# WestBond Enterprises Corporation

## Quarterly Report
## December 31, 2011

## Management Discussion and Analysis

**Dated February 21, 2012 to Accompany the Interim Consolidated Financial Statements for the Three and Nine Month Periods Ended December 31, 2011**

**Caution Regarding Forward Looking Statements –** ***This discussion includes statements about our expectations for the future. We believe that our expectations are reasonable; however, actual outcomes may differ materially from our expectations due to changes in operating performance, availability of and prices for raw materials, availability of trained labour, US$/Cdn$ exchange rate fluctuations, unexpected competition, and other technical, market and economic factors.***

### Description of Our Business

We, WestBond Enterprises Corporation or the "Company," are a paper converter that supplies disposable paper products to many markets. A full description of our business and products is contained in the Management Discussion and Analysis included in our 2011 Annual Report. A pdf version of the 2011 Annual Report may be downloaded from our web site at www.westbond.ca or from the SEDAR web site at www.sedar.com. For a printed copy, please contact the Company. Additional information on the Company is also available on our web site and on the SEDAR web-site.

### Discussion of Operations and Financial Condition

You should refer to our interim consolidated financial statements for the three and nine month periods ended December 31, 2011 and our consolidated financial statements for the year ended March 31, 2011 while you read this discussion. Those financial statements provide significant, material information that is not meant to be, nor is it, included in this discussion. This discussion is meant to provide information not included in the financial statements and an explanation of some of the financial statement information. You should also refer to the Management Discussion and Analysis that was included in our 2011 Annual Report. Information included in that discussion is only up-dated in this discussion. Information that has not changed materially since July 18, 2011, the date of the Management Discussion and Analysis in the 2011 Annual Report, is not repeated here.

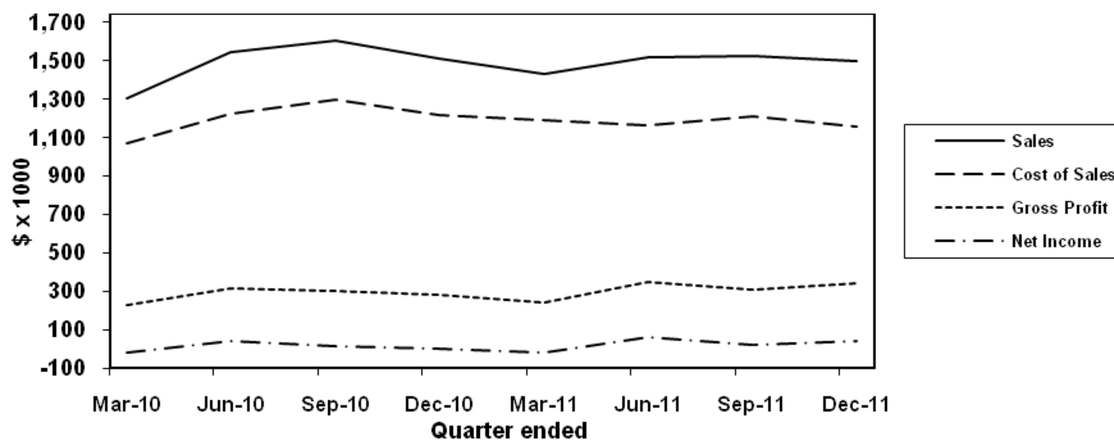
Sales were $1,499,303 for the three months ended December 31, 2011, which is 1.6% lower than for the three months ended September 30, 2011 and 0.5% less than for the three months ended December 31, 2010. We realized net income of $41,871 ($0.004 per share) for the three months ended December 31, 2011, compared to a loss of $133 ($0.000 per share) for the three months ended December 31, 2010. This year's results are better than the same period last year because of increased selling prices and production efficiencies, which were offset by higher materials prices and increased factory overhead, shipping costs and sales commissions.

The table and graph on the next page shows the trends over the past eight quarters.

