

# Management Discussion & Analysis

**Three and Nine Month Periods  
Ended  
May 31, 2013 and May 31, 2012**  
(expressed in Canadian Dollars)



July 30, 2013

On November 6, 2012, and subsequent to having received shareholder approval to do so, Seprotech Systems Incorporated ("Seprotech") filed Articles of Amendment changing its name to BluMetric Environmental Inc. ("BluMetric" or the "Company"). On November 16, 2012 BluMetric completed a reverse take-over (the "RTO") with WESA Group Inc. ("WESA"). On November 17, 2012 BluMetric and WESA were amalgamated. In accordance with IFRS 3, comparative historical financial information referred to in this discussion and analysis reflects the results for WESA for the respective periods, except that results for the former Seprotech have been included from November 17-30, 2012.

This discussion is dated as of July 30, 2013 and explains the material changes in BluMetric's financial condition and results of operations for the interim period ended May 31, 2013 (the "Q3 2013") and compares the Q3 2013 results to the previous interim period ended May 31, 2012 (the "Q3 2012"). The information provided in this document is not intended to be a comprehensive review of all matters concerning the Company. The unaudited consolidated financial statements and notes thereto constitute an integral part of the discussion and should be read in conjunction with these comments. This discussion and analysis of the financial condition and the results of operations may contain forward-looking statements regarding the Company's business strategy; potential variances impacting the Company's internal and external performance drivers and the Company's ability to meet its ongoing working capital needs through the ensuing twelve months. These statements are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.

No securities commission or regulatory authority has reviewed the accuracy or adequacy of the information presented herein and, as noted in the financial statements for the interim period ended May 31, 2013, these statements were not subject to audit by our independent chartered accountants.

## Description of Business

BluMetric Environmental Inc. ([www.blumetric.ca](http://www.blumetric.ca)) delivers sustainable solutions to complex environmental issues. The Company serves clients in many industrial sectors, and at all levels of government, in Canada and abroad. The Company has been in business since 1976.

BluMetric operates through two divisions:

- The Professional Services division provides environmental earth sciences and engineering solutions, contaminated site remediation, water resource management, industrial hygiene, occupational health & safety, and renewable energy. This division operates under the names "WESA", "Envir-Eau", and "OEL-HydroSys".
- The Water division is focussed on design-build and pre-engineered solutions to industrial/commercial water and wastewater treatment needs. This division operates under the names "WESAtech" and "Septechn".

Following completion of the RTO, the Company now conducts business under its new name, BluMetric Environmental Inc. ("BluMetric"). The TSX.V trading symbol is "BLM". The head office of BluMetric is at 3108 Carp Road, Ottawa, Ontario, K0A 1L0.

## Core Services & Products

### BluMetric Professional Services Division

Our professional staff includes scientists, engineers, industrial hygienists, environmental auditors, project managers, financial specialists, and support personnel. BluMetric prides itself on finding cost-effective, practical, and sustainable solutions to each client's environmental issues. BluMetric offers a wide range of environmental professional services, including but not limited to:

#### Hydrogeology and Hydrology

- Watershed hydrology and source water protection planning
- Contaminant and water supply hydrogeology

#### Environmental Assessment and Due Diligence

- Phase I, II & III environmental site assessments
- Environmental impact assessments
- Air emissions modeling and compliance approvals
- Arctic and remote site investigations
- Geomatics & data management

#### Engineering, Rehabilitation & Design

- Soil and groundwater remedial systems design and implementation
- Property development (Green, Grey and Brown fields) planning and approvals
- Risk Assessments)

#### Solid, Liquid, & Hazardous, Waste Management

- Landfill design, permitting, and operations
- Waste auditing, reduction, segregation, handling and transportation systems
- Leachate treatment systems design and construction
- Landfill gas management
- Nutrient management

#### Renewable Energy, Waterpower and Hydraulic Structures

- Project assessment, prefeasibility and feasibility studies
- Environmental Assessment & stakeholder consultation
- Regulatory approvals and permitting
- Detailed engineering design, & construction management
- Water management planning
- Dam stability and safety analysis

#### Industrial Hygiene, Occupational Health & Safety

- Workplace air sampling and monitoring
- Designated substances, chemical/biological hazards, toxicity assessments and remediation
- Workplace compliance and management systems audits
- Worker and management training
- Advisory services to management and joint health and safety committees

#### Management Systems

- ISO 14001
- MOE DWQMS (ISO/DIS 24512)
- OHSAS 18001
- Environmental best management practices
- Emergency response program development

#### BluMetric Water Division

The business of the BluMetric Water Division is the design, manufacture and implementation of water and wastewater treatment systems for industrial, commercial and government clients. Our focus is on the selection of the most appropriate technologies and processes for each client's needs. We provide a single source solution from process definition through construction, commissioning and on-going support.

#### *Equipment, Product & Technology Offerings*

- Aerobic & Anaerobic biological process systems
- Reverse Osmosis, Ultrafiltration & Microfiltration membrane systems
- Ion exchange systems
- Media filtration
- Activated carbon adsorption
- Dissolved air flotation

- Enhanced oxidation
- Evaporation
- Dewatering and sludge handling

#### *Service Offerings*

- Design-build, turnkey, and traditional project management
- Process definition and technology selection
- Treatability studies and pilot-scale testing
- Regulatory approvals and permitting
- System engineering and detailed design
- Equipment procurement, installation and commissioning
- Operational support

In addition to the above, the Water Division of BluMetric provides extensive service to the Canadian Forces under long-term contracts for the maintenance, repair, refurbishment and upgrading of the land forces Reverse Osmosis Water Purification Units (ROWPU) and for the navy's Shipboard Reverse Osmosis Desalination (SROD) systems

#### **Core Business Units and Strategy**

The Company delivers its product and service offerings through its two operating divisions, as follows:

The Professional Services division provides environmental earth sciences and engineering solutions, contaminated site remediation, water resource management, industrial hygiene, occupational health & safety, and renewable energy. This division operates under the names "WESA", "Envir-Eau", and "OEL-HydroSys".

