional cash through some or all of the following methods: public or private equity or debt financing, income offerings, capital leases, collaborative and licensing agreements, and joint venture or partnership financings. However, there is no assurance of obtaining additional financing through these arrangements on acceptable terms, if at all.

The ability to generate new cash will depend on external factors, many beyond the Company's control, as outlined in the Risks and Uncertainties section. Should sufficient capital not be raised, Ceapro may have to delay, reduce the scope of, eliminate, or divest one or more of its discovery, research, or development technology or programs, any of which could impair the value of the business.

During the year ended December 31, 2010 the Company was approved for non-repayable funding in the amount of $124,000 from Alberta Ingenuity. During 2011, the Company received $62,000 (2010 - $20,750) which was recorded as a reduction of research and product development expenses. The Company anticipates receiving an additional amount of $41,250 in 2012 under this program.
The Company was approved for non-repayable funding for up to 50% of eligible costs to a maximum of $99,900 under the Growing Forward Product Development program. The Company recognized $60,076 during the year ended December 31, 2011 (2010 - $39,824) as a reduction of research and product development expenses. This program has now been completed.

The Company was approved for non-repayable funding in the amount of $50,000 for eligible costs from the Atlantic Canada Opportunities Agency. The Company recognized $10,879 during the year ended December 31, 2011 (2010 - $39,121) as a reduction of research and product development expenses. This program has now been completed.

The Company was approved for non-repayable funding to a maximum of $21,250 of eligible expenditures under the Novel Crops Initiative program from the Prince Edward Island Department of Agriculture. The Company recorded the amount of $5,000 as a reduction of research and product development expenditures under this program in the year ended December 31, 2011 (2010 - $5,925). The Company anticipates receiving an additional amount of $5,000 in 2012 under this program.

The Company was approved for non-repayable funding of $7,055 under the Growing Forward Lean Manufacturing Initiative. The Company recognized $5,823 as a reduction of the cost of certain property and equipment and $1,232 as a reduction of research and development expenditures in the year ended December 31, 2010. The full amount of $7,055 was included in accounts receivable at December 31, 2010 and received in the first quarter of 2011. This program has now been completed.

The Company received a repayable non-interest bearing contribution for research and development expenditures in the amount of $50,000 in 2011 (2010 - $50,000) from Innovation PEI which is recorded as a repayable research funding liability on the consolidated balance sheets less $15,367 which was repaid. The contribution is repayable quarterly at a rate of one percent of sales revenue subject to a minimum payment of $12,500 per quarter. The Company anticipates repayment of $52,133 during the year ended December 31, 2012.

The Company was approved for non repayable grant funding from Innovation PEI for a maximum of $100,000. During the year ended December 31, 2011 the company received $30,000 and recognized $19,500 against eligible expenses and $10,500 as deferred revenue. The Company anticipates an additional $70,000 could be received in 2012.

The Company is eligible to claim up to $1,339,625 of eligible research and development expenditures incurred in 2011 and 2012 under the Canadian Agricultural Adaptation Program. All amounts claimed under the program are repayable interest free over eight years beginning in 2013. The Company has received funding of $123,081 to date under this program.

During the year ended December 31, 2011 the Company commenced a research and development project agreement. Under this project the Company paid cash of $56,177 in 2011 and will make an additional payment of $28,236 in 2012. The other party to the research and development project agreement will make an in-kind contribution to the project of $42,262.

During the year ended December 31, 2011 the company entered into a Contribution Agreement with AI-BIO Solution for a non-repayable grant contribution totaling up to $1,600,000 towards the construction of a new bio-processing facility and subject to compliance with all terms and conditions of the agreement. In accordance with the agreement, the Company received $750,000 in 2011 presently classified as restricted cash and cash equivalents, and anticipates additional amounts will be received as follows - $650,000 in 2012, $40,000 in 2013 and $160,000 in 2014. It is anticipated that as these amounts are expended they will be recorded as a reduction of capital cost.

The Company is currently reviewing additional options available to raise capital.

## Related Party Transactions

During 2011, $22,000 (2010 - $22,000) of royalties were earned by employees and directors from their investment in previous Ceapro royalty offerings. As at December 31, 2011, $6,000 (2010 - $28,000) of royalties were payable to employees and directors. As at December 31, 2011, $nil (2010 - $72,000) of royalties payable to employees and directors were converted to common shares.

At December 31, 2011 officers and directors owned $nil (2010 - $70,000) of convertible debentures. During 2011 officers and directors earned $6,000 of interest on convertible debentures (2010 – $6,000). During 2011 officers and directors converted $nil (2010 - $3,000) of interest on convertible debentures into common shares.

During 2011 the Company paid key management salaries, short-term benefits, consulting fees and director fees totaling $485,000 (2010 – $437,000) and key management personnel received share-based payments of $49,000 (2010 - $36,000).

During 2011 directors converted $175,000 (2010 - $nil) of fees payable to 1,590,909 common shares of the Company. Directors and officers converted $70,000 (2010 - $nil) of the principal amount of matured convertible debentures to 700,000 common shares of the Company. Amounts payable to directors was $175,000 (2010 - $140,000).

These transactions are in the normal course of operations and are measured at the amount of consideration established and agreed to by the related parties.

