

**Consolidated Financial Statements for the  
Years ended December 31, 2008 & 2007**



## **Management's Report**

To the Shareholders of **Ceapro Inc.**,

The accompanying consolidated financial statements of Ceapro Inc., and all information presented in this annual report, are the responsibility of Management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles. The financial statements include some amounts that are based on the best estimates and judgments of Management. Financial information used elsewhere in the annual report is consistent with that in the financial statements.

To further the integrity and objectivity of data in the financial statements, Management of the Company has developed and maintains a system of internal controls, which Management believes will provide reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements, and that assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the financial statements in the annual report principally through its Audit Committee. The Audit Committee is appointed by the Board, and all of its members are outside and unrelated Directors. The Committee meets periodically with Management and the external auditors to discuss internal controls over the financial reporting process and financial reporting issues, to make certain that each party is properly discharging its responsibilities, and to review quarterly reports, the annual report, the annual financial statements, management discussion and analysis, and the external auditors' report. The Committee reports its findings to the Board for consideration when approving the financial statements for issuance to the shareholders. The Company's auditors have full access to the Audit committee, with and without Management being present.

The financial statements have been audited by the Company's auditors, Stout & Company LLP, the external auditors, in accordance with auditing standards generally accepted in Canada on behalf of the shareholders.

Sincerely,

**SIGNED "Gilles Gagnon"**  
**Acting President and Chief Executive Officer**

**SIGNED "Branko Jankovic, CA"**  
**Chief Financial Officer**

## **Auditors' report**

To the Shareholders of Ceapro Inc.,

We have audited the consolidated balance sheets of Ceapro Inc. as at December 31, 2008 and 2007, and the consolidated statements of net loss and comprehensive loss, and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Edmonton, Canada  
March 16, 2009

SIGNED: "Stout & Company LLP"  
Chartered Accountants

# Financial Statements

## CEAPRO INC. Consolidated Balance Sheets

	December 31 2008	December 31 2007
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 16,525	\$ 1,282,326
Accounts receivable	551,594	708,165
Inventories (note 3)	406,967	156,584
Prepaid expenses and deposits	82,568	130,100
	<b>1,057,654</b>	<b>2,277,175</b>
RESTRICTED CASH (note 7)	-	50,000
LICENSE (note 9b)	30,000	-
PROPERTY AND EQUIPMENT (note 4)	2,199,740	2,260,418
	<b>\$ 3,287,394</b>	<b>\$ 4,587,593</b>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 1,150,814	\$ 494,413
Current portion of deferred revenue	57,125	107,007
Current portion of long-term debt (note 5)	131,582	112,638
Current portion of royalties payable (note 6)	455,549	138,185
Current portion of employee future benefits obligation (note 7)	187,000	-
SGGF legal fees (note 9a)	1,466,283	-
	<b>3,448,353</b>	<b>852,243</b>
DEFERRED ROYALTY REVENUE	272,944	328,377
EMPLOYEE FUTURE BENEFITS OBLIGATION (note 7)	117,012	283,648
LONG-TERM DEBT (note 5)	1,366,232	1,499,768
ROYALTIES PAYABLE (note 6)	13,981	69,905
	<b>5,218,522</b>	<b>3,033,941</b>
<b>SHAREHOLDERS' (DEFICIENCY) EQUITY</b>		
SHARE CAPITAL (note 8b)	5,016,395	5,016,395
CONTRIBUTED SURPLUS (note 8c)	374,018	259,329
DEFICIT	(7,321,541)	(3,722,072)
	<b>(1,931,128)</b>	<b>1,553,652</b>
	<b>\$ 3,287,394</b>	<b>\$ 4,587,593</b>

Contingencies (note 9a and 9c)  
See accompanying notes

Approved on Behalf of the Board  
SIGNED: "John Zupancic"  
Director

SIGNED: "Edward Taylor"  
Director

# Financial Statements

## CEAPRO INC.

### Consolidated Statements of Net Loss and Comprehensive Loss, and Deficit

Years ended December 31

	2008	2007
<b>Revenue</b>		
Sales (note 10)	\$ 4,228,073	\$ 3,447,694
Cost of goods sold	2,641,188	1,793,997
Gross margin	1,586,885	1,653,697
<b>Expenses</b>		
General and administration	1,688,978	1,258,885
Royalties	401,876	325,733
Sales and marketing	385,132	418,816
Amortization	336,569	120,444
Interest on long-term debt	83,651	42,954
Interest on callable debt and other	-	875
	2,896,206	2,167,707
Loss from operations	(1,309,321)	(514,010)
<b>Other income (expenses)</b>		
Research and product development	(891,382)	(695,661)
Bioenergy Feasibility Study	(5,868)	(91,121)
Other income (loss) (note 11)	73,385	(88,542)
Loss before SGGF legal fees	(2,133,186)	(1,389,334)
SGGF legal fees (note 9a)	(1,466,283)	-
Income Taxes (note 12)		
Current		
Reduction as a result of applying non-capital losses carried forward against the current year's taxable income		
<b>NET LOSS AND COMPREHENSIVE LOSS FOR THE YEAR</b>	<b>(3,599,469)</b>	<b>(1,389,334)</b>
Deficit, beginning of year	(3,722,072)	(2,332,738)
<b>Deficit, end of year</b>	<b>\$ (7,321,541)</b>	<b>\$ (3,722,072)</b>
Net loss per common share:		
Basic	\$ (0.08)	\$ (0.03)
Diluted	\$ (0.08)	\$ (0.03)
Weighted average number of common shares outstanding	47,050,063	42,337,607

