

Q2  
2009  
QUARTERLY REPORT

UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE SECOND QUARTER ENDED  
JUNE 30, 2009



# Management's Discussion & Analysis

The MD&A provides commentary on the results of operations for the periods ended June 30, 2009 and 2008, the financial position as at June 30, 2009 and December 31, 2008, and the outlook of Ceapro Inc. ("Ceapro") based on information available as at August 10, 2009. The following information should be read in conjunction with the unaudited interim consolidated financial statements as at June 30, 2009, and related notes thereto, which are prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP) for interim statements, as well as the audited consolidated financial statements and Management Discussion and Analysis (MD&A) for the year ended December 31, 2008. All comparative percentages are between the periods ended June 30, 2009 and 2008 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 an assessment of Ceapro's future plans and operations as at August 10, 2009, 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 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 medical, cosmetic, 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, and nutraceutical 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; and
- An extension to *the active ingredients* product range offering, through new plant extract products.

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 active ingredients;
- Developing and marketing additional high-value proprietary therapeutic products;
- Deploying *CeaProve*<sup>®</sup> and maximizing product utilization; and
- Advancing new technology to a partnering or spin out position;

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. Our marketing strategy emphasizes providing technical support to our distributors and their customers 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 the requisite resources (intellectual and human capital) and the competitive advantages (partnerships) to exploit our technology. 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, and other income 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 financial statements for the quarter ended June 30, 2009 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. 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 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.

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 three customers at June 30, 2009.

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 two more payments of \$176,250 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 \$45,000 annually based upon estimated 2009 U.S. dollar sales of \$4,500,000. Estimated sales were assumed by annualizing sales during the first six months of 2009. The Company does purchase some materials and services in U.S. dollars and to a lesser extent 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%	+1%
		Earnings & Equity	Earnings & Equity
<b>Financial assets</b>			
Accounts receivable	\$502,411	\$ 5,024	\$ (5,024)
<b>Financial liabilities</b>			
Accounts payable and accrued liabilities	\$128,363	\$ (1,284)	\$ 1,284
<b>Total increase (decrease)</b>		\$ 3,740	\$ (3,740)

The carrying amount of accounts receivable and accounts payable and accrued liabilities in USD represents the Company's exposure at June 30, 2009.

ii) Interest rate

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 of \$1,541.

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. 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 Canadian GAAP 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 stock-based compensation, and the discount rate used in determining the employee future benefits obligation. 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.

## Recently Adopted Accounting Pronouncements

### Recently Adopted

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 is applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company adopted 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 did not have a material impact on these consolidated financial statements.

### Future Accounting Pronouncements

In 2006, Canada's Accounting Standards Board ("AcSB") ratified a strategic plan that will result in Canadian 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 the current year the Company has begun to prepare its detailed IFRS conversion plan. This plan is 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.

During the second quarter of 2009 the Company engaged a consultant to provide assistance with the IFRS conversion plan. Several key accounting issues that would most likely affect the Company were identified by the consultant and will provide guidance for further work and considerations that need to be evaluated.

During 2010 the Company plans to prepare financial statements under IFRS for all interim and annual reporting periods after the preparation of its financial statements prepared in accordance with Canadian GAAP. The 2010 financial statements prepared under IFRS will not be released to the public in 2010, but will provide comparative figures required for 2011 reporting.

## Results of Operations

### Six Months and Quarters Ended June 30, 2009 and 2008

#### SELECTED INFORMATION

\$000s except per share data	Six Months Ended June 30		Quarter Ended June 30	
	2009	2008	2009	2008
Total revenues	2,714	2,308	1,212	1,456
Income (loss) from operations	449	(618)	216	(181)
Net income (loss)	569	(1,696)	466	(1,087)
Basic (loss) per share	0.01	(0.04)	0.01	(0.02)
Diluted (loss) per share	0.01	(0.04)	0.01	(0.02)

The first six months of fiscal 2009 saw an increase in revenues of \$406,000 or 18%. Sales of all products were higher in 2009 than 2008 with the exception of a large decrease in oat oil sales. Sales of oat oil in 2009 will commence in the third quarter whereas in 2008 oat oil was sold in both the first and second quarters.

