FUNCTIONAL
TECHNOLOGIES

CONSOLIDATED FINANCIAL STATEMENTS

For The Three Months Ended November 30, 2012

(Expressed in Canadian dollars)

January 28, 2013

Functional Technologies Corp.

Consolidated Statements of Financial Position

As at		November 30, 2012		August 31, 2012
ASSETS				
Current Assets				
Cash	$	1,166,956	$	384,613
Amounts receivable (Note 4)		194,412		254,934
Government assistance receivable (Note 9)		-		13,332
Prepaid expenses		83,561		59,532
Deposits		89,706		38,168
Inventory (Note 5)		-		-
		1,534,635		750,579
Long-term deposits		-		10,000
Property, plant and equipment (Note 7)		802,511		1,347,699
Licenses and patents (Note 8)		562,993		625,131
		2,900,139		**2,733,409**
LIABILITIES				
Accounts payable and accrued liabilities (Note 6)		910,753		887,490
Current portion of long-term debt (Note 10)		1,123,964		1,379,835
Current portion of long-term lease obligation (Note 11)		494,265		29,667
Provision for repayment of government assistance (Note 9)		3,269,488		3,269,488
		5,798,470		5,566,480
Long-term debt (Note 10)		125,000		125,000
Long-term lease obligation (Note 11)		-		462,873
Preferred shares liability (Note 12)		2,000		2,000
		5,925,470		6,156,353
SHAREHOLDERS' EQUITY				
Share capital (Note 13(b))		25,824,733		24,019,349
Share-based payment reserve		4,443,448		4,405,806
Accumulated deficit		(33,293,512)		(31,848,099)
		(3,025,331)		(3,422,944)
	$	**2,900,139**	**$**	**2,733,409**

Nature of operations and going concern (Note 1)
Commitments (Note 14)
Events after the reporting period (Note 17)

Approved by the Board /s/ /s/

Functional Technologies Corp.
Consolidated Statements of Loss and Comprehensive Loss

	For the three months ended			
		November 30, 2012		November 30, 2011
SALES	$	18,369	$	20,087
COST OF GOODS SOLD		(13,655)		(14,437)
GROSS PROFIT		4,714		5,650
EXPENSES				
Depreciation		14,638		62,824
Amortization		8,884		44,870
Consulting		132,949		136,610
Filing fees		39,974		3,199
Office and general		53,135		151,600
Professional		271,314		134,838
Rent		43,790		29,296
Research and development		25,420		115,195
Salaries and wages		179,729		445,088
Sales and marketing		4,950		20,079
Share based compensation (Note 13(c))		37,642		44,146
Travel and meals		42,770		65,869
LOSS BEFORE OTHER ITEMS		(850,481)		(1,247,964)
OTHER INCOME (EXPENSES)				
Foreign exchange gain (loss)		(41,839)		44,398
Accretion of interest		(9,781)		(12,057)
Interest income		649		4,780
Government assistance		(1,821)		68,465
Loss on impairment (Note 7 and Note 8)		(542,140)		-
		(594,932)		105,586
NET LOSS AND COMPREHENSIVE LOSS FOR THE PERIODS	**$**	**(1,445,413)**	**$**	**(1,142,378)**
Basic and diluted loss per common share	$	(0.03)	$	(0.02)
Weighted average number of common shares outstanding		50,712,802		48,796,895

See accompanying Notes to the consolidated financial statements

Functional Technologies Corp.

Consolidated Statements of Changes of Shareholders' Equity

	Common Shares Issued and Outstanding		Share Capital		Contingent Shares		Share-based payment reserve		Accumulated Deficit		Total Shareholders' Equity
Balance – August 31, 2011	**48,796,895**	**$**	**22,875,362**	**$**	**786,000**	**$**	**4,020,522**	**$**	**(19,212,394)**	**$**	**8,469,490**
Net Loss	-		-		-		-		(12,635,705)		(12,635,705)
Private Placement	2,225,000		358,257		-		86,743		-		445,000
Share issue costs – cash	-		(26,470)		-		-		-		(26,470)
Fair value of warrants issued as finders' fees	-		(5,663)		-		5,663		-		-
Shares issued in conjunction with Bridge Loan (Note 10(a))	122,549		31,863		-		-		-		31,863
Shares issued for contingent shares	600,000		786,000		(786,000)		-		-		-
Share based compensation	-		-		-		292,878		-		292,878
Balance – August 31, 2012	**51,744,444**	**$**	**24,019,349**	**$**	**-**	**$**	**4,405,806**	**$**	**(31,848,099)**	**$**	**(3,422,944)**
Net Loss	-		-		-		-		(1,445,413)		(1,445,413)
Private Placement	9,626,000		1,925,200		-		-		-		1,925,200
Share issue costs – cash	-		(119,816)		-		-		-		(119,816)
Share based payments	-		-		-		37,642		-		37,642
Balance – November 30, 2012	**61,370,444**	**$**	**25,824,733**	**$**	**-**	**$**	**4,443,448**	**$**	**(33,293,512)**	**$**	**(3,025,331)**

Functional Technologies Corp.

