



# Q1 2011

Unaudited Consolidated  
Financial Statements  
for the First Quarter  
ended March 31, 2011

# Management's Discussion & Analysis

The MD&A provides commentary on the results of operations for the periods ended March 31, 2011 and 2010, the financial position as at March 31, 2011 and the outlook of Ceapro Inc. ("Ceapro") based on information available as at June 15, 2011. The following information should be read in conjunction with the unaudited condensed consolidated financial statements as at March 31, 2011, and related notes thereto, which are prepared in accordance with International Accounting Standard 34 *Interim Financial Reporting* ("IAS 34") of International Financial Reporting Standards (IFRS), as well as the audited consolidated financial statements and Management Discussion and Analysis (MD&A) for the year ended December 31, 2010 prepared in accordance with Canadian generally accepted accounting principles. All comparative percentages are between the periods ended March 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](http://www.sedar.com).

## FORWARD-LOOKING STATEMENTS

This MD&A offers our assessment of Ceapro's future plans and operations as at June 15, 2011, 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.

## 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*<sup>®</sup>, 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 to *the active ingredients* product range offering, through new plant extract products;
- A variety of novel manufacturing technologies.

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:

- Increasing sales and expanding markets for our current active ingredients;
- Developing and marketing additional high-value proprietary therapeutic products;
- Developing and improving manufacturing technologies to ensure strong financial performance;
- 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, 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, grants, 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's unaudited condensed consolidated financial statements for the quarter ended March 31, 2011 have been prepared on a going concern basis which assumes that the Company will continue in operation for the foreseeable future and accordingly will be able to realize its assets and discharge liabilities in the normal course of operations. Since inception, the Company has accumulated net losses, generated inconsistent operating cash flow and has not yet achieved consistent profitability. During 2010 and the first quarter of 2011 the Company demonstrated that it has reached the critical mass to operate profitably and generate funds to carry out its business vision. The Company has relied on the proceeds of public and private offerings of equity securities and debentures, debt, and other income offerings to support the Company's operations. The Company's ability to continue as a going concern is dependant on obtaining additional financial capital, maintaining profitability, and generating positive cash flow. While there can be no assurance that the Company will be able to access capital when needed, achieve consistent profitability, or generate sufficient cash flow, the Company believes it has accomplished these goals in the first quarter of 2011 as evidenced by improvements in working capital and shareholder's deficiency.

The consolidated financial statements for the period ended March 31, 2011 do not reflect the adjustments that might be necessary to the carrying amount of reported assets, liabilities, and revenues and expenses, and the balance sheet classification used if the Company were unable to continue operations. Such adjustments could be material.

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

a) Credit risk:

The Company makes sales to customers that are well-established and well-financed within their respective industries. There is always a risk relating to the financial stability of customers and their ability to pay, but management views this risk as minimal. Approximately 95% of accounts receivable are due from two customers at March 31, 2011 and all accounts receivable are current. The Company mitigates its exposure to credit risk on its cash balances by maintaining its bank accounts with a Canadian Chartered Bank. The Company's maximum exposure to credit risk on its cash and accounts receivable is the carrying value of these items at March 31, 2011, a total of \$943,801.

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. Royalties are in arrears as they have only been paid partially in cash since the second quarter of 2008 due to the limited financial resources of the Company. Subsequent to the end of the quarter, the Company repaid \$378,000 of this obligation. 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	1 - 3 years	4 - 7 years	Total
	\$	\$	\$	\$
Accounts payable and accrued liabilities	605,871			605,871
Long-term debt, including interest	208,613	1,163,408		1,372,021
Royalties payable	406,455			406,455
Royalty financial liability	114,250	291,337	49,635	455,222
Liability on license agreement	12,960	82,080	146,880	241,920
Convertible debentures including interest	540,000			540,000
Employee future benefit obligation	-	-	210,130	210,130
Repayable research funding	25,000	25,000		50,000
Repayable CAAP funding	-	56,958		56,958
<b>Total</b>	<b>1,913,149</b>	<b>1,618,783</b>	<b>210,130</b>	<b>3,938,577</b>

c) Market risk is comprised of interest rate risk and foreign currency 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 Company is exposed to foreign currency fluctuations because a substantial portion of sales are denominated in U.S. dollars. A one percent change in the Canadian/U.S. dollar exchange rate will impact revenues by approximately \$60,000 annually based upon 2011 U.S. dollar sales of \$6,000,000. The Company does purchase some materials and services in U.S. dollars and to a very minor extent in Euros. This amount will vary by product sold.

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.

	Carrying Amount (USD)	Foreign Exchange Risk (USD)	
		-1% Earnings & Equity	+1% Earnings & Equity
<b>Financial assets</b>			
Accounts receivable	448,460	4,485	(4,485)
<b>Financial Liabilities</b>			
Accounts payable and accrued liabilities	134,280	(1,343)	1,343
<b>Total increase (decrease)</b>		<b>3,142</b>	<b>(3,142)</b>

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

d) 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.

e) 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.

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 its ability to raise capital.

Ceapro's 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.

f) People and Process risk:

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 requirements that may be required.

## **Adoption of International Financial Reporting Standards**

The unaudited interim condensed consolidated financial statements included in this Quarterly Report reflect the adoption of IFRS, with effect from January 1, 2010. 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 financial statements subsequent to this report will be prepared in accordance with IFRS.

Note 3 to the unaudited interim condensed 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 three months ended March 31, 2010, for the year ended December 31, 2010 and as at January 1, 2010.

## Future Accounting Pronouncements

### Financial instruments

IFRS 9 Financial instruments ("IFRS 9") was issued by the IASB on November 12, 2009 and will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 9 on its financial statements.

## Results of Operations

### Three Months and Quarter Ended March 31, 2011, 2010 (IFRS), and 2009 (GAAP)

#### CONSOLIDATED INCOME STATEMENT

\$000s except per share data	2011	%	2010	%	2009	%
<b>Total revenues</b>	<b>1,534</b>	<b>100%</b>	<b>1,155</b>	<b>100%</b>	<b>1,502</b>	<b>100%</b>
Cost of goods sold	612	40%	690	60%	572	38%
<b>Gross margin</b>	<b>922</b>	<b>60%</b>	<b>465</b>	<b>41%</b>	<b>930</b>	<b>62%</b>
Research and product development expenses	187	12%	136	12%	136	9%
General and administration expenses	304	20%	296	26%	479	32%
Selling and marketing	30	2%	21	2%	60	4%
Other operating loss (income)	23	2%	3	0%	(5)	0%
<b>Income (loss) from operations</b>	<b>376</b>	<b>25%</b>	<b>9</b>	<b>1%</b>	<b>260</b>	<b>17%</b>
Finance costs	51	3%	55	5%	158	11%
<b>Income (loss) before tax</b>	<b>325</b>	<b>22%</b>	<b>(46)</b>	<b>-4%</b>	<b>102</b>	<b>7%</b>
Income tax	-		-		-	
<b>Net income (loss)</b>	<b>325</b>	<b>22%</b>	<b>(46)</b>	<b>-4%</b>	<b>102</b>	<b>7%</b>
Basic net income (loss) per common share	0.01		(0.00)		0.00	
Diluted net income (loss) per common share	0.01		(0.00)		0.00	

**Revenue.** The sales of active ingredients to the personal care and animal health industries increased by 33% or \$379,000 in the first three months of 2011 due primarily to significantly higher sales volumes for avenanthramides.

**Cost of Goods Sold.** Cost of Goods Sold decreased by 11% or \$78,000 to \$612,000 from \$690,000.

**Gross margin.** Gross margin increased by \$457,000 to \$922,000 from \$465,000.

Income from operations was \$376,000 compared to \$9,000 in 2010 largely due to higher product sales and gross margin. Research and development costs increased \$51,000 due primarily to expenditures undertaken as a result of new research projects.

There was an increase in general and administration expenses of \$8,000 and sales and marketing costs in the amount of \$9,000.

Net income in the first three months of 2011 of \$325,000 increased significantly by \$371,000 in comparison with a net loss in the first three months of 2010 (\$46,000).

## Revenue

<u>\$000s</u>	<u>2011</u>	<u>2010</u>	<u>Change</u>
Total sales	1,534	1,155	33%

## PRODUCT SALES

In the first quarter of 2011, sales to the personal care industry rose \$353,000 or 31% primarily as a result of significantly higher sales volumes of avenanthramides, the Company's flagship product. There was also \$26,000 of sales to the animal health sector in the first quarter of 2011 compared to \$0 animal health sector sales in the same quarter of 2011.

## Expenses

### COST OF GOODS SOLD AND GROSS MARGIN

<u>\$000s</u>	<u>2011</u>	<u>2010</u>	<u>Change</u>
Sales	1,534	1,155	33%
Cost of goods sold	612	690	-11%
Gross margin	922	465	98%
Gross margin %	60%	40%	49%

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 11%, from \$690,000 in the first quarter of 2010 to \$612,000 in the same period of 2011. As a percentage of revenue, the cost of goods sold decreased by 20% from 60% in 2010 to 40% in 2011. The improvements in the amount of gross margin and the gross margin percentage are due to the mix of product sales which featured high sales volumes of high margin product, increased yields from raw materials, and increased manufacturing plant output.

### RESEARCH AND PRODUCT DEVELOPMENT

<u>\$000s</u>	<u>2011</u>	<u>2010</u>	<u>Change</u>
Salaries and benefits	134	86	
Regulatory and patents	23	15	
Other	10	18	
	167	119	40%
Product development - Ceaprove®	20	17	18%
Total research and product development expenditures	187	136	38%

Research and product development expenses in the first three months of 2011 increased by 40% from 2010 expenses as a result of new research and development projects commenced in 2010 and continued throughout 2011 and higher costs for patents. There was an increase of 17% in costs for Ceaprove<sup>®</sup> related to contract manufacturing of the product. As a result, total research and product development expenditures increased by 38%, mainly to support the development and commercialization of new and existing products.