There was net income in the second quarter of \$569,000 which includes the reversal of \$426,000 of a legal fee accrual previously recorded in 2008. Income from operations was \$449,000 compared with a loss from operations of \$618,000 in 2008 largely due to higher gross margins, and lower operating expenses. Research costs decreased \$58,000 due primarily to sharply lower expenditures for *CeaProve*®. There were no expenditures for a bio-energy feasibility study that was completed in 2008.

The second quarter of 2009 resulted in a decrease in sales of \$244,000 or 17% compared to 2008. This was primarily due to a large decrease in oat oil sales as the 2009 production run was not available for sale until the third quarter. Income from operations in the second quarter was \$216,000. Net income for the quarter was \$466,000 which includes the reversal of \$426,000 of previously accrued legal fees. Research costs increased marginally in the quarter primarily due to higher costs for salary and wage costs and increased patent costs. There was a second quarter foreign exchange loss of \$26,000 versus a gain of \$22,000 in 2008 that negatively impacted financial results.

## Revenue

\$000s	Six Months Ended June 30			Quarter Ended June 30		
	2009	2008	Change	2009	2008	Change
Total sales	2,714	2,308	18%	1,212	1,456	-17%

## PRODUCT SALES

Total sales have grown in 2009 to record levels for the six months year to date.

The increased sales reflect growing sales of *Ceapro* active ingredients.

Sales in the second quarter decreased as oat oil produced in 2009 is not available for sale until the third quarter whereas in 2008 most oat oil sales occurred in the second quarter.

## Expenses

### COST OF GOODS SOLD AND GROSS MARGINS

\$000s	Six Months Ended June 30			Quarter Ended June 30		
	2009	2008	Change	2009	2008	Change
Sales	2,714	2,308		1,212	1,456	
Cost of goods sold	1,019	1,374		447	809	
Gross margin	1,695	934	81%	765	647	18%
Gross margin %	62%	40%		63%	44%	

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

Margins are significantly higher in both the first six months and second quarter of 2009 due to process improvements successfully implemented during the year to date, the acquisition of higher quality raw material versus that obtained in previous years, lower labour turnover, a sales mix that had higher sales volume of higher margin products, and a stronger value of the US dollar versus the Canadian dollar versus 2008.

The second quarter was favourably impacted by very efficient production operations.

### GENERAL AND ADMINISTRATION

\$000s	Six Months Ended June 30			Quarter Ended June 30		
	2009	2008	Change	2009	2008	Change
Salaries and benefits	213	251		105	119	
Consulting	94	86		51	61	
Insurance	52	62		25	34	
Investor relations	84	88		49	41	
Legal	57	56		23	43	
Directors Compensation	102	76		64	38	
Other	206	235		107	110	
Total general and administration expenses	808	854	-5%	424	446	-5%

General and administration expense (G&A) for the first six months of 2009 decreased \$46,000 or 5%. Directors compensation increased due to stock based compensation incurred as a result of stock options issued in the second quarter. Consulting fees of \$15,000 were incurred during the quarter for the IFRS conversion project. Most other costs decreased which reflects efforts by the Company to reduce expenditures and focus on core areas of the business.

The same factors noted for the first six months of 2009 were also applicable in the second quarter and resulted in lower expenses of \$22,000 for the quarter. One exception noted was slightly higher investor relations costs due to the timing of the annual general meeting. The 2009 annual general meeting was held in the second quarter versus the third quarter in 2008.

## SALES AND MARKETING

\$000s	Six Months Ended June 30			Quarter Ended June 30		
	2009	2008	Change	2009	2008	Change
Salaries and benefits	53	203		15	103	
Travel	11	36		4	15	
Other	21	35		6	19	
<b>Total sales and marketing</b>	<b>85</b>	<b>274</b>	<b>-69%</b>	<b>25</b>	<b>137</b>	<b>-82%</b>

Sales and marketing expenses decreased significantly largely due to staff reductions for marketing activities. There was also a decrease in travel costs and conference expenses associated with market expansion and production of corporate promotional material in the first half of the year.

The second quarter of 2009 showed a greater reduction in expenditures of 82% versus 2008 as this quarter had the full impact of all staff reduction measures and associated travel costs.