Consolidated Statements of Cash Flow

		For the three months ended		
		November 30, 2012		November 30, 2011
OPERATING ACTIVITIES				
Net loss for the period	$	(1,445,413)	$	(1,142,378)
Adjustment for items not affecting cash				
Depreciation of capital assets		14,638		62,824
Amortization of intangible assets		8,884		44,870
Share based compensation		37,642		44,146
Accretion of interest on long-term debt		1,505		1,013
Accretion of interest on lease obligation		8,276		6,588
Loss on impairment		542,140		-
		(832,328)		(982,937)
Net changes in non-cash working capital items				
Amounts receivable (payable)		60,522		183,800
Government assistance receivable (payable)		13,332		(44,193)
Prepaid expenses		(24,029)		16,521
Deposits		(41,538)		6,520
Inventory		-		4,711
Accounts payable and accrued liabilities		23,263		(319,394)
Reclassification of Deposit		41,665		
		(759,113)		(1,134,972)
FINANCING ACTIVITIES				
Proceeds from share issuance, net of share issuance costs		1,805,383		-
Repayment of long-term debt		(259,427)		(6,882)
Proceeds from long-term debt		-		4,007
Lease repayment		(4,500)		(13,500)
		1,541,456		(16,375)
INVESTING ACTIVITIES				
Purchase of property, plant and equipment		-		(16,804)
Proceeds on disposal on property, plant and equipment		-		786
Government assistance relating to property, plant and equipment		-		7,395
Acquisition of licenses and patents		-		(22,985)
		-		(31,608)
Net increase (decrease) in cash		**782,343**		**(1,182,955)**
Cash, Beginning of period		**384,613**		**4,236,302**
Cash, End of period	**$**	**1,166,956**	**$**	**3,053,347**

1. NATURE OF OPERATIONS AND GOING CONCERN

Functional Technologies Corp. (the "Company") was incorporated under the corporate laws of British Columbia, Canada on October 18, 1999. The Company's head office is located at #410 – 2389 Health Sciences Mall, Vancouver BC, V6T 1Z3.

The Company is a functional foods and biological health products company that is developing and commercializing advanced yeast products and other novel biological products for the food and health care industry.

The Company had a comprehensive loss of $1,445,413 for the three months ended November 30, 2012 (2011 - $1,142,378. The Company also had a working capital deficiency of $4,263,835 as at November 30, 2012 (2011 - $2,816,949 surplus).

For events after the reporting period, see Note 17.

In the immediate term, the Company's ability to continue as a going concern is dependent upon its ability to generate positive operating cash flow and to raise additional capital to fund its ongoing business operations. Additional capital may be sought from existing shareholders and creditors and from the sale of additional common shares or other equity or debt instruments. There is no assurance such additional capital will be available to the Company on acceptable terms or at all. In the longer term, the recoverability of the carrying value of the Company's long-lived assets is dependent upon profitable commercialization of its technologies and the ability of the Company to obtain financing to support its ongoing development of these technologies. Whether the Company can achieve profitability and positive cash flow and obtain adequate financing are material uncertainties. These material uncertainties cast significant doubt upon the Company's ability to continue as a going concern.

These consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") appropriate for a going concern. The going concern basis of accounting assumes the Company will continue to realize the value of its assets and discharge its liabilities and other obligations in the ordinary course of business. Should the Company be required to realize the value of its assets in other than the ordinary course of business, the net realizable value of its assets may be materially less than the amounts shown in the consolidated financial statements. These consolidated financial statements do not include any adjustments to the amounts and classifications of assets and liabilities that may be necessary should the Company be unable to repay its liabilities and meet its other obligations in the ordinary course of business or to continue operations.

2. BASIS OF PREPARATION AND ADOPTION OF IFRS

Statement of Compliance

These condensed consolidated interim financial statements have been prepared using accounting policies consistent with International Financial Reporting Standards ("IFRS"), and in accordance with International

2. BASIS OF PREPARATION AND ADOPTION OF IFRS (continued)

Accounting Standards ("IAS") 34, Interim Financial Reporting, as issued by the International Accounting Standards Board ("IASB").

These condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements for the year ended August 31, 2012, which have been prepared in accordance with IFRS as issued by the IASB. The accounting policies followed in these condensed consolidated interim financial statements are consistent with those applied in the Company's consolidated financial statements for the year ended August 31, 2012.