## GENERAL AND ADMINISTRATION

<i>\$000s</i>	2011	2010	Change
Salaries and benefits	94	89	
Consulting	50	42	
Board of Directors compensation	40	44	
Investor relations	8	6	
Insurance	28	28	
Accounting and Audit fees	14	17	
Legal	3	21	
Rent	23	17	
Other	44	32	
<b>Total general and administration expenses</b>	<b>304</b>	<b>296</b>	<b>3%</b>

General and administration expense for the first three months of 2011 increased by \$9,000 or 3% as a result of increased expenses for consulting of \$8,000; increased salaries of \$5,000; increased rent of \$6,000; and other expenses increasing by \$13,000 mainly related to office supplies/facilities; conferences and IT support expenses. There was a decrease in legal expenses by \$18,000 due to lessened requirements for legal services.

## SALES AND MARKETING

<i>\$000s</i>	2011	2010	Change
Courses & Conferences	8	4	
Travel	10	8	
Other	12	10	
<b>Total sales and marketing</b>	<b>30</b>	<b>22</b>	<b>35%</b>

Sales and marketing expenses in the first three months of 2011 increased by 9,000 or 35% due to market expansion activities through attending major personal care and cosmetic conferences.

The Company is currently reviewing new marketing initiatives for 2011 and anticipates continued participation at major events and increased expenditures over 2010 levels.

## OTHER OPERATING LOSS

<i>\$000s</i>	2011	2010
Foreign exchange losses	19	3
Other expenses	4	-
	23	3

Other operating loss in the first three months of 2011 is comprised primarily of \$19,000 of foreign exchange loss and \$4,000 of miscellaneous expenses compared to foreign exchange loss of \$3,000 in 2010 mostly due to the strengthening of the Canadian dollar versus the US dollar.

## FINANCE COSTS

<i>\$000s</i>	2011	2010	Change
Interest on royalty financial liability	13	14	-7%
Interest on long-term loan	16	18	-11%
Interest on convertible debentures	10	10	0%
Accretion of convertible debentures	7	8	-13%
Interest on liability on license agreement	5	4	25%
Bank charges	-	1	-100%
	51	55	-7%

As at March 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*<sup>®</sup>, 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.

During the first three months of 2011 interest on royalty financial liability declined \$1,000 as a result of a lower balance of royalty financial liability from the previous year.

During the first three months of 2011 Interest on long-term debt declined \$2,000 as a result of a lower principal balance of long-term debt from the same quarter in the previous year.

On December 31, 2009, the Company issued secured convertible debentures for cash of \$500,000. The debentures bear interest at 8% per annum, mature on December 31, 2011, and are convertible at any time at a price of \$0.10 per common share at the option of the holder. The debentures may be redeemed at the option of the Company upon giving notice of 60 days. In the first three months of 2011 the Company recorded interest expense on convertible debentures in the amount of \$10,000 and accretion of \$7,000, an increase of \$1,000 in accretion compared to the first three months of 2010.

The Company has increased interest expenses on the liability relating to the licensing agreement with the University of Guelph for an exclusive variety of mint plant in the amount of \$11,596 at December 31, 2010.

## DEPRECIATION EXPENSES

For the three months of 2011 the total amortization of \$73,000 (2010 - \$89,000) was allocated as follows: \$8,000 to General and administration expense (2010 - \$9,000), \$17,000 to inventory (2010 - \$35,000), and \$48,000 (2010 - \$45,000) to cost of goods sold. Depreciation expenses were decreased mostly due to some leasehold improvements becoming fully amortized.

## 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	2010 (IFRS)				2009 (GAAP)		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Total revenues	1,534	1,696	1,708	1,018	1,155	395	1,261	1,212
Net income (loss)	325	162	97	240	(46)	(634)	(4)	466
Basic net income (loss) per common share	0.006	0.003	0.002	0.005	(0.001)	(0.012)	(0.000)	0.010
Diluted net income (loss) per common share	0.006	0.003	0.002	0.005	(0.001)	(0.012)	(0.000)	0.010

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	March 31, 2011	December 31, 2010
Non-current assets	1,685	1,713
Current assets	1,435	1,107
Current liabilities	(1,736)	(1,936)
<b>Total assets less current liabilities</b>	<b>1,384</b>	<b>884</b>
Non-current liabilities	1,658	1,666
Shareholders' equity	(274)	(782)
<b>Total capital employed</b>	<b>1,384</b>	<b>884</b>

Non-current assets decreased by \$28,000 due to a depreciation provision of \$73,000 offset by the acquisition of \$45,000 of property and equipment.

Trade and other receivables including deposits and prepaid expenses were lower than December 31, 2010 by \$116,000 and cash increased over 2010 by \$312,000. Inventories were higher by \$132,000.

Current liabilities totaling \$1,736,000 decreased by the net amount of \$200,000 mostly due to a decrease in trade payables and accrued liabilities of \$256,000; a net royalty payable increase of \$28,000; an increase in current portion of long-term debt of \$2,000; current portion of repayable research funding was reclassified from non-current in the amount of \$13,000; convertible debentures accretion in the amount of \$8,000; and current portion of royalty financial liability increased by \$6,000; current portion of liability on license agreement decreased of \$2,000.

Non-current liabilities totaling \$1,658,000 decreased by the net amount of \$8,000 due to principal repayment of long-term debt in the amount of \$38,000 and decreasing royalty financial liability in the amount of \$22,000 and a decreasing non-current portion of repayable research funding in the amount of \$13,000 due to reclassification to current portion offset by an additional accrued employee future benefit obligation of \$5,000; an additional liability on license agreement accrual of \$3,000 and receipt of the CAAP loan in the amount of \$57,000.

Shareholders' deficiency of \$274,000 at March 31, 2011 improved by \$508,000 from a shareholders' deficiency of \$782,000 at December 31, 2010 due to increases in share capital of \$175,000 from the conversion of debt, the recognition of stock based compensation in contributed surplus of \$8,000 and net income of \$325,000.

## NET DEBT

\$000s	March 31, 2011	December 31, 2010	
Cash and cash equivalents	499	187	
Current financial liabilities	1,060	696	
Non-current financial liabilities	1,249	1,506	
Total financial liabilities	2,309	2,202	
NET DEBT	1,810	2,015	-10%

*\*Includes long-term debt, current portion of long term debt, convertible debentures, repayable research funding, current portion of repayable research funding, current portion of royalties payable, liability on license agreement, and CAAP loan.*

The Company's net debt decreased by \$298,000 or 15% due to an increase in cash in the amount of \$312,000; long-term debt repayment decreased in the amount of \$36,000; royalty financial liability decreasing by \$16,000; convertible debentures accretion increased in the amount of \$8,000 and the receipt of CAAP funding of \$57,000; liability on license agreement increased in the amount of \$2,000.

## SOURCES AND USES OF CASH

The following table outlines our sources and uses of funds during the first quarters of the current and past years.

\$000s	Three Months Ended March 31	
	2011	2010
	\$	\$
<b>Sources of funds:</b>		
Funds generated from operations (cash flow)	463	116
Changes in non-cash working capital items	(111)	(87)
Share capital issued, net of costs	-	-
Repayable CAAP Funding	57	-
Convertible debentures proceeds	-	-
	409	29
<b>Uses of funds:</b>		
Purchase of property and equipment and deposits	(45)	(5)
Interest paid	(16)	(18)
Repayment of long term debt	(36)	(34)
	(97)	(57)
Net change in cash	312	(28)

*\*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 was significantly improved in the first three months of 2011 in comparison with the same period of 2010. It resulted from a significant increase in cash generated by operating activities of \$347,000 which was due to a sharp increase in net income of \$372,000 and cash inflow from financing activities by \$55,000 offset by slight decreases in working capital balances by \$24,000 and increased investment in property and equipment by \$40,000.

## FREE CASH FLOW\*

\$000s	Three Months Ended March 31	
	2011	2010
	\$	\$
Cash flows provided by (used in) operating activities	336	11
Purchase of property and equipment and deposits	(45)	(5)
<i>Free Cash InFlow (OutFlow)</i>	291	6

*\*Free cash flow (available cash) represents cash flow from operating activities less capital expenditures net of proceeds from disposal. Free cash flow (FCF) represents the cash that a Company is able to generate after laying out the money required to maintain or expand its asset base. Free cash flow is important because it allows a Company to repay debt obligations and pursue opportunities that enhance shareholder value.*

Free cash flow significantly improved in the first three months of 2011 by \$285,000 mostly due to improved cash flow from operating activities of \$325,000 partially offset by increased spending in 2010 on property and equipment in the amount of \$40,000. Higher sales and improved margins improved the operating performance of the Company.

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, capital investment and debt service 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 June 15, 2011 were 56,578,948 (May 5, 2010 – 51,710,063). In addition, 3,105,000 stock options as at June 15, 2011 (May 5, 2010 – 2,485,000) were outstanding that are potentially convertible into an equal number of common shares at various prices.

Ceapro's working capital position was (\$300,000) at March 31, 2011, an improvement of \$529,000 from (\$829,000) 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 financings, 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.

The Company was approved for non-repayable funding in the amount of \$124,000 from Alberta Ingenuity. During the first quarter of 2011, the Company received \$13,750 which was recorded as a reduction of research and product development expenses. The Company anticipates receiving an additional amount of \$48,250 in 2011 and \$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 \$21,639 in the first quarter of 2011 under this program as a reduction of research and development expenses. The Company anticipates the balance of eligible funding to be received in the second quarter of 2011.