## Summary of Quarterly Results

The following table summarises the results of operations for the past eight quarters. We have extracted the data from our consolidated financial statements, which are prepared in Canadian dollars and in accordance with International Financial Reporting Standards (IFRS). Results for the quarter ended March 31, 2011 were previously reported in accordance with Canadian Generally Accepted Accounting Principles (GAAP). The company's transition to IFRS effective April 1, 2010 had no effect on net income or comprehensive income for any of the quarters in the year ended March 31, 2011. The results for the quarter ended March 31, 2010 have been calculated in accordance with GAAP. This table has, however, been presented in conformance with the expense groupings used in the IFRS financial statements; specifically, foreign exchange gains and losses and interest expense, which were included in general and administrative expenses under GAAP, have been classified under IFRS outside of operating profit as other expenses (income).

| | Quarters ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Cdn$ x 1,000** | **Dec 31 2011** | **Sep 30 2011** | **Jun 30 2011** | **Mar 31 2011** | **Dec 31 2010** | **Sep 30 2010** | **Jun 30 2010** | **Mar 31 2010** |
| | **IFRS** | | | | | | | **GAAP** |
| Sales | 1,499 | 1,523 | 1,517 | 1,432 | 1,507 | 1,604 | 1,542 | 1,301 |
| Cost of sales | 1,159 | 1,215 | 1,167 | 1,192 | 1,221 | 1,299 | 1,227 | 1,072 |
| Gross profit | 340 | 308 | 350 | 240 | 286 | 305 | 315 | 229 |
| Selling and marketing expenses | 137 | 139 | 133 | 128 | 129 | 141 | 139 | 117 |
| General and administrative expenses | 139 | 146 | 132 | 133 | 144 | 138 | 132 | 125 |
| Other expenses (income) | 7 | (5) | 5 | 7 | 12 | 11 | (8) | 15 |
| Net income (loss) before taxes | 57 | 28 | 80 | (28) | 1 | 15 | 52 | (28) |
| Income tax expense (recovery) | 15 | 8 | 21 | (7) | 1 | 4 | 12 | (6) |
| Net income (loss) | 42 | 20 | 59 | (21) | 0 | 11 | 40 | (22) |
| Earnings (loss) per share, basic and diluted - Cdn$ | 0.004 | 0.002 | 0.005 | (0.002) | 0.000 | 0.001 | 0.004 | (0.002) |
| **Sales - % change over previous quarter** | -1.6 | 0.4 | 6.0 | -5.0 | -6.1 | 4.1 | 18.5 | -16.5 |
| **Costs, expenses and net income - % of Sales** | | | | | | | | |
| Cost of sales | 77.3 | 79.8 | 77.0 | 83.2 | 81.0 | 80.9 | 79.6 | 82.4 |
| Selling and marketing expenses | 9.2 | 9.1 | 8.7 | 9.0 | 8.6 | 8.8 | 9.0 | 9.0 |
| General and administrative expenses | 9.3 | 9.6 | 8.7 | 9.3 | 9.5 | 8.6 | 8.5 | 9.6 |
| Other expenses (income) | 0.4 | -0.3 | 0.3 | 0.5 | 0.8 | 0.7 | -0.5 | 1.2 |
| Income tax expense | 1.0 | 0.5 | 1.4 | -0.5 | 0.1 | 0.3 | 0.8 | -0.5 |
| Net income | 2.8 | 1.3 | 3.9 | -1.5 | 0.0 | 0.7 | 2.6 | -1.7 |



***Sales***

Sales for the three months ended December 31, 2011 are 0.5% lower than for the same period last year and 1.6% lower than the previous quarter, ended September 30, 2011. Sales for the nine months ended December 31, 2011 were 2.4% lower than for the same period last year. Competition from low priced US and Chinese producers and the cheap US dollar continued to keep sales of our personal hygiene products at a reduced level compared to last year. An increase in our prices implemented in June 2011 partially offset the decreased volumes. The increase over last year in other products is primarily due to the timing of large orders placed by one of our customers.

| ***Sales*** | Three months ended December 31 | | Change over last year$ | Nine months ended December 31 | | Change over last year |
|---|---|---|---|---|---|---|
| Product Line | 2011<br>$ | 2010<br>$ | | 2011<br>$ | 2010<br>$ | |
| Personal hygiene | 492,517 | 556,488 | -11.5% | 1,691,253 | 1,894,514 | -10.7% |
| Clinical and long-term care | 891,083 | 905,882 | -1.6% | 2,559,540 | 2,573,360 | -0.5% |
| Other | 115,703 | 44,619 | 159.3% | 288,796 | 185,630 | 55.6% |
| | 1,499,303 | 1,506,989 | -0.5% | 4,539,589 | 4,653,504 | -2.4% |

***Cost of Sales***

Direct costs (production labour and materials), as a percentage of sales, were lower in the 2011 periods than in the 2010 periods due to increased sales prices for our products and to good pricing received on much of our paper purchases. Overheads and depreciation in 2011 and 2010 were similar.