Basis of Presentation

The Company's consolidated financial statements have been prepared on the historical cost basis except for the revaluation of certain financial assets and financial liabilities to fair value. The comparative figures presented in these consolidated financial statements are in accordance with IFRS.

The preparation of consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and further periods if the review affects both current and future periods.

3. SIGNIFICANT ACCOUNTING POLICIES

Details of the Group

In addition to the Company, the consolidated financial statements include all subsidiaries. Subsidiaries are corporations over which the Company is able, directly or indirectly, to control the financial and operating policies, which is the authority usually connected with holding majority voting rights. Subsidiaries are fully consolidated from the date on which control is acquired by the Company. Inter-company transactions and balances are eliminated upon consolidation. They are de-consolidated from the date that control by the Company ceases.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

The subsidiaries of the Company are as follows:

- Phyterra Bio Inc. incorporated under the corporate laws of Canada
- Phyterra Yeast Inc. incorporated under the corporate laws of Canada
- Phyterra Yeast USA Inc. incorporated under the corporate laws of Delaware, USA
- Maritime Pulse Drying Inc. incorporated under the corporate laws of Canada
- Phyterra Europe GmbH, incorporated under the corporate laws of Germany (See Note 17)
- Functional Technologies (West) Corp. incorporated under the corporate laws of Canada.

Critical Judgments and Sources of Estimation Uncertainty

The preparation of these consolidated financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. These consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and future periods if the revision affects both current and future periods. These estimates are based on historical experience, current and future economic conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Critical Judgments

The following are critical judgments that management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the consolidated financial statements:

(i) The determination of categories of financial assets and financial liabilities has been identified as an accounting policy which involves judgments or assessments made by management.

(ii) Management is required to assess the functional currency of each entity of the Company. In concluding that the CAD is the functional currency of the parent and its subsidiaries, management considered the currency that mainly influences the cost of providing goods and services in each jurisdiction in which the Company operates. As no single currency was clearly dominant the Company also considered secondary indicators including the currency in which funds from financing activities are denominated and the currency in which funds are retained.

(iii) Management is required to assess whether to test for impairment of long-lived assets in accordance with IAS 36. In assessing whether there is any indication that long-lived assets may be impaired, management is required to make judgments on the status of related projects and the future plans towards commercialization.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash

Cash consists of cash and demand deposits. The Company is not exposed to significant credit or interest rate risk although cash and cash equivalents may be held in excess of federally insured limits with major financial institution.

Amounts Receivable

Receivables are recognized initially at fair value and are subsequently measured at amortized cost using the effective interest method, less provision for impairment. Receivables are classified as loans and receivables. A provision for impairment of receivables is established when there is objective evidence that the Company will not be able to collect an amount due according to the original terms of the receivable.

Inventory

Inventory is recorded at the lower of cost and net realizable value. The cost of inventory is based on the weighted average cost principle, and includes expenditures incurred in acquiring the inventory, production or conversion costs and other costs incurred in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes materials, labor and an appropriate share of production overhead based on normal operating capacity. Costs of materials are determined on an average per unit basis. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

In establishing any impairment of inventory, management estimates the likelihood that inventory carrying values will be affected by changes in market demand or physical deterioration of stock which would impair the value of inventory on hand.

Accounts Payable and Accrued Liabilities

Payables are obligations to pay for materials or services that have been acquired in the ordinary course of business from suppliers. Payables are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Payables are classified as other financial liabilities and are initially recorded at fair value and are subsequently measured at amortized cost using the effective interest method.

Property, Plant and Equipment

Property, plant and equipment is measured at cost less any government assistance received or receivable, accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials,

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

costs directly attributable to bringing the assets to a working condition for their intended use, and the costs of dismantling and removing items and restoring the site on which they are located.

Property, plant and equipment is depreciated from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use, using various methods less its residual value over the estimated useful lives of the assets as follows:

Asset Class	Depreciation Method	Depreciation Rate
Building	Straight line	4%
Computer hardware	Declining balance	30%
Equipment	Straight line	20%
Furniture and fixtures	Straight line	20%
Vehicles	Straight line	30%
Leasehold improvements	Straight line	Term of lease

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on disposal of the asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in profit or loss in the consolidated statement of comprehensive loss.

The Company compares the carrying value of property, plant and equipment to estimated net recoverable amounts, based on estimated future cash flows, to determine whether there is any indication of impairment whenever events or circumstances warrant.

Licenses and Patents

License and patent costs include all direct costs of acquiring licenses and licensed patents, net of government assistance received. These costs are amortized on a straight line basis over their estimated useful lives of 20 years.

The amortization rate and method is reviewed at each financial reporting period and adjusted if appropriate.