The Water division is focussed on design-build and pre-engineered solutions to industrial/commercial water and wastewater treatment needs. This division operates under the names "WESAtech" and "Seprotech".

The Company's business is executed by a staff of approximately 180, located in eight offices in Canada (Ottawa – Headquarters, Toronto, Montreal, Kitchener, Gatineau, Kingston, Sudbury, and Yellowknife), and through an office in El Salvador which services a growing number of projects in the Central American region.

The business has grown significantly over the past decade (approximately 50 staff in five offices in 2002; approximately 165 staff in eight offices in 2008). The company's strategy was then shaped by economic conditions, which in 2008 caused management to purposely curtail growth until the outcome of the global financial crisis became more apparent. Despite volatile economic conditions, the Company was able to take advantage of opportunities which enabled it to achieve better performance than expected including modest growth and increased operating profit from 2009 through 2011.

Within the overall organizational envelope, the various offices have a high degree of autonomy, and each office's respective market focus is slightly different in response to the industrial sector opportunities particular to the region in which they are located. For example, the Yellowknife office is focussed on northern contaminated site remediation and mining projects; Kitchener office services a variety of commercial and industrial sectors such as auto parts manufacturing, land development, and waste management; etc.

Over the years, the Company has also undertaken significant project assignments internationally in Africa, the Middle East, Central America and the Caribbean.

The Company's geographic and market focus distribution also provides a degree of risk mitigation through diversification, insofar as some industrial sectors and regions will be more active than others at any given time. The Company anticipates near-term geographic expansion within Canada and abroad as it continues to build its service reach.

In the near and medium term, the Company intends to continue with its strategy of increasing geographic scope of its activities by expanding into Western Canada and the Maritimes, both organically and by way of strategic acquisition.

The Company's working capital is expected to support planned business operations into the next fiscal year. While the Company reported a working capital deficit at the end of the interim fiscal period, subsequent to the period end it completed a brokered private placement of convertible debentures for gross proceeds of \$1,434,000, which is expected to return the company to positive working capital position.

### **Key Performance Drivers**

Management believes that the Company's strategic plan continues to be somewhat insulated from external performance drivers, since the majority of its revenues are in Canadian dollars and from the fee-for-service business which does not generally have raw materials cost exposure. As the business grows, some sensitivity to exchange rates and commodity prices may develop. Other external performance drivers include the interplay between regional and global economic conditions and the degree to which potential clients place emphasis on environmental issues (regulatory or otherwise) in their business practices.

To the extent that major customer segments (e.g. the mining industry) are impacted by such external performance drivers (e.g. global commodity prices) there could be an impact on some components of the business. However, such effects continue to be somewhat mitigated by the diverse nature of the Company's product and service offerings, which typically results in the various customer segments not experiencing adverse business conditions at the same time.

Key internal performance drivers include the ability to continue to attract high quality staff, competitive pricing; management skill in developing the company's market presence and in executing client service and design-build projects; tight control of project and overhead costs; adequate and available working capital; maintenance of a high level of customer satisfaction; and a strong commitment to environmental and social responsibility.

These performance drivers have been reflected in revenue growth and maintenance of positive cash flow and earnings over many years. The balance sheet reflected positive working capital over the same period, and while negatively impacted by the RTO is considered sufficient to support the current business plan into the next fiscal period.

### **Capability to Deliver Results**

The Company has built a cadre of roughly 194 (130 pre- RTO) dedicated staff, and until completion of the RTO was owned entirely by employees active in the business, resulting in key employees having developed a very strong identity with the business.

The current Board of Directors is comprised of five persons, three of whom are independent. The Company expects to add one or two independent directors during the next several months in order to add depth of experience in key areas of the business.

Senior management includes: William (Bill) M. Touzel, C.A., CEO; Roger M. Woeller, M.Sc.,P.Geo, Chief Corporate Development Officer; Nell van Walsum, M.Sc.,P.Geo, President, Professional Services Division; Harry J. Marshall, President, Water and Wastewater Division, and Ian W. Malone, Chief Financial Officer. This team is supported by well qualified and highly experienced individuals leading each of the Company's branch offices and major service sectors.

Since 2001, the management team has built annual revenues from approximately \$5 million to pre-RTO levels of greater than \$20 million. The Company was consistently profitable through this extended period of growth.

The Company offers competitive and attractive employment arrangements, and has been able to attract high quality employees at all its locations.

### **Selected Annual Information**

The following table shows selected consolidated financial data for BluMetric based on WESA's results for the three most recently completed fiscal years. It should be noted that the following amounts do not include consolidation of financial results of the former Seprotech. Since the RTO took place prior to the end of WESA's 2012 fiscal year, no comparative annual information for the year ended November 30, 2012 was filed.

**For the years ended November 30**

|  | 2011 <sup>(1)</sup> | 2010       | 2009       |
|--|---------------------|------------|------------|
|  | \$                  | \$         | \$         |
| Total revenue  | 22,472,195          | 20,358,736 | 22,617,760 |
| Direct external project costs                                | 8,633,771           | 7,295,154  | 9,742,730  |
| Net fee revenue  | 13,838,424          | 13,063,582 | 12,875,030 |
| Direct salaries & benefits <sup>(1)</sup>                    | 9,374,274           | 8,567,514  | 8,438,304  |
| Gross margin <sup>(1)</sup>                                  | 4,464,150           | 4,496,068  | 4,436,726  |
| Gross margin percentage of total revenue <sup>(1)(2)</sup>   | 20%                 | 22%        | 20%        |
| Gross margin percentage of net fee revenue <sup>(1)(2)</sup> | 32%                 | 34%        | 34%        |
| Total S, G&A expenses net of SR&ED credits <sup>(1)(4)</sup> | 3,025,934           | 2,799,462  | 2,755,424  |
| Gross margin less SG&A expenses <sup>(1)</sup>               | 1,438,216           | 1,696,606  | 1,681,302  |
| Interest expense   | 64,566              | 65,843     | 48,539     |
| Amortization   | 393,048             | 382,883    | 370,739    |
| Other income / expense                                       | 1,156               | 2,862      | nil        |
| Income before distributions & taxes                          | 979,446             | 1,245,018  | 1,262,024  |
| Income before distributions & taxes per share                | \$1.54              | \$2.03     | \$2.06     |
| Net income after distributions & taxes <sup>(3)</sup>        | 157,202             | 230,408    | 566,287    |
| Common shares outstanding                                    | 634,468             | 611,459    | 611,459    |
| Net income per share   | \$0.25              | \$0.38     | \$0.93     |
| Total assets   | 12,425,550          | 13,207,399 | 11,491,593 |
| Working capital  | 2,498,375           | 2,166,002  | 2,387,070  |
| Long term debt   | 1,635,835           | 1,550,217  | 2,008,767  |
| Shareholders' equity   | 5,470,884           | 5,199,011  | 4,968,603  |