| ***Cost of Sales*** | Three months ended December 31 | | Nine months ended December 31 | |
|---|---|---|---|---|
| | 2011<br>% of sales | 2010<br>% of sales | 2011<br>% of sales | 2010<br>% of sales |
| Materials | 50.3% | 53.7% | 52.2% | 54.1% |
| Production labour | 8.7% | 8.9% | 8.1% | 8.5% |
| Factory overhead labour | 4.3% | 4.8% | 4.2% | 4.6% |
| Variable overhead | 2.8% | 2.3% | 2.4% | 2.4% |
| Fixed overhead | 7.4% | 7.3% | 7.3% | 7.0% |
| Depreciation | 3.8% | 4.0% | 3.8% | 3.9% |
| Gross Margin | 22.7% | 19.0% | 22.0% | 19.5% |

Our normal operating range for materials has been 51% to 55% and the average for the year ended March 31, 2011 was 54.8%. Materials cost fluctuations are due to variations in the yield factors (the amount of product that a certain weight of paper will produce), paper prices and product mix.

The labour fluctuations, which are also subject to shifts in the product mix, are within our usual operating ranges. Employee productivity improvements continue to affect our direct labour costs in a positive way. We increased our wage rates last year in order to retain the more efficient employees and to attract good machine operators. The inability to hire or retain production employees can result in lost sales.

***Selling Expenses***

Selling expenses were similar during 2011 and 2010, at 9.0% and 8.8%, respectively, of sales. Increased shipping and other costs were offset by lower commissions and employee benefits.

***General and Administrative Expenses***

General and administrative expenses were similar in 2011 and 2010.

During the nine months ended December 31, 2011, the company incurred total short-term employee benefits of $248,360 (2010 – $246,903) to its key management personnel, comprising the directors and officers of the company, and incurred $5,138 (2010 – $7,252) of professional fees in the normal course of operations paid to DuMoulin Black LLP, a law firm in which J. Douglas Seppala, a director of the company, is a partner. The professional fees are for legal services provided to the Company at rates normally charged to arm's length parties.

## Liquidity, Financial Position and Capital Resources

Our financial position improved during the nine months ended December 30, 2011. We had working capital of $748,470 at December 31, 2011, compared to $841,510 at March 31, 2011. The working capital is reduced because we have used surplus cash flows to purchase equipment. Our operating cash flows were $343,628 during the nine months ended December 31, 2011, an average of $38,181 per month, compared to an average of $22,420 per month during the year ended March 31, 2011, before accounting for fluctuations in non-cash working capital.

We plan to re-invest our surplus cash flow in new equipment to continue to expand the Company's product lines and improve efficiency and to pay off bank debt.

We have a revolving bank loan facility of $1,000,000, of which $380,516 was used at December 31, 2011. The loan outstanding at any time may not be greater than the total of 75% of Canadian accounts receivable, 50% of US accounts receivable and 50% of inventory, less accounts payable having priority over the bank, such as to governments and employees. Accounts receivable older than 90 days and inventory in excess of $700,000 are not included in the calculation. Substantially all of the Company’s assets are pledged as collateral for the revolving bank loan facility.

We use the revolving bank loan facility primarily to finance operating working capital. Inventory and accounts receivable levels normally fluctuate by as much as $200,000 and accounts payable by an additional $200,000. We purchase our paper supplies in relatively large quantities and often have large shipments to customers on credit, which are the main reasons for these fluctuations.

We drew down our $200,000 non-revolving loan facility in November 2011 to partially finance the purchase of specific equipment that we commissioned to be built. The loan is repayable in 11 monthly instalments of principal of $5,556 commencing December 30, 2011 and the final payment of the then remaining principal and interest is due on November 30, 2012. The loan bears interest at bank prime plus 1%, payable monthly. A fixed charge on the specific equipment purchased is pledged as collateral.

We currently plan to spend a total of approximately $500,000 on equipment expansions and improvements during the year ending March 31, 2012, of which $436,668 has been spent to December 31, 2011. We drew down the $200,000 non-revolving loan at the end of November 2011 to partially finance these expansions and improvements. The rest of the financing will come from operating cash flows. We may acquire additional equipment, if worthy new product opportunities arise. Financing for additional equipment would be available through operating cash flow and additional term loans.

## Transition to International Financial Reporting Standards

We adopted International Financial Reporting Standards (“IFRS”) effective April 1, 2011. The differences between IFRS and Canadian GAAP that had the most significant impact on our financial statements are described in our management discussion and analysis for the year ended March 31, 2011. The significant accounting policies adopted on transition are described in Note 3 to the Interim Consolidated Financial Statements. The effects of the transition to IFRS, including the elections we made, are described in Note 4 to the Interim Consolidated Financial Statements.