Impairment of Long-Lived Assets

At each reporting date, the carrying amounts of the Company's long-lived assets are reviewed to determine whether there is any indication that those assets are impaired. If any such indication exists, the fair value of the asset is estimated in order to determine the extent of the impairment, if any. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. An asset's recoverable amount is the higher of fair value less costs to sell and value in use. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset or cash generating unit is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and an impairment loss is recognized in comprehensive income for the period.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in comprehensive income.

Leases

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset. Other leases are operating leases and are not recognized in the statement of financial position.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Financial Instruments

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held to maturity, available for sale, loans and receivables or at fair value through profit or loss.

Financial assets classified as fair value through profit or loss are measured at fair value with unrealized gains and losses recognized in comprehensive income. Cash, restricted cash, short-term investments and deposits are classified as fair value through profit or loss.

Financial assets classified as loans and receivables and held to maturity are measured at amortized cost. Amounts receivable and government assistance receivable are classified as loans and receivables.

Financial assets classified as available for sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income except for losses in value that are considered other than temporary. As at November 30, 2012 and August 31, 2012 the Company has not classified any financial assets as available for sale.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Transaction costs associated with financial instruments classified as fair value through profit or loss are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

All financial liabilities are initially recorded at fair value and designated upon inception as fair value through profit or loss or other financial liabilities.

Financial liabilities classified as other financial liabilities are measured at amortized cost. Accounts payable and accrued liabilities, long-term debt, lease obligation, provision for repayment of government assistance and preferred shares liability are classified as other financial liabilities.

Financial liabilities classified as fair value through profit or loss are measured at fair value with unrealized gains and losses recognized in comprehensive income. At November 30, 2012 and August 31, 2012, the Company has not classified any financial liabilities as fair value through profit or loss.

Share Capital

Common shares issued by the Company are classified as equity. Costs directly attributable to the issue of common shares, share purchase warrants and share options are recognized as a deduction from equity, net of any related income tax effects.

Equity Financing

The Company engages in equity financing transactions to obtain the funds necessary to continue operations. These equity financing transactions may involve issuance of common shares or units. Units typically comprise a certain number of common shares and share purchase warrants. Depending on the terms and conditions of each equity financing transaction, the warrants are exercisable into additional common shares at a price prior to expiry as stipulated by the terms of the transaction. The Company has adopted a relative fair value method with respect to the measurement of common shares and share purchase warrants issued as private placement units. The relative fair value of the common shares issued in the private placements is determined by the closing quoted bid price on the announcement date. The relative fair value of the share purchase warrants issued in the private placements is determined by the Black Scholes option pricing method on the announcement date.

Share-Based Payment Transactions

The share option plan allows the Company's directors, officers, employees and consultants to acquire common shares of the Company. The fair value of share options granted is recognized as a share-based compensation expense with a corresponding increase in the equity settled share-based payment reserve in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

For employees the fair value is measured at grant date and each tranche is recognized separately on a straight line basis over the period during which the share options vest. The fair value of the share options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the share options were granted. At the end of each reporting period, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

Equity-settled share-based payment transactions with non-employees are measured at the fair value of the goods or services received. However, if the fair value cannot be estimated reliably, the share-based payment transaction is measured at the fair value of the equity instruments granted at the date the Company receives the goods or the services.

Current and Deferred Income Taxes

Income tax expense comprises current and deferred income taxes. Income taxes are recognized in the statement of comprehensive loss, except to the extent that it relates to items recognized in other comprehensive loss or directly in equity. In this case the income taxes are also recognized in other comprehensive loss or directly in equity, respectively.

The current income taxes are calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date. Management periodically evaluates positions taken in income tax returns with respect to situations in which applicable income tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the taxation authorities.

Deferred income taxes are recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred income taxes are not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income taxes is determined using tax rates (and laws) that have been enacted or substantially enacted at the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available against which the temporary differences can be utilized.

Deferred income taxes are provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue Recognition

Revenue from products sold is recognized when evidence of a sales arrangement exists, title and risk has passed to the customer in accordance with the selling contract, the revenue arising from the sale is fixed and determinable and collection is believed to be reasonably assured.

Research and Development Costs

Research costs, which are costs incurred with a view to obtaining new scientific or technical knowledge, are expensed as incurred. Development costs, which are generally associated with the creation or improvement of a commercial product, are also expensed as incurred unless the Company believes a development project meets generally accepted criteria for deferral. No development costs have been deferred to date.

Government Assistance

Government assistance is either recorded as a reduction of the cost of the applicable asset or as other income as determined by the nature of the assistance.

Government assistance receivable is recognized when there is reasonable assurance that the Company has complied and will continue to comply with all the conditions of the arrangement between the Company and governmental funding authority.

Loss per Share

Basic loss per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period. The computation of diluted loss per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on loss per share. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the "if converted" method. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method.

