

INNOVATIVE COMPOSITES INTERNATIONAL INC.

Condensed interim consolidated financial statements for the quarter ended
March 31, 2014
(expressed in US dollars)

reflecting the Company's adoption of
International Financial Reporting Standards ("IFRS"), as
issued by the International Accounting Standards Board ("IASB")

UNAUDITED

**NOTICE OF NO AUDITOR REVIEW OF CONDENSED
INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying unaudited condensed consolidated interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

INNOVATIVE COMPOSITES INTERNATIONAL INC.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
AS AT MARCH 31, 2014
(Unaudited, Expressed in United States Dollars)

	Notes	March 31, 2014 \$	September 30, 2013 \$
ASSETS			
Current assets			
Cash and cash equivalents		797,440	690,290
Other receivables		30,486	56,893
Accounts receivable		253,634	244,887
Prepaid expenses	6	78,151	133,110
Inventory	7	512,578	551,406
Total current assets		1,672,289	1,676,586
Non-current assets			
Property and equipment	8	3,343,516	3,571,233
Intangible assets	9	1,688,899	1,837,475
Goodwill	11	808,777	808,777
Total assets		7,513,481	7,894,071
LIABILITIES			
Current liabilities			
Bank indebtedness	12	914,860	-
Accounts payable and accrued liabilities		1,255,264	1,604,990
Current portion of royalty liability		-	752,956
Total current liabilities		2,170,124	2,357,946
Non-current liabilities			
Convertible debentures and other loans	13	2,714,137	1,417,847
Royalty liability		257,385	-
Deferred income tax liability		183,193	220,927
Total liabilities		5,324,839	3,996,720
EQUITY			
Capital stock	10	26,404,850	26,323,580
Shares to be issued		142,670	142,670
Warrants	10	106,000	295,000
Contributed surplus		2,458,901	2,566,063
Convertible debt conversion option		646,690	272,690
Accumulated other comprehensive income		255,413	255,413
Deficit		(27,929,599)	(26,082,524)
Total shareholders' equity		2,084,925	3,772,890
Non-controlling interest	11	103,717	124,461
Total Equity		2,188,642	3,897,351
Total liabilities and equity		7,513,481	7,894,071

GOING CONCERN (Note 2)

COMMITMENTS AND CONTINGENCIES (Note 14)

SUBSEQUENT EVENTS (Note 16)

APPROVED ON BEHALF OF THE BOARD

_____, Director

_____, Director

See accompanying notes to the consolidated financial statements.

INNOVATIVE COMPOSITES INTERNATIONAL INC.
CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS
(Unaudited, expressed in United States Dollars)

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	Three months ended March 31		Six months ended March 31	
	2014 \$	2013 \$	2014 \$	2013 \$
REVENUE	408,223	626,540	1,182,740	1,213,683
COST OF SALES	668,695	720,222	1,422,700	1,295,417
GROSS MARGIN	(260,472)	(93,682)	(239,960)	(81,734)
EXPENSES				
General and operating expenses	320,057	486,059	785,550	1,018,540
Administration and management wages, fees and expenses	111,991	703,909	497,008	1,341,392
Marketing and sales fees and expenses	66,821	193,610	132,104	413,374
Engineering wages, fees and expenses	148,239	356,766	245,684	743,302
	647,108	1,740,344	1,660,346	3,516,608
Loss before the under-noted	(907,580)	(1,834,026)	(1,900,306)	(3,598,342)
Foreign exchange gain (loss)	85,146	(7,154)	147,221	(44,066)
Interest income and Other income	12	1,447	50	2,656
Finance Cost	(217,750)	(36,973)	(386,517)	(85,492)
Net loss before income taxes	(1,040,172)	(1,876,706)	(2,139,552)	(3,725,244)
Deferred income tax recovery	18,867	18,867	37,734	37,734
NET LOSS AND COMPREHENSIVE LOSS FOR THE PERIOD	(1,021,305)	(1,857,839)	(2,101,818)	(3,687,509)
Loss and comprehensive loss attributable to:				
Controlling Interest	(1,010,933)	(1,847,467)	(2,081,074)	(3,666,766)
Non-controlling interest	(10,372)	(10,372)	(20,744)	(20,743)
	<u>(1,021,305)</u>	<u>(1,857,839)</u>	<u>(2,101,818)</u>	<u>(3,687,509)</u>
NET LOSS PER SHARE (basic and diluted)	(0.01)	(0.02)	(0.03)	(0.04)
NET LOSS PER SHARE CONTROLLING INTEREST (basic and diluted)	(0.01)	(0.02)	(0.02)	(0.04)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES	84,176,204	83,216,627	83,793,020	83,216,627

See accompanying notes to the consolidated financial statements.