(1) Prior to 2011, the company had always recorded staff vacation pay expense during the period in which individual staff members actually used their allotted vacation time. At November 30, 2011 the company recorded an accrued liability for earned but unused staff vacation pay for the first time. This totalled \$465,939, including \$322,754 charged to direct salaries and benefits (related to client service staff), and \$143,185 charged to operating expenses (related to staff who's salaries are included in overheads). Had management maintained its previous policy and not made the noted adjustment, FY 2011 results would have included lower direct salaries and benefits of \$9,051,520 resulting in a higher gross margin of \$4,786,904 (21% of total revenue or 35% of net fee revenue); SG&A expenses would have been \$2,882,749 (through a reduction of "Executive, accounting IT & HR salaries & benefits" to \$1,049,546; see note (4) below); Gross margin less SG&A expenses would have been \$1,904,155; and income before distributions and taxes would have been \$1,445,385

- (2) Management monitors “Gross margin percentage of net fee revenue” more closely than “Gross margin percentage of total revenue”. Gross margin as a percentage of “top line” or total revenue is unpredictable and somewhat meaningless, as the magnitude of direct external “pass-through” project costs does not necessarily have a bearing on the professional fees charged on fee-for-service projects.
- (3) “Bottom line” net income is not meaningful, since the Company had historically distributed a significant portion of its operating income to staff and management by way of profit sharing and management fees that are subtracted from operating income (along with other costs, such as interest expenses, amortization of fixed assets, scientific research and experimental development (SR&ED) tax credits, income taxes, etc.) in deriving net income. Timing differences between accounting and taxation reporting were also taken into account in deriving the optimum profit sharing totals, and therefore net income.
- (4) Breakdown of Operating Expenses

| Operating Expenses Details                             | 2011 <sup>(1)</sup> | 2010      | 2009      |
|--|---------------------|-----------|-----------|
|  | \$                  | \$        | \$        |
| Executive, accounting, IT & HR salaries <sup>(1)</sup> | 1,192,731           | 948,668   | 719,693   |
| Office supplies & expenses                             | 880,174             | 708,770   | 780,288   |
| Occupancy costs  | 665,837             | 653,822   | 627,501   |
| Telephone & communications                             | 258,696             | 261,726   | 248,150   |
| Professional & general liability insurance             | 253,025             | 197,964   | 161,343   |
| Bad debts (recovery)                                   | (156,534)           | 157,976   | 405,504   |
| Professional fees                                      | 127,218             | 61,023    | 133,461   |
| Marketing costs  | 93,608              | 115,040   | 92,400    |
| Bank charges   | 27,353              | 31,304    | 30,909    |
| Foreign exchange losses (gains)                        | 13,789              | 1,226     | (22,159)  |
| Total  | 3,355,896           | 3,137,519 | 3,177,090 |

## Results of Operations

The Company had very satisfactory performance in FY 2011, with growth in earnings, and operating profits (after allowing for a first-time recording of a vacation pay accrual as noted above). As the Company's business patterns are subject to seasonal influences, the initial two quarters were not profitable in accordance with the usual seasonal pattern, but this was more than offset by strong third and fourth quarter performance as is also the norm. The consulting division (WESA Inc.) accounted for 86% of revenues in FY 2011.

While the global business environment remained volatile, the continuing enactment and implementation of environmental regulation has created a continued strong demand for the Company's service and product offerings. This trend is expected to continue, and the Company is continually taking steps to ensure it can take advantage of opportunities as they arise.

### **Highlights of Interim Period ended May 31, 2013**

During the interim period ended May 31, 2013 the Company made significant progress in both of its operating divisions, the Water Division announcing completion of five reverse osmosis contracts in South America worth \$1.6 million; the award of a \$1 million wastewater treatment contract in Port Chester, New York and a \$1.38 million reverse osmosis contract in Peru. During the same period the Professional Services Division announced the award of an environmental investigation and site monitoring project worth \$600,000. BluMetric also established an "on ground" sales capability in the Middle East during the quarter.

### **Discussion of Results and Financial Condition for the Interim Period Ended May 31, 2013**

It should be noted that the quarter ended May 31, 2013 includes two full quarters of post-RTO consolidated operations following the first quarter's post-amalgamation inclusion of only two weeks of the former Seprotech's results during that quarter. The comparable quarters in fiscal 2012 do not include any of the former Seprotech's results.

During the interim period ended May 31, 2013, total revenues were approximately \$7.3 million (May 31, 2012, \$5.8 million) an increase of approximately \$1.5 million (21%), which was largely attributable to addition of the former Seprotech to the business. The contribution to revenue from the Water Division was approximately \$2.5 million for the quarter, which was comparable to the former Seprotech's Q3, 2012 revenues. The contribution to revenue from the Professional Services division was approximately \$4.7 million, a slight deterioration from the amount that was attributable to the former WESA alone for the comparable quarter. The level of activity of the Professional Services group is historically slower during the winter months, which was exacerbated by the unusually long spring, however subsequent to quarter end, both divisions are continuing to ramp up activities as is typical of the summer field season.

Gross Margin for the quarter was \$1.25 million, or 17% (May 31, 2012, \$1.105 million or 19.0%), a 2% decrease from the same quarter in 2012. The erosion in consolidated gross margin percentages reflected an improvement in margins in the Professional Services Division, but inconsistent margins within the operating units comprising the Water Division.