See accompanying notes

# Financial Statements

## CEAPRO INC. Consolidated Statements of Cash Flows

	Years ended December 31	
	2008	2007
<b>Operating Activities</b>		
Net loss and comprehensive loss for the year	\$ (3,599,469)	\$ (1,389,334)
Items not affecting cash and cash equivalents		
Amortization	336,569	120,444
Recognition of deferred royalty revenue	(48,306)	(39,390)
Employee future benefits obligation	20,364	64,308
Stock based compensation	114,689	70,241
	<b>(3,176,153)</b>	<b>(1,173,731)</b>
<b>Changes in Non-Cash Working Capital Items</b>		
Restricted cash	50,000	(50,000)
Accounts receivable	156,571	(73,909)
Inventories	(250,383)	3,872
Prepaid expenses and deposits	47,532	48,651
Accounts payable and accrued liabilities	656,401	158,797
Deferred revenue	(57,009)	10
SGGF legal fees	1,466,283	-
	<b>2,069,395</b>	<b>87,421</b>
	<b>(1,106,758)</b>	<b>(1,086,310)</b>
<b>Investing Activities</b>		
Purchase of license	(30,000)	-
Purchase of property and equipment	(275,891)	(1,770,233)
Deposits on property and equipment	-	167,828
	<b>(305,891)</b>	<b>(1,602,405)</b>
<b>Financing Activities</b>		
Repayment of long-term debt	(114,592)	(436,731)
Repayment of callable debt	-	(36,313)
Proceeds from long-term debt	-	1,612,406
Proceeds from issuance of share capital	-	2,692,100
Proceeds from exercise of stock options	-	163,876
Share capital issue costs	-	(287,030)
Increase (decrease) in royalties payable	261,440	(48,193)
	<b>146,848</b>	<b>3,660,115</b>
Increase (decrease) in cash and cash equivalents	<b>(1,265,801)</b>	971,400
Cash and cash equivalents at beginning of year	<b>1,282,326</b>	310,926
<b>Cash and cash equivalents at end of year</b>	<b>\$ 16,525</b>	<b>\$ 1,282,326</b>
Cash and cash equivalents consist of:		
Cash on deposit with banks	\$ 16,525	\$ 8,047
CAD\$ term deposit	-	1,000,000
US\$ term deposit	-	274,279
	<b>\$ 16,525</b>	<b>\$ 1,282,326</b>
Supplementary information		
Interest paid	\$ 83,651	\$ 43,829
Royalties paid	\$ 172,356	\$ 375,926

See accompanying notes

## 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 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 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, negative 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 potentially faces material financial exposure if it is unable to make timely payments it has agreed to in a lawsuit settlement agreement (see note 18). The Company's ability to continue as a going concern is dependant on obtaining additional financial capital, achieving profitability, and generating 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.

### 2. ACCOUNTING POLICIES

#### (a) Use of estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The significant areas requiring the use of management estimates relates to provisions made for inventory valuation, amortization of property and equipment, the assumptions used in determining stock based compensation, and the interest rate used in determining the value of employee future benefits obligation. Actual results could differ from those estimates.

#### (b) Principles of consolidation

The consolidated 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., and Ceapro USA Inc.

#### (c) Cash and cash equivalents

Cash and cash equivalents are defined as amounts on deposit with financial institutions and readily convertible term deposits.

#### (d) Revenue recognition

Revenue from the sale of health and wellness products is recognized as revenue at the time the products are shipped to customers.

The sale of royalty interests are recorded as deferred royalty revenue and are matched to future royalty expenses.

Royalty, licenses, and product development fees are recorded in accordance with the terms of the applicable agreements.

#### (e) Inventories

Inventory of raw materials is valued at the lower of cost and net realizable value on a first-in, first-out basis.

Inventory of work-in-process and active ingredients is valued at the lower of cost and net realizable value on an average cost basis.

Inventory of finished veterinary products is valued at the lower of cost and net realizable value on a first-in, first-out basis.

#### (f) Licenses

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

#### (g) Property and equipment

Property and equipment are recorded at cost and are amortized over their estimated useful lives as follows:

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

In 2007, a change was made in the Company's estimate of the useful life of manufacturing equipment from 20% declining balance to straight line amortization over 10 years. This is considered to be a change in an accounting estimate. The impact of this change in accounting estimate in 2007 was to lower amortization expense in the amount of \$86,844. The future impact of this change is lower amortization expense until the manufacturing equipment is fully amortized.