	Three months ended March 31		Six months ended March 31	
	2014 \$	2013 \$	2014 \$	2013 \$
CASH FLOWS USED IN OPERATING ACTIVITIES:				
Net loss	(1,021,305)	(1,857,839)	(2,101,818)	(3,687,509)
Charges not involving cash:				
Stock based compensation	(231,918)	384,053	(103,661)	738,317
Accrued (gain) loss on foreign exchange on debt	(84,000)	(40,341)	(153,833)	(67,432)
Accretion of long-term liabilities	96,400	26,145	185,622	54,624
Deferred Income tax recovery	(18,867)	(18,867)	(37,734)	(37,734)
Shares issued for interest and services	34,758	-	81,270	-
Depreciation and amortization of property and equipment and intangible assets	245,036	268,875	382,638	518,327
	<u>(979,896)</u>	<u>(1,237,974)</u>	<u>(1,747,516)</u>	<u>(2,481,407)</u>
Changes in non-cash working capital balances:				
(Increase) decrease in other receivables	(9)	(21,215)	26,407	(27,350)
(Increase) decrease in accounts receivable	266,741	(9,996)	(8,747)	(88,385)
Decrease (increase) in prepaid expenses	(6,597)	6,309	54,959	2,777
Decrease (increase) in inventory	(31,758)	49,720	38,828	75,359
Increase (decrease) in accounts payable and accrued liabilities	111,703	142,779	(349,726)	213,247
(Decrease) increase in cheques issued in excess of cash	-	(11,014)	-	(7,006)
	<u>-</u>	<u>(11,014)</u>	<u>-</u>	<u>(7,006)</u>
Cash flows used in operating activities	<u>(639,816)</u>	<u>(1,081,390)</u>	<u>(1,985,795)</u>	<u>(2,312,765)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:				
Increase in bank indebtedness	-	-	914,860	-
Repayment of loans	-	(66,581)	(495,571)	(118,636)
Proceeds from convertible debentures	620,000	-	1,709,000	-
Share issue costs and transaction costs	-	-	(29,000)	-
	<u>620,000</u>	<u>(66,581)</u>	<u>2,099,289</u>	<u>(118,636)</u>
Cash flows provided by (used in) financing activities	<u>620,000</u>	<u>(66,581)</u>	<u>2,099,289</u>	<u>(118,636)</u>
CASH FLOWS USED IN INVESTING ACTIVITIES:				
Additions to prototype development costs	-	(7,594)	-	(18,428)
Dispositions (additions) to property and equipment	-	10,815	(6,344)	(46,731)
	<u>-</u>	<u>3,221</u>	<u>(6,344)</u>	<u>(65,159)</u>
Cash flows provided by (used in) investing activities	<u>-</u>	<u>3,221</u>	<u>(6,344)</u>	<u>(65,159)</u>
Increase (decrease) in cash and cash equivalents	(19,816)	(1,144,750)	107,150	(2,496,560)
Cash and cash equivalents, beginning of period	<u>817,256</u>	<u>2,804,920</u>	<u>690,290</u>	<u>4,156,730</u>
Cash and cash equivalents, end of period	<u><u>797,440</u></u>	<u><u>1,660,170</u></u>	<u><u>797,440</u></u>	<u><u>1,660,170</u></u>
CASH AND CASH EQUIVALENTS				
Cash	797,440	66,232	797,440	66,232
Cash equivalents	-	1,593,938	-	1,593,938
	<u><u>797,440</u></u>	<u><u>1,660,170</u></u>	<u><u>797,440</u></u>	<u><u>1,660,170</u></u>

See accompanying notes to the consolidated financial statements.

INNOVATIVE COMPOSITES INTERNATIONAL INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE PERIODS ENDED MARCH 31, 2014 and 2013
(Unaudited, Expressed in United States Dollars)