## ROYALTIES

\$000s	Six Months Ended June 30			Quarter Ended June 30		
	2009	2008	Change	2009	2008	Change
Total royalties expenses	245	244	0%	90	154	-42%
Recognition of deferred royalty revenue	(31)	(26)		(14)	(16)	
<b>Net royalty expense</b>	<b>214</b>	<b>218</b>	<b>-2%</b>	<b>76</b>	<b>138</b>	<b>-45%</b>

As of June 30, 2009, royalty investors receive royalties equal to 7.448% (2008- 10.59%) of revenues from product sales and royalty, license, and product development fees of active ingredients and veterinary therapeutic products, to a maximum of twice the amount invested. During the first quarter the 3.142% royalty was fully accrued which reduced the royalty rate for the second quarter to 7.448%. It is expected that the royalty rate will decrease by another 5.163% in the third quarter. AVAC 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 throughout 2009 will vary directly with fluctuations in royalty rates, product sales, royalty, license and product development fees, product sales mix, and any new royalty interest offerings or AVAC investments that may be completed.

## INTEREST & AMORTIZATION

\$000s	Six Months Ended June 30			Quarter Ended June 30		
	2009	2008	Change	2009	2008	Change
Total interest expense	39	43	-9%	19	21	-10%
Amortization	100	163	-39%	12	86	-86%

Interest costs declined as a result of a lower principal balance of long-term debt from the previous year. Amortization was lower due to the allocation of plant equipment amortization into inventory and cost of sales during the quarter ended June 30, 2009.

## Other Income (Expenses)

### RESEARCH AND PRODUCT DEVELOPMENT

\$000s	Six Months Ended June 30			Quarter Ended June 30		
	2009	2008	Change	2009	2008	Change
Salaries and benefits	193	128		99	72	
Regulatory and patents	67	55		38	28	
Other	10	23		6	11	
	270	206	31%	143	111	29%
Product development - <i>CeaProve®</i>	11	133	-92%	2	26	-92%
Total research and product development expenses	281	339	-17%	145	137	6%

Research and product development expenses for the six month period increased 31% primarily due to the hiring of a new research scientist as well as regulatory and patent costs. There was a significant decrease in costs for *CeaProve®* due to the strategic decision to outlicense the technology. As a result, net research and product development expenditures decreased by 17%.

For the second quarter research and development expenses increased 29% while net research and development increased 6%. While the same factors influenced both six month and second quarter results, expenditures for *CeaProve®* had been sharply curtailed in the second quarter of 2008 as a result of the strategic decision to outlicense the technology so the second quarter expenditure reduction was much lower than the first quarter.

Expenditures for *CeaProve®* are expected to be higher commencing in the third quarter due to increased clinical trial activities that have commenced.

### BIO-ENERGY FEASIBILITY STUDY

There were no expenditures on the bio-energy feasibility study in 2009 as the project was completed in the second quarter of 2008. During the first six months of 2008, costs net of government funding in the amount of \$18,000 were recognized by the Company. The Company has decided to not pursue this project any further.

### OTHER INCOME (EXPENSES)

Other income is comprised primarily of \$26,000 of foreign exchange losses during the six months ended June 30, 2009. The foreign exchange losses in the second quarter were \$31,000. The US dollar depreciated steadily against the Canadian dollar during the second quarter.

## 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.

	2009		2008				2007	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
<i>\$000s except per share data</i>								
Total revenues	1,212	1,502	1,049	871	1,456	852	776	591
Net (loss) income	466	103	(1,415)	(488)	(1,087)	(609)	(528)	(602)
Basic (loss) income per share	0.01	0.00	-0.04	(0.01)	(0.02)	(0.01)	(0.01)	(0.01)
Diluted (loss) income per share	0.01	0.00	-0.04	(0.01)	(0.02)	(0.01)	(0.01)	(0.01)

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

## Liquidity and Capital Resources

Ceapro 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.

Agricultural Financial Services Corporation has provided a term loan of up to \$1,612,406 for plant and equipment financing. The loan was fully drawn down at December 31, 2007 and regular monthly payments began in February 2008.