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 received \$10,879 in the first quarter of 2011 under this program. 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 \$5,925 as a reduction of research and product development expenditures

under this program in the year ended December 31, 2010. An amount of \$5,925 was included in accounts receivable at December 31, 2010 with respect to this agreement and was received in the first quarter of 2011. The Company anticipates receiving further funding of up to \$5,000 in 2011 and \$5,000 in 2012.

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 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 from Innovation PEI which is recorded as a repayable research funding liability on the balance sheet. The Company may be eligible for a further contribution of \$50,000 in 2011. 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 first payment is due in the third quarter of 2011.

The Company is also eligible to claim up to \$1,339,625 of eligible research and development expenditures 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 received funding of \$56,958 in the first quarter of 2011 under this program.

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

## **Related Party Transactions**

During the first three months of 2011, \$6,000 (2010 - \$5,000) of royalties were earned by employees and directors from their investment in previous Ceapro royalty offerings. As at March 31, 2011, \$34,000 (2010 - \$90,000) of royalties were payable to employees and directors. During the first three months of 2011 directors converted \$175,000 of fees payable into 1,590,909 common shares of the company.

The Company has a loan receivable totaling \$1,184,000 (2010 - \$1,068,000) from its wholly owned subsidiary Ceapro Technology Inc. and a loan receivable totaling \$6,721,000 (2010 - \$6,110,000) from its wholly owned subsidiary Ceapro Veterinary Products Inc. The Company earned \$164,000 (2010 - \$149,000) in interest income from its loan advanced to Ceapro Veterinary Products Inc. All transactions between the Company and its wholly owned subsidiaries are eliminated in consolidated financial statements.

During the first three months of 2011 officers and directors earned \$1,000 of interest on convertible debentures (2010 - \$1,000). As at March 31, 2011 officers and directors owned \$70,000 (2010 - \$70,000) of convertible debentures. As at March 31, 2011, consulting fees of \$25,000 (2009 - \$38,000) were payable to a Company controlled by a director and included in accounts payable and accrued liabilities. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

During the first three months the Company paid Key management salaries, short-term benefits, consulting fees and director fees totaling \$143,000 (2010 - \$135,000) and Key management personnel share-based payments \$7,000 (2010 - \$12,000).

## **Commitments and Contingencies**

- a) During the year ended December 31, 2008, the Company entered into a licensing agreement with the University of Guelph for an exclusive variety of a mint plant. The Company paid a licensing fee of \$30,000 and is amortizing the license over 10 years. The license is carried on the balance sheet at March 31, 2011 at \$23,000 (December 31, 2010 - \$24,000) which reflects amortization during the first three months of 2011 of \$1,000 (2010 - \$1,000). The amortization expense of \$1,000 (2010 - \$1,000) has been included in amortization on the income statement. The Company is obligated to pay the university an amount equal to 8% of net sales from products derived from the mint plants subject to minimum payments as follows:

	\$
2011	12,960
2012	20,160
2013	27,360
2014	34,560
2015	41,760
2016	48,960
2017	56,160
<b>Total</b>	<b>241,920</b>

The Company has recognized a liability relating to the licensing agreement with the University of Guelph for an exclusive variety of a mint plant. As long as the Company continues to license the mint, it is obligated to pay the university an amount equal to 8% of net sales from products derived from the mint plants subject to expected minimum payments of \$247,680 as at January 1, 2010. The lower thresholds for recognition under IAS 37 have resulted in the Company recognizing a liability at January 1, 2010 in the amount of \$115,708 which has been recorded directly through equity. The carrying amount of this liability was \$128,839 at March 31, 2011 and \$127,304 at December 31, 2010.

- b) 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.

## Outlook

The first quarter results of 2011 represents the best ever in the history of Ceapro and builds on the consistent positive trend of solid operating results we have displayed over the last two years. We have continued to show improvement in our balance sheet and this will help support further growth initiatives.

While continuing to further increase our market share, mostly with our flagship product, avenanthramides, we will continue to focus our research program on the development of active ingredients from spearmint, the development of a powder formulation of beta glucan as well as new formulations for avenanthramides that would allow for the potential development of pharmaceuticals. Early stage projects initiated in 2010 are providing some very interesting findings.

Moving forward, our growth strategy is based on excellence in science. Science is to support the efficacy of our quality products, to develop new products and to keep our suite of manufacturing technologies lean, efficient, and novel.

Given our solid financial results and the clear demonstration of our capacity to develop and sell innovative products and technologies through a highly skilled team, Ceapro is now attracting a lot of attention from governments, academic institutions, and companies that are all expressing a strong desire to partner with Ceapro. We are now in the fortunate position to prioritize projects according to our available resources and we expect to sign new partnerships in 2011.

## 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](http://www.sedar.com).

# **Financial Statements**

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**Unaudited Condensed Consolidated Financial Statements for the  
First Quarter Ended March 31, 2011**

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**Ceapro Inc.**

# Financial Statements

CEAPRO INC.

## Consolidated Balance Sheets

	March 31 2011 Unaudited \$	December 31 2010 Unaudited \$	January 1, 2010 Unaudited \$
<b>ASSETS</b>			
Current Assets			
Cash	499,256	186,690	115,502
Accounts receivable	444,545	570,362	151,144
Inventories (note 4)	411,799	279,425	516,821
Prepaid expenses and deposits	79,656	70,230	62,309
	1,435,256	1,106,707	845,776
Non-Current Assets			
License (note 6)	23,250	24,000	27,000
Property and equipment (note 5)	1,661,332	1,689,052	1,897,878
	1,684,582	1,713,052	1,924,878
<b>TOTAL ASSETS</b>	<b>3,119,838</b>	<b>2,819,759</b>	<b>2,770,654</b>
<b>LIABILITIES AND SHAREHOLDERS' DEFICIENCY</b>			
Current Liabilities			
Accounts payable and accrued liabilities	605,871	862,163	846,538
Current portion of long-term debt (note 7)	148,396	146,426	138,806
Royalties payable	406,455	378,051	758,436
Current portion of royalty financial liability	70,092	63,360	49,857
Current portion of repayable research funding	25,000	12,500	-
Current portion of liability on license agreement	4,566	6,136	11,596
SGGF legal fees (note 15)	-	-	314,983
Convertible debentures (note 8)	475,000	467,500	-
	1,735,380	1,936,136	2,120,216
Non-Current Liabilities			
Royalty financial liability	243,502	266,075	329,434
Employee future benefits obligation (note 9)	165,349	160,187	136,786
Liability on license agreement	124,273	121,168	104,112
Long-term debt (note 7)	1,043,154	1,081,000	1,227,426
CAAP loan	56,958	-	-
Convertible debentures (note 8)	-	-	440,000
Repayable research funding	25,000	37,500	-
	1,658,236	1,665,930	2,237,758
Shareholders' Deficiency			
Share capital (note 10b)	5,945,858	5,770,858	5,479,202
Equity component of convertible debentures (note 8)	45,000	45,000	45,000
Contributed surplus	355,785	347,445	286,214
Deficit	(6,620,421)	(6,945,610)	(7,397,736)
	(273,778)	(782,307)	(1,587,320)
<b>TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIENCY</b>	<b>3,119,838</b>	<b>2,819,759</b>	<b>2,770,654</b>

CONTINGENCIES (note 15)

See accompanying notes

# Financial Statements

CEAPRO INC.

Consolidated Statements of Net Income (Loss) and Comprehensive Income (Loss)

Unaudited

	Three Months Ended March 31,	
	2011	2010
	Unaudited	Unaudited
	\$	\$
Revenue (note 17)	1,533,594	1,154,862
Cost of goods sold	612,248	690,042
Gross margin	921,346	464,820
Research and product development	187,275	135,713
General and administration	304,511	295,915
Sales and marketing	30,028	21,169
Other operating loss (note 12)	23,063	3,168
Income from operations	376,469	8,855
Finance costs (note 13)	51,280	55,312
Income (loss) before tax	325,189	(46,457)
Income taxes		
Current	117,000	22,000
Reduction as a result of applying non-capital losses carried forward against the current period's taxable income	(117,000)	(22,000)
Net income (loss) and comprehensive income (loss) for the period	325,189	(46,457)
Net income (loss) per common share:		
Basic	0.01	(0.00)
Diluted	0.01	(0.00)
Weighted average number of common shares outstanding	56,508,241	51,710,063

See accompanying notes

# Financial Statements

CEAPRO INC.  
Consolidated Statements of Changes in Equity  
Unaudited

	Share Capital (note 10b)	Equity component of convertible debentures	Contributed surplus	Deficit	Shareholders' deficiency
	\$	\$	\$	\$	\$
Balance December 31, 2010 (note 3)	5,770,858	45,000	347,445	(6,945,610)	(782,307)
Shares issued for debt	175,000	-	-	-	175,000
Share-based payments	-	-	8,340	-	8,340
Net income and comprehensive income for the period	-	-	-	325,189	325,189
Balance March 31, 2011	5,945,858	45,000	355,785	(6,620,421)	(273,778)
Balance January 1, 2010 (note 3)	5,479,202	45,000	286,214	(7,397,736)	(1,587,320)
Share based payments	-	-	14,373	-	14,373
Net income and comprehensive income for the period	-	-	-	(46,457)	(46,457)
Balance March 31, 2010	5,479,202	45,000	300,587	(7,444,193)	(1,619,404)