	Number of shares	Capital Stock	Shares to be Issued	Warrants	Contributed Surplus	Convertible Debt Conversion Option	Non-controlling interest	Deficit	Accumulated Other Comprehensive Income	Total Equity
Balance, September 30, 2012	83,216,627	30,954,592		473,419	4,215,557	776,000	165,948	(27,551,596)		9,033,920
Expiry of warrants			-	-	-			11	-	11
Expiry of warrants	-	-	-	(239,419)	-	-	-	239,419	-	-
Forfeiture of options	-	-	-	-	(11,665)	-	-	-	-	(11,665)
Expiry of options	-	-	-	-	(297,116)	-	-	297,116	-	-
Vested options	-	-	-	-	749,982	-	-	-	-	749,982
Net loss for the period	-	-	-	-	-	-	(20,744)	(3,666,766)	-	(3,687,510)
Balance, March 31, 2013	83,216,627	30,954,592	-	234,000	4,656,758	776,000	145,204	(30,681,816)	-	6,084,738
Balance, September 30, 2013	83,216,626	26,323,580	142,670	295,000	2,566,063	272,690	124,461	(26,082,524)	255,413	3,897,353
Convertible Debt Conversion Option	-	-	-	-	-	374,000	-	-	-	374,000
Share for debt	1,009,784	81,270	-	-	-	-	-	-	-	81,270
Expiry of warrants	-	-	-	(234,000)	-	-	-	234,000	-	-
Issue of warrants	-	-	-	45,000	-	-	-	-	-	45,000
Forfeiture of options	-	-	-	-	(231,918)	-	-	-	-	(231,918)
Vested options	-	-	-	-	124,756	-	-	-	-	124,756
Net loss for the period	-	-	-	-	-	-	(20,744)	(2,081,075)	-	(2,101,819)
Balance, March 31, 2014	84,226,410	26,404,850	142,670	106,000	2,458,901	646,690	103,717	(27,929,599)	255,413	2,188,642

See accompanying notes to the consolidated financial statements.

1. NATURE OF OPERATIONS

Innovative Composites International Inc. and its subsidiaries (the “Company”) is primarily in the business of manufacturing and selling lightweight structural products utilizing fiber reinforced thermoplastics for use in various industries, including transportation, automotive, construction (including flexible retail and modular housing) as well as industrial applications.

The Company’s shares are listed on the Canadian Securities Exchange (CSE) and the over-the-counter exchange OTCQX. The head office, principal address and records office of the Company are located at 33 Davies Avenue, Toronto, Ontario M4M 2A9. These condensed consolidated financial statements were approved and authorized for issue by the Board of Directors on June 5, 2014.

2. GOING CONCERN

The Company’s ability to realize its assets and discharge its liabilities and commitments in the normal course of business is dependent on the support of its creditors, the ability to obtain additional financing, and ultimately, the attainment of profitable operations.

The Company had operating revenues of \$408,223 and \$626,540 during the three months ended March 31, 2014 and 2013 respectively, and incurred losses of \$1,021,105 and \$1,857,839 respectively. As at March 31, 2014, the Company had negative working capital of \$497,835 and a deficit of \$27,929,599.

The Company needs to supplement its working capital and cash position via additional sources of debt and equity financing. Management is seeking to obtain the necessary funding to continue in the normal course of operations; however, there is no assurance that these funds will be available on terms acceptable to the Company or at all. These material uncertainties cast significant doubt upon the Company’s ability to continue as a going concern.

These condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to a going concern. Accordingly, they do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and liquidate its liabilities and commitments in other than the normal course of business and at amounts different from those in the accompanying consolidated financial statements. Such adjustments could be material.

3. BASIS OF PREPARATION

These condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”) and Interpretations of the IFRS Interpretations Committee (“IFRIC”). The policies set out below have been consistently applied to all periods presented.

These consolidated financial statements have been prepared using the historical cost basis except for the revaluation of certain financial instruments.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation of these condensed interim consolidated financial statements, in accordance with IAS 34, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. These condensed interim consolidated financial statements include estimates, which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the condensed interim 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 the revision affects both current and future periods.

Information about critical judgements and estimates in applying accounting policies have the most significant effect on the following amounts recognized in the interim condensed consolidated financial statements:

- Asset carrying values and impairment charges
- Value of patents and prototype development costs
- Recognition and recoverability of potential deferred taxes
- Value of share-based compensation
- Value of financial liabilities
- Contingencies and commitments
- Allocation of purchase price related to business combination
- Depreciation
- Other

Please refer to the audited financial statements for the year ended September 30, 2013 for details concerning the Company's significant accounting policies.

Basis of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries as follows:

- (a) Innovative Composites, Inc (100% owned), a company incorporated in Michigan, USA
- (b) Ecoscapes Composites, LLC (100% owned), a company incorporated in South Carolina, USA
- (c) Georgia Composites, LLC. (65% owned by Innovative Composites, Inc.), a company incorporated in Georgia, USA

All material intercompany balances and transactions have been eliminated.

5. FUTURE ACCOUNTING CHANGES

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the IASB or IFRIC that are mandatory for accounting periods beginning after January 1, 2013 or later periods. Updates that are not applicable or are not consequential to the Company have been excluded thereof. The Company is currently assessing the impact of these standards on its consolidated financial statements.