Total common shares issued and outstanding as at August 10, 2009 were 51,710,063 (August 21, 2008 – 47,050,063). In addition, 2,538,335 stock options (August 21, 2008 – 1,030,000) and no warrants (August 21, 2008 – 4,806,608) were outstanding that are potentially convertible into an equal number of common shares at various prices. Shareholders' deficiency of (\$839,000) at June 30, 2009 improved from a shareholders' deficiency of (\$1,931,000) at December 31, 2008.

Ceapro's working capital deficiency was (\$1,249,249) at June 30, 2009, an improvement from a deficiency of (\$2,390,699) at December 31, 2008.

The Company will be required to pay \$352,500 during the remainder of 2009 pursuant to a lawsuit settlement agreement. And an additional \$73,448 will be required to be paid to the Company's former President and Chief Executive Officer.

To meet future requirements, Ceapro intends to raise additional cash through some or all of the following methods: public or private equity or debt financing, income offerings, capital leases, collaborative and licensing agreements, and joint venture or partnership financings. However, there is no assurance of obtaining additional financing through these arrangements on acceptable terms, if at all. The ability to generate new cash will depend on external factors, many beyond the Company's control, as outlined in the Risks and Uncertainties section. Should sufficient capital not be raised, Ceapro may have to delay, reduce the scope of, eliminate, or divest one or more of its discovery, research, or development technology or programs, any of which could impair the value of the business.

## Related Party Transactions

During the first six months of 2009, \$29,056 of royalties were earned by employees and directors from their investment in previous Ceapro royalty offerings. At June 30, 2009, \$75,028 of royalties were payable to employees and directors. Consulting fees of \$75,000 were earned by a company controlled by a director

during the six months ended June 30, 2009. 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.

## Contingencies

(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.

During the year ended December 31, 2008, all claims related to the Saskatchewan Claim were dismissed. During the quarter end March 31, 2009 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 which are payable in four equal quarterly installments of \$176,250 commencing March 31, 2009. Payments are 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. The first two payments have been made in the first and second quarters and the final two payments of \$176,250 are included on the balance sheet under SGGF legal fees. In the event the Company should default on the provisions of the Settlement Agreement, the defendants would be entitled to enforce security with respect to the balance of payments owing 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.

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. During the quarter ended June 30, 2009, the Company was advised by one of its legal counsels that they did not intend to pursue collection of their previously billed legal fees. The amount of these fees is \$426,300 and this amount has been recorded as a recovery in the quarter. The remaining amount of these disputed fees is \$314,983 and this amount has been accrued in the financial statements and included 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 agreed to indemnify the Board of Directors and certain past members of the Board of Directors in relation to the bond.

(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

Despite challenging global economic conditions in the past year and the severe economic recession currently impacting the global economy, Ceapro's outlook is positive. The first six months of 2009 represent a very strong operational performance and Ceapro is cautiously optimistic of robust sales growth and improving financial performance based on the sound foundation of work completed to date, and on innovations current and future.

The new production facility and technology improvements are now working efficiently and Ceapro is confident it is now poised to realize the benefits of more efficient production, greater capacity, and flexibility to expand sales and markets.

Ceapro has made strides in the development of *CeaProve*<sup>®</sup>, its pre-diabetes screening product. Pursuant to the strategic review, the Company has out-licensed the technology for the medical market and a clinical trial has commenced and is expected to generate the current data needed to successfully launch the product in all markets. Ceapro is currently engaged in discussions with other parties for the mass market. There is no assurance that further transactions will be completed.

During 2009, Ceapro will continue to further develop new products for its Active Ingredient business and is reviewing in-licensing opportunities that have been presented to the Company in recognition of the strength of Ceapro's core extraction technology and in recognition of Ceapro's proven track-record of product commercialization. The sale of additional new extracts is expected to drive increases in revenues and enhance profitability in the future.

Ceapro intends to implement its operating plans in a measured and responsible manner. Additional working capital is required to support the expected increases in the volume of sales of existing products, the introduction of new products to existing and new markets, and the further development of new technology. The Company cautions that the availability of these additional investments may affect the pace of growth.

