# Management Discussion & Analysis

**Three-Month Periods Ended December 31, 2013 and November 30, 2012**
(expressed in Canadian Dollars)

BluMetric Environmental Inc.

February 28, 2014

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-to-30, 2012.

This discussion is dated as of February 28, 2014, and explains the material changes in BluMetric's financial condition and results of operations for the three-month period ended December 31, 2013 (the "Q1 2014") and compares these results to the previous three-month interim period ended November 30, 2012 (the "Q1 2013"). The information provided in this document is not intended to be a comprehensive review of all matters concerning the Company. The 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 contains forward-looking statements about expected future events and the financial and operating performance of the Company. These statements, which include descriptions of 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 12 months, are included in the "Selected Financial Information", "Liquidity", and "Business Outlook" sections which follow. 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.

## Description of Business

BluMetric Environmental Inc. (www.blumetric.ca), a cleantech company, 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 and/or its predecessors have been in business since 1976.

The Company's business is executed by a staff of approximately 170, located in nine offices in Canada (Ottawa – Headquarters, Toronto, Montreal, Kitchener, Gatineau, Kingston, Sudbury, Barrie 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 130 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 it is located. For example, the Yellowknife office is focussed on northern contaminated site remediation and mining projects in the north; the Kitchener office services a variety of commercial and industrial sectors such as auto parts manufacturing, land development, and waste management; other regional offices show a similar sensitivity to local needs.

Over the years, the Company has also undertaken significant project assignments internationally in the United States, 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 are more active than others at any given time.

The head office of BluMetric is at 3108 Carp Road, Ottawa, Ontario, K0A 1L0.

### Core Business Units and Their Products and Services

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

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

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

<u>BluMetric Professional Services Group</u>

This group comprises 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
- Environmental Assessment and Due Diligence
- Engineering, Rehabilitation, and Design
- Renewable Energy, Waterpower, and Hydraulic Structures
- Industrial Hygiene, and Occupational Health & Safety
- Management Systems

<u>BluMetric Water Group (Design/Build)</u>

The BluMetric's Water group designs, manufactures, and implements water and wastewater and waste 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. In general, the services we provide fall under the following headings:

- Equipment, Product, and Technology Offerings
- Service Offerings

In addition to the above, the Water group provides extensive service to the Canadian Armed Forces under long-term contracts for the maintenance, repair, refurbishment, and upgrading of the Canadian Army's Reverse Osmosis Water Purification Units (ROWPU) and for the Navy's Shipboard Reverse Osmosis Desalination (SROD) systems.

**Strategy**

In the near and medium term, the Company intends to continue with its strategy of increasing the geographic scope of its activities by expanding further into Western Canada and Northern Canada, at first organically and in the longer term by way of strategic acquisition. The Company also plans international growth, as well as strengthening existing markets such as the Windsor to Quebec City Corridor. The Company is in the process of developing a strong representative network to deliver design-build water and waste water treatment solutions and products, particularly in the United States. This is expected to take advantage of the growing recovery of the United States economy, and that country's urgent need to replace aging infrastructure, ahead of which the gap will be bridged with solutions which can extend the life of existing plants, thereby facilitating measured and financially feasible reconstruction. This is being done with the introduction of new products afforded through strategic alliances and research and development programs.

The Company's working capital is expected to support planned business operations during the current fiscal year. While the Company reported a working capital deficit at the end of the three-month fiscal period ended December 31, 2013 this largely reflects the re-classification of long-term debt held by the Company's bank to a short-term liability, due to the cross-default arising from a failure to meet one of its financial covenants. (See below under "Liquidity".)

## Key Performance Drivers

Management believes that the Company's growth strategy continues to be somewhat insulated from international economic and commodity demand factors, since much of its revenues are in Canadian dollars and derived from the fee-for-service business which does not generally have raw materials cost exposure. As the business grows, especially in the US and Latin America, some positive impact will be derived from exchange rates and commodity prices. 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 (such as 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.

Beyond these external and international factors, some key performance drivers remain: the ability of the Company to continue to attract high-quality staff; unique technical and managerial approaches to project planning and execution; competitive pricing (often a reflection of an innovative approach to the selected solution); management's ability and 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 an ongoing strong commitment to environmental and social responsibility.

These performance drivers are expected to result in continued revenue growth and a return to the positive cash flow and earnings as demonstrated by WESA historically over many years. The balance sheet reflected positive working capital over the same historical period, and while it was negatively impacted by the RTO, is now beginning to show recovery during and beyond the December 31, 2013 quarter.

## Capability to Deliver Results

### Board of Directors

The Board of Directors consists of six members, having recently been expanded with the addition of two new independent directors (for a total of four independent directors), one of whom brings financial and entrepreneurial expertise, the other extensive public and private sector experience in the water industry.

**Executive Management**

Composition of the senior management team is unchanged from the last fiscal year end, and comprises: Roger M. Woeller, Co-CEO; William M. Touzel, Co-CEO (the Company and Mr. Touzel are in the process of negotiating a revised employment agreement.); Nell van Walsum, President, Professional Services group; Dan Scroggins, President, Water group; 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.

**Employees**

The Company has built a team of approximately 170 (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 Company offers competitive and attractive employment arrangements, and has been able to attract high-quality employees at all its locations.