## 2. ACCOUNTING POLICIES (continued)

### (h) Research and product development expenditures

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

### (i) Foreign currency

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at year end exchange rates and non-monetary assets at the exchange rates prevailing when the assets were acquired. Foreign currency denominated revenue and expense items are translated at the rate of exchange in effect at the time of the transaction. Foreign currency gains or losses arising on translation are included in income.

### (j) Income taxes

The liability method is used for determining income taxes. Under this method, future income tax assets and liabilities are recognized for the estimated tax recoverable or payable that would arise if assets and liabilities were recovered or settled at the financial statement carrying amounts. Future 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 income in the period in which they occur. The amount of the future income tax assets recognized is limited to the amount that is more likely than not to be realized.

### (k) Lease Obligations

Leases are classified as capital or operating leases. A lease that transfers substantially all of the benefits and risks incidental to the ownership of property is classified as a capital lease. At the inception of a capital lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property's fair value at the beginning of the lease. All other leases are accounted for as operating leases wherein payments are expensed as incurred.

### (l) Government assistance

Government assistance is periodically granted to the Company under available government incentive programs. Government assistance relating to research and development expenditures is recorded as a reduction of the expenditures when received.

### (m) Investment tax credits

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

### (n) Net loss per common share

Basic net loss per common share is computed by dividing the net 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 convertible securities and convertible debt were converted to common shares. The treasury stock method of calculating diluted per share amounts is used whereby any proceeds from the conversion of convertible securities or convertible debt that are in-the-money are assumed to be used to purchase common shares of the Company at the average market price during the period. When the Company is in a net loss position, the conversion of convertible securities and debt is considered to be anti-dilutive.

### (o) Stock based compensation

Stock based compensation is accounted for using the fair value method whereby compensation expense related to these programs is recorded in the statement of net loss and comprehensive loss and deficit with a corresponding increase to contributed surplus. The fair value of options granted is determined at the date of grant and expensed over the vesting period. The value of the warrants issued to agents is recorded as share issue costs with a corresponding increase to contributed surplus.

Consideration paid on the exercise of stock options and warrants is credited to share capital. Upon the exercise of the stock options and warrants, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. The Company does not incorporate an estimated forfeiture rate for stock options and agents warrants that may not vest, but accounts for forfeitures as they occur.

### (p) Employee future benefits

The Company accrues its obligations under an employee defined retirement benefit plan and related costs, net of plan assets. The cost of retirement benefits earned by employees is determined using the accumulated benefit method and management's best estimate of expected plan investment performance and retirement ages of employees. Past service costs relating to plan amendments are accrued and recognized in the year the amendments occur.

## 2. ACCOUNTING POLICIES (continued)

### (q) Impairment of long-lived assets

In the event that facts and circumstances indicate that the carrying value of the long-lived assets may be impaired, the Company performs a recoverability evaluation. If the evaluation indicates that the carrying value is not recoverable from undiscounted cash flows attributable to the assets, then an impairment loss is measured by comparing the carrying amount of the asset to its fair value.

### (r) Recently adopted accounting pronouncements

Effective January 1, 2008, the Company adopted two new CICA standards, Section 3862 "Financial Instruments - Disclosures" and Section 3863 "Financial Instruments - Presentation" which replaced Section 3861 "Financial Instruments - Disclosure and Presentation". The new disclosure standards increase the emphasis on the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. The new presentation standard carried forward the former presentation requirements. The Company determined that the implementation of these new standards did not have any impact on the Company's financial position or results of operations. The disclosures related to these sections are reported in note 15 of these consolidated financial statements.

Effective January 1, 2008, the Company adopted CICA Handbook Section 3031 "Inventories". This Section related to the accounting for inventories and revises and enhances the requirements for assigning costs to inventories. The Company determined that the implementation of this Section did not have a material impact on its consolidated financial statements.

Effective January 1, 2008, the Company adopted the revised CICA Handbook Section 1400, "*General Standards of Financial Statement Presentation*" which was amended to provide guidance on the assessment of whether an entity is a going concern and related disclosures. The adoption of this new standard did not have a material impact on these consolidated financial statements.

Effective January 1, 2008, the Company adopted the new Handbook Section 1535 "Capital Disclosures". This Section establishes standards for disclosing information about an entity's capital and how it is managed in order that a user of the financial statements may evaluate the entity's objectives, policies and processes for managing capital. The Company's capital disclosures are reported in note 17 of these consolidated financial statements.

Effective January 1, 2007, the Company adopted the revised CICA Handbook section 1506 "Accounting Changes", which requires that: (a) a voluntary change in accounting principles can be made if, and only if, the changes result in more reliable and relevant information, (b) changes in accounting policies are accompanied with disclosures of prior period amount and justification for the change, and (c) for changes in estimates, the nature and amount of the change should be disclosed. The Company has not made any voluntary change in accounting policies since the adoption of the revised standard.

Effective January 1, 2007, the Company prospectively adopted without restatement, the new CICA Handbook sections 3855 - Financial Instruments - Recognition and Measurement, 1530 - Comprehensive Income, and 3865 - Hedges. These sections provide standards for the recognition, measurement, disclosure, and presentation of financial assets, financial liabilities and derivatives. The standards prescribe when a financial instrument is to be recognized on the balance sheet and at what amount. They also specify how gains and losses on financial instruments are to be presented.