IFRS 9 – Financial instruments (“IFRS 9”) was issued by the IASB in October 2010 and will replace IAS 39 Financial Instruments: Recognition and Measurement (“IAS 39”). IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. The effective date of IFRS 9 has not yet been determined.

5. FUTURE ACCOUNTING CHANGES (Continued)

IFRS 10 – Consolidated Financial Statements ("IFRS 10") was issued by the IASB in May 2011. IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Prior to the issuance of IFRS 10, consolidation was required when an entity had the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces Standing Interpretation Committee - 12, Consolidation - Special Purpose Entities and parts of IAS 27, Consolidated and Separate Financial Statements. The standard is effective for annual periods beginning on or after January 1, 2013 with earlier adoption permitted. The Company does not expect the implementation of this standard to have a significant impact on the consolidated financial statements.

IFRS 11 – Joint arrangements ("IFRS 11") was issued by the IASB in May 2011. IFRS 11 is a new standard which focuses on classifying joint arrangements by their rights and obligations rather than their legal form. Entities are classified into two groups: parties having rights to the assets and obligations for the liabilities of an arrangement, and rights to the net assets of an arrangement. Entities in the former case account for assets, liabilities, revenues and expenses in accordance with the arrangement, whereas entities in the latter case account for the arrangement using the equity method. IFRS 11 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

IFRS 12 – Disclosure of interests in other entities ("IFRS 12") was issued by the IASB in May 2011. IFRS 12 is a new standard which provides disclosure requirements for entities reporting interests in other entities, including joint arrangements, special purpose vehicles, and off balance sheet vehicles. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

IFRS 13 – Fair value measurement ("IFRS 13") was issued by the IASB in May 2011. IFRS 13 is a new standard which provides a precise definition of fair value and a single source of fair value measurement considerations for use across IFRSs. The key points of IFRS 13 are as follows: fair value is measured using the price in a principal market for the asset or liability, or in the absence of a principal market, the most advantageous market; financial assets and liabilities with offsetting positions in market risks or counter party credit risks can be measured on the basis of an entity's net risk exposure; disclosures regarding the fair value hierarchy have been moved from IFRS 7 to IFRS 13, and further guidance has been added to the determination of classes of assets and liabilities; a quantitative sensitivity analysis must be provided for financial instruments measured at fair value; a narrative must be provided discussing the sensitivity of fair value measurements categorised under Level 3 of the fair value hierarchy to significant unobservable inputs; and information must be provided on an entity's valuation processes for fair value measurements categorized under Level 3 of the fair value hierarchy. IFRS 13 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

6. PREPAID EXPENSES

	March 31, 2014	September 30, 2013
	\$	\$
Prepaid lease expenses	-	86,897
Other prepaid expenses	<u>78,151</u>	<u>46,213</u>
Total prepaid expenses	<u><u>78,151</u></u>	<u><u>133,110</u></u>

Prepaid lease expenses relate to the facility in South Carolina and the head office in Toronto.

7. INVENTORY

	March 31, 2014	September 30, 2013
	\$	\$
Raw materials	430,647	501,491
Work in process	81,931	49,915
Total inventory	<u>512,578</u>	<u>551,406</u>

For the quarter ended March 31, 2014, inventories of \$269,202 (2013 - \$720,222) were expensed and included in cost of goods sold.

8. PROPERTY AND EQUIPMENT

	Machinery and equipment	Leasehold improvements	Total
	\$	\$	\$
Cost at September 30, 2013	<u>4,890,294</u>	<u>106,173</u>	<u>4,996,467</u>
Additions	6,345	-	6,345
Cost at March 31, 2014	<u>4,896,639</u>	<u>106,173</u>	<u>5,002,812</u>
Accumulated depreciation at September 30, 2013	<u>1,395,174</u>	<u>30,060</u>	<u>1,425,234</u>
Charge for the period	231,968	2,094	234,062
Accumulated depreciation at March 31, 2014	<u>1,627,142</u>	<u>32,154</u>	<u>1,659,296</u>
Net book value as at September 30, 2013	<u>3,495,120</u>	<u>76,113</u>	<u>3,571,233</u>
Net book value as at March 31, 2014	<u>3,269,497</u>	<u>74,019</u>	<u>3,343,516</u>