See accompanying notes

# Financial Statements

CEAPRO INC.  
Consolidated Statements of Cash Flows  
Unaudited

Three Months Ended March 31,

	2011 Unaudited \$	2010 Unaudited \$
<b>OPERATING ACTIVITIES</b>		
Net income (loss) for the period	325,189	(46,457)
Adjustments to reconcile net income (loss) to cash provided by operating activities		
Interest expense	43,780	47,812
Depreciation	73,165	88,922
Accretion on convertible debentures	7,500	7,500
Employee future benefits obligation	5,162	3,624
Share-based payments	8,340	14,373
	463,136	115,774
<b>CHANGES IN NON-CASH WORKING CAPITAL ITEMS</b>		
Accounts receivable	125,817	(119,406)
Inventories	(132,374)	(36,474)
Prepaid expenses and deposits	(9,426)	(12,343)
Accounts payable and accrued liabilities	(94,697)	81,686
	(110,680)	(86,537)
	352,456	29,237
Interest paid	(16,277)	(18,144)
<b>CASH GENERATED FROM OPERATIONS</b>	<b>336,179</b>	<b>11,093</b>
<b>INVESTING ACTIVITY</b>		
Purchase of property and equipment	(44,695)	(5,246)
<b>FINANCING ACTIVITIES</b>		
Repayment of long-term debt	(35,876)	(34,009)
Repayable CAAP Funding	56,958	-
	21,082	(34,009)
Increase (decrease) in cash	312,566	(28,162)
Cash at beginning of period	186,690	115,502
Cash at end of period	499,256	87,340

See accompanying notes

The non-cash transaction described in note 10 (b) has been excluded from the statement of cash flows.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. NATURE OF BUSINESS OPERATIONS AND GOING CONCERN

Ceapro Inc. (the "Company") is incorporated under the Canada Business Corporations Act and is listed on the TSX Venture Exchange. The Company's primary business activities relate to the marketing and development of various health and wellness products and technology relating to plant extracts.

The Company's head office address is suite 4174 Enterprise Square, 10230 Jasper Avenue, Edmonton, AB T5J 4P6.

The consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge liabilities in the normal course of operations. However, certain conditions may cast some doubt upon the validity of this assumption. Since inception, the Company has accumulated net losses, generated inconsistent operating cash flow and has not yet achieved consistent profitability. The Company has relied on the proceeds of public and private offerings of equity securities and debentures, debt, and other income offerings to support the Company's operations. The Company's ability to continue as a going concern is dependant on obtaining additional financial capital, achieving profitability, and generating consistent positive cash flow. There can be no assurance that the Company will be able to access capital when needed, achieve profitability, or generate positive cash flow.

These financial statements do not reflect the adjustments that might be necessary to the carrying amount of reported assets, liabilities and revenues and expenses and the balance sheet classification used if the Company were unable to continue operations. Such adjustments could be material.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### a) Statement of Compliance

These unaudited condensed consolidated interim financial statements of the Company have been prepared in accordance with International Accounting Standard 34 *Interim Financial Reporting* ("IAS 34") as issued by the International Accounting Standards Board ("IASB") and using the accounting policies disclosed below.

These interim financial statements are the Company's first financial statements prepared using International Financial Reporting Standards ("IFRS"). The 2010 financial statements include an opening balance sheet as at January 1, 2010, the date at which the impact of IFRS transitions were recorded against equity, in accordance with the provisions of IFRS 1 "First time adoption of International Financial Reporting Standards" and the 2010 comparative statements were prepared using the same basis of accounting. A detailed reconciliation of the financial statements prepared under Canadian Generally Accepted Accounting Principles ("Canadian GAAP") and the comparative 2010 IFRS financial information is presented in note 3.

Certain information and disclosures normally required to be included in notes to the annual consolidated financial statements have been condensed or omitted. Accordingly these interim financial statements should also be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2010.

These financial statements were authorized for issue by the Board of Directors on June 15, 2011.

## **b) Basis for Presentation**

These unaudited condensed consolidated interim financial statements have been prepared on the historical cost basis. All transactions are recorded on an accrual basis.

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements and in preparing an opening IFRS balance sheet at January 1, 2010 for the purpose of transition to IFRS unless otherwise indicated. These policies reflect IFRS outstanding as at June 15, 2011. Any subsequent changes to IFRS that are effective for the year ending December 31, 2011 could result in a restatement of these interim financial statements.

The consolidated interim financial statements include the accounts of the Company and its wholly-owned subsidiaries, Ceapro Technology Inc., Ceapro Veterinary Products Inc., Ceapro Active Ingredients Inc., Ceapro BioEnergy Inc., Ceapro (P.E.I) Inc. and Ceapro USA Inc.

All intercompany accounts and transactions have been eliminated on consolidation.

## **c) Use of estimates**

The preparation of consolidated financial statements in conformity with IFRS requires management to make critical judgments, estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses recorded during the reporting period. In making estimates and judgments, management relies on external information and observable conditions where possible, supplemented by internal analysis as required.

Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

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 value of employee future benefits obligation, the liability portion of convertible debentures, the liability on the license agreement, and the estimated sales projections used to value the royalty financial liability. Actual results could differ from those estimates.

## **d) Cash and cash equivalents**

Cash and cash equivalents include cash on hand, demand deposits and all highly liquid short-term investments with original maturities of three months or less.

## **e) Revenue recognition**

Revenues from the sale of health and wellness products are recognized as revenues at the time the products are shipped to customers, title passes, significant risks and rewards have been transferred and collectability is reasonably assured. Revenues are measured at the fair value of consideration received or receivable, less a provision for uncollectible amounts, excluding discounts, rebates and sales taxes.

## **f) Inventories**

Inventories are valued at the lower of cost and net realizable value.

Costs of inventory include costs of purchase, cost of conversion and any other costs incurred in bringing the inventories to their present location and condition. Costs of conversion include direct costs (materials and labor) and indirect costs (fixed and variable production overheads). Fixed overheads are allocated based on normal capacity. Raw Materials are assigned costs by using a first-in-first-out cost formula and work-in-progress and finished goods are assigned costs by using a weighted average cost formula.

Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

## **g) Property and Equipment**

Property and equipment are recorded at cost less accumulated depreciation and any accumulated impairment losses. Depreciation methods and rates are calculated as follows:

Manufacturing equipment	10 years straight-line
Office equipment	20% declining balance
Computer equipment	30% declining balance
Leasehold Improvements	Over the term of the lease

Cost for property and equipment includes the purchase price, import duties, non-refundable taxes and any other costs directly attributable to bringing the asset into the location and condition to be capable of operating. Significant parts of an item of property and equipment with different useful lives are recognized and depreciated separately. Depreciation commences when the asset is available for use. The assets residual values, useful lives and method of depreciation are reviewed at each financial year end and adjustments are accounted for prospectively if appropriate. An item of property and equipment is derecognized on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of an asset is included in the income statement in the period the asset is derecognized.

## **h) Borrowing costs**

Borrowing costs are capitalized when such costs are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to prepare for its intended use. All other borrowing costs are recognized as an expense in the period in which they are incurred.

## **i) Asset Impairment**

The carrying amounts of property and equipment and intangible assets with a finite life are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If such indication exists, the Company estimates the recoverable amount of the assets, which is the higher of its fair value less cost to sell and its value in use. Value in use is estimated as the present value of future cash flows generated by this asset (or group of assets) including eventual disposal. If the recoverable amount of an asset is less than its carrying amount, the carrying amount is reduced to its recoverable amount and an impairment loss is recognized immediately in the profit or loss statement. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the lesser of the revised estimated recoverable amount and the carrying amount that would have been recorded had no impairment loss been recognized previously. Any such recovery is recognized immediately in the profit or loss statement.

## **j) Leases**

Leases are classified as finance or operating leases. A lease is classified as a finance lease if it effectively transfers substantially all of the risks and rewards incidental to ownership.

At the commencement of the lease the Company recognizes finance leases as an asset acquisition and an assumption of an obligation in the consolidated balance sheet at amounts equal to the lower of the fair value of the leased property or, the present value of the minimum lease payments. The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the incremental borrowing rate is used. The interest element of the lease payment is recognized as finance cost over the lease term to achieve a constant periodic rate of interest on the remaining balance of the liability. Any initial direct costs of the lessee are added to the amount recognized as an asset. The useful life and depreciation method is determined on a consistent basis with the Company's policies for property and equipment. The asset is depreciated over the shorter of the lease term and its useful life.

All other leases are accounted for as operating leases, wherein payments are expensed on a straight-line basis over the term of the lease.

## **k) Intangible assets**

### **Licenses**

Licenses are recorded at cost and are amortized straight-line over the life of the license.

### **Research and product development expenditures**

Research costs are expensed when incurred. Product development costs are also expensed when incurred unless they meet recognition criteria for capitalization. Costs are reduced by government grants and investment tax credits where applicable.

Following initial capitalization of product development expenditures, the asset is carried at cost less accumulated amortization and any accumulated impairment losses. Amortization commences when product development is completed and the asset is available for use. It is amortized over the period of expected future economic benefit. The expected lives of assets are reviewed on an annual basis and if necessary, changes in useful lives are accounted for prospectively.

## **l) Trade receivables**

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments (more than 30 days overdue) are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in the income statement within operating costs. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against other operating costs in the income statement.

#### **m) Foreign Currency Transactions**

The Canadian dollar is the functional and presentation currency of the Company and each of the Company's subsidiaries.

Foreign currency monetary assets and liabilities of the Company and its subsidiaries are translated using the period end closing rate and non-monetary assets and liabilities, measured at historic cost, are translated at the rate of exchange at the date of the transaction. Foreign currency transactions are translated at the spot exchange rate which is in effect at the date of the transaction. Foreign currency gains or losses arising on translation are included in other operating income (loss) in the income statement.