The standards relating to comprehensive income require the reporting and presentation of among other things, certain unrealized gains and losses outside of net income or loss as a separate component of shareholders' equity. Comprehensive income is defined as a change in equity (net assets) of an enterprise during a period from transactions and other events and circumstances from non-owner sources. The Company has no financial instruments or activities that give rise to other comprehensive income (loss).

The Company has not participated in any hedging activities. As a result, the standards relating to hedges have had no impact on the consolidated financial statements for the years ended December 31, 2008 and December 31, 2007.

The adoption of these new standards concerning financial instruments and comprehensive income has had no material impact on the consolidated financial statements for the years ended December 31, 2008 and December 31, 2007.

### (s) Future accounting pronouncements

In 2006, Canada's Accounting Standards Board ("AcSB") ratified a strategic plan that will result in GAAP, as used by public entities, being converged with International Financial Reporting Standards ("IFRS") over a transitional period. In February 2008, the AcSB confirmed January 1, 2011 as the date that Canadian public entities will be required to start reporting under IFRS. Companies will be required to provide qualitative disclosure on the key elements and timing of their transition plan to IFRS no later than their 2008 annual Management Discussion and Analysis. Qualitative disclosure of the impact of the transition is required in companies' 2009 interim and annual Management Discussion and Analysis. Comparative financial information for 2010 will be required when companies begin reporting 2011 results under IFRS.

During 2009 the Company will begin preparing its detailed IFRS conversion plan. This plan will be aimed at identifying the differences between IFRS and the Company's current accounting policies, assessing the impact on the Company's financial reporting and, when necessary, analyzing alternative policies that could be adopted.

## 2. ACCOUNTING POLICIES (continued)

In February 2008, The CICA issued new Handbook Section 3064 "Goodwill and Intangible Assets", replacing Handbook Section 3062 "Goodwill and Other Intangible Assets" and Handbook Section 3450 "Research and Development Costs". The new section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Handbook Section 3062. The Company has determined that the adoption of this new section will not have a material impact on its consolidated financial statements.

## 3. INVENTORIES

	Dec. 31, 2008	Dec. 31, 2007
Raw materials	\$ 200,548	\$ 113,138
Work in progress	98,752	1,829
Finished goods	107,667	41,617
	<u>\$ 406,967</u>	<u>\$ 156,584</u>

Inventories expensed in cost of goods sold during the year ended December 31, 2008 is \$1,475,912 (2007 - \$997,120). During the year ended December 31, 2008, the Company decreased the carrying value of inventory by \$28,663 (2007 - nil) due to lower estimated product yields from certain raw materials and certain finished products reaching their expiry date.

## 4. PROPERTY AND EQUIPMENT

	2008		
	Cost	Accumulated Amortization	Net Book Value
Manufacturing equipment	\$ 2,786,259	\$ 788,587	\$ 1,997,672
Office equipment	75,611	48,735	26,876
Computer equipment and software	231,436	117,558	113,878
Leasehold improvements	103,435	42,121	61,314
	<u>\$ 3,196,741</u>	<u>\$ 997,001</u>	<u>\$ 2,199,740</u>
	2007		
	Cost	Accumulated Amortization	Net Book Value
Manufacturing equipment	\$ 2,577,649	\$ 521,110	\$ 2,056,539
Office equipment	66,249	42,494	23,755
Computer equipment and software	181,275	89,150	92,125
Leasehold Improvements	95,991	7,992	87,999
	<u>\$ 2,921,164</u>	<u>\$ 660,746</u>	<u>\$ 2,260,418</u>

## 5. LONG-TERM DEBT

	2008	2007
Loan, payable at \$17,384 per month, principal and interest at 5.49%, secured by a general security agreement, due January, 2013.	\$ 1,497,814	\$ 1,612,406
Less current portion	131,582	112,638
	<u>\$ 1,366,232</u>	<u>\$ 1,499,768</u>

Estimated principal payments due in the next five years are as follows:

2009	\$ 131,582
2010	138,806
2011	146,426
2012	154,465
2013	926,535
	<u>\$ 1,497,814</u>

The effective interest rate of 5.49% is a preferred rate and the monthly payments of \$17,384 reflect this preferred rate. In the event of default of any terms and conditions of the loan and enforcement of these terms and conditions by the lender, the preferred 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 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.