9. INTANGIBLE ASSETS

	Fiber reinforced thermoplastic technology \$	Intangibles acquired from Eleison (i) \$	Prototype development costs and patents capitalized fees (ii) \$	Total \$
Cost at September 30, 2013	2,147,064	970,000	276,481	3,393,545
Additions	-	-	-	-
Cost at March 31, 2014	<u>2,147,064</u>	<u>970,000</u>	<u>276,481</u>	<u>3,393,545</u>
Accumulated amortization at September 30, 2013	1,138,079	388,000	29,991	1,556,070
Charge for the period	46,202	97,000	5,374	148,576
Accumulated amortization at March 31, 2014	<u>1,184,281</u>	<u>485,000</u>	<u>35,365</u>	<u>1,704,646</u>
Net book value at September 30, 2013	<u>1,008,985</u>	<u>582,000</u>	<u>246,490</u>	<u>1,837,475</u>
Net book value at March 31, 2014	<u>962,783</u>	<u>485,000</u>	<u>241,116</u>	<u>1,688,899</u>

10. CAPITAL STOCK

The capital stock is as follows:

(a) Authorized

Unlimited number of common shares

(b) Issued

	Common shares #	Amount \$
Balance, September 30, 2013	83,216,626	26,323,580
Shares issued for debt	1,009,784	81,270
Balance, March 31, 2014	<u>84,226,410</u>	<u>26,404,850</u>

10. CAPITAL STOCK (Continued)

(c) Warrants

A summary of changes in warrants is as follows:

	Warrants #	Weighted average exercise price CDN \$	Estimated grant date fair value \$
Balance, September 30, 2013	3,895,600	0.18	295,000
Expired warrants	(670,000)	0.75	(234,000)
Issued warrants	2,905,600	0.05	45,000
Balance, March 31, 2014	6,131,200	0.05	106,000

As at March 31, 2014, the following warrants were issued and outstanding:

Number of warrants #	Weighted average exercise price CDN \$ (US \$)	Value \$	Expiry date
3,225,600	0.05 (\$0.05)	61,000	September 5, 2015
1,806,400	0.05 (\$0.05)	35,000	October 8, 2015
486,400	0.05 (\$0.05)	4,000	February 9, 2016
612,800	0.05 (\$0.05)	6,000	March 7, 2016
6,131,200	0.05 (\$0.05)	106,000	

d) Share options

The Company has a share option plan (the "Plan") for the purchase of common shares for its directors, officers, employees, consultants and other service providers. The aggregate number of common shares reserved for issuance under the Plan shall not exceed 20% of the issued and outstanding common shares on a non-diluted basis at the time of shareholder approval. In no case shall the Plan result in:

- the number of options granted in any 12-month period to any one optionee exceeding 5% of the issued shares of the Company;
- the number of options granted in any 12-month period to any one consultant exceeding 2% of the issued shares of the Company; and
- the number of options granted in any 12-month period to employees undertaking investor relations activities exceeding 2% of the issued shares of the Company.

A summary of changes in share options is as follows:

	#	Weighted average exercise price CDN\$
Balance, September 30, 2013	8,394,000	0.50
Options granted	8,947,182	0.05
Options cancelled	(3,126,000)	0.54
Options forfeited	(4,182,915)	0.21
Balance, March 31, 2014	10,032,267	0.20

11. BUSINESS COMBINATION

Eleison Composites, LLC

On October 24, 2011, the Company, through its wholly-owned subsidiary in Michigan, USA, Innovative Composites, Inc., completed the acquisition of all assets and certain liabilities of Eleison Composites, LLC ("Eleison") for total cash consideration of \$2,000,000 and a royalty payable of \$1,000,000 (the fair value of which on the date of acquisition was determined to be \$721,995) (the "Acquisition"). As a result of the Acquisition, the Company acquired a 65% equity interest in Georgia Composites LLC, which holds three of the five patents acquired in the Acquisition. The transaction was accounted for as a business combination with Innovative Composites, Inc. as the acquirer.

Management's primary reason for supporting the Acquisition was consistent with their belief that by acquiring the exclusive licensing rights to the assets and intangible assets Eleison held, the Company would be able to lower and realize net savings in the manufacturing costs of vertically integrating Eleison's operations and customers. Additionally, management believed that the acquisition would provide the Company and its existing and future customers with superior quality composite panels compared with the panels manufactured by the Company prior to the acquisition without any substantial increase in prices.

Direct costs incurred in connection with this acquisition were approximately \$50,000 and were charged to general and administrative expenses, in the consolidated statement of loss and comprehensive loss for the year ended September 30, 2012.

The net acquired assets have been recorded as follows:

	Estimated fair value (\$)
Accounts receivable	433,389
Inventory	446,456
Machinery and equipment	1,056,032
Patents	970,000
Goodwill	808,777
Deferred tax liability	(377,330)
Non-controlling interest in Georgia Composites	(207,435)
Accrued liabilities and accounts payable	(407,894)
Total	<u>2,721,995</u>

The total consideration paid was comprised of the following:

	(\$)
Cash	2,000,000
Royalty payable*	721,995
Total consideration	<u>2,721,995</u>

* The royalty is payable over the three years after acquisition for a total of \$1 million.