#### **n) Income taxes**

Income tax expense comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case the tax expense is also recognized directly in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates and laws enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred income tax assets and liabilities are provided for using the liability method on temporary differences between the tax bases and carrying amounts of assets and liabilities. Deferred tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the year in which temporary differences are expected to be recovered or settled. Changes to these balances, including changes due to changes in income tax rates, are recognized in profit or loss in the period in which they occur.

Deferred tax assets are recognized to the extent future recovery is probable. Deferred tax assets are reduced to the extent it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

#### **o) Government assistance**

Government grants are recognized where there is a reasonable assurance that grant will be received and all attached conditions will be complied with. Government grants are recognized as an offset to expenses over the periods in which the Company recognizes expenses which the grants are intended to compensate. Government grants related to assets are recognized as cost reduction of the assets and reduce depreciation over the expected useful life of the related assets.

#### **p) Investment tax credits**

Investment tax credits relating to qualifying scientific research and experimental development expenditures are accrued provided it is probable that the credits will be realized. When recorded, the investment tax credits are accounted for as a reduction of the related expenditures.

#### **q) Net income (loss) per common share**

Basic net income (loss) per common share is computed by dividing the net income (loss) by the weighted average number of common shares outstanding during the year. Diluted per share amounts reflect the potential dilution that could occur if the Company's convertible securities and convertible debentures were converted to common shares. Diluted income (loss) per common share is calculated by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effect of all dilutive potential common shares. When the Company is in a net loss position, the conversion of convertible securities and debt is considered to be anti-dilutive.

#### **r) Share-based payments**

The Company issues equity-settled share-based awards to eligible employees, directors, officers and consultants under stock option plans that vest over periods ranging from 2 years to 5 years and have a maximum term of five years. Share-based payments are accounted for using the fair value method whereby compensation expense related to these programs is recorded in the statement of net income (loss) and comprehensive income with a corresponding increase to contributed surplus. The fair value of options granted is determined using Black-Scholes-Merton pricing model at the grant date and expensed over the vesting period. Expected forfeitures are estimated at the date of grant and subsequently adjusted if further information indicates estimated forfeitures will change. Upon the exercise of the stock options consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

#### **s) Convertible debentures**

Certain financial instruments comprise a liability and an equity component. The various components of these instruments are accounted for in equity and other financial liabilities according to their classification, as defined in IAS 32 "Financial Instruments: Disclosure and Presentation". The component classified as other financial liabilities is valued at issuance at the present value (taking into account the credit risk at issuance date) of the future cash flows (including interest and repayment of the nominal value) of an instrument with the same characteristics (maturity, cash flows) but without any option for conversion or redemption in shares. The component classified as equity is defined as the difference between the fair value of the total instrument and the fair value of the financial liability component.

The financial liability component is subsequently measured at amortized cost using the effective interest rate method. The finance costs recognized in respect of the convertible debentures include interest expense based on the coupon rate of the debenture and the accretion of the liability component to the amount that will be payable on redemption.

#### **t) Employee future benefits**

The Company accrues its obligations under an employee defined retirement benefit plan and related costs. The cost of retirement benefits earned by employees is determined using the projected unit credit method and management's best estimate of expected retirement ages of employees. The discount rate used is based on the interest rates for high quality corporate bonds. Past service costs relating to plan amendments are accrued and recognized in the year the amendments occur. The Company recognizes actuarial gains and losses in the statement of net income (loss) and comprehensive income (loss).

## **u) Provisions**

A provision is recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and a reliable estimate of the obligation can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The unwinding of the discount is recognized as a finance cost.

## **v) Trade and other payable**

Trade and other payables, including accruals, are recorded when the Company is required to make future payments as a result of purchases of assets or services. Trade and other payables are recognized initially at fair value and are subsequently measured at amortized cost using the effective interest rate method.

## **w) Financial Instruments**

All financial instruments are measured at initial recognition at fair value plus any transaction costs that are directly attributable to the acquisition of the financial instruments except for transaction costs related to financial instruments classified as at fair value through profit or loss ("FVTPL") which are expensed as incurred. The Company has designated its financial instruments as follows:

- i) Cash and cash equivalents are designated as FVTPL which are measured at fair value, with changes in fair value being recorded in net income at each period end;
- ii) Accounts receivable have been classified as loans and receivables and are measured at amortized cost using the effective interest method, less any allowance for uncollectability. The Company recognizes purchase or sale of financial assets using trade date accounting.
- iii) Accounts payable and accrued liabilities, long-term debt, the debt component of convertible debentures, royalties payable, repayable research funding, the royalty financial liability, the liability on license agreement and the CAAP loan are classified as financial liabilities and are measured at amortized cost using the effective interest rate method.

## **x) Consolidated statement of cash flows**

The Company prepares its consolidated statement of cash flows using the indirect method.

## **y) Future Changes in Accounting Policies**

### Financial instruments

IFRS 9 Financial instruments ("IFRS 9") was issued by the IASB on November 12, 2009 and will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of IFRS 9 on its financial statements.

### 3. TRANSITION TO IFRS

The Company has adopted IFRS effective January 1, 2011. Prior to the adoption of IFRS the Company prepared its financial statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The Company's financial statements for the year ending December 31, 2011 will be the first annual financial statements that comply with IFRS. Accordingly, the Company will make an unreserved statement of compliance with IFRS beginning with its 2011 annual financial statements. The Company's transition date is January 1, 2010 (the "transition date") and the Company has prepared its opening IFRS balance sheet at that date. These financial statements have been prepared in accordance with the accounting policies described in Note 2. The Company will ultimately prepare its opening balance sheet and financial statements for 2010 and 2011 by applying existing IFRS with an effective date of December 31, 2011 or prior. Accordingly, the opening balance sheet and financial statements for 2010 and 2011 may differ from these financial statements.

An explanation as to how the transition from Canadian GAAP to IFRS has affected the Company's financial position, financial performance, and cash flows, is set out in the following reconciliations and explanatory notes that accompany the reconciliations.

#### **b) Elected exemptions from full retrospective application**

In preparing these consolidated financial statements in accordance with IFRS 1 *First-time Adoption of International Financial Reporting Standards* ("IFRS 1"), the Company has applied certain of the optional exemptions from full retrospective application of IFRS. The optional exemptions applied are described below.

##### i) Employee benefits

The Company has elected to recognize all cumulative actuarial gains and losses that existed at the transition date in opening retained earnings for its employee future benefit plan. The application of this exemption did not result in an IFRS transition adjustment to the opening balance sheet on the transition date;

The Company has elected to disclose the amounts required under IAS 19 *Employee Benefits* as the amounts are determined for each accounting period prospectively from the transition date to IFRS;

##### ii) Share-based payment transactions

The Company has elected not to apply IFRS 2 *Share-based Payment* to equity instruments granted that had vested by the transition date;

##### iii) Business combinations

The Company has elected not to apply IFRS 3 *Business Combinations* retrospectively to business combinations that occurred before the date of transition to IFRS;

##### iv) Lease

The Company has applied the transitional provisions in IFRIC 4 *Determining whether an Arrangement contains a Lease* and had chosen to determine whether an arrangement existing at the date of transition to IFRS contains a lease on the basis of facts and circumstances existing at that date;

##### v) Compound financial instruments

The Company has elected not to identify separately the amounts within equity that are attributable to the equity and liability elements of convertible debentures issued prior to the date of transition where the liability component is no longer outstanding at the date of transition to IFRS;

vi) Borrowing costs

The Company has elected to apply the transitional provisions of IFRS 23 *Borrowing Costs* and will only commence the capitalization of borrowing costs that are directly attributable to the acquisition and construction of qualifying assets for which the commencement date is subsequent to the date of transition to IFRS.

**c) Mandatory exceptions to retrospective application**

In preparing these consolidated financial statements in accordance with IFRS 1 the Company has applied certain mandatory exceptions from full retrospective application of the IFRS. The mandatory exception that is applicable to the Company on its conversion to IFRS is described below.

Estimates

Hindsight was not used to create or revise estimates. The Company's estimates in accordance with IFRS at the date of transition are consistent with estimates made for the same date in accordance with previous GAAP.

**d) Reconciliation of the Company's equity reported in accordance with Canadian GAAP to its equity in accordance with IFRS**

Reconciliation of the Company's equity at January 1, 2010

	Previous Canadian GAAP \$	Effect of transition to IFRS \$	IFRS \$
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash	115,502		115,502
Accounts receivable	151,144		151,144
Inventories (note 4)	516,821		516,821
Prepaid expenses and deposits	62,309		62,309
	845,776		845,776
<b>Non-Current Assets</b>			
License (note 6)	27,000		27,000
Property and equipment (note 5)	1,897,878		1,897,878
	1,924,878		1,924,878
<b>TOTAL ASSETS</b>	<b>2,770,654</b>		<b>2,770,654</b>
<b>LIABILITIES AND SHAREHOLDERS' DEFICIENCY</b>			
<b>Current Liabilities</b>			
Accounts payable and accrued liabilities	846,538		846,538
Current portion of long-term debt (note 7)	138,806		138,806
Royalties payable	758,436		758,436
Current portion of royalty financial liability (iv)	60,000	(10,143)	49,857
Current portion of liability on license agreement (iii)	-	11,596	11,596
SGGF legal fees (note 15)	314,983		314,983
	2,118,763	1,453	2,120,216
<b>Non-Current Liabilities</b>			
Royalty financial liability (iv)	220,422	109,012	329,434
Employee future benefits obligation (note 9)	136,786		136,786
Liability on license agreement (iii)	-	104,112	104,112
Long-term debt (note 7)	1,227,426		1,227,426
Convertible debentures (note 8)	440,000		440,000
	2,024,634	213,124	2,237,758
<b>Shareholders' Deficiency</b>			
Share capital (note 10b)	5,479,202		5,479,202
Equity component of convertible debentures (note 8) (ii)	60,000	(15,000)	45,000
Contributed surplus (i)	478,945	(192,731)	286,214
Deficit	(7,390,890)	(6,846)	(7,397,736)
	(1,372,743)	(214,577)	(1,587,320)
<b>TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIENCY</b>	<b>2,770,654</b>	<b>-</b>	<b>2,770,654</b>