SG&A expenses for the quarter ended May 31, 2013 were \$1,722,544 compared with \$987,023 for the same period in 2012, which in addition to reflecting inclusion for the full interim period of the former Seprotech business, also reflected an increase in headcount required to achieve and execute anticipated business growth, increases in several overhead cost categories, some non-recurring costs associated with both the RTO and the debenture which closed after the quarter end, and an increase in amortization.

Operating loss before finance costs and taxes was \$(720,479) for the quarter ended May 31, 2013, versus an operating profit of \$21,025 for the same period in the previous year.

Finance costs of \$52,352 for the quarter ended May 31, 2013 were higher than the \$12,230 reported for the comparable period in 2012, reflecting interest costs on the debt assumed from Seprotech at time of and subsequent to the RTO, as well as higher credit line utilisation during the most recent quarter.

The result was a net loss of \$(772,831) for the quarter compared to a modest profit of \$8,795 during the same period in the previous year.

Shareholders' equity increased to approximately \$7.7 million as at May 31, 2013 (May 31, 2012, \$5.4 million), reflecting the impact of the RTO and the concurrent equity raise.

The Statement of Financial Condition as at May 31, 2013 reflects the consolidation arising from the RTO, and indicates working capital of \$26,686 (as compared with working capital of approximately \$2.7 million at August 31, 2012, largely as a result of absorbing the former Seprotech's significant working capital deficit. Subsequent to the May quarter end discussed herein, the Company concluded a private placement of convertible debentures with gross proceeds of \$1,434,000 which has augmented the reported working capital. (see below under "Liquidity").

### **International Markets**

Historically the Company has conducted a small percentage of its work outside of Canada, with particular emphasis recently on the Central America / Caribbean region. The percentage of export business is expected to increase significantly in the next few years. Total billing to clients outside of Canada for the past three years are as follows:

|      |           |
|------|-----------|
| 2010 | \$654,447 |
| 2011 | \$664,139 |
| 2012 | \$663,884 |

Over the past two decades, the Company has been involved in project work in Mexico, various countries of Central and South America and the Caribbean, Africa, and Saudi Arabia. Some of this work has been for private sector clients, some has been funded by agencies of the Canadian government, and some has been through international financial institutions.

### **Technology and Innovation**

The Company operates in a business environment (environmental geosciences and engineering, water treatment, industrial hygiene, etc.) and market areas (a wide variety of industrial sectors) that are continually being influenced by technological advancement and innovation, improvements in best-practices, changes in environmental regulatory requirements, and the like. The future success of the company will be partially dependent upon its ability to continue to expand its knowledge in the fields in which it operates.

### **Cost Reduction Strategies**

The Company is actively pursuing growth and expects certain costs to increase in advance of revenue growth. That said, and in view of the escalation of overhead costs since the RTO the Company is actively reviewing all of its cost structures with a view to optimising internal efficiency. The process will be undertaken in two phases, the first to identify where immediate cost savings can be achieved, and the second where longer term efficiencies can be realised, through use of software and other tools.

### **Sales and Marketing**

The Company's business has historically been developed largely through existing client relationships, word-of-mouth, and marketplace presence.

The Company has expanded its Corporate Development group with specific responsibility to guide the overall business development and growth initiatives (both organic and through M&A activities), and to support and assist both operating divisions with major sales opportunities, marketing materials, market research, etc.

## Summary of Quarterly Results

### Quarterly Results – \$000's (Except Earnings (Loss) per share)

| Quarter Ended   | 2013     |           |        |         | 2012   |        |        |        |
|---|----------|-----------|--------|---------|--------|--------|--------|--------|
|   | May 31   | Feb 28    | Nov 30 | Aug 31  | May 31 | Feb 28 | Nov 30 | Aug 31 |
| Total revenue   | 7,267    | 6,024     | 6,340  | 6,733   | 5,831  | 4,487  | 6,940  | 7,264  |
| Direct external project costs                             | 3,047    | 2,072     | 2,362  | 2,571   | 2,183  | 1,606  | 3,101  | 3,031  |
| Net fee revenue   | 4,061    | 3,952     | 3,978  | 4,162   | 3,648  | 2,881  | 3,841  | 4,233  |
| Direct salaries & benefits                                | 3,033    | 2,873     | 2,568  | 2,581   | 2,543  | 2,270  | 2,527  | 2,395  |
| Total cost of sales                                       | 6,016    | 4,945     | 4,930  | 5,152   | 4,725  | 3,852  | 5,543  | 5,426  |
| Gross margin  | 1,250    | 1,079     | 1,410  | 1,581   | 1,105  | 611    | 1,314  | 1,838  |
| GM % of total revenue                                     | 17%      | 18%       | 22%    | 23%     | 19%    | 14%    | 19%    | 25%    |
| GM % of net fee revenue                                   | 31%      | 27%       | 35%    | 38%     | 30%    | 21%    | 34%    | 43%    |
| S,G & A Expenses (net of SR&ED credits)                   | 1,722    | 1,368     | 881    | 945     | 939    | 936    | 767    | 710    |
| Gross margin less SG&A expenses                           | (472)    | (289)     | 529    | 636     | 166    | (325)  | 547    | 1,128  |
| Costs directly attributable to the RTO                    | -        | -         | 134    | 120     | 48     | 9      |        |        |
| Interest expense  | 52       | 73        | 36     | 20      | 9      | 7      | 15     | 22     |
| Amortization  | 181      | 173       | 112    | 105     | 93     | 87     | 114    | 101    |
| Other (income) / expense                                  | -        | -         | -      | (2)     | 8      | -      | 1      | -      |
| Income (loss) before distributions & taxes <sup>(1)</sup> | (773)    | (490)     | 249    | 393     | 8      | (428)  | (427)  | 1,005  |
| Income (loss) per share <sup>(1)</sup>                    | \$(0.03) | \$ (0.02) |        | \$0.014 |        |        |        |        |

- (1) On November 30, 2012 following completion of the RTO, the number of common shares outstanding was 22,360,331. The comparative period has been adjusted such that the income per share uses the same weighted-average denominator of 15,329,276 common shares.