Non controlling interest in Georgia Composites, LLC

	(\$)
Balance, September 30, 2013	<u>124,461</u>
Loss attributable to non-controlling interest	(20,744)
Balance, March 31, 2014	<u>103,717</u>

12. BANK INDEBTEDNESS

On November 8, 2013, the line of credit financing with mBank of Michigan in the amount of \$1.5 million was closed. Draws on the line are governed by a borrowing based formula tied to accounts receivable and raw materials inventory. Draws on the line extending above \$750,000 will be permitted only after the Company meets certain performance benchmarks. The line of credit is secured by a pledge of accounts receivable, inventory and cash. Proceeds from the line are being used to assist the Company in fulfilling its sales orders, and for general working capital purposes. Currently the interest rate is at 5.25% per annum.

13. CONVERTIBLE DEBENTURES AND OTHER LOANS

	March 31, 2014 \$	September 30, 2013 \$
Convertible debenture (i)(ii)	2,714,137	1,417,847
Equipment financing	-	-
	<u>2,714,137</u>	<u>1,417,847</u>
Less: current portion	-	-
Long-term portion of loans	<u>2,714,137</u>	<u>1,417,847</u>

- (i) On September 4, 2013, the Company issued the first tranche of a non-brokered convertible debenture for gross proceeds of CDN \$2,016,000 (\$1,917,000), through a private placement. The debenture bears interest at 10% and is due on September 5, 2015. At the option of the debenture holders, the debenture is convertible into common shares of the Company at a conversion price of CDN\$0.03 per share, and, if the conversion option is exercised in full by all debenture holders, the principal amount would be converted into 67,200,000 common shares. The convertible debenture and conversion price are denominated in Canadian dollars, the same as the parent Company's functional currency.

Debenture holders have been provided with a first priority security interest over all of the assets of the Company, while agreeing to subordinate for accounts receivable and inventory financings. The Company has the right to prepay the Debentures upon payment of an additional three month's interest, although Debenture holders will have the right to convert should the Company seek to exercise its prepayment rights. The Debentures were issued pursuant to a trust indenture with Olympia Transfer Services Inc. acting as trustee. The debenture holders received 1,600 share purchase warrants for every CDN \$1,000 of principal subscribed for, each such warrant entitling the holder to purchase one additional share at a purchase price of CDN\$0.05 for a period of two years (i.e. expiring on September 5, 2015). A total of 3,225,600 warrants were issued in connection with the closing of this first tranche. Proceeds were used to repay in full a debenture issued in September 2009 (refer to Note 14 (ii) below).

The debenture issued on September 4, 2013, by the parent in Canadian dollars as per its functional currency, is classified as a long-term liability, with the exception of the portions relating to the conversion feature of \$393,000 and warrants of \$61,000 (Note 11(d)) which are classified under shareholders' equity. A deferred tax liability of \$120,310 was also recognized in relation to the conversion feature. The fair value of convertible debenture was determined utilizing the effective interest rate method at an 18% discount rate, resulting in the carrying value of the debenture being less than its face value. The discount is being accreted over the term of the debenture. The value attributable to the Conversion option and warrants is determined utilizing the residual approach by subtracting the present value of the liability component from the face value of the convertible debenture.

Fair value of liability at date of issuance	\$1,404,979
Accretion included in finance cost	<u>12,868</u>
Balance, September 30, 2013	<u>\$1,417,847</u>

13. CONVERTIBLE DEBENTURES AND OTHER LOANS (Continued)

Total transaction costs of \$94,000, incurred in closing the first tranche of the debenture, were prorated and subtracted from the present value of liability and equity portions of the debenture. Transaction costs included trustee fees, legal fees, and finder's fees equal to 3% of cash subscribers sourced by certain arm's length third parties.

- (ii) On October 8, 2013, the Company issued the second tranche of a non-brokered convertible debenture for gross proceeds of CDN \$1,129,000 (\$1,089,000), through a private placement. The debenture bears interest at 10% and is due on October 8, 2015. At the option of the debenture holders, the debenture is convertible into common shares of the Company at a conversion price of CDN\$0.03 per share, and, if the conversion option is exercised in full by all debenture holders, the principal amount would be converted into 37,633,333 common shares. The convertible debenture and conversion price are denominated in Canadian dollars, the same as the parent Company's functional currency.