## 6. ROYALTIES PAYABLE

	2008	2007
Royalties payable pursuant to financial assistance received (note 6 (a))	\$ 111,844	\$ 125,829
Royalties payable pursuant to royalty interest offering (note 6 (c),(d),and (e))	357,686	82,261
	<b>\$ 469,530</b>	<b>\$ 208,090</b>
Less current portion	455,549	138,185
	<b>\$ 13,981</b>	<b>\$ 69,905</b>

- (a) In the year ended December 31, 1999, the Company received financial assistance in the amount of \$164,882 for the research and development of new products, patents, and markets. The Company is obligated to pay a 5% royalty (to a maximum of two times the financial assistance received) on sales generated from products developed using these funds. The portion of this obligation paid or accrued as at December 31, 2008 was \$329,764 (2007 - \$329,764). Pursuant to an agreement signed in March 2006, the terms of repayment were amended to allow all royalties payable as at December 31, 2005 in the amount of \$223,692 to be repaid \$13,981 per quarter commencing March 31, 2006. Royalties incurred subsequent to December 31, 2005 are to be repaid quarterly within 60 days of the quarter end. The Company has deferred payment of the royalties due for the periods ended March 31, June 30, and September 30, 2008. These amounts total \$41,943.
- (b) In the year ended December 31, 2004, the Company received a commitment for financial assistance totaling \$250,000 for pre-market activities of CeaProve® (a health and wellness product) upon completion of project objectives as outlined and agreed to by both parties. As at December 31, 2008, \$225,000 (2007 - \$225,000) of this commitment has been received. The Company is obligated to pay a royalty (to a maximum of two times the financial assistance received) on sales generated from CeaProve® on the following basis: 0% of revenues earned to December 31, 2005, 2.5% of revenues earned to December 31, 2006, and 5% thereafter until repaid. No royalties have been incurred during the current or prior years. The Company has repaid at December 31, 2008 \$nil (2007 - \$nil) of this obligation. Upon completion of the repayment of the financial assistance received, the Company will be required to repay \$19,750 advanced during the year ended December 31, 2002. The portion of this obligation paid or accrued as at December 31, 2008 was \$nil (2007 - \$nil).
- (c) In the year ended December 31, 2003, the Company completed a Royalty Income Unit offering through the terms described in an Offering Memorandum. Each royalty interest has a right to receive royalties equal to 0.00001% from the sale or licensing of the Company's active ingredients and animal health products, to a maximum cumulative amount of \$2.08 per unit. Proceeds from the offering of \$516,348 (before related expenses) represent the sale of a 5.163% royalty interest in the Company's future sales and licensing of active ingredients and animal health products. Maximum royalties payable are two times the amount invested or \$1,032,695. The portion of this obligation paid or accrued at December 31, 2008 was \$886,403 (2007 - \$688,077).
- (d) In the year ended December 31, 2003, the Company sold a 1.418% royalty interest in the Company's future sales and licensing of active ingredients and animal health products for \$141,796. In the year ended December 31, 2004, the Company sold an additional 1.724% royalty interest in the future sales and licensing of active ingredients and animal health products for \$172,401. The cumulative royalty interest of 3.142% for \$314,197 results in combined maximum royalties of two times the amount invested or \$628,394. The portion of this obligation paid or accrued at December 31, 2008 was \$585,098 (2007 - \$452,252).
- (e) 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. The portion of this obligation paid or accrued as at December 31, 2008 was \$251,032 (2007 - \$154,421).
- (f) In the year ended December 31, 2005, the Company received a commitment for financial assistance totaling \$362,250 for product innovation development in the area of Veterinary Therapeutics and Active Ingredients. As at December 31, 2008, \$362,250 (2007 - \$362,500) of the commitment has been received. The Company is obligated to pay a 2.5% royalty to a maximum of \$75,000 per quarter (to a maximum of two times the financial assistance received or \$724,500) on sales generated from products developed using these funds. These payments will commence when the royalty payments on investment agreements in note 6(a) are fully satisfied. The portion of the obligation paid or accrued at December 31, 2008 was \$nil (2007 - \$nil).

## 6. ROYALTIES PAYABLE (continued)

(g) In the year ended December 31, 2005, the Company received a commitment for financial assistance totaling \$800,000 for pre-market activities of CeaProve® (a health and wellness product) upon completion of project objectives as outlined and agreed to by both parties. As at December 31, 2008, \$510,000 of this commitment has been received (2007 - \$510,000). The Company is obligated to pay a royalty (to a maximum of one and a half times the financial assistance received or \$1,200,000) on sales of CeaProve® on the following basis: 0% of net sales and net sub-licensing revenues earned until royalty payments have been fully satisfied under the investment agreement in note 6(b), and 5% thereafter until repaid to a maximum of \$125,000 per quarter. No royalties have been incurred during the current year. The portion of this obligation paid or accrued as at December 31, 2008 was \$nil (2007 - \$nil).

## 7. EMPLOYEE FUTURE BENEFITS OBLIGATION

The Company has an unfunded non-registered, non-indexed defined retirement benefit plan for certain officers. The retirement benefit is two months' salary for each year they are employed by the Company. During the year ended December 31, 2008, pursuant to a termination agreement with the Company's former President and Chief Executive Officer, the company has settled the benefit obligation with this senior officer resulting in a curtailment loss of \$68,751. The Company is obligated to complete all required payments under the termination agreement by December 31, 2009 and therefore is disclosing the remaining obligation to this individual of \$187,000 as current. A restricted cash balance from the prior year of \$50,000 was utilized to make payments on this obligation during the year.