Foreign Currency Translation

Functional and Presentation Currency

The financial statements of each of the Company's subsidiaries are prepared in the local currency of their home jurisdictions. Consolidation of each subsidiary includes re-measurement from the local currency to the subsidiary's functional currency. Each subsidiary's functional currency, being the currency of the primary economic environment in which the subsidiary operates, is the Canadian dollar. The consolidated financial statements are presented in Canadian dollars.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Exchange rates published by the Bank of Canada were used to translate subsidiary financial statements into the consolidated financial statements. Income and expenses for each statement of comprehensive loss presented are translated using the exchange rates prevailing on the transaction dates. All resulting foreign exchange differences are recognized in comprehensive income.

Foreign Currency Transactions

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing on the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in comprehensive loss.

Accounting Standards and Interpretations Issued but Not Yet Adopted

The following accounting standards, amendments and interpretations have been issued but are not effective until annual periods beginning after January 1, 2012, unless otherwise indicated, earlier application is permitted. As at the date of these consolidated financial statements, the following standards, amendments and interpretations have not been applied in these consolidated financial statements.

(i) IFRS 9 Financial Instruments (New; to replace IAS 39); effective for annual periods beginning on or after January 1, 2015.

(ii) IFRS 10 Consolidated Financial Statements; effective for annual periods beginning on or after January 1, 2013. Early application is permitted. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supersedes IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidated - Special Purpose Entities.

(iii) IFRS 11 Joint Arrangements; effective for annual periods beginning on or after January 1, 2013. Early application is permitted. IFRS 11 establishes principles for financial reporting by parties to a joint arrangement. IFRS 11 supersedes the current IAS 31 Interest in Joint Ventures and SIC-13 Jointly Controlled Entities - Non-Monetary Contributions by Ventures.

(iv) IFRS 12 Disclosure of Interest in Other Entities; effective for annual periods beginning on or after January 1, 2013. Early application is permitted. IFRS 12 applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(v) IFRS 13 Fair Value Measurements; to be applied for annual periods beginning on or after January 1, 2013. Early application is permitted. IFRS 13 defines fair value, sets out in a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements).

(vi) IAS 12 Income Taxes, Amendments Regarding Deferred Tax: Recovery of Underlying Assets; effective for annual periods beginning on or after January 1, 2012.

4. AMOUNTS RECEIVABLE

The Company's amounts receivable are as follows:

As at		November 30, 2012		August 31, 2012
HST receivable	$	184,634	$	158,423
Trade receivables		9,022		96,511
	$	**194,412**	**$**	**254,934**

5. INVENTORY

Inventory consists of yeast held for resale or used for research and development activity. During the period ending August 31, 2012, the yeast inventory was close to its expiry date and was therefore written off. No additional inventory was purchased during the three months ended November 30, 2012 therefore the balance is still nil.

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The Company's accounts payable and accrued liabilities are as follows:

As at		November 30, 2012		August 31, 2012
Trade accounts payable	$	764,725	$	687,162
Accrued liabilities		-		111,373
Salaries and wages payable		138,000		63,110
Statutory remittances payable		8,028		25,845
	$	**910,753**	**$**	**887,490**

7. PROPERTY, PLANT AND EQUIPMENT

The following tables summarize the Company's property, plant and equipment:

	Building $	Computer Hardware $	Equipment $	Furniture and Fixtures $	Vehicle $	Leasehold Improvement $	Land $	Total $
Cost								
Balance August 31, 2011	849,862	80,310	1,739,227	25,723	34,270	303,497	152,246	3,185,135
Additions	3,881	6,119	183,968	11,266	-	26,625	-	231,859
Provision for repayable government assistance	-	-	107,405	-	-	-	-	107,405
Disposals	-	-	-	-	(731)	-	-	(731)
Government Assistance	-	-	(7,395)	-	-	-	-	(7,395)
Balance August 31, 2012	853,743	86,430	2,023,205	36,989	33,539	330,122	152,246	3,516,274
Additions	-	-	-	-	-	-	-	-
Disposals	-	-	-	-	-	-	-	-
Impairment of Capital Assets	(530,450)	-	-	-	-	-	-	(530,450)
At November 30, 2012	323,292	86,430	2,023,205	36,989	33,539	330,122	152,246	2,985,824
Accumulated Depreciation and Impairment								
At August 31, 2011	(34,411)	(43,843)	(361,577)	(15,020)	(21,508)	(21,488)	-	(497,847)
Depreciation	(5,841)	(10,591)	(117,500)	(5,302)	-	(10,953)	-	(150,187)
Impairment	(283,041)	(2,688)	(941,729)	(3,509)	-	(289,573)	-	(1,520,540)
Balance August 31, 2012	(323,292)	(57,122)	(1,420,806)	(23,831)	(21,508)	(322,014)	-	(2,168,674)
Depreciation	-	(2,691)	(2,493)	(1,394)	(7,221)	(839)	-	(14,638)
Impairment	-	-	-	-	-	-	-	-
At November 30, 2012	(323,292)	(59,813)	(1,423,299)	(25,225)	(28,729)	(322,843)	-	(2,183,312)
Carrying Value								
Balance August 31, 2012	530,450	29,307	602,399	13,158	12,031	8,108	152,246	1,347,699
Balance November 30, 2012	-	26,617	599,905	11,764	4,810	7,269	152,246	802,511

During the three months ended November 30, 2012 the Company recognized an impairment charge of $530,450 (2011 - $nil) on real property assets on Prince Edward Island.