Reconciliation of the Company's equity at December 31, 2010

	Previous Canadian GAAP \$	Effect of transition to IFRS \$	IFRS \$
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash	186,690		186,690
Accounts receivable	570,362		570,362
Inventories (note 4)	279,425		279,425
Prepaid expenses and deposits	70,230		70,230
	1,106,707		1,106,707
<b>Non-Current Assets</b>			
License (note 6)	24,000		24,000
Property and equipment (note 5)	1,689,052		1,689,052
	1,713,052		1,713,052
<b>TOTAL ASSETS</b>	<b>2,819,759</b>		<b>2,819,759</b>
<b>LIABILITIES AND SHAREHOLDERS' DEFICIENCY</b>			
<b>Current Liabilities</b>			
Accounts payable and accrued liabilities	862,163		862,163
Current portion of long-term debt (note 7)	146,426		146,426
Royalties payable	378,051		378,051
Current portion of royalty financial liability (iv)	60,000	3,360	63,360
Convertible debentures (note 8)	467,500		467,500
Current portion of liability on license agreement (iii)	-	6,136	6,136
Current portion of repayable research funding	12,500		12,500
	1,926,640	9,496	1,936,136
<b>Non-Current Liabilities</b>			
Royalty financial liability (iv)	166,198	99,877	266,075
Employee future benefits obligation (note 9)	160,187		160,187
Liability on license agreement (iii)	-	121,168	121,168
Long-term debt (note 7)	1,081,000		1,081,000
Repayable research funding	37,500		37,500
	1,444,885	221,045	1,665,930
<b>Shareholders' Deficiency</b>			
Share capital (note 10b)	5,770,858		5,770,858
Equity component of convertible debentures (note 8) (ii)	60,000	(15,000)	45,000
Contributed surplus (i)	507,188	(159,743)	347,445
Deficit	(6,889,812)	(55,798)	(6,945,610)
	(551,766)	(230,541)	(782,307)
<b>TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIENCY</b>	<b>2,819,759</b>	<b>-</b>	<b>2,819,759</b>

Reconciliation of the Company's equity at March 31, 2010

	Previous Canadian GAAP \$	Effect of transition to IFRS \$	IFRS \$
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash	87,340		87,340
Accounts receivable	270,550		270,550
Inventories	553,295		553,295
Prepaid expenses and deposits	74,651		74,651
	985,836		985,836
<b>Non-Current Assets</b>			
License	26,250		26,250
Property and equipment	1,814,952		1,814,952
	1,841,202		1,841,202
<b>TOTAL ASSETS</b>	<b>2,827,038</b>		<b>2,827,038</b>
<b>LIABILITIES AND SHAREHOLDERS' DEFICIENCY</b>			
<b>Current Liabilities</b>			
Accounts payable and accrued liabilities	939,295	1,440	940,735
Current portion of long-term debt	140,673		140,673
Royalties payable	784,824		784,824
Current portion of royalty financial liability (iv)	60,000	(6,434)	53,566
Current portion of liability on license agreement (iii)	-	10,231	10,231
SGGF legal fees (note 15)	314,983		314,983
	2,239,775	5,237	2,245,012
<b>Non-Current Liabilities</b>			
Royalty financial liability (iv)	207,228	106,366	313,594
Employee future benefits obligation	140,410		140,410
Liability on license agreement (iii)	-	108,376	108,376
Long-term debt	1,191,550		1,191,550
Convertible debentures	447,500		447,500
	1,986,688	214,742	2,201,430
<b>Shareholders' Deficiency</b>			
Share capital	5,479,202		5,479,202
Equity component of convertible debentures (ii)	60,000	(15,000)	45,000
Contributed surplus (i)	501,095	(200,508)	300,587
Deficit	(7,439,722)	(4,471)	(7,444,193)
	(1,399,425)	(219,979)	(1,619,404)
<b>TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIENCY</b>	<b>2,827,038</b>	<b>-</b>	<b>2,827,038</b>

i) Share-based payments

The company recognizes share-based compensation expense for the fair value of stock options granted under Canadian GAAP and IFRS. However, the timing and amount of expense may differ.

Under Canadian GAAP, if the expected lives of an award that vests over a number of periods does not differ significantly the award can be treated as one grant and the related compensation can be recognized on a straight-line basis. Additionally a company could elect either to estimate the expected forfeiture rate at the date of grant or recognize forfeitures as they occurred. Under IFRS when an award vests over a number of periods each vesting tranche is treated as a separate grant with a separate vesting date and fair value. The application of an estimated forfeiture rate for stock option grants is required.

The company previously recognized forfeitures as they occurred and recognized compensation expense on a straight-line basis. On the date of transition the Company recognized an adjustment to decrease the contributed surplus balance by \$21,689 and \$21,689 was credited directly through equity.

Under IFRS 2 "Share-based Payment" the Company cannot make a subsequent adjustment to equity after vesting date. However, the requirement does not preclude the Company from recognizing a transfer within equity. On the date of transition the Company has transferred from contributed surplus, share-based payments in the amount of \$171,042, relating to stock options that were fully vested and expired prior to January 1, 2010. The transfer was made through equity.

ii) Income taxes

The Company issued convertible debentures during the year ended December 31, 2009. Under Canadian GAAP it is expected that a compound instrument can be settled without the incidence of tax. The tax basis of the liability component is considered equal to its carrying amount and no temporary difference with respect to deferred tax arises. Under IFRS the tax base of the liability component is equal to the sum of the liability and equity components which results in a taxable temporary difference. As a result the Company recorded a deferred tax liability on the date of transition in the amount of \$15,000 of which the offset was charged directly against the equity component of the convertible debentures. Concurrent with this transaction the Company also recognized a deferred tax asset on previously unrecognized deductible temporary differences. This entry has been recorded directly through equity on transition.

Under Canadian GAAP when an asset is transferred between enterprises within a consolidated group, a deferred tax asset should not be recognized in the consolidated financial statements for a temporary difference arising between the tax basis of the asset in the buyer's tax jurisdiction and its cost as reported in the consolidated financial statements. Under IFRS a deferred tax asset is recognized for the difference in the tax basis of the buyer and the cost as reported in the consolidated financial statements as a result of intra-group transfers. On the date of transition this results in additional tax effected deductible temporary differences \$656,159, however, as it is not probable that taxable profit will be available against which the deductible temporary differences can be utilized, a deferred tax asset has not been recognized.

iii) Liability on license agreement

The Company has recognized a liability relating to the licensing agreement with the University of Guelph for an exclusive variety of a mint plant. As long as the Company continues to license the mint, it is obligated to pay the university an amount equal to 8% of net sales from products derived from the mint plants subject to expected minimum payments of \$247,680 as at January 1, 2010. The lower thresholds for recognition under IAS 37 have resulted in the Company recognizing a liability at January 1, 2010 in the amount of \$115,708 which is the present value of the future estimated payments using a discount rate of 15%. This entry has been recorded directly through equity.

iv) Royalty financial liabilities

On December 28, 2005 the Company sold a 2.285% royalty interest in the Company's future sales and licensing of active ingredients, animal health, and CeaProve® products for \$457,000. Maximum royalties payable are two times the amount invested or \$914,000. Under Canadian GAAP the Company accounted for this royalty interest offering as a revenue transaction. The proceeds received were recorded as deferred revenue and were recognized into income on a ½ basis consistent with the related royalty expense.

Under IFRS the proceeds received from this royalty interest offering do not meet the definition of revenue under IAS 18. The transaction should be accounted for as a financial liability. On the date of transition the Company reclassified \$280,422 of deferred revenue under Canadian GAAP to a royalty financial liability under IFRS. The royalty financial liability was measured based on a discount rate of approximately 15% which is derived by taking into account future estimated repayments to satisfy the financial liability. The increase in the liability of \$98,869 was recorded directly through equity.