### **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**

---

**Unaudited Consolidated Financial Statements for the  
Second Quarter Ended June 30, 2009**

---

**Cepro Inc.**

# Financial Statements

## CEAPRO INC.

### Consolidated Balance Sheets

	June 30 2009 (Unaudited)	December 31 2008 (Audited)
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 122,635	\$ 16,525
Accounts receivable	592,225	551,594
Inventories	477,128	406,967
Prepaid expenses and deposits	71,794	82,568
	<b>1,263,782</b>	1,057,654
LICENSE	28,500	30,000
PROPERTY AND EQUIPMENT (NET OF ACCUMULATED AMORTIZATION)	2,039,967	2,199,740
	<b>\$ 3,332,249</b>	<b>\$ 3,287,394</b>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 859,123	\$ 1,150,814
Current portion of deferred revenue	62,837	57,125
Current portion of long-term debt	135,146	131,582
Current portion of royalties payable	714,994	455,549
Current portion of employee future benefits obligation	73,448	187,000
SGGF legal fees (Note 9)	667,483	1,466,283
	<b>2,513,031</b>	3,448,353
DEFERRED ROYALTY REVENUE	236,225	272,944
EMPLOYEE FUTURE BENEFITS OBLIGATION	124,826	117,012
LONG-TERM DEBT	1,297,155	1,366,232
ROYALTIES PAYABLE	-	13,981
	<b>4,171,237</b>	5,218,522
<b>SHAREHOLDERS' DEFICIENCY</b>		
SHARE CAPITAL	5,479,202	5,016,395
CONTRIBUTED SURPLUS	434,643	374,018
DEFICIT	(6,752,833)	(7,321,541)
	<b>(838,988)</b>	(1,931,128)
	<b>\$ 3,332,249</b>	<b>\$ 3,287,394</b>

Contingencies (Note 9)

See accompanying notes

# Financial Statements

## CEAPRO INC.

### Consolidated Statements of Net Income (Loss), Comprehensive Income (Loss) and Deficit

Unaudited

	Six Months Ended June 30		Quarters Ended June 30	
	2009	2008	2009	2008
<b>Revenue</b>				
Sales	\$ 2,713,927	\$ 2,307,586	\$ 1,212,018	\$ 1,455,619
Cost of goods sold	1,018,818	1,373,884	446,775	809,330
Gross margin	1,695,109	933,702	765,243	646,289
<b>Expenses</b>				
General and administration	807,516	854,090	417,194	445,977
Royalties	214,458	218,034	76,431	137,659
Sales and marketing	85,063	274,279	24,761	136,517
Amortization	99,805	163,111	11,511	85,982
Interest on long-term debt	38,794	42,544	18,880	21,088
	1,245,636	1,552,058	548,777	827,223
Income (loss) from operations	449,473	(618,356)	216,466	(180,934)
<b>Other income (expenses)</b>				
Research and product development	(281,195)	(339,320)	(145,624)	(137,160)
Bio-energy feasibility study	-	(14,371)	-	3,865
Other income (expenses)	(25,870)	31,562	(31,210)	(17,626)
	(307,065)	(322,129)	(176,834)	(150,921)
Comprehensive income (loss) before SGGF legal fees recovery (expense) and income taxes	142,408	(940,485)	39,632	(331,855)
SGGF legal fees recovery (expense)	426,300	(755,469)	426,300	(755,469)
Income taxes				
Current	241,000	-	184,000	-
Reduction as a result of applying non-capital losses carried forward against the current period's taxable income	(241,000)	-	(184,000)	-
<b>NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) FOR THE PERIOD</b>	<b>568,708</b>	<b>(1,695,954)</b>	<b>465,932</b>	<b>(1,087,324)</b>
Deficit, beginning of period	(7,321,541)	(3,722,072)	(7,218,765)	(4,330,702)
<b>Deficit, end of period</b>	<b>\$ (6,752,833)</b>	<b>\$ (5,418,026)</b>	<b>\$ (6,752,833)</b>	<b>\$ (5,418,026)</b>
Net income (loss) per share:				
Basic	\$ 0.01	\$ (0.04)	\$ 0.01	\$ (0.02)
Diluted	\$ 0.01	\$ (0.04)	\$ 0.01	\$ (0.02)