### **Quarterly Trend Analysis**

Quarterly trend analysis over the past eight quarters is materially impacted by completion of the reverse RTO during the immediately prior quarter. The interim period ended May 31, 2013 is the second fiscal period to reflect consolidated operations for the amalgamated entities for the entire quarter. In addition, results for the comparable interim period in the prior fiscal year do not include any results for the former Seprotech. As a result, comparisons with prior interim periods may not provide a meaningful indication of relative performance. In addition, there are differences of a seasonal nature which are more prevalent in the professional services division than in the water/wastewater products division which further impacts on comparative analysis.

Historically, the Company's business has followed a seasonal cycle which dictates that its quarters ended February 28 and May 31, experience relatively lower levels of activity when compared to the balance of the year. This seasonal cycle is partly weather-related, as it is obviously considerably easier and more productive to conduct outdoor environmental investigations, site remediation activities, and various construction-related projects in Canada during the summer; additionally, the December holiday downtime period has a significant impact on the level of activity possible in the respective quarter each year.

Net fee revenue for each quarter of 2011 was larger than the same quarter of the previous year, reflecting an overall increase in the level of activity across the year. Q1 and Q2 were each roughly 2% higher in 2011 than 2010, while Q3 and Q4 were each roughly 9% higher.

Gross margin is lowest in the winter and spring quarters, and highest in the summer and fall quarters. This pattern reflects the reality that the Company's staff as a whole can achieve much higher "utilization" (percentage of time actively engaged in revenue producing projects) during the summer and fall quarters.

Quarterly 2012 results follow the typical seasonal cycle. While the quarter ended November 30, 2012 reported lower revenue than for the same period in the previous year, the gross margin improved from 19% to 22%. Activities to complete the RTO during the late spring, summer and autumn of 2012 contributed some disruption to normal activities.

Quarterly 2013 results to date were significantly impacted by the RTO which closed in November 2012, with revenues for the first quarter largely reflecting pre-RTO WESA performance, and a small profit (\$249k) reported compared with a loss (\$428k) for the prior period quarter.

The second quarter 2013 results reflect the full consolidation of the amalgamated entities, as well as the usual negative seasonal impact on the Professional Services Division. Revenues of approximately \$6 million reflected on-budget performance from the Water Division, but below-target revenues in the

Professional Services division. The net loss of \$(490)k was comparable with the prior year interim period loss of \$(428)k.

The third quarter 2013 results reflect strong revenue growth relative to both the same period in 2012 and also to the prior period in 2013, with the Professional Services Division moving closer to target as spring progressed. The Water Division, while still meeting revenue targets, experienced lower gross margins related to a change in the mix of work during the quarter. This, coupled with the previously noted increases in certain overhead costs resulted in a net loss of \$(773)k.

The Company has made significant progress in meeting its integration goals following completion of the RTO, notably the fitting up of a new office adjacent to the existing head office building, and the re-location/consolidation of Ottawa-based staff among the various locations. In addition to one-time costs associated with these activities, the company has absorbed significant transaction costs over the last 6-9 months, as well as the costs of being a public company.

The impact of the RTO on operations is expected to continue to be significant and positive, in light of the pre-existing synergies between the merging entities. Accordingly, continued distortion in trend analysis can be expected going forward until operating adjustments are fully absorbed and comparative amounts reflect combined operations.

Management is aggressively looking at ways to ensure that costs are in line with revenues on a go-forward basis, consistent with its growth strategy. In that regard, the Water Division has a robust pipeline of projects, and the Professional Services Division is continuing to ramp up its activities as is typical of the season.

## **Liquidity**

The Corporation had working capital of \$26,686 at May 31, 2013, compared with a surplus of \$2,686,750 at August 31, 2012. The significant decline is almost entirely the result of absorbing Seprotech's working capital deficit upon amalgamation in November, 2012. Prior to the amalgamation, the Company had a history of several years of profitable operations and internally generated cash flow, and working capital is expected to recover as the effects of the merger are absorbed. As noted above, subsequent to interim period end, the Company completed a private placement of convertible debentures for gross proceeds of \$1,434,000 which will help replenish working capital as the Company enters its traditionally busier season.

The Company has an operating line-of-credit facility provided by a Canadian chartered bank with a limit of \$2.0 million under normal margin and compliance requirements. The Company is in compliance with its bank covenants.

As noted above, the recurring seasonal/cyclical patterns of the business typically result in one unprofitable quarter (December – February), one roughly break-even quarter (March – May), and two successive profitable quarters (June – November) in each fiscal year. Use of bank lines of credit generally increases during the busier and more-profitable period of each year, and cash usage reduces during the slower periods of the year as receivables are collected and expenses decline.

## Capital Resources

The Company had positive shareholder equity at the end of the quarter, however, in light of the diminished working capital position management will continue to explore opportunities to raise additional capital to support the corporate growth strategy.

While ongoing operational capital needs are modest, and typically relate to purchase of computer and office equipment for either replacement purposes or to equip new staff, the Company's growth strategy contemplates both business acquisitions and internal growth. Accordingly, the Company may opportunistically approach the capital markets for additional equity funding if conditions are favorable.

## Business Risks

The Company is subject to a number of risks and uncertainties in the normal course of business, and these risks could materially impact the financial condition of the Company. These risks and uncertainties, include, but may not be limited to, the following: The Company's continuing ability to negotiate and secure contracts, and to maintain or grow revenues organically and through strategic alliances, mergers and/or acquisitions.

- The Company's ability to return to generating positive and increased profit margins.
- Reliance on key personnel.

## Outlook

The following represents forward-looking information and users are cautioned that actual results may vary.

On a go-forward basis, the Company is targeting organic revenue growth as well as growth through acquisitions. This will require:

- Improving margins, tightly managing overhead and cost structure in existing operations and branch offices
- Maintaining and increasing the existing client base;
- Selectively Increasing staff complement in existing operations and branch offices to assist in increasing revenues and gross margins and growing earnings;
- Addition of new branch offices in strategically important locations;
- Acquisition of complementary businesses in strategically important sectors or locations.