Debenture holders have been provided with a first priority security interest over all of the assets of the Company, while agreeing to subordinate for accounts receivable and inventory financings. The Company has the right to prepay the Debentures upon payment of an additional three month's interest, although Debenture holders will have the right to convert should the Company seek to exercise its prepayment rights. The Debentures were issued pursuant to a trust indenture with Olympia Transfer Services Inc. acting as trustee. The debenture holders received 1,600 share purchase warrants for every CDN \$1,000 of principal subscribed for, each such warrant entitling the holder to purchase one additional share at a purchase price of CDN\$0.05 for a period of two years (i.e. expiring on October 8, 2015). A total of 1,806,400 warrants were issued in connection with the closing of this second tranche.

The debenture issued on October 8, 2013, by the parent in Canadian dollars as per its functional currency, is classified as a long-term liability, with the exception of the portions relating to the conversion feature of \$229,000 and warrants of \$35,000 (Note 10(c)) which are classified under shareholders' equity. The fair value of convertible debenture was determined utilizing the effective interest rate method at an 18% discount rate, resulting in the carrying value of the debenture being less than its face value. The discount is being accreted over the term of the debenture. The value attributable to the Conversion option and warrants is determined utilizing the residual approach by subtracting the present value of the liability component from the face value of the convertible debenture.

- (iii) On January 31, 2014, the Company issued another tranche of a non-brokered convertible debenture for gross proceeds of CDN \$304,000 (\$275,000), through a private placement. The debenture bears interest at 10% and is due on January 31, 2016. At the option of the debenture holders, the debenture is convertible into common shares of the Company at a conversion price of CDN\$0.01 per share, and, if the conversion option is exercised in full by all debenture holders, the principal amount would be converted into 30,400,000 common shares. The convertible debenture and conversion price are denominated in Canadian dollars, the same as the parent Company's functional currency.

Debenture holders have been provided with a subordinated first claim over all of the assets of the Company, ranked after security held by senior debenture holders. The Company has the right to prepay the Debentures upon payment of an additional three month's interest, although Debenture holders will have the right to convert should the Company seek to exercise its prepayment rights. The debenture holders received 1,600 share purchase warrants for every CDN \$1,000 of principal subscribed for, each such warrant entitling the holder to purchase one additional share at a purchase price of CDN\$0.05 for a period of two years (i.e. expiring on January 31, 2016). A total of 486,400 warrants were issued in connection with the closing of this tranche.

The debenture issued on January 31, 2014, by the parent in Canadian dollars as per its functional currency, is classified as a long-term liability, with the exception of the portions relating to the conversion feature of \$65,000 and warrants of \$4,000 (Note 10(c)) which are classified under shareholders' equity.

13. CONVERTIBLE DEBENTURES AND OTHER LOANS (Continued)

The fair value of convertible debenture was determined utilizing the effective interest rate method at an 18% discount rate, resulting in the carrying value of the debenture being less than its face value. The discount is being accreted over the term of the debenture. The value attributable to the Conversion option and warrants is determined utilizing the residual approach by subtracting the present value of the liability component from the face value of the convertible debenture.

- (iv) On March 7, 2014, the Company issued another tranche of a non-brokered convertible debenture for gross proceeds of CDN \$383,000 (\$345,000), through a private placement. The debenture bears interest at 7% and is due on March 7, 2016. At the option of the debenture holders, the debenture is convertible into common shares of the Company at a conversion price of CDN\$0.01 per share, and, if the conversion option is exercised in full by all debenture holders, the principal amount would be converted into 38,300,000 common shares. The convertible debenture and conversion price are denominated in Canadian dollars, the same as the parent Company's functional currency.

Debenture holders have been provided with a subordinated first claim over all of the assets of the Company, ranked after security held by senior debenture holders. The Company has the right to prepay the Debentures upon payment of an additional three month's interest, although Debenture holders will have the right to convert should the Company seek to exercise its prepayment rights. The debenture holders received 1,600 share purchase warrants for every CDN \$1,000 of principal subscribed for, each such warrant entitling the holder to purchase one additional share at a purchase price of CDN\$0.05 for a period of two years (i.e. expiring on March 7, 2016). A total of 612,800 warrants were issued in connection with the closing of this tranche.

The debenture issued on March 7, 2014, by the parent in Canadian dollars as per its functional currency, is classified as a long-term liability, with the exception of the portions relating to the conversion feature of \$80,000 and warrants of \$6,000 (Note 10(c)) which are classified under shareholders' equity. The fair value of convertible debenture was determined utilizing the effective interest rate method at an 18% discount rate, resulting in the carrying value of the debenture being less than its face value. The discount is being accreted over the term of the debenture. The value attributable to the Conversion option and warrants is determined utilizing the residual approach by subtracting the present value of the liability component from the face value of the convertible debenture.