<b>Accrued benefit obligation</b>	<b>2008</b>		<b>2007</b>	
Unfunded balance, beginning of year	\$	283,648	\$	219,340
Curtailment loss		68,751		-
Benefits paid		(67,361)		-
Current service cost		14,496		37,918
Interest costs on accrued benefit obligation		4,478		26,390
		<b>304,012</b>		283,648
Less current portion		(187,000)		-
	\$	<b>117,012</b>	\$	283,648

<b>Elements of defined benefit costs recognized in the year</b>	<b>2008</b>		<b>2007</b>	
Current service cost	\$	14,496	\$	37,018
Interest cost on accrued benefit obligation		4,478		20,390
Curtailment loss		68,751		-
	\$	<b>87,725</b>	\$	57,408

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 December 31, 2008 was 4.19% (2007 - 4.22%).

## 8. SHARE CAPITAL

(a) Authorized

Unlimited number of Class A voting common shares  
 Unlimited number of Class B non-voting common shares

(b) Issued - Class A common shares

	<b>2008</b>		<b>2007</b>	
	Number of Shares	Amount	Number of Shares	Amount
Balance at beginning of year	47,050,063	\$ 5,016,395	37,505,505	\$ 2,508,059
Changes during the year:				
Equity placements	-	-	8,684,190	2,692,100
Exercise of options	-	-	860,368	163,877
Equity component of stock based compensation, net	-	-	-	11,847
Share capital issue costs	-	-	-	(359,488)
	<b>47,050,063</b>	<b>\$ 5,016,395</b>	47,050,063	\$ 5,016,395

## 8. SHARE CAPITAL (continued)

### (c) Contributed surplus

The following table summarizes the changes in contributed surplus:

	2008		2007	
Balance at beginning of year	\$	259,329	\$	128,478
Stock based compensation expense (note 8 (d))		114,689		143,023
Exercise of stock options		-		(12,172)
	\$	374,018	\$	259,329

### (d) Stock options

The Company has granted stock options to eligible employees, directors, officers, and consultants under stock option plans that vest over periods ranging from twelve months to five years and have a maximum term of five years.

The Company accounts for options granted under these plans in accordance with the fair value based method of accounting for stock based compensation. In the current year the Company granted 1,225,000 (2007 - 490,000) stock options. The application of the fair value based method requires the use of certain assumptions regarding the risk-free market interest rate, expected volatility of the underlying stock and life of the options. The weighted average risk-free rate used in 2008 was 3.22% (2007 - 4.21%), the weighted average expected volatility was 86% (2007 - 81%) which was based on prior trading activity of the Company's shares, and the weighted average expected life of the options was 5 years. The stock based compensation expense recorded during the current year relating to options granted in 2008, 2007 and 2006 was \$114,689 (2007 - \$70,565).

A summary of the status of the Company's stock options at December 31, 2008 and 2007 and changes during the years ended on those dates is as follows:

	2008		2007	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise price
Outstanding at beginning of year	2,308,092	\$ 0.26	3,082,460	\$ 0.24
Granted	1,225,000	0.16	490,000	0.28
Expired	(1,723,092)	0.24	(404,000)	0.23
Exercised	-	-	(860,368)	0.19
Outstanding at end of year	1,810,000	\$ 0.21	2,308,092	\$ 0.26
Exercisable at end of year	786,000	\$ 0.22	1,768,092	\$ 0.26

The following table summarizes information about the Company's stock options outstanding:

Exercise Price	Year of Expiration	2008 Number of Options	2007 Number of Options
\$0.12	2013	780,000	-
\$0.25	2013	240,000	-
\$0.28	2012	390,000	390,000
\$0.30	2012	100,000	100,000
\$0.30	2011	150,000	225,000
\$0.27	2011	150,000	150,000
\$0.25	2008	-	1,443,092
		1,810,000	2,308,092

### (e) Warrants

A summary of the status of the Company's warrants at December 31, 2008 and 2007 and changes during the years ended on those dates is as follows:

	2008		2007	
	Number of Warrants	Average Exercise Price	Number of Warrants	Average Exercise Price
Outstanding at beginning of year	4,806,608	\$ 0.44	774,066	\$ 0.44
Issued	-	-	4,806,608	-
Expired	-	-	(774,066)	-
Outstanding at end of year	4,806,608	\$ 0.44	4,806,608	\$ 0.44

## 8. SHARE CAPITAL (continued)

The following table summarizes information about the Company's warrants outstanding:

Exercise Prices	Expiration Date	2008 Number Outstanding	2007 Number Outstanding
\$ 0.31	February 27, 2009	464,513	464,513
\$ 0.45	February 27, 2009	4,342,095	4,342,095
		<b>4,806,608</b>	<b>4,806,608</b>

- (f) On June 27, 2007, the Company completed a brokered private placement unit offering of 8,684,190 units for aggregate gross proceeds of \$2,692,100. Each unit was priced at \$0.31 and contained one common share of the Company and one half of a common share purchase warrant. Each whole common share purchase warrant entitles the holder to acquire one additional common share at a price of \$0.45 per common share until February 27, 2009. As part compensation of the brokered private placement, a total of 464,513 broker warrants were issued. Each broker warrant entitles the holder to acquire one additional common share at a price of \$0.31 per common share. The Company has recorded share capital issue costs and a corresponding increase in contributed surplus of \$72,458 to reflect the fair value of the warrants. The fair value of the warrants granted was calculated assuming the risk free interest rate was 4.56%, the expected life was 1.7 years and the expected volatility was 86%.