**e) Reconciliation of the Company's net income (loss) and comprehensive income (loss) and deficit reported in accordance with Canadian GAAP to its net income (loss) and comprehensive income (loss) and deficit in accordance with IFRS**

Reconciliation of the Company's net loss and comprehensive loss and deficit for the three months ended March 31, 2010

		Previous Canadian GAAP \$	Effect of transition to IFRS \$	IFRS \$
Revenue (note 17)		1,154,862		1,154,862
Cost of goods sold	(i)	692,118	(2,076)	690,042
Gross margin		462,744	2,076	464,820
Research and product development	(i)	138,128	(2,415)	135,713
General and administration	(i)	299,201	(3,286)	295,915
Sales and marketing		21,169		21,169
Other operating loss (note 12)		3,168		3,168
Income from operations		1,078	7,777	8,855
Finance costs (note 13)	(ii)	49,910	5,402	55,312
Income (loss) before tax		(48,832)	2,375	(46,457)
Income taxes				
Current		22,000	-	22,000
Reduction as a result of applying non-capital losses carried forward against the current period's taxable income		(22,000)	-	(22,000)
Net income (loss) and comprehensive income (loss) for the year		(48,832)	2,375	(46,457)
Deficit, beginning of period		(7,390,890)		(7,397,736)
Deficit, end of period		(7,439,722)		(7,444,193)
Net loss per common share:				
Basic		(0.00)		(0.00)
Diluted		(0.00)		(0.00)
Weighted average number of common shares outstanding		51,710,063		51,710,063

Reconciliation of the Company's net income and comprehensive income and deficit for the year ended December 31, 2010

		Previous Canadian GAAP \$	Effect of transition to IFRS \$	IFRS \$
Revenue (note 17)		5,576,636		5,576,636
Cost of goods sold	(i)	3,041,469	18,735	3,060,204
Gross margin		2,535,167	(18,735)	2,516,432
Research and product development	(i)	764,351	9,708	774,059
General and administration	(i)	1,274,467	4,545	1,279,012
Sales and marketing		69,513		69,513
Other operating loss		29,964		29,964
Write off of property and equipment		12,278		12,278
SGGF legal fees (note 15)		(314,983)		(314,983)
Income (loss) from operations		699,577	(32,988)	666,589
Finance costs	(ii)	198,499	15,963	214,463
Income (loss) before tax		501,078	(48,952)	452,126
Income taxes				
Current		272,536	-	272,536
Reduction as a result of applying non-capital losses carried forward against the current period's taxable income		(272,536)	-	(272,536)
Net income (loss) and comprehensive income (loss) for the year		501,078	(48,952)	452,126
Deficit, beginning of year		(7,390,890)		(7,397,736)
Deficit, end of year		(6,889,812)		(6,945,610)
Net income (loss) per common share:				
Basic		0.01		0.01
Diluted		0.01		0.01
Weighted average number of common shares outstanding		53,219,621		53,219,621

The following explanatory notes relating to the Company's reconciliations of net income (loss) and comprehensive income (loss) from Canadian GAAP to IFRS should be read in conjunction with the Company's explanatory notes relating to its reconciliations of equity.

i) Share-based payments

As a result of differences in accounting treatment between Canadian GAAP and IFRS the Company decreased share-based payment expenses by the amount of \$7,777 at March 31, 2010 and increased the expenses by the amount of \$32,988 at December 31, 2010.

ii) Finance costs

Liability on license agreement

The Company has increased interest expenses on the liability relating to the licensing agreement with the University of Guelph for an exclusive variety of a mint plant in the amount of \$11,596 at December 31, 2010.

Royalty financial liability

The Company has increased interest expenses from the unwinding of the discount on the royalty financial liability in the amount of \$5,402 at March 31, 2010 and \$4,368 at December 31, 2010.

**f) Statements of Cash Flows**

There were no significant changes to the presentation of cash flows as reported under Canadian GAAP to IFRS with the exception of the Company reporting interest paid directly in the statement of cash flows under IFRS whereas under Canadian GAAP it was disclosed as supplementary information to the statement of cash flows.

**4. INVENTORIES**

The Company had the following inventory at the end of each reporting period:

	March 31, 2011	December 31, 2010	January 1, 2010
	\$	\$	\$
Raw materials	208,786	224,262	218,604
Work in progress	109,039	15,996	135,026
Finished goods	93,974	39,167	163,191
	<u>411,799</u>	<u>279,425</u>	<u>516,821</u>

Inventories expensed in cost of goods sold during the three months ended March 31, 2011 is \$579,907 (three months ended March 31, 2010 - \$682,921).

## 5. PROPERTY AND EQUIPMENT

Cost at	Equipment not available for use \$	Manufacturing Equipment \$	Office Equipment \$	Computer Equipment \$	Leasehold Improvements \$	Total \$
January 1, 2010	176,431	2,635,342	75,861	240,070	120,014	3,247,718
additions	-	80,029	419	10,294	350	91,092
write-offs	-	(16,949)	-	-	-	(16,949)
December 31, 2010	176,431	2,698,422	76,280	250,364	120,364	3,321,861
January 1, 2011	176,431	2,698,422	76,280	250,364	120,364	3,321,861
additions	7,327	37,126	-	242	-	44,695
write-offs	-	-	-	-	-	-
March 31, 2011	183,758	2,735,548	76,280	250,606	120,364	3,366,556
Accumulated Depreciation at						
January 1, 2010		1,063,270	54,135	152,878	79,557	1,349,840
depreciation		223,878	4,387	27,189	32,186	287,640
write-offs		(4,671)	-	-	-	(4,671)
December 31, 2010		1,282,477	58,522	180,067	111,743	1,632,809
January 1, 2011		1,282,477	58,522	180,067	111,743	1,632,809
depreciation		64,511	888	5,285	1,731	72,415
write-offs		-	-	-	-	-
March 31, 2011		1,346,988	59,410	185,352	113,474	1,705,224
Carrying value at						
March 31, 2011	183,758	1,388,560	16,870	65,254	6,890	1,661,332
December 31, 2010	176,431	1,415,945	17,758	70,297	8,621	1,689,052
January 1, 2010	176,431	1,572,072	21,726	87,192	40,457	1,897,878

Depreciation expense allocation for the following periods:

	Cost of goods			
	sold \$	Inventory \$	G&A \$	Total \$
Three Months ending March 31, 2011	48,708	16,740	7,717	73,165
Three Months ending March 31, 2010	45,526	34,868	8,528	88,922
Year ending December 31, 2010	249,764	3,649	37,227	290,640

## 6. LICENSE

During the year ended December 31, 2008, the Company entered into a licensing agreement with the University of Guelph for an exclusive variety of a mint plant. The Company paid a licensing fee of \$30,000 and is amortizing the license over 10 years, which is the finite life of the agreement, \$3,000 per year.

	March 31, 2011 \$	December 31, 2010 \$	January 1, 2010 \$
Cost of License	30,000	30,000	30,000
Accumulated amortization	6,750	6,000	3,000
Net book value	23,250	24,000	27,000

The amortization expense is presented under general and administration expense for the following periods:

Three Months Ended March 31, 2011	750
Three Months Ended March 31, 2010	750
Year Ended December 31, 2010	3,000

## 7. LONG-TERM DEBT

	March 31, 2011 \$	December 31, 2010 \$	January 1, 2010 \$
Loan payable at \$17,384 per month, principal and interest at 5.49%, secured by a general security agreement, due January, 2013.	1,191,550	1,227,426	1,366,232
Less current portion	148,396	146,426	138,806
	1,043,154	1,081,000	1,227,426

Interest expense is presented under finance costs for the following periods:

Three Months Ended March 31, 2011	16,277
Three Months Ended March 31, 2010	18,144
Year Ended December 31, 2010	69,808

In the event of default of any terms and conditions of the loan and enforcement of these terms and conditions by the lender, the current interest rate will be cancelled from the date of enforcement of the action. If such a circumstance were to arise, the interest rate would become 7.49% and would result in monthly payments of \$18,925. The security agreement also includes a standard subjective acceleration clause for material adverse events. The Company is in compliance with all terms and conditions.

## 8. CONVERTIBLE DEBENTURES

On December 31, 2009, the Company issued secured convertible debentures for cash of \$500,000. The debentures bear interest at 8% per annum, mature on December 31, 2011, and are convertible at any time at a price of \$0.10 per common share at the option of the holder. The debentures may be redeemed at the option of the Company upon giving notice of 60 days. The Company may satisfy interest payments through the delivery of common shares at the weighted average market price of the Common Shares for the 20 trading days the Common Shares traded on the TSX-V immediately prior to the date on which the interest obligation is due. The debenture security ranks subordinate to the Company's existing long term debt as well as \$500,000 for a potential working capital facility. Currently there is no working capital facility.

The convertible debentures contain both liability and equity components. The Company has allocated the total proceeds received between the liability and equity components of the convertible debentures using the residual method, based on an interest rate of 15%, which is the estimated cost of borrowing at which the Company could borrow similar debt without a conversion feature.

	March 31, 2011	December 31, 2010	January 1, 2010
	\$	\$	\$
Total value of convertible debentures	520,000	512,500	485,000
Equity component	60,000	60,000	60,000
Deferred tax on equity component	(15,000)	(15,000)	(15,000)
	45,000	45,000	45,000
Liability component	475,000	467,500	440,000

Interest and accretion expenses are presented under finance costs for the following periods:

	Interest expense	Accretion
Three Months Ended March 31, 2011	10,000	7,500
Three Months Ended March 31, 2010	10,000	7,500
Year Ended December 31, 2010	41,096	27,500

## 9. EMPLOYEE FUTURE BENEFIT OBLIGATION

The Company has an unfunded, non-registered, non-indexed defined retirement benefit plan for an officer. The retirement benefit is two months' salary for each year he is employed by the Company.

Management is required to make an estimate regarding the discount rate used to determine the accrued benefit obligation. This estimate is of a long-term nature, which is consistent with the nature of the employee future benefits. The discount rate used to determine the accrued benefit obligation as at March 31, 2011 was 4.19% (December 31, 2010 - 4.19%).

	Three Months Ended March 31, 2011	Year Ended December 31, 2010
<b>Accrued benefit obligation</b>	<b>\$</b>	<b>\$</b>
Unfunded balance, beginning of period	160,187	136,786
Current service cost	3,484	17,297
Interest costs on accrued benefit obligation	1,678	6,104
	<b>165,349</b>	<b>160,187</b>

	Three Months Ended March 31, 2011	Year Ended December 31, 2010
<b>Elements of defined benefit costs recognized in the period</b>	<b>\$</b>	<b>\$</b>
Current service cost	3,484	17,297
Interest cost on accrued benefit obligation	1,678	6,104
	<b>5,162</b>	<b>23,401</b>

Defined benefit costs have been presented under research and product development expenses in the consolidated statements of net income (loss) for the period.