14. COMMITMENTS AND CONTINGENCIES

The Company has entered into certain management contracts. Minimum cash payments remaining for these contracts approximate \$75,000 and are due within the next financial year.

On September 12, 2011, the Company entered into an operating lease for its manufacturing facility in Orangeburg, South Carolina, USA, which expires on December 31, 2017. As at December, 2013, minimum rental commitments remaining under this lease approximate \$2,098,000 including approximately \$469,000 due within the next financial year.

Minimum consolidated rental commitments for successive years are as follows:

<u>Year</u>	<u>Amount</u>
2014	472,667
2015	483,000
2016	498,000
2017	513,000
2018	135,000
	<u>2,102,000</u>

15. FINANCIAL INSTRUMENTS

(a) Fair Value of Financial Instruments:

The carrying amounts for cash and cash equivalents, accounts receivable, amounts receivable, accounts payable and accrued liabilities and the current portion of loans approximate fair market value because of the limited terms of these instruments. Other long-term liabilities and convertible debentures are initially measured at fair value, net of transaction costs, and are subsequently measured at amortized cost using the effective interest method.

(b) Capital Management:

The capital structure of the Company consists of debt and equity attributable to common shareholders and includes convertible debentures and other loans, capital stock, warrants, contributed surplus, convertible debt conversion option and deficit.

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support its research and development activities, general and administrative expenses, working capital and overall capital expenditures. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The Company has been dependent on external financing to fund its activities. In order to carry out its business plan, the Company will raise additional amounts as needed.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the periods ended March 31, 2014 and 2013. Neither the Company nor its subsidiaries are subject to externally imposed capital requirements.

(c) Financial Risk Factors:

The Company's risk exposures and the impact on the Company's financial instruments are summarized below. There have been no changes in the risks, objectives, policies and procedures from the previous year.

(i) Credit risk

The Company's credit risk is primarily attributable to accounts receivable and amounts receivable included in current assets. The Company's credit risk attributable to accounts receivables was mitigated by no customers accounting for more than 35% of the accounts receivable balance as at March 31, 2014.

(ii) Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at March 31, 2014 the Company had a cash and cash equivalents balance of \$817,256 to settle current liabilities of \$2,315,806. Accounts payable and accrued liabilities generally have contractual maturities of less than 30 days and are subject to normal trade terms (Note 2).

15. FINANCIAL INSTRUMENTS (Continued)

(c) Financial Risk Factors: (Continued)

(iii) Foreign currency risk

The Company is subject to foreign exchange risk as certain payments for fees and expenses, as well as loan interest payments are made in Canadian dollars:

	March 31, 2014 CDN \$	September 30, 2013 CDN \$
Cash	29,000	658,000
Amounts receivable	34,000	59,000
Accounts payable and accrued liabilities	(285,000)	(585,000)
Convertible debenture	(3,000,000)	(1,460,000)
Net statement of financial position exposure	(3,222,000)	(1,328,000)

The Company is, therefore, subject to gains and losses due to fluctuations in the US dollar relative to the Canadian dollar. As at March 31, 2014 and as at September 30, 2013, the Company did not hedge its foreign exchange risk.

(iv) Interest rate risk

The Company holds cash and cash equivalents in deposit form in a major Chartered Canadian bank. The Company is sensitive to changes in the interest rates through interest income earned on its cash and cash equivalents balance. The convertible debentures (Note 13), according to its terms, bears fixed interest rates of 10% or 7%, and therefore the Company is not sensitive to changes in the prime interest rate through interest expense paid on these debentures.

16. SUBSEQUENT EVENTS

- a) On April 14, 2014, the Company closed an additional convertible debenture offering in the aggregate principal amount of \$60,000 CDN, bearing interest at 7%, 96,000 warrants issued, and subordinated first claim over all the assets of the Company.
- b) On May 8, 2014, the Company closed an additional convertible debenture offering in the aggregate principal amount of \$60,000 CDN, bearing interest at 16%, 96,000 warrants issued, and subordinated first claim over all the assets of the Company. An insider of the Company subscribed to \$20,000 of this offering.
- c) On May 6, 2014, the Company entered into a forbearance agreement with the landlord at its South Carolina facility. The forbearance arose from a default under the lease for arrears in the amount of \$191,054. This amount is to be paid in eight equal installments from May through December 2014.
- d) On May 13, 2014, the Company received an eviction notice to vacate the Michigan facility by July 1, 2014.