## New Accounting Policies

There are no new accounting policies that are effective for our current fiscal year that are expected to have a material effect on our consolidated financial statements. While we have early adopted IFRS 9 *Financial Instruments* and its related amendments, this has not had any effect on our financial statements.

## Share Capital

The Company has only one class of share capital, common shares without par value. The Company also has a stock option plan and a shareholder rights plan and has issued warrants to purchase common shares.

| | February 21, 2012 |
|---|---|
| Authorized common shares without par value | Unlimited |
| Issued common shares | 11,063,800 |
| Shares issuable on exercise of outstanding warrants | 1,060,000 |
| Shares issuable on exercise of outstanding stock options | 800,000 |
| Shares available for future stock option grants | 1,200,000 |

The stock option plan permits the directors of the Company to grant incentive options to the employees, directors, officers and consultants of the Company.

The shareholder rights plan (the "Plan") is meant to protect the Company's shareholders from unfair, abusive or coercive takeover strategies. The Plan will remain in effect until the Company's annual general meeting in 2012, subject to further renewal. The Plan, in effect, allows holders of common shares to purchase additional common shares from the Company at a 50% discount to the prevailing market price on the occurrence of certain triggering events, including acquisition by a person or group of persons of 20% or more of the shares of the Company in a transaction that is not a Permitted Bid under the Plan. The rights under the Plan are not exercisable by the acquiring person or group of persons. The rights under the Plan are not triggered by purchases of shares made pursuant to a take-over bid that is made to all shareholders on identical terms by way of a take-over bid circular prepared in compliance with applicable securities laws, and certain other conditions set out in the agreement signed to implement the Plan.

# *WestBond Enterprises Corporation*

## *Notice to Reader*

The accompanying interim consolidated financial statements of WestBond Enterprises Corporation for the three and nine month periods ended December 31, 2011 and 2010 have been prepared by and are the responsibility of the company's management. They are unaudited and have not been reviewed by independent auditors.

# WestBond Enterprises Corporation
## Consolidated Statements of Financial Position
**Canadian Dollars**
**(Unaudited)**

| | Notes | December 31 2011 $ | March 31 2011 $ | April 1 2010 $ |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Non-Current Assets** | | | | |
| Plant and equipment | 5 | 2,752,837 | 2,494,728 | 2,521,077 |
| Lease deposits | | 22,433 | 22,433 | 22,433 |
| | | 2,775,270 | 2,517,161 | 2,543,510 |
| **Current Assets** | | | | |
| Inventory | | 1,049,558 | 1,010,150 | 994,256 |
| Trade and other receivables | | 857,090 | 682,588 | 454,774 |
| Prepaid expenses | | 21,757 | 15,188 | 21,999 |
| Cash and cash equivalents | | 70,391 | 159,186 | 276,008 |
| | | 1,998,796 | 1,867,112 | 1,747,037 |
| **Total Assets** | | 4,774,066 | 4,384,273 | 4,290,547 |
| **EQUITY AND LIABILITIES** | | | | |
| **Equity** | | | | |
| Common shares issued and outstanding | | 2,099,703 | 2,099,703 | 2,099,703 |
| Warrants | | 32,364 | 32,364 | 32,364 |
| Stock options | | 254,510 | 254,510 | 254,510 |
| Retained earnings | | 652,323 | 530,668 | 501,653 |
| **Equity attributable to common share holders** | | 3,038,900 | 2,917,245 | 2,888,230 |
| **Liabilities** | | | | |
| **Non-Current Liabilities** | | | | |
| Deferred tax liability | | 484,840 | 441,426 | 431,015 |
| **Current Liabilities** | | | | |
| Revolving bank loans | | 380,516 | 337,000 | 475,000 |
| Term bank loans | 6 | 194,444 | - | 39,426 |
| Trade and other payables | | 675,366 | 688,602 | 456,876 |
| | | 1,250,326 | 1,025,602 | 971,302 |
| **Total Liabilities** | | 1,735,166 | 1,467,028 | 1,402,317 |
| **Total Equity and Liabilities** | | 4,774,066 | 4,384,273 | 4,290,547 |