These objectives assume the Company will have generated sufficient working capital to support the underlying activities necessary to achieve the respective targets.

## Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

## Transactions with Related Parties

All related party transactions are reflected under terms and conditions reflecting prevailing market conditions at the transaction date and are recorded at fair market value. As at May 31, 2013 there was an advance of \$100,000 from a shareholder and director, being made available on a month to month basis, and carrying an interest rate of 7% p.a.

## Proposed Transactions

As at May 31, 2013 there were no significant assets or business acquisitions or dispositions being considered by the Company.

## Inter-corporate Relationships

BluMetric has one wholly-owned subsidiary, WESA Tecnologias S.A. de C.V., located in El Salvador.

## Financial Instruments and other instruments

### Financial Assets and Financial Liabilities

Financial instruments are classified into one of the following categories: loans and receivables, and financial liabilities at amortized cost. The following table summarizes information regarding the carrying values of the Company's financial instruments:

|   | May 31, 2013   | August 31,<br>2012 |
|---|----------------|--------------------|
| Cash  | \$ -           | \$ -               |
| Accounts receivable                           | 4,389,645      | 7,173,977          |
| Total cash and receivables                    | 4,389,645      | 7,173,977          |
| Credit facilities and bank loans              | (1,412,639)    | (3,039,471)        |
| Trade and other payables                      | (4,306,939)    | (3,433,700)        |
| Note, loans payable and secured debenture     | (324,320)      | -                  |
| Obligation under finance leases               | (29,301)       | -                  |
| Long-term Debt                                | (2,733,200)    | (1,437,431)        |
| Total financial liabilities at amortized cost | \$ (8,806,399) | \$ (7,910,602)     |

## Fair Value

The carrying amounts for cash, accounts receivable, credit facilities and bank loans, trade and other payables, note and loans payable approximate fair value because of the short-term maturity of these instruments.

The fair values of obligations under long-term debt and capital leases are determined by discounting future cash flows using rates that are implicit in the specific contracts. The carrying value approximates their fair value.

The fair value of the secured debenture is deemed to approximate its carrying value in view of the short term to maturity.

### **Risk Management Objectives and Policies**

The Company is exposed to various risks in relation to financial instruments. The Company's financial assets and liabilities by category are summarised below. The main types of risk are Credit Risk, Market Risk and Liquidity Risk.

The Company's risk management is co-ordinated in close cooperation with the board of directors, and focuses on actively securing the Company's short to medium-term cash flows by minimizing the exposure to financial markets.

The Company does not actively engage in the trading of financial assets for speculative purposes nor does it write options. The most significant financial risks to which the Company is exposed are described below.

### **Credit Risk**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its obligations. The financial instruments that potentially expose the Company to credit risk are accounts receivable, and cash. The credit risk for cash is considered negligible, since the counterparties are reputable Canadian banks with high quality credit ratings .

The Company typically has a limited number of customers resulting in concentration of customers in revenue and receivables, as disclosed in Note 21.

The Company has credit evaluation, approval and monitoring processes intended to mitigate potential credit risks. The Company performs ongoing credit evaluations of new and existing customers' financial condition and reviews the collectability of its trade receivables in order to mitigate any possible credit losses. The allowance for doubtful accounts and past due receivables are reviewed by management at each reporting date. The Company updates its estimate of the allowance for doubtful accounts based on an examination of the aged accounts receivable listing, considering such factors as customer payment history, status of pending litigation and the current financial condition of the customers. Accounts receivable are written off once determined not to be collectible.

Trade receivables disclosed above include amounts (see below for aged analysis) that are past due at the end of the reporting period for which the Company has not recognised an allowance for doubtful accounts because there has not been a significant change in credit quality and the amounts (which include interest accrued after the receivable is more than 60 days outstanding) are still considered recoverable. There are no credit issue concerns regarding amounts due to the company which are current.

The Company's management considers that all financial assets which are not impaired or past due for each of the May 31, 2013 and August 31, 2012 reporting dates under review are of good credit quality.

Trade accounts receivable comprise the following balances:

|                                 | <u>As at May 31,</u><br><u>2013</u> | <u>As at August</u><br><u>31, 2012</u> |
|---------------------------------|-------------------------------------|--|
|                                 | \$                                  | \$                                     |
| Current or under 60 days        | 2,721,843                           | 4,679,007                              |
| Past due 61 to 90 days          | 286,721                             | 1,381,906                              |
| Past due greater than 90 days   | 1,472,226                           | 637,555                                |
| Allowance for doubtful accounts | <u>(230,586)</u>                    | <u>(128,333)</u>                       |
| Total trade accounts receivable | <u>4,250,204</u>                    | <u>6,570,135</u>                       |

The continuity of the allowance for doubtful accounts is as follows:

|                            | <u>As at May 31,</u><br><u>2013</u> | <u>As at August</u><br><u>31, 2012</u> |
|----------------------------|-------------------------------------|--|
|                            | \$                                  | \$                                     |
| Opening balance            | (128,333)                           | (67,638)                               |
| Bad debt expense provision | (637,965)                           | (82,224)                               |
| Accounts written off       | 535,712                             | 21,529                                 |
| Closing balance            | <u>(230,586)</u>                    | <u>(128,333)</u>                       |

### Market Risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Company's net earnings or the value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

#### *Interest rate risk*

Interest rate risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in interest rates. At the end of the interim period the Company had \$1,412,639 in outstanding revolving credit facilities which were floating rate obligations carrying at Prime + 0.5% and \$324,320 in outstanding note and loans payable which was a fixed rate obligation. A 1% increase in interest rates at the reporting date would increase the net loss and reduce equity for the period by \$2,675.

#### *Foreign currency risk*

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in currency exchange rates.