## 9. CONTINGENCIES AND COMMITMENTS

- (a) Ceapro Inc. commenced litigation against a number of defendants in 2002 in the Court of Queen's Bench of Saskatchewan (the "Saskatchewan Claim"). The defendants against whom the case proceeded to trial were the Government of Saskatchewan, Saskatchewan Government Growth Fund Ltd. (SGGF), Saskatchewan Government Growth Fund Management Corporation (SGGFMC), Gary K. Benson, Janice MacKinnon, and Can-Oat Milling Products Inc. The Saskatchewan Claim raises numerous causes of action against various of the defendants including a claim against all based in civil conspiracy. Ceapro claimed damages in excess of \$19 million for loss of its investment in Canamino Inc., plus additional damages for loss of goodwill and other losses and for other relief.

As of December 31, 2008, all claims related to the Saskatchewan Claim have been dismissed. The Company faced a potentially material legal cost exposure as a result of dismissal of all claims. Appeal proceedings with respect to the Final Trial Judgment were commenced during the year.

Legal fees and other direct costs associated with the lawsuit have been funded for all periods prior to December 31, 2007 by the Company from funds received from lawsuit contributors who, in exchange, would receive an interest in the proceeds (if any) from the Saskatchewan Claim; and through agreements with the Company's legal counsel to accept a portion of their fees on a contingency basis. There has been no funding from lawsuit contributors to pay any legal fees invoiced in 2008 and management is of the opinion that these legal fees will only be required to be paid upon receipt of funding from lawsuit contributors or proceeds from the litigation. The amount of these disputed fees is \$741,283 and this amount has been accrued in the financial statements and reflected in SGGF legal fees on the balance sheet.

In addition, the Company was required to post a bond with the court in the amount of \$305,000 which was secured by guarantees of certain members of the current and past Board of Directors of the Company. The Company has indemnified the Board of Directors and certain past members of the Board of Directors in relation to the bond.

Subsequent to the year end the Company and defendants reached an agreement with respect to the settlement of the appeal proceedings and the legal costs payable to the defendants. The Company agreed to consent to the dismissal of all appeal proceedings and to pay to the defendants \$705,000 in legal costs. See note 18. The company has also accrued \$20,000 in additional legal costs. These accruals are reflected in SGGF legal fees on the balance sheet.

- (b) 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. The Company paid a licensing fee of \$30,000 and will amortize the license over 10 years. The Company is obligated to pay the university an amount equal to eight percent of net sales from products derived from the mint plants subject to minimum payments as follows:

2009	5,760
2010	5,760
2011	12,960
2012	20,160
2013 to 2017	208,800
	<b>\$ 253,440</b>

For 2008, the Company recognized a minimum payment of \$2,400 in royalty expense.

- (c) 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.

## 10. SALES

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.

**11. OTHER INCOME (LOSS)**

	2008	2007
Foreign exchange gains (losses)	85,747	(121,582)
Interest and other income (loss)	(12,362)	33,040
	<b>\$ 73,385</b>	<b>\$ (88,542)</b>

**12. INCOME TAXES**

## (a) Non-capital losses

The Company has accumulated non-capital losses carried forward for income tax purposes of approximately \$10,029,800, the benefit of which has not been reflected in these consolidated financial statements. These losses may be applied against future taxable income within the limitations prescribed by the Income Tax Act and expire as follows:

2015	293,400
2026	651,500
2027	3,701,200
2028	5,383,700
	<b>\$ 10,029,800</b>

## (b) Capital losses

The Company has accumulated capital losses of approximately \$6,807,000, which can be carried forward indefinitely to offset future capital gains.

## (c) Scientific research and experimental development (SR &amp; ED)

The Company has accumulated an SR & ED expenditure pool of approximately \$1,506,000, which can be carried forward indefinitely to be applied against future taxable income.

The Company has accumulated SR & ED investment tax credits of approximately \$21,000. These credits may be applied against future federal income taxes payable and expire as follows:

2009	400
2012	20,600
	<b>\$ 21,000</b>

## (d) Temporary differences

A future income tax asset reflects the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future income tax asset are as follows:

Income tax effect of deductible temporary differences:	2008	2007
Non-capital losses and SR & ED expenditures carried forward	<b>\$ 2,884,000</b>	\$ 1,983,000
Net capital losses carried forward	<b>851,000</b>	1,004,000
SR&ED investment tax credits	<b>21,000</b>	37,000
Undepreciated capital cost for tax purposes in excess of net book value	<b>1,423,000</b>	2,195,000
Deferred revenue recognized for tax purposes	<b>83,000</b>	129,000
Valuation allowance	<b>(5,262,000)</b>	(5,348,000)
	<b>\$ -</b>	<b>\$ -</b>

For consolidated financial statement purposes, no future income tax asset has been recorded at December 31, 2008 and 2007 as it is not more likely than not to be realized.