# WestBond Enterprises Corporation

## Consolidated Statements of Comprehensive Income

**Canadian Dollars**

**(Unaudited)**

| | Notes | Three months ended December 31 | | Nine months ended December 31 | |
|---|---|---|---|---|---|
| | | 2011 | 2010 | 2011 | 2010 |
| | | $ | $ | $ | $ |
| **Sales** | | 1,499,303 | 1,506,989 | 4,539,589 | 4,653,504 |
| **Cost of sales** | 8 | 1,158,918 | 1,221,122 | 3,541,595 | 3,747,238 |
| **Gross Profit** | | 340,385 | 285,867 | 997,994 | 906,266 |
| **Selling and distribution expenses** | 9 | 137,124 | 129,221 | 408,173 | 409,264 |
| **General and administrative expenses** | 7, 10 | 139,568 | 144,165 | 417,358 | 414,576 |
| **Operating Profit** | | 63,693 | 12,481 | 172,463 | 82,426 |
| **Foreign exchange losses (gains)** | | 1,754 | 8,209 | (5,581) | 4,031 |
| **Interest expense** | | 5,027 | 3,488 | 12,975 | 10,558 |
| **Profit Before Tax** | | 56,912 | 784 | 165,069 | 67,837 |
| **Income tax expense** | | 15,041 | 917 | 43,414 | 17,139 |
| **Profit (Loss) and Comprehensive Income (Loss) for the Period** | | 41,871 | (133) | 121,655 | 50,698 |
| **Weighted average shares outstanding** | | 11,063,800 | 11,063,800 | 11,063,800 | 11,063,800 |
| **Earnings (loss) per share, basic and fully diluted** | | 0.004 | (0.000) | 0.011 | 0.005 |

# WestBond Enterprises Corporation
## Consolidated Statements of Changes in Equity
### Canadian Dollars
### (Unaudited)

| | Common Shares | Warrants | Stock Options | Retained Earnings | Total |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| **As at April 1, 2010** | 2,099,703 | 32,364 | 254,510 | 501,653 | 2,888,230 |
| **Profit for the period** | - | - | - | 50,698 | 50,698 |
| **As at December 31, 2010** | 2,099,703 | 32,364 | 254,510 | 552,351 | 2,938,928 |
| | | | | | |
| **As at March 31, 2011** | 2,099,703 | 32,364 | 254,510 | 530,668 | 2,917,245 |
| **Profit for the period** | - | - | - | 121,655 | 121,655 |
| **As at December 31, 2011** | 2,099,703 | 32,364 | 254,510 | 652,323 | 3,038,900 |

# WestBond Enterprises Corporation
## Consolidated Statements of Cash Flows
**Canadian Dollars**
**(Unaudited)**

| | Notes | Three months ended December 31 | | Nine months ended December 31 | |
|---|---|---|---|---|---|
| | | **2011** | **2010** | **2011** | **2010** |
| | **Notes** | **$** | **$** | **$** | **$** |
| **Operating Activities** | | | | | |
| Profit (loss) for the period | | 41,871 | (133) | 121,655 | 50,698 |
| Adjustments to reconcile profit (loss) to cash flows from operating activities | | | | | |
| - depreciation | | 58,558 | 61,813 | 178,559 | 184,519 |
| - deferred income tax | | 15,041 | 917 | 43,414 | 17,139 |
| Cash flows from operating activities before changes in non-cash working capital | | 115,470 | 62,597 | 343,628 | 252,356 |
| (Increase) decrease in | | | | | |
| - inventory | | (104,577) | (1,616) | (39,408) | 40,244 |
| - trade and other receivables | | (80,467) | (109,105) | (174,502) | (404,777) |
| - prepaid expenses | | 10,000 | 9,663 | (6,569) | 1,307 |
| (Decrease) increase in | | | | | |
| - trade and other payables | | (49,553) | (61,779) | (31,186) | 187,327 |
| Net Cash Flow from Operating Activities | | (109,127) | (100,240) | 91,963 | 76,457 |
| **Investing Activities** | | | | | |
| Purchase of plant and equipment | 11 | (97,637) | (105,912) | (418,718) | (180,107) |
| **Financing Activities** | | | | | |
| Term loan proceeds | | 200,000 | - | 200,000 | - |
| Repayment of term loans | | (5,556) | - | (5,556) | (39,426) |
| (Decrease) increase in revolving bank loans | | (86,484) | 72,374 | 43,516 | (41,583) |
| Net Cash Flow from Financing Activities | | 107,960 | 72,374 | 237,960 | (81,009) |
| **Net Increase (Decrease) in Cash and Cash Equivalents** | | (98,804) | (133,778) | (88,795) | (184,659) |
| **Cash and Cash Equivalents at the Beginning of the Period** | | 169,195 | 225,127 | 159,186 | 276,008 |
| **Cash and Cash Equivalents at the End of the Period** | | 70,391 | 91,349 | 70,391 | 91,349 |
| **Interest Paid** | | 5,012 | 3,466 | 12,983 | 10,700 |

## 1. GENERAL INFORMATION

WestBond Enterprises Corporation and its subsidiary (together, the company) are a paper converter that manufactures disposable products for medical, hygienic and industrial uses. The company's manufacturing facilities are in Canada and its sales are primarily to Canada and the United States of America. The company is incorporated in British Columbia, Canada, and has its principal place of business at 7871 – 82nd Street, Delta, British Columbia.