8. LICENSES AND PATENTS

The following tables summarize the Company's license and patent costs:

	PATENTS				
	Algae Technology $	Yeast Technology $	Trademarks $	Licences $	Total $
Cost					
Balance at August 31, 2011	2,851,228	432,856	32,390	295,293	3,611,767
Additions	127,566	273,084	9,592	4,483	414,725
Balance at August 31, 2012	2,978,794	705,940	41,982	299,776	4,026,492
Additions	-	(41,669)	105	-	(41,564)
Disposals	-	-	-	-	-
Balance at November 30, 2012	2,978,794	664,271	42,087	299,776	3,984,928
Accumulated Depreciation and Impairment:					
Balance at August 31, 2011	(420,802)	(41,731)	-	(41,667)	(504,200)
Depreciation	(36,848)	(24,174)	-	(15,887)	(76,909)
Impairment	(2,521,144)	(222,625)	-	(76,483)	(2,820,252)
Balance at August 31, 2012	(2,978,794)	(288,530)	-	(134,037)	(3,401,361)
Depreciation	-	(5,568)	-	(3,316)	(8,884)
Impairment	-	(11,690)	-	-	(11,690)
Balance at November 30, 2012	(2,978,794)	(305,788)	-	(137,353)	(3,421,935)
Carrying Value:					
Balance August 31, 2012	-	417,410	41,982	165,739	625,131
Balance November 30, 2012	-	358,483	42,087	162,423	562,993

9. GOVERNMENT ASSISTANCE

The Company has entered into a number of grant and loan arrangements with agencies of the Government of Canada and the Government of Prince Edward Island.

Grants received are recognized as income, rather than as a liability, as the amounts received only become repayable if the related project achieves defined objectives, and then repayment is based on a fixed percentage of related revenue. Amounts that so become repayable would be recorded as liability until payment is made. Grants received may also become repayable if the Company breaches the terms of the arrangement.

Loans received are unconditionally repayable, and are therefore recognized as a liability at the time of receipt.

9. GOVERNMENT ASSISTANCE (continued)

During the year ended August 31, 2012, the Company made certain strategic decisions that caused the government agencies to notify the Company of their view that the Company is not in compliance with the terms of the arrangements, but have not yet served the Company with formal notice of default. Discussions with the government agencies are ongoing.

The Company has determined, as a result of the above, that the amounts previously recorded under the arrangements have become liabilities. As the amount to be repaid and the timing of repayment are uncertain, the Company has recorded a provision for all amounts previously received, being $3,279,654, and presents this amount as a current liability. There was no change during the three months ended November 30, 2012.

During the three months ended November 30, 2012, the Company adjusted the remaining balance by $(1,821). The amount claimed during the three months ended November 30, 2011 was $68,465. As at November 30, 2012, $nil (August 2012 - $13,332) was receivable in relation to a government assistance arrangement.

10. LONG-TERM DEBT

November 30, 2012					
Lender	**Total Carrying Amount**	**Current Portion**	**Long-term Portion**	**Interest Rate**	**Maturity Date**
Ford Credit	$ 4,518	$ 4,518	$ -	Nil	Aug 2013
Bank of Montreal	150,000	25,000	125,000	Prime + 3%	On Demand
PEI Century 2000 Fund Inc.	295,870	295,870	-	Prime + 4%	On Demand
Innovation PEI Inc.	260,789	260,789	-	Prime + 3%	On Demand
ACOA	226,945	226,945	-	Nil	On Demand
ACOA	29,865	29,865	-	Nil	On Demand
ACOA	230,419	230,419	-	Nil	On Demand
ACOA	50,559	50,559	-	Nil	On Demand
	$ 1,248,964	**$ 1,123,964**	**$ 125,000**		

10. LONG-TERM DEBT (continued)

		August 31, 2012			
Lender	Total Carrying Amount	Current Portion	Long-term Portion	Interest Rate	Maturity Date
Ford Credit	$ 6,024	$ 6,024	$ -	Nil	Aug 2013
Bank of Montreal	150,000	25,000	125,000	Prime + 3%	On Demand
PEI Century 2000 Fund Inc.	295,870	295,870	-	Prime + 4%	On Demand
Innovation PEI Inc.	260,789	260,789	-	Prime + 3%	On Demand
ACOA	231,978	231,978	-	Nil	On Demand
ACOA	29,670	29,670	-	Nil	On Demand
ACOA	228,914	228,914	-	Nil	On Demand
ACOA	51,590	51,590	-	Nil	On Demand
RCM & Co SO Debt fund	250,000	250,000	-	18%	Feb 2013
	$ 1,504,835	**$ 1,379,835**	**$ 125,000**		

Long-term debt is secured by certain assets of the Company.