## (e) Income tax reconciliation

The Company's consolidated income tax position comprises tax benefits and provisions arising from the respective tax positions of its taxable entities. The Company's income tax provision differs from that calculated by applying statutory rates for the following reasons:

	2008	2007
Income taxes (recovery) based on federal and provincial statutory income tax rate of 29.50% (2007 - 32.12%)	<b>\$ (1,061,843)</b>	\$ (446,254)
Tax effect of expenses that are not deductible	<b>8,839</b>	8,140
Tax effect of current year non-capital losses not recognized	<b>1,588,180</b>	1,188,826
Tax effect relating to property and equipment	<b>(504,525)</b>	(738,063)
Tax effect of deferred revenue recognized	<b>(30,651)</b>	(12,649)
	<b>\$ -</b>	<b>\$ -</b>

### 13. RELATED PARTY TRANSACTIONS

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

	2008	2007
Royalties earned by employees and directors	\$ 57,461	\$ 59,233
Royalties earned by former employees	11,271	-
Sale of lawsuit interests to employees and directors	-	25,000
Amounts payable to employees and directors included in royalties payable	45,882	13,272
Amounts receivable from directors and employees included in accounts receivable	-	8,500
Consulting fees earned by a company controlled by a director	75,000	-

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.

### 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 also located in North America. The distribution of revenue by location of customer is as follows:

	2008	2007
North America	\$2,843,273	\$2,364,387
Other	1,384,800	1,083,307
	<b>\$4,228,073</b>	<b>\$3,447,694</b>

### 15. FINANCIAL INSTRUMENTS

The Company has designated its financial instruments as follows: cash and cash equivalents are classified as held-for-trading, which is measured at fair value; accounts receivable are classified as loans and receivables which are measured at amortized cost; accounts payable and accrued liabilities, long-term debt, royalties payable and the SGGF legal fees are classified as other liabilities and are also measured at amortized cost. The fair value of accounts payable, the current portion of long term debt, royalties payable and the SGGF legal fees approximates 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 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 94% of accounts receivable are due from two customers.

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 is required to make payments totaling \$705,000 in 2009 pursuant to a lawsuit settlement agreement. In the event it defaults on required payments, the Company faces the potential of a material adverse court cost award. The Company may be exposed to liquidity risks if it is unable to collect its trade accounts receivable balances in a timely manner, which could in turn impact the Company's long-term ability to meet commitments under its current facilities. In order to manage this liquidity risk, the Company regularly reviews its aged accounts receivable listing to ensure prompt collections. The Company regularly reviews its cash availability and whenever conditions permit, the excess cash is deposited in short-term interest bearing instruments to generate revenue while maintaining liquidity.

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:

i) 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 \$39,700 annually based upon 2008 U.S. dollar sales of \$3,974,000. The Company does purchase some materials and services in U.S. dollars and to a lesser extent in Euros. This amount will vary by product sold.

## 15. FINANCIAL INSTRUMENTS (continued)

c) Market risk (continued)

i) Foreign Currency risk (continued)

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%	+1%
		Earnings & Equity	Earnings & Equity
<b>Financial assets</b>			
Accounts receivable	\$426,500	\$ 4,265	\$ (4,265)
<b>Financial liabilities</b>			
Accounts payable and accrued liabilities	\$301,000	\$ (3,010)	\$ 3,010
<b>Total increase (decrease)</b>		\$ 1,255	\$ (1,255)

The carrying amount of accounts receivable and accounts payable and accrued liabilities in USD represents the Company's exposure at December 31, 2008.

ii) 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.

## 16. LEASE COMMITMENTS

The Company is committed to future annual payments under operating leases for manufacturing facilities and office space as follows:

2009	\$ 203,562
2010	118,574
	<u>\$ 322,136</u>

## 17. Capital Disclosures

The Company considers its capital to be working capital and its shareholder (deficiency) equity. 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 2007.

## 18. Subsequent Events

On March 16, 2009, the Company entered into a Settlement Agreement with all Co-Defendants in the Saskatchewan Government Growth Fund lawsuit (see note 9a). Pursuant to the Settlement Agreement, the Company consented to the dismissal of all appeal actions commenced by it. The Company will make aggregate payments to the Co-Defendants of \$705,000 by way of four equal quarterly installments of \$176,250 commencing on March 31, 2009. Payments will be secured by a general security agreement against all of the Company's present and after acquired property subordinated to the general security agreement already in place on the Company's long-term debt (see note 5).

In the event the Company should default on the provisions of the Settlement Agreement, the Co-Defendants would be entitled to enforce their security with respect to the balance of payments outstanding and would be entitled to open up all cost matters with respect to the litigation and make arguments to the Saskatchewan Court of Queen's Bench that additional costs should be awarded. The Company has accrued legal fees of \$725,000 consisting of the \$705,000 under the settlement agreement and additional legal fees of \$20,000. The accrual is reflected in SGGF legal fees on the balance sheet.