## 2. BASIS OF PREPARATION AND ADOPTION OF IFRS

The company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010 the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS") and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the company has commenced reporting on this basis in these financial statements. In the financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to the transition elections disclosed in note 4, the company has consistently applied the same accounting principles in its opening IFRS statement of financial position at the transition date, April 1, 2010, and throughout all periods presented, as if these policies had always been in effect. Note 4 discloses the impact of the transition to IFRS on the company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the company's consolidated financial statements for the year ended March 31, 2011.

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of February 21, 2012, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the company's annual consolidated financial statements for the year ending March 31, 2012 could result in restatement of these interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

These condensed interim consolidated financial statements should be read in conjunction with the company's Canadian GAAP financial statements for the year ended March 31, 2011. Note 4 discloses IFRS information for the year ended March 31, 2011 not provided in the financial statements for the year ended March 31, 2011.

## 3. SIGNIFICANT ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATION UNCERTAINTY

### Basis of Measurement

These consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value.

### Consolidation

These financial statements consolidate the accounts of WestBond Enterprises Corporation and its wholly-owned subsidiary, WestBond Industries Inc. All intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

## 3. SIGNIFICANT ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATION UNCERTAINTY (continued)

**Functional and Presentation Currency and Foreign Currency Translation**

The consolidated financial statements are presented in Canadian dollars, which is the currency of the primary economic environment in which the company operates (the "functional currency"). Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the dates of the transactions. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in currencies other than the functional currency are recognized in the statement of income.

**Plant and Equipment**

Plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, if appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the statement of income during the period in which they are incurred.

Depreciation is charged to earnings using the straight-line method in amounts sufficient to depreciate the costs of the assets over their estimated useful lives as follows:

| | |
|---|---|
| Factory equipment | - 5 to 25 years |
| Leasehold improvements | - 5 to 10 years |
| Office equipment | - 3 to 15 years |

The company allocates the cost initially recognized in respect of an item of plant and equipment to its significant parts and depreciates separately each such part. Residual values, method of depreciation and useful lives of the plant and equipment are reviewed annually and adjusted if appropriate. Depreciation is not charged on assets until they are available for use in the location and condition necessary to be capable of operating in the manner intended by management.

Plant and equipment are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit or CGU). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (which is the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. When events or circumstances warrant, impairment losses are evaluated for potential reversals.

**Inventory**

Inventory is measured at the lower of cost and net realizable value. Raw materials inventory costs include all costs incurred to bring the materials to their current state and location, including the purchase price, duties, non-refundable taxes and freight. Finished goods inventory includes, in addition to the cost of the raw materials incorporated into their manufacture, the costs of labour incurred directly in their manufacture and an allocation of indirect variable overhead, fixed overhead and depreciation on plant and equipment. Costs are assigned to inventory on a first-in, first-out basis. The overhead allocation is based on the pro-portionate costs of the direct materials and labour costs included in finished goods inventory to the total materials and labour costs incurred during the period.

## 3. SIGNIFICANT ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATION UNCERTAINTY (continued)

**Financial Instruments**

Financial assets and liabilities are recognized when the company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

(i) Financial Assets at Amortized Cost: Financial assets are initially measured at fair value and classified as subsequently measured at amortized cost or fair value on the basis the business model for managing the financial asset and the contractual cash flow characteristics of the financial assets. A financial asset is subsequently measured at amortized cost only if it is held in a business model whose objective is to hold assets in order to collect contractual cash flows and the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest. The company's cash and cash equivalents and trade receivables and other receivables are subsequently measured at amortized cost using the effective interest method less a provision for impairment. Gains or losses on financial assets in this category are recognized in profit or loss when the financial asset is derecognized, impaired or reclassified.

(ii) Financial Assets at Fair Value: Financial assets not meeting the criteria for subsequent measurement at amortized cost are initially and subsequently measured at fair value. Gains or losses arising from changes in fair value are recognized in profit or loss unless the financial asset is an equity instrument that is not held for trading and the company has made an irrevocable election at initial recognition to present subsequent changes in its fair value in other comprehensive income. The company has no financial assets that are in this category.