See accompanying notes

# Financial Statements

## CEAPRO INC.

### Consolidated Statements of Cash Flows

Unaudited

	Six Months Ended June 30		Quarters Ended June 30	
	2009	2008	2009	2008
<b>Operating Activities</b>				
Net income (loss) for the period	\$ 568,708	\$ (1,695,954)	\$ 465,932	\$ (1,087,324)
Items not affecting cash				
Amortization	178,681	163,111	90,387	85,982
Employee future benefits obligation	7,814	30,996	2,871	15,498
Recognition of deferred royalty revenue	(31,007)	(26,366)	(13,847)	(16,633)
Stock based compensation	60,625	54,135	45,737	11,982
	784,821	(1,474,078)	591,080	(990,495)
<b>Changes in Non-Cash Working Capital Items</b>				
Accounts receivable	(40,631)	(57,483)	(329)	190,717
Inventories	(70,161)	(302,930)	(87,913)	(145,918)
Prepaid expenses and deposits	10,774	52,616	11,274	19,269
Accounts payable and accrued liabilities	(291,691)	(13,405)	(222,269)	(185,648)
Current portion of employee future benefits obligation	(113,552)	-	(83,817)	-
Deferred revenue	-	(57,008)	-	(14)
SGGF legal fees	(798,800)	755,469	(602,550)	755,469
	(519,240)	(1,096,819)	(394,524)	(356,620)
<b>Investing Activities</b>				
Purchase of license	-	(30,000)	-	(30,000)
Purchase of property and equipment	(17,408)	(211,899)	(10,239)	(12,544)
	(17,408)	(241,899)	(10,239)	(42,544)
<b>Financing Activities</b>				
Repayment of long-term debt	(65,513)	(51,392)	(33,274)	(30,972)
Proceeds from issuance of share capital	466,000	-	466,000	-
Share issue costs	(3,193)	-	(3,193)	-
Increase in royalties payable	245,464	148,155	90,277	72,046
	642,758	96,763	519,810	41,074
Increase (decrease) in cash and cash equivalents	106,110	(1,241,955)	115,047	(358,090)
Cash and cash equivalents at beginning of period	16,525	1,282,326	7,588	398,461
<b>Cash and cash equivalents at end of period</b>	<b>\$ 122,635</b>	<b>\$ 40,371</b>	<b>\$ 122,635</b>	<b>\$ 40,371</b>
Cash and cash equivalents consist of:				
Cash on deposit (overdraft) with banks	\$ 122,635	\$ (34,629)	\$ 122,635	\$ (34,629)
CAD\$ term deposit		75,000		75,000
	\$ 122,635	\$ 40,371	\$ 122,635	\$ 40,371
<b>Supplementary information</b>				
Interest paid	\$ 38,794	\$ 42,544	\$ 18,880	\$ 21,088
Royalties paid	\$ -	\$ 82,260	\$ -	\$ 82,260

See accompanying notes

# Notes to Consolidated Financial Statements

## 1. Accounting Principles for Interim Financial Statements and Going Concern

The accompanying unaudited interim consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") for interim financial statements. The accounting principles and methods of computation adopted in these financial statements are the same as those of the audited financial statements for the year ended December 31, 2008.

Omitted from these statements are certain information and note disclosures normally included in the annual financial statements prepared in accordance with Canadian GAAP. The financial statements and notes presented should be read in conjunction with the audited financial statements for the year ended December 31, 2008.

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 9). 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. Recently Adopted and Future Accounting Pronouncements

### *Recently Adopted*

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 is applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company adopted 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 did not have a material impact on these consolidated financial statements.

### *Future Accounting Pronouncements*

In 2006, Canada's Accounting Standards Board ("AcSB") ratified a strategic plan that will result in Canadian 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.

# Notes to Consolidated Financial Statements

## 2. Recently Adopted and Future Accounting Pronouncements (Continued)

During the year 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.

## 3. Inventories

	June 30 2009	December 31 2008
Raw materials	\$ 200,381	\$ 200,548
Work in progress	233,405	98,752
Finished goods	43,342	107,667
	<u>\$ 477,128</u>	<u>\$ 406,967</u>

## 4. 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

	Number of Shares	Amount
Balance December 31, 2008	47,050,063	\$ 5,016,395
Equity Placements	4,660,000	\$ 466,000
Share Issue Costs	-	(3,193)
Balance June 30, 2009	<u>51,710,063</u>	<u>\$ 5,479,202</u>

(c) Stock options outstanding are as follows:

Year of Expiration	Exercise Price	Number of Options Outstanding	
		June 30 2009	December 31 2008
2014	\$0.13	900,000	-
2013	\$0.12	713,335	780,000
2013	\$0.25	210,000	240,000
2012	\$0.28	390,000	390,000
2012	\$0.30	100,000	100,000
2011	\$0.30	75,000	150,000
2011	\$0.27	150,000	150,000
		<u>2,538,335</u>	<u>1,810,000</u>

### (d) Warrants

	June 30 2009	December 31 2008
Issued and outstanding, beginning of period	4,806,608	4,806,608
Expired	(4,806,608)	-
Issued and outstanding, end of period	<u>-</u>	<u>4,806,608</u>

All outstanding warrants expired on February 27, 2009.

# Notes to Consolidated Financial Statements

## 5. Employee Future Benefits Obligation

	Six Months ended June 30, 2009	Three Months ended June 30, 2009	December 31 2008
Unfunded balance, beginning of period	\$ 304,012	\$ 279,220	\$ 283,648
Curtailment loss	-	-	68,751
Benefits paid	(113,552)	(84,177)	(67,361)
Current service cost	5,761	2,445	14,496
Interest costs on accrued obligation	2,053	786	4,478
	198,274	198,274	304,012
Less current portion	(73,448)	(73,448)	(187,000)
Unfunded balance, end of period	\$ 124,826	\$ 124,826	\$ 117,012

## 6. Related Party Transactions

	Six Months Ended June 30	
	2009	2008
Royalties earned by employees and Directors	\$ 29,056	\$ 38,817
Royalties payable to employees and Directors	\$ 75,028	\$ 38,817
Consulting fees paid to a company controlled by a director	\$ 75,000	\$ 38,812

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.

## 7. Other Income (Expenses)

Other income (expenses) is comprised as follows:

	Six Months Ended June 30	
	2009	2008
Foreign exchange gains (losses)	\$ (26,114)	\$ 22,043
Interest Income	244	9,519
Total other income (expenses)	\$ (25,870)	\$ 31,562

## 8. Segmented Information

The Company operates primarily in one industry segment, which is the active ingredient 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:

	Six Months Ended June 30	
	2009	2008
North America	\$ 1,494,944	\$ 1,533,892
Other	1,218,983	773,694
	\$ 2,713,927	\$ 2,307,586

# Notes to Consolidated Financial Statements

## 9. Contingencies

(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.

During the year ended December 31, 2008, all claims related to the Saskatchewan Claim were dismissed. During the quarter end March 31, 2009 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 which are payable in four equal quarterly installments of \$176,250 commencing March 31, 2009. Payments are 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. The first two payments have been made in the first and second quarters and the final two payments of \$176,250 each are included on the balance sheet under SGGF legal fees.

In the event the Company should default on the provisions of the Settlement Agreement, the Defendants would be entitled to enforce security with respect to the balance of payments owing 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.

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. During the quarter ended June 30, 2009, the Company was advised by one of its legal counsels that they did not intend to pursue collection of their previously billed legal fees. The amount of these fees is \$426,300 and this amount has been recorded as a recovery in the quarter. The remaining amount of these disputed fees is \$314,983 and this amount has been accrued in the financial statements and included 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 agreed to indemnify the Board of Directors and certain past members of the Board of Directors in relation to the bond.

(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.

# Notes to Consolidated Financial Statements

## 10. 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 95% of accounts receivable are due from three 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 two more payments of \$176,250 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 \$45,000 annually based upon estimated 2009 U.S. dollar sales of \$4,500,000. Estimated sales were assumed by annualizing sales during the first six months of 2009. The Company does purchase some materials and services in U.S. dollars and to a lesser extent Euros. This amount will vary by product sold.

# Notes to Consolidated Financial Statements

## 10. Financial Instruments (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	\$ 502,411	\$ 5,024	\$ (5,024)
<b>Financial liabilities</b>			
Accounts payable and accrued liabilities	\$ 128,363	\$ (1,284)	\$ 1,284
<b>Total increase(decrease)</b>		\$ 3,740	\$ (3,740)

The carrying amount of accounts receivable and accounts payable and accrued liabilities in USD represents the Company's exposure at June 30, 2009.

### 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.

## 11. 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 2008.