The Company operates internationally and is therefore subject to foreign currency risk as follows:

**FX exposure and Interest rate exposure**

|                     | May 31, 2013 | May 31, 2013 | August 31,<br>2012 | August 31,<br>2012 |
|---------------------|--------------|--------------|--------------------|--------------------|
|                     | CAD          | US           | CAD                | US                 |
|                     | \$           | \$           | \$                 | \$                 |
| Cash                | 99,742       | 103,412      | 98,741             | 97,526             |
| Accounts Receivable | 838,644      | 869,506      | 29,547             | 29,184             |
| Trade payables      | 318,572      | 330,295      | 75,303             | 74,377             |

The Company incurs expenses and earns revenues in Canadian and U.S. dollars. To date the Company has not used foreign currency forward contracts or other hedging strategies to manage its foreign currency exposure, but it endeavours to create natural hedges where there are opportunities to do so.

Exposures to foreign exchange rates vary during the year depending on the volume of overseas transactions. Nevertheless, the analysis above is considered to be representative of the Company's exposure to currency risk.

A 10% strengthening of the US dollar against the Canadian dollar would have decreased the net loss and increased equity by \$ 66,627.

**Liquidity Risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company currently settles all of its financial obligations out of cash and bank indebtedness. The ability to do so relies on the Company collecting its accounts receivable in a timely manner and by maintaining sufficient cash in excess of anticipated needs. The following table outlines the liquidity risk associated with the Company's payment obligations as at the periods ended May 31, 2013 and May 31, 2012 respectively.

|   | May 31, 2013        |                          |                     |                     |                   |                     |
|---|---------------------|--------------------------|---------------------|---------------------|-------------------|---------------------|
|   | Total               | In less than<br>3 months | 3 - 12<br>Months    | 1 - 2 Years         | 2 - 5 Years       | Total               |
| Credit facilities and bank loans          | \$ 1,080,000        | \$ 1,080,000             | \$ -                | \$ -                | \$ -              | \$ 1,080,000        |
| Trade and other payables                  | 4,306,939           | 3,169,601                | 1,137,338           | -                   | -                 | 4,306,939           |
| Deferred revenue                          | 82,395              | 82,395                   | -                   | -                   | -                 | 82,395              |
| Note, loans payable and secured debenture | 324,320             | 324,320                  | -                   | -                   | -                 | 324,320             |
| Finance lease obligation                  | 31,700              | 3,835                    | 11,506              | 6,687               | 9,672             | 31,700              |
| Long-term debt                            | 2,733,200           | 109,806                  | 329,449             | 1,328,272           | 965,673           | 2,733,200           |
|   | <u>\$ 8,558,554</u> | <u>\$ 4,769,957</u>      | <u>\$ 1,478,293</u> | <u>\$ 1,334,959</u> | <u>\$ 975,345</u> | <u>\$ 8,558,554</u> |

| August 31, 2012                  | Payment Due         |                          |                   |                   |                   | Total               |
|----------------------------------|---------------------|--------------------------|-------------------|-------------------|-------------------|---------------------|
|                                  | Total               | In less than<br>3 months | 3 - 12<br>Months  | 1 - 2<br>Years    | 2 - 5 Years       |                     |
| Credit facilities and bank loans | \$ 3,039,471        | \$ 3,039,471             | \$ -              | \$ -              | \$ -              | \$ 3,039,471        |
| Trade and other payables         | 3,433,700           | 3,433,700                | -                 | -                 | -                 | 3,433,700           |
| Deferred revenue                 | 179,215             | 179,215                  | -                 | -                 | -                 | 179,215             |
| Long-term debt                   | 1,367,412           | 70,019                   | 210,057           | 280,075           | 807,261           | 1,367,412           |
|                                  | <u>\$ 8,019,798</u> | <u>\$ 6,722,405</u>      | <u>\$ 210,057</u> | <u>\$ 280,075</u> | <u>\$ 807,261</u> | <u>\$ 8,019,798</u> |

### Changes in accounting policies including Initial Adoption

Adoption of amendments to IAS 1 (effective for annual periods beginning on or after July 1, 2012.) The Company is required to group items presented in other comprehensive income (OCI) into those that, in accordance with other IFRSs, will not be reclassified subsequent to profit and loss and those that will be reclassified subsequently to profit and loss when specific conditions are met. The existing option to present items of OCI either before tax or net of tax remains unchanged; however, if the items are presented before tax, then the amendments to IAS 1 require the tax related to each of the two groups of OCI to be shown separately.

### New Standards and Interpretations Issued but not yet Effective

At the date of authorisation of these financial statements, certain new standards, amendments and interpretations to existing standards have been published by the IASB but are not yet effective, and have not been adopted early by the Company.

Management anticipates that all of the relevant pronouncements will be adopted in the Company's accounting policies for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments and interpretations that are expected to be relevant to the Company's financial statements is provided below. Certain other new standards and interpretations have been issued but are not expected to have a material impact on the Company's financial statements.

### IFRS 9 'Financial Instruments' (IFRS 9)

The IASB aims to replace IAS 39 'Financial Instruments: Recognition and Measurement' (IAS 39) in its entirety with IFRS 9. To date, the chapters dealing with recognition, classification, measurement and de-recognition of financial assets and liabilities have been issued. These chapters are effective for annual periods beginning on or after 1 January 2015. Chapters dealing with impairment methodology and hedge accounting are still being developed. Further, in November 2012, the IASB published an exposure draft in order to make limited modifications to IFRS 9's financial asset classification model to address application issues. The Company's management has yet to assess the impact of this new standard on its consolidated financial statements. However, Management does not expect to implement IFRS 9 until all of its chapters have been published and they can comprehensively assess the impact of all changes.

## **Consolidation standards**

A package of new consolidation standards is effective for annual periods beginning or after 1 January 2013. Information on these new standards is presented below. Management has not yet completed its assessment of the impact of these new and revised standards on the Company's consolidated financial statements.