(iii) Financial Liabilities at Amortized Cost: Financial liabilities at amortized cost include trade payables, bank debt and long-term debt. Trade payables are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method. Bank debt and long-term debt are recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

(iv) Financial Liabilities at Fair Value through Profit or Loss: A financial liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges. The company holds no instruments classified in this category.

Financial liabilities in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of income. Gains and losses arising from changes in fair value are presented in the statement of income within other gains and losses in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which is classified as non-current.

## 3. SIGNIFICANT ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATION UNCERTAINTY (continued)

(v) Derivative financial instruments: The company has no derivative financial instruments.

**Impairment of financial assets**

At each reporting date the company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the company recognizes an impairment loss, as follows:

(i) Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

(ii) Available-for-sale financial assets: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of income. This amount represents the cumulative loss in accumulated other comprehensive income that is reclassified to net income.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed.

**Cash and Cash Equivalents**

Cash and cash equivalents are defined as cash on hand, demand deposits and short-term, highly liquid investments that are readily convertible to known amounts of cash within ninety days of deposit.

**Stock-Based Compensation Plan**

The company has a stock-based compensation plan that permits the directors of the company to grant incentive stock options to its employees, directors and consultants. Stock options generally vest over eight quarters (12.5% per quarter) and expire after five years. Each vesting block in an award is considered a separate award with its own vesting period and grant date fair value. The fair value of each block is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense for options granted to employees and directors, or the cost of goods or services acquired in exchange for options granted to non-employees, is recognized over each block's vesting period by reflecting a contribution to shareholders' equity based on the number of awards expected to vest. The number of awards expected to vest is reviewed at least annually, with any impact being recognized immediately.

**Income Taxes**

Income tax comprises current and deferred tax. Income tax is recognized in the statement of income except to the extent that it relates to items recognized directly in equity, in which case the income tax is also recognized directly in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates and laws that have been enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

In general, deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the end of the reporting period and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent

## 3. SIGNIFICANT ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATION UNCERTAINTY (continued)

that it is probable that the assets can be recovered. Deferred income tax assets and liabilities are presented as non-current.

**Revenue**

Revenue is recognized in the period during which the significant risks and rewards of ownership pass to the purchaser, it is probable that the economic benefits will flow to the company, the amount of revenue and costs incurred can be reliably measured and the company retains no managerial or effective control over the goods sold. This is generally when the goods are shipped. Revenue is measured based on agreed upon prices, net of estimated returns, discounts and rebates.

**Earnings Per Share**

Basic earnings per share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated using the treasury stock method. This method assumes that common shares are issued for the exercise of stock options and warrants and that the assumed proceeds are used to purchase common shares at the average market price during the period. The excess, if any, over the number of shares assumed issued and the number of shares assumed purchased is added to the basic weighted average number of shares outstanding to determine the diluted number of common shares outstanding. If the average market price during the period is less than the exercise price of the stock options, no dilution will occur.

**Use of Estimates**

The preparation of financial statements requires the company's management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the disclosures in the notes to the consolidated financial statements. Actual results may differ from these estimates. Significant estimates are made in the determination of allowances for doubtful accounts receivable, the net realizable value of inventories, the useful lives of plant and equipment and the reversal dates of deferred income tax assets and liabilities.

## 4. TRANSITION TO IFRS

The company's transition to IFRS did not have any effect on the net income, comprehensive income, equity or cash flows for the year ended March 31, 2011 or any of the interim periods in that year. The following asset reclassifications and adjustments were made on the company's transition to IFRS:

- Plant and equipment costs and accumulated depreciation were reduced by $75,700 each at April 1, 2010 and each subsequent balance sheet date. There was no change to the net book value. Under IFRS, expenditures on equipment already in service are capitalized if the improvement is expected to benefit more than the current period, and then depreciated over the life of that improvement. If the improvement replaces a previous component of the equipment, the cost and accumulated depreciation related to the replaced component are removed. Under Canadian GAAP, expenditures on equipment already in service are capitalized only if they improve the original performance or extend the life of the equipment. Expenditures to repair or replace original components are expensed and the original cost of the component is left in the accounts and depreciated over the remaining life of the equipment. This adjustment reflects the cost and accumulated depreciation of components that were replaced during improvement projects before the date of transition.
- Lease deposits in the amount of $22,433 at April 1, 2010 and each subsequent balance sheet date, have been reclassed as a non-current asset, separate from prepaid expenses, where they were included in the Canadian GAAP financial statements.