(a) The Company entered into a loan agreement with R.C. Morris & Company Special Opportunities Debt Fund Limited Partnership, a corporation controlled by the Interim Chief Executive Officer. Under the loan agreement, the Company issued 122,549 common shares at an estimated fair value of $31,863 and paid a $10,000 structuring fee as partial consideration for advancing the loan. The loan was paid back in full on October 10th, 2012.

11. LEASE OBLIGATION

On December 1, 2009, the Company entered into a lease agreement with an option to purchase land and building relating to a planned production facility located in Summerville, Prince Edward Island. The Company classified this lease as a finance lease. The initial term of the lease was 5 years; the Company had an option to renew for an additional 10 years. Under the lease agreement, the Company is required to make monthly lease payments of $4,500.

The Company calculated the fair value of the lease at $540,000 by discounting the future lease payments using a discount rate of 5.13%. The $540,000 was allocated to land and building based on the relative fair value of the land and building at the effective date of the lease; as a result, $21,735 and $518,265 were allocated to land and building, respectively.

During the three months ended November 30, 2012, $6,225 (November 30, 2011 - $6,588) of interest was accreted to the carrying value of the lease and charged to comprehensive income. The Company made lease payments of $4,500 (November 30, 2011 - $ 13,500). During the period the Company made a strategic decision to discontinue making payments under the lease.

11. LEASE OBLIGATION (continued)

On November 30, 2012, the amount due under the lease was $494,265 (August 31, 2012 - $492,540), all of which was reclassified as a current liability (August 31, 2012 - $29,667) as a result of the Company's decision to discontinue lease payments. The value of the building has been impaired to $nil.

12. PREFERRED SHARES LIABILITY

As part of the acquisition of a subsidiary, the Company assumed a preferred shares liability with a fair value of $182,000 of which $180,000 was offset with two promissory Notes receivable with a face value of $180,000. The preferred shares liability consists of 400,000 Class B preferred shares. The promissory notes bear interest at 6.67% which is due and payable at the date of maturity. At the date of maturity accrued interest will fund the payment of interest payable on the Class B preferred shares liability. These Notes are due on August 28, 2013 for mandatory redemption of Class B preferred shares liability.

At November 30, 2012 and August 31, 2012, the fair value of the preferred shares liability was $2,000.

13. SHARE CAPITAL

(a) Authorized:

100,000,000 common shares without par value.

(b) Issued and outstanding:

<u>During the three months ended November 30, 2012</u>

The Company completed the second tranche of its non-brokered private placement by issuing 9,626,000 units at $0.20 per unit for cash of $1,925,200. Each unit consists of one common share and one transferable common share purchase warrant. Each warrant will entitle the holder to purchase one common share at a price of $0.30 for a period of 24 months from the closing of the non-brokered private placement. In connection with the non-brokered private placement, the Company paid cash finders' fees totaling $119,816 and issued finders warrants for the purchase of a total of 9,626,000 common shares of the Company. Each finders warrant will entitle the holder to purchase one common share at a price of $0.30 for a period of 24 months from the closing of the non-brokered private placement except that at the Company's election, the warrants will expire 30 days following the delivery of notice, which may be given if the closing price of the Company's common shares is at least $0.60 for at least 10 consecutive trading days.

(c) Options:

The Company has an incentive share option plan (the "Plan"). Under the Plan, the Company's Board of Directors has reserved 9,759,379 common shares for share option awards to directors, officers,

13. SHARE CAPITAL (continued)

employees and consultants. Share options issued under the Plan may have a term of up to ten years and are exercisable at a price determined at the time of each award.

A summary of the status of the share options granted under the Plan as of November 30, 2012 and August 31, 2012, and the change for the three month ended are as follows:

	November 30, 2012			August 31, 2012		
	Number Outstanding		Weighted Average Exercise Price	Number Outstanding		Weighted Average Exercise Price
Outstanding	4,116,666	$	0.57	5,389,167	$	0.61
Granted	300,000		0.28	950,000		0.31
Exercised	-		-	-		-
Expired	(491,666)		0.62	(2,222,501)		0.74
Forfeited	-		-	-		-
Outstanding	**3,925,000**	**$**	**0.53**	**4,116,666**	**$**	**0.57**

During the three months ended November 30, 2012, the Company granted options to acquire 300,000 common shares with a weighted average fair value of $0.14 per option.