## 10. SHARE CAPITAL

- a. Authorized
  - i. Unlimited number of Class A voting common shares. Class A common shares have no par value.
  - ii. Unlimited number of Class B non-voting common shares. There are no issued Class B shares.
- b. Issued - Class A common shares

	Three Months Ended March 31, 2011		Year Ended December 31, 2010	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Balance at beginning of the period	54,988,039	5,770,858	51,710,063	5,479,202
Changes during the period				
Shares issued for debt	1,590,909	175,000	3,277,976	291,656
Balance at end of the period	<b>56,578,948</b>	<b>5,945,858</b>	54,988,039	5,770,858

During the first quarter of 2011 the Company's directors exchanged debt obligations totaling \$175,000 into 1,590,909 common shares of the Company. This non cash transaction has been excluded from the consolidated statement of cash flows.

During the year ended December 31, 2010, the Company issued 3,006,224 common shares for the settlement of royalty payable obligations totaling \$270,560 and 271,752 common shares for full settlement of interest due on convertible debentures in the amount of \$21,096. These non-cash transactions have been excluded from the consolidated statement of cash flows.

c. Stock options outstanding are as follows:

Fair Value at grant date	Exercise Price \$	Year of Expiration	Weighted Average Contractual Life Remaining (years)	March 31, 2011 Number of Options	December 31, 2010 Number of Options	January 1, 2010 Number of Options
0.0620	0.10	2015	4.4	650,000	650,000	-
0.1042	0.13	2014	3.2	900,000	900,000	900,000
0.0836	0.12	2013	2.4	630,000	630,000	660,000
0.1494	0.25	2013	1.8	210,000	210,000	210,000
0.1864	0.28	2012	1.5	390,000	390,000	390,000
0.2182	0.30	2012	0.8	100,000	100,000	100,000
0.1985	0.30	2011	0.2	75,000	75,000	75,000
0.2029	0.27	2011	0.6	150,000	150,000	150,000
			2.7	3,105,000	3,105,000	2,485,000

## 11. RELATED PARTY TRANSACTIONS

The Company has no balances and no transaction amounts with its wholly-owned Subsidiaries: Ceapro Technology Inc., Ceapro Veterinary Products Inc., Ceapro Active Ingredients Inc., Ceapro BioEnergy Inc., Ceapro (P.E.I) Inc. and Ceapro USA Inc. except as disclosed below.

Related party transactions during the periods not otherwise disclosed in these consolidated financial statements are as follows:

	Three Months Ended March 31	
	2011	2010
	\$	\$
Royalties earned by employees and directors	6,204	5,341
Amounts payable to employees and directors included in royalties payable	33,962	89,922
Convertible debentures owned by officers and directors	70,000	70,000
Interest earned in Convertible Debentures by officers and directors	1,400	1,400
Key management salaries, short-term benefits, consulting fees and director fees	143,000	135,000
Key management personnel share-based payments	7,364	12,446
Consulting fees payable to a company controlled by a director in accounts payable and accrued liabilities	25,000	37,500
Director fees converted by directors into common shares	175,000	-
Loans due from Ceapro Technology Inc.	1,183,954	1,067,634
Loan due from Ceapro Veterinary Products Inc.	6,720,448	6,109,498
Interest earned from Ceapro Veterinary Products Inc.	163,913	149,012

Transactions with the Company's wholly-owned subsidiaries are eliminated on consolidation. Ceapro Veterinary Products Inc. is charged interest on loan balances and other than this interest, there are no further transactions with the exception of the Company funding Ceapro Technology Inc. expenses.

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

## 12. OTHER OPERATING LOSS

	Three Months Ended March 31	
	2011	2010
	\$	\$
Foreign exchange losses	19,052	3,162
Other expenses	4,011	6
	23,063	3,168

## 13. FINANCE COSTS

	Three Months Ended March 31	
	2011	2010
	\$	\$
Interest on royalty financial liability	12,722	14,257
Interest on long-term loan	16,277	18,144
Interest on convertible debentures	10,000	10,000
Accretion of convertible debentures	7,500	7,500
Interest on liability on license agreement	4,774	4,339
Bank charges	7	1,072
	51,280	55,312

## 14. SEGMENTED INFORMATION

The Company operates in one industry segment, which is the active ingredient product technology industry. The majority of the revenue is derived from sales in North America. All the assets of the Company, which support the revenues of the Company, are located in Canada. The distribution of revenue by location of customer is as follows:

	Three Months Ended March 31	
	2011	2010
	\$	\$
United States	1,121,217	785,033
Other	410,135	369,509
Canada	2,242	320
	1,533,594	1,154,862

## 15. CONTINGENCIES AND COMMITMENTS

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 this 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 second quarter in 2010.

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.

## **16. OPERATING LEASE**

The Company is committed to future annual payments under operating leases for manufacturing facilities and office space. All operating leases expire by September 30, 2012. Total lease commitments from April 1, 2011 until September 30, 2012 are \$346,100.

## **17. REVENUE**

Substantially all sales are export sales to five distributors of the Company's products. The Company is therefore dependent on those distributors to maintain and expand the volume of product sales to existing and new customers.

## **18. FINANCIAL INSTRUMENTS**

The fair value of accounts receivable, accounts payable and accrued liabilities and royalties payable approximate their carrying amount due to their short-term nature. The fair value of long-term debt is estimated to approximate its carrying value because the interest rate does not differ significantly from current interest rates for similar types of borrowing arrangements. The liability component of convertible debentures was calculated using a 15% discount rate. Management considers that no events have occurred subsequent to the inception of this financing arrangement that would indicate that the fair value differs substantially from carrying value.

The repayable research funding and the Canadian Agricultural Adaptation Program ("CAAP") loan are recorded at the amount drawn under the agreement which represents the estimated fair value of the obligation plus the deferred interest benefit.

The royalty financial liability and the liability on license agreement was estimated using a discount rate that results from the estimated future repayment of those obligations. As there has been no significant change in estimated future repayments, and as the estimated discount rate also approximates the company's estimated cost of capital for similar borrowing arrangements, management believes the carrying amount of these obligations do not differ significantly from their fair value.

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

### a) Credit risk:

The Company makes sales to customers that are well-established and well-financed within their respective industries. There is always a risk relating to the financial stability of customers and their ability to pay, but management views this risk as minimal. Approximately 95% of accounts receivable are due from two customers at March 31, 2011 and all accounts receivable are current. The Company mitigates its exposure to credit risk on its cash balances by maintaining its bank accounts with a Canadian Chartered Bank. The Company's maximum exposure to credit

risk on its cash and accounts receivable is the carrying value of these items at March 31, 2011, a total of \$943,801.

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. Royalties are in arrears as they have only been paid partially in cash since the second quarter of 2008 due to the limited financial resources of the Company. 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	1 - 3 years	4 - 7 years	Total
	\$	\$	\$	\$
Accounts payable and accrued liabilities	605,871			605,871
Long-term debt, including interest	208,613	1,163,408		1,372,021
Royalties payable	406,455			406,455
Royalty financial liability	114,250	291,337	49,635	455,222
Liability on license agreement	12,960	82,080	146,880	241,920
Convertible debentures including interest	540,000			540,000
Employee future benefit obligation	-	-	210,130	210,130
Repayable research funding	25,000	25,000		50,000
Repayable CAAP funding	-	56,958		56,958
<b>Total</b>	<b>1,913,149</b>	<b>1,618,783</b>	<b>210,130</b>	<b>3,938,577</b>

c) Market risk:

Market risk is comprised of interest rate risk and foreign currency 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 Company is exposed to foreign currency fluctuations because a substantial portion of sales are denominated in U.S. dollars. A one percent change in the Canadian/U.S. dollar exchange rate will impact revenues by approximately \$60,000 annually based upon estimated 2011 U.S. dollar sales of \$6,000,000. The Company does purchase some materials and services in U.S. dollars and to a very minor extent in Euros. This amount will vary by product sold.

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.

	Carrying Amount (USD)	Foreign Exchange Risk (USD)	
		-1% Earnings & Equity	+1% Earnings & Equity
<b>Financial assets</b>			
Accounts receivable	448,460	4,485	(4,485)
<b>Financial Liabilities</b>			
Accounts payable and accrued liabilities	134,280	(1,343)	1,343
<b>Total increase (decrease)</b>		3,142	(3,142)

## 2. Interest rate risk.

The Company has minimal interest rate 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.

### d) Fair value of financial instruments

IFRS requires that the Company disclose information about the fair value of its financial assets and liabilities. Fair value estimates are made at the balance sheet date based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

As at March 31, 2011, at December 31, 2010 and at January 1, 2010 the Company's cash has been classified as Level 1 within the fair value hierarchy.

## 19. CAPITAL DISCLOSURES

The Company considers its capital to be its shareholder deficiency. The Company's objectives in managing capital is to ensure a sufficient liquidity position to finance its manufacturing operations, research and development activities, administration and marketing expenses, working capital and overall capital expenditures, including those associated with patents and trademarks. The Company makes every effort to manage its liquidity to minimize dilution to its shareholders, when possible.

The Company has funded its activities through public offerings and private placements of common shares, royalty offerings, loans, convertible debentures, and grant contributions.

The Company is not subject to externally imposed capital requirements and the Company's overall strategy with respect to capital risk management remains unchanged from the year ended December 31, 2010.

## **20. SUBSEQUENT EVENTS**

Subsequent to March 31, 2011 the Company repaid its royalties payable obligation in the amount of \$378,051 which represents the balance due at December 31, 2010.

The Company was approved for a non-repayable grant of up to \$100,000 from Innovation PEI to carry out a research and development project.