### **IFRS 10 'Consolidated Financial Statements' (IFRS 10)**

IFRS 10 supersedes IAS 27 'Consolidated and Separate Financial Statements' (IAS 27) and SIC 12 'Consolidation - Special Purpose Entities'. IFRS 10 revises the definition of control and provides extensive new guidance on its application. These new requirements have the potential to affect which of the Company's investees are considered to be subsidiaries and therefore change the scope of consolidation. However, the requirements on consolidation procedures, accounting for changes in non-controlling interests and accounting for loss of control of a subsidiary remain the same. Management's provisional analysis is that IFRS 10 will not change the classification (as subsidiaries or otherwise) of any of the Company's existing investees at 30 November 2012

### **IFRS 11 'Joint Arrangements (IFRS 11)**

IFRS 11 supersedes IAS 31 'Interests in Joint Ventures' (IAS 31). It aligns more closely the accounting by the investors with their rights and obligations relating to the joint arrangement. In addition, IAS 31's option of using proportionate consolidation for joint ventures has been eliminated. IFRS 11 now requires the use of the equity accounting method, which is currently used for investments in associates.

### **IFRS 12 'Disclosure of Interests in Other Entities' (IFRS 12)**

IFRS 12 integrates and makes consistent the disclosure requirements for various types of investments, including unconsolidated structured entities. It introduces new disclosure requirements about the risks to which an entity is exposed from its involvement with structured entities.

### **Transition guidance for IFRS 10, 11, 12**

Subsequent to issuing the new standards the IASB made some changes to the transitional provisions in IFRS 10, IFRS 11 and IFRS 12. The guidance confirms that the entity is not required to apply IFRS 10 retrospectively in certain circumstances and clarifies the requirements to present adjusted comparatives. The guidance also makes changes to IFRS 11 and IFRS 12 which provide similar relief from the presentation or adjustment of comparative information for periods prior to the immediately preceding period. Further, it provides additional relief by removing the requirement to present comparatives for the disclosures relating to unconsolidated structured entities for any period before the first annual period for which IFRS 12 is applied.

The new guidance is also effective for annual periods on or after 1 January 2013

### **Consequential amendments to IAS 27 'Separate Financial Statements' (IAS 27) and IAS 28 'Investments in Associates and Joint Ventures' (IAS 28)**

IAS 27 now only addresses separate financial statements. IAS 28 brings investments in joint ventures into its scope. However, IAS 28's equity accounting methodology remains unchanged

### **IFRS 13 'Fair Value Measurement' (IFRS 13)**

IFRS 13 clarifies the definition of fair value and provides related guidance and enhanced disclosures about fair value measurements. It does not affect which items are required to be fair-valued. IFRS 13 applies prospectively for annual periods beginning on or after 1 January 2013. Management is in the process of reviewing its valuation methodologies for conformity with the new requirements and has yet to complete its assessment of their impact on the Company's consolidated financial statements.

### **Amendments to IAS 19 'Employee Benefits' (IAS 19 Amendments)**

The IAS 19 Amendments include a number of targeted improvements throughout the Standard. The main changes relate to defined benefit plans. They:

- eliminate the 'corridor method', requiring entities to recognise all actuarial gains and losses arising in the reporting period
- changes the measurement and presentation of certain components of defined benefit cost
- enhance the disclosure requirements, including information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in them

The IAS 19 Amendments are effective for annual periods beginning on or after 1 January 2013 and will apply retrospectively. The Company does not expect to be affected by these amendments to IAS 32

### **Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)**

The Amendments to IAS 32 add application guidance to address inconsistencies in applying IAS 32's criteria for offsetting financial assets and financial liabilities in the following two areas:

- the meaning of 'currently has a legally enforceable right of set-off'
- that some gross settlement systems may be considered equivalent to net settlement.

The Amendments are effective for annual periods beginning on or after 1 January 2014 and are required to be applied retrospectively. Management does not anticipate a material impact on the Group's consolidated financial statements from these Amendments.

### **Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)**

Qualitative and quantitative disclosures have been added to IFRS 7 'Financial Instruments: Disclosures' (IFRS 7) relating to gross and net amounts of recognised financial instruments that are (a) set off in the statement of financial position and (b) subject to enforceable master netting arrangements and similar agreements, even if not set off in the statement of financial position. The Amendments are effective for annual reporting periods beginning on or after 1 January 2013 and interim periods within those annual periods. The required disclosures should be provided retrospectively. Management does not anticipate a material impact on the Group's consolidated financial statements from these Amendments.

### **Annual Improvements 2009-2011 (the Annual Improvements)**

The Annual Improvements 2009-2011 (the Annual Improvements) made several minor amendments to a number of IFRSs. The amendments relevant to the Company are summarised below:

#### **Clarification of the requirements for opening statement of financial position:**

- clarifies that the appropriate date for the opening statement of financial position is the beginning of the preceding period (related notes are no longer required to be presented)
- addresses comparative requirements for the opening statement of financial position when an entity changes accounting policies or makes retrospective restatements or reclassifications, in accordance with IAS 8.

#### **Clarification of the requirements for comparative information provided beyond minimum requirements:**

- clarifies that additional financial statement information need not be presented in the form of a complete set of financial statements for periods beyond the minimum requirements
- requires that any additional information presented should be presented in accordance with IFRS and the entity should present comparative information in the related notes for that additional information.

#### **Tax effect of distribution to holders of equity instruments:**

- addresses a perceived inconsistency between IAS 12 'Income Taxes' (IAS 12) and IAS 32 'Financial Instruments: Presentation' (IAS 32) with regards to recognising the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction
- clarifies that the intention of IAS 32 is to follow the requirements in IAS 12 for accounting for income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction

**Segment information for total assets and liabilities:**

- clarifies that the total assets and liabilities for a particular reportable segment are required to be disclosed if, and only if: (i) a measure of total assets or of total liabilities (or both) is regularly provided to the chief operating decision maker; (ii) there has been a material change from those measures disclosed in the last annual financial statements for that reportable segment.

The Annual Improvements noted above are effective for annual periods beginning on or after 1 January 2013. Management does not anticipate a material impact on the Company's consolidated financial statements from these Amendments

**Summary of Outstanding Shares and Dilutive Instruments**

The Company currently has the following shares and dilutive instruments outstanding:

|           |                          |
|-----------|--------------------------|
| Shares:   | 25,191,656 Common Shares |
| Warrants: | 138,059 broker warrants  |
| Options:  | 456,500 options          |

**Additional Information**

Additional information on the Company can be found at [www.blumetric.ca](http://www.blumetric.ca) and at [www.sedar.com](http://www.sedar.com)