The fair value of share options awarded was estimated using the Black-Scholes option pricing model with the following assumptions:

		November 30, 2012		August 31,2012
Risk-free interest rate		1.24%		1.28%
Expected annual volatility		73%		68%
Expected life (in years)		2.82		2.93
Expected dividend yield		0%		0%
Weighted average grant date fair value per option	$	0.28	$	0.23

13. SHARE CAPITAL (continued)

The following table summarizes information about the share options outstanding at November 30, 2012:

Number	Exercise Price	Expiry Date
100,000	0.50	February 7, 2013
25,000	0.60	May 7, 2013
200,000	0.35	May 1, 2014
235,000	0.50	July 14, 2014
720,000	0.50	September 15, 2014
25,000	0.60	September 15, 2014
305,000	0.60	September 16, 2014
100,000	0.65	May 19, 2015
200,000	0.30	October 16, 2015
75,000	0.62	January 20, 2016
140,000	0.78	February 22, 2016
100,000	0.70	March 13, 2016
100,000	0.80	May 2, 2016
125,000	0.77	May 27, 2016
15,000	0.90	June 2, 2016
60,000	0.83	June 6, 2016
150,000	0.80	June 17, 2016
650,000	0.60	August 5, 2016
100,000	0.49	January 6, 2017
400,000	0.21	June 27, 2017
100,000	0.24	September 21, 2017
3,925,000		

(d) Warrants:

A summary of status of warrants as at November 30, 2012 and August 31, 2012 and the change for the periods are as follows:

	November 30, 2012			
Expiry Date	Warrants outstanding		Weighted average exercise price	Weighted average remaining contractual life (in years)
December 16, 2012	4,189,147	$	0.56	0.04
August 8, 2014	2,355,000		0.56	1.69
October 9, 2014	9,626,000		0.30	1.86
	16,170,147	**$**	**0.41**	**1.36**

13. SHARE CAPITAL (continued)

		August 31, 2012		
Expiry Date	**Warrants outstanding**		**Weighted average exercise price**	**Weighted average remaining contractual life (in years)**
December 16, 2012	4,189,147	$	0.70	0.29
August 8, 2014	2,355,000		0.30	1.94
	6,544,147	**$**	**0.56**	**0.88**

14. COMMITMENTS

The Company's cash commitments for its non-financial liabilities are as follows:

Fiscal Year Ending		**Minimum Royalty and Maintenance**
2013		6,083
2014		6,083
2015		6,083
2016		6,083
2017		6,083
2018 Thereafter		66,917
	$	**97,332**

15. RELATED PARTY DISCLOSURES

(a) Key Management Compensation

Remuneration of directors and key management personnel were as follows:

		Three months ended November 30, 2012		**Three months ended November 30, 2011**
Management compensation	$	161,341	$	185,575
Share-based payments		7,094		65,837
	$	**168,435**	**$**	**251,412**

(b) Transactions with other related parties

i) During the three months ended November 30, 2012, the Company paid financing fees of $nil (2011 $9,349) and legal fees of $39,287 (2011 - $63,336) to a law firm in which a director is an associate counsel.

ii) During the three months ended November 30, 2012, the Company paid consulting fees of $69,047 to a Company in which an officer had an ownership interest (2011 - $363,500 to three directors).

15. RELATED PARTY DISCLOSURES (continued)

iii) Included in accounts payable and accrued liabilities at November 30, 2012 is $nil (August 31, 2012 - $28,250) due to corporations controlled by a director and an officer.

iv) See Note 10 (a).

16. CONTINGENCIES

The Company may from time to time be involved in various claims, lawsuits, and disputes with third parties, actions involving allegations of discrimination, or breach of contract incidental to the operations of its business. The Company is currently involved in an employment - related litigation on Prince Edward Island which has been provided for in the financial statements. The Company does not believe the litigation could have a materially adverse effect on its financial condition or results of operations.

17. EVENTS AFTER THE REPORTING PERIOD

The Company dissolved its wholly-owned subsidiary, Phyterra Yeast Inc. GmbH effective at December 31, 2012.

The Company entered into an agreement to transfer certain non-core assets, which had been impaired in their entirety, in a prior period to a company controlled by former employees. The former employees have released the Company from all claims, including those for severance.

The Company reached a settlement with the Atlantic Canada Opportunities Agency (“ACOA” or the “Agency”) resolving all of the Company’s outstanding liabilities with the Agency, totalling $3,900,000, for payments over time totalling $2,800,000 plus interest. In the prior reporting period, the Company had taken a provision of $3,300,000 in anticipation of an eventual settlement with ACOA. The settlement is subject to the completion and execution of definitive agreements.