## 4. TRANSITION TO IFRS (continued)

The company made the following elections on its transition to IFRS:

- The order of line items in the Statement of Financial Position has been based on the relevant importance to the company.
- The Statement of Comprehensive Income is presented with expenses classified by function as management believes this provides meaningful information. Disclosure of the nature of the expenses is included in the Notes to the Financial Statements.
- The company elected not to apply IFRS 2 *Share Based Payments* to equity instruments that had vested before the transition date. All of the company's stock options outstanding had fully vested before the transition date.
- The company has elected to early adopt IFRS 9 *Financial Instruments* and its related amendments in order to eliminate the need to reflect another change in accounting policy later. IFRS 9 is required to be adopted for annual periods beginning on or after January 1, 2015.
- The company has not provided a reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS because there are no reconciling items.

The following information, required by IFRS, was not included in the Canadian GAAP financial statements for the year ended March 31, 2011:

- **Lease Payments** – During the year ended March 31, 2011, the company expensed $310,118 in minimum lease payments, and $107,947 in additional lease payments for operating costs and property taxes, on its operating leases for premises.
- **Related Party Transactions** – During the year ended March 31, 2011 the company incurred total compensation, comprising short term employee benefits (including wages, salaries, bonuses, taxes and perquisites), of $330,360 to key management personnel.
- **Dilution of Earnings Per Share** – The potential effect on earnings per share of the warrants and stock options outstanding during the year ended March 31, 2011 was anti-dilutive, accordingly they were excluded from the calculation of diluted earnings per share. If the average market price exceeds the exercise price of the warrants and stock options, the warrants and stock options will have a potential dilutive effect on earnings per share.

## 5. FIXED ASSET PURCHASE COMMITMENT

The company completed its commitment to purchase equipment in the amount of US$287,000 during the nine months ended December 31, 2011.

## 6. TERM BANK LOANS

During the nine months ended December 31, 2011, the company received a $200,000 non-revolving term loan. The loan bears interest at bank prime plus 1%, payable monthly. The loan is re-payable in monthly principal instalments of $5,556 commencing December 30, 2011 and the final payment of the balance of principal and interest is due November 30, 2012.

## 7. RELATED PARTY TRANSACTIONS

During the nine months ended December 31, 2011, the company incurred total short-term employee benefits of $248,360 (2010 – $246,903) to its key management personnel and incurred $5,138 (2010 – $7,252) of legal fees in the normal course of operations with a firm in which a director of the company is a partner.

| | Three months ended December 31 | | Nine months ended December 31 | |
|---|---|---|---|---|
| | **2011** | **2010** | **2011** | **2010** |
| | **$** | **$** | **$** | **$** |
| **8. COST OF SALES** | | | | |
| Materials | 753,697 | 809,324 | 2,368,456 | 2,519,006 |
| Production labour | 130,322 | 134,620 | 366,786 | 394,950 |
| Factory overhead labour | 65,145 | 72,976 | 190,534 | 212,321 |
| Variable overhead | 42,250 | 34,100 | 110,287 | 113,974 |
| Fixed overhead | 110,663 | 109,866 | 331,992 | 327,056 |
| Depreciation | 56,841 | 60,236 | 173,540 | 179,931 |
| | 1,158,918 | 1,221,122 | 3,541,595 | 3,747,238 |
| **9. SELLING AND DISTRIBUTION EXPENSES** | | | | |
| Shipping | 104,216 | 100,530 | 318,597 | 313,648 |
| Wages, commissions and other employee benefits | 27,034 | 20,686 | 73,299 | 78,686 |
| Other | 5,874 | 8,005 | 16,277 | 16,930 |
| | 137,124 | 129,221 | 408,173 | 409,264 |
| **10. GENERAL AND ADMINISTRATIVE EXPENSES** | | | | |
| Administration and office | 31,227 | 35,820 | 96,367 | 93,156 |
| Corporate promotion | 3,897 | 1,979 | 5,416 | 4,094 |
| Professional fees | 11,352 | 9,665 | 34,181 | 36,545 |
| Salaries and other employee benefits | 93,092 | 96,701 | 281,394 | 280,781 |
| | 139,568 | 144,165 | 417,358 | 414,576 |
| **11. NON-CASH INVESTING ACTIVITIES** | | | | |
| Increase in accounts payable related to purchase of plant and equipment | 28,572 | 14,772 | 17,950 | 1,429 |