## Commitments and Contingencies

(a) During the year ended December 31, 2011 the Company and its wholly owned subsidiary, Ceapro Veterinary Products Inc. were served with a statement of claim from AVAC Ltd. alleging damages of $724,500 pursuant to a product development agreement. The Company and Ceapro Veterinary Products Inc., have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However at this time the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

Subsequent to December 31, 2011, the Company and its wholly owned subsidiary, Ceapro Technology Inc. were served with a statement of claim from AVAC Ltd. alleging damages of $1,470,500 pursuant to two product development agreements. The Company and Ceapro Technology Inc., have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However at this time the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

(b) During the year ended December 31, 2008, the Company recorded a provision of $741,283 for disputed legal fees related to a previous litigation case that was settled with all defendants in 2009. The terms of the legal settlement were fully satisfied in 2009. During the second quarter of 2009, the Company was advised by one legal firm that they did not intend to pursue collection of their previously billed legal fees. The amount of the fees was $426,300 and this was recorded as a recovery in the second quarter of 2009.

During the second quarter of 2010, management reviewed the exposure of the remaining provision totaling $314,983. Based upon the review by management at June 30, 2010 with its legal counsel and the circumstances applicable at that time, management believes the Company is no longer exposed to the remaining accrued legal fees liability and the amount of $314,983 was recorded as a recovery in the year ended December 31, 2010.

(c) During the year ended December 31, 2008 the Company entered into licensing agreement with the University of Guelph for an exclusive variety of a mint plant. During the year ended December 31, 2011, the Company has entered into a new licensing agreement with the University of Guelph for additional market rights for the exclusive variety of a mint plant.

In accordance with the new agreement, there are future minimum royalty payments of $10,000 per annum starting in 2012 for royalty payments which will be calculated as 5% of net sales from products derived from the mint plants.

(d) In the normal course of operations the Company may be subject to litigation and claims from customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required. Although it is not possible to estimate the extent of potential costs, if any, management believes that the ultimate resolution of such contingencies would not have a material adverse effect on the financial position of the Company.

## Subsequent Events

Subsequent to December 31, 2011, the Company and its wholly owned subsidiary, Ceapro Technology Inc. were served with a statement of claim from AVAC Ltd. alleging damages of $1,470,500 pursuant to two product development agreements. The Company and Ceapro Technology Inc., have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However at this time the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

## Outlook

"From Field to Formulation"- you will be hearing these words a lot from Ceapro in the future. It's what we do best and to the personal care industry it represents key sought after attributes like traceability and sustainability. It comprises activities in four key activities that are what Ceapro represents - plant source/agronomy, product development and scale up, commercial manufacturing, and providing product solutions to our customers - the scientists and formulators who want the latest natural innovations Ceapro has to offer.

Starting with plant sources and agronomy, we head into 2012 excited on several fronts. With our spearmint project we have demonstrated that we can grow the plants in multiple regions of Canada and most importantly, the high level of active ingredients has been confirmed and supports the competitive advantages we had expected this plant to provide. The plants will be further multiplied with new commercial growers in 2012. We have begun the process of developing extracts for testing and anticipate that multiple products may be produced from this single plant. Ceapro is currently reviewing several other attractive plant and feedstock technologies with a view to in-licensing and expects to finalize agreements in the short term.

On the product development front, we anticipate that 2012 will be equally exciting. We are currently evaluating the spearmint extracts for multiple personal care applications including anti-inflammatory and natural preservative properties. Current work being performed at the University of Guelph suggests the high level of anti-inflammatories may have applications in the equine and companion animal markets as well as the human osteo-arthritis market. There is currently a human clinical trial ongoing examining the effects of a tea made from the spearmint on arthritis. A therapeutic tea product would represent huge growth potential for Ceapro. Ceapro has successfully made high quality soluble product versions of certain liquid formulations and it is anticipated there will be new powders launched in 2012. New generation avenanthramide products, also called colloidal oat extracts, are also being developed and promise to not only lead to new products, but also new markets including functional foods.

The area of manufacturing will perhaps be the most exciting news for Ceapro in 2012 as we move to building a new facility that is being kick started with a generous grant of $1.6 million from Alberta Innovates Bio-Solutions. Our new plant will incorporate several technology improvements currently being tested and optimized and operate in a semi-continuous process rather than the current batch mode. The new plant will be designed to be Good Manufacturing Process compliant to meet the most rigorous quality standard our clients present. We anticipate this plant will have a capacity several times our current plant and allow for the production of several new products. We are aiming for full production by late 2013.

In 2012 Ceapro will continue to build on the capability to market its products better and with enhanced representation around the globe. New distributors will continue to be added to reach the worldwide audience and Ceapro intends to complete a thorough marketing analysis in Q2 2012 with the assistance of a third party firm to identify, build, and support the infrastructure needed to market Ceapro products globally. This will be a comprehensive process and we anticipate we will make some additional marketing investments in 2012.

To our shareholders who have been with us for the long term, we have made tremendous progress over the last few years as evidenced by our balance sheet improvement.  We have done the right things to build our business in a prudent and responsible way and we are a company of substance that truly has accomplished more than most any other biotech company in Canada.  We intend to continue to do the right things to build shareholder value and expect that eventually the capital markets will realize the true value of Ceapro.

## Additional Information

Additional information relating to Ceapro Inc., including a copy of the Company's Annual Report and Proxy Circular, can be found on SEDAR at www.sedar.com.