**Gender Diversity**

The Company has made a commitment to gender diversity, in recognition of the superior results that can be expected to flow from embracing the benefits of intellectual knowledge of both genders. Among the Company's two groups, one, our Professional Services group, is headed by a woman, Nell van Walsum, which makes her one of the three members of the senior operational team. Moreover, BluMetric has just appointed Jane Pagel, a well-respected cleantech executive with a background in business and government, as one of the two new independent members of the Company's Board of Directors. This appointment helps the Board to begin to reflect the diversity of BluMetric's middle management, which has a nearly even distribution of men and women.

## Selected Annual Information

The following table shows selected consolidated financial data for BluMetric for the three most recently completed fiscal periods; it should be noted that the following amounts only include consolidation of financial results of the former Seprotech since the date of the RTO (November 16, 2012). 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, however audited financial statements for WESA Group Inc for the nine months ended August 31, 2012 have been filed and are summarized below.

**For the eleven months ended November 30, 2011, the nine months ended August 31, 2012, and the thirteen months ended September 30, 2013**

| | 2013 (13 Months) | | 2012 (9 Months) | | 2011 (11 Months) |
|---|---|---|---|---|---|
| | $ | | $ | | $ |
| Total revenue | 31,549,194 | | 16,645,601 | | 22,472,195 |
| Gross margin | 5,612,915 | | 2,892,789 | | 4,464,150 |
| Gross margin percentage of total revenue | 18% | | 17% | | 20% |
| Total SG&A expenses | 6,500,643 | | 2,654,091 | | 3,734,653 |
| Net income (loss) | (2,316,252) | | (114,104) | | 794,586 |
| Common shares outstanding | 25,191,656 | | 634,468 | | 634,468 |
| Net income per share | (0.12) | | (0.20) | | $1.10 |
| Total assets | 19,798,751 | | 13,948,908 | | 11,841,205 |
| Working capital | (1,787,469) | | 2,550,543 | | 2,811,700 |
| Long term debt | 2,153,732 | | 1,706,722 | | 1,654,373 |
| Shareholders' equity | 6,223,730 | | 5,309,825 | | 5,394,717 |

## Results of Operations

While the Company substantially met its revenue targets for FY 2013, it did not achieve what management expects in terms of satisfactory margins or profitability. A significant part of the Company's business (Professional Services) is subject to seasonal influences, hence the second and third quarters reflected a customary downturn which was not completely offset by the Water group's performance. This trend in results for both groups continued into the third quarter, suggesting that the negative performance reflected more than a seasonal fluctuation. During the third and fourth quarters and during the reporting period, management took steps to: engage more managers in the business planning and cost reduction process; including trimming of the workforce (which as of the date of this analysis was 170 compared with 195 as at September 30, 2013).

While the global business environment remained volatile, the ongoing enactment and implementation of environmental regulations has continued to create strong demand for the Company's service and product offerings. This trend is expected to continue, and the Company is working to ensure it can take advantage of opportunities as they arise.

**Highlights – First Quarter 2014**

Revenue in the first quarter 2014 was $7.6 million compared with $6.3 million for the prior quarter ended November 30, 2012, an increase of $1.3 million, or 21%. The revenue split between the water and professional services divisions was 35% and 65% respectively.

Both divisions benefitted from a strong order book during the first two months of the quarter, with December being subject to the typically shorter billing period attributable to the holidays. Even though the first quarter included the holiday season, there was an increase in the gross margin from 22% in the quarter ended November 30, 2012 to 24% or $1,856,536 for the quarter ended December 31, 2013, reflecting improvements in operations in both groups.

SG&A expenses of $1.7 million incurred during the quarter were $0.6 million higher than the $1.1 million reported for the quarter ended November 30, 2012. Since this quarter only reflected consolidated results from November 18 to November 30, 2012, comparison with the immediately prior interim period may be helpful. Compared with this immediately prior interim period ended September 30, 2013, SG&A expenses dropped from $2.7 million to $1.7 million, a 59% reduction.

The trend for major line items (e.g. overhead salaries) is down, as measured over the past three quarters, and this trend is expected to continue further, in response to lay-offs in the quarter ended December 31, 2013 which are not yet fully reflected in the results, and due to other specific steps taken by management to reduce overhead (e.g. rationalization of facilities).

Interest expense for the quarter was $119,000 compared with $110,000 for the comparable prior period, reflecting higher loan utilization and borrowing costs, plus incremental debt assumed upon completion of the RTO.

The net income for the quarter was $18,000 compared with a net income of $176,000 for the comparable prior period. The result reflects stock option expense of $113,000 and depreciation and amortization expense of $221,000. In the comparable prior period, there was no stock option expense and depreciation and amortization expense was only $112,000.

**Highlights – Three- Month period ended December 31, 2013**

During the three months ended December 31, 2013 the Company was substantially on target with revenues generated reaching $7.6 million. In addition to recurring business there was significant progress in both operating groups in securing new contracts. As previously reported, the Water group announced the award of a $2.3 million waste-water treatment contract in Panama, and the Professional Services group announced the award of a mining-related environmental project exceeding $3.0 million in the Sudbury area.

## Segmented Information

### Revenue

The Company currently operates under a single reportable segment consisting of the following revenue streams:

| | **For the three months ended December 31, 2013** | For the three months ended November 30, 2012 |
|---|---|---|
| Consulting services | **$ 5,013,852** | $ 4,781,680 |
| Design/build services | **2,610,919** | 1,527,290 |
| | **$ 7,624,771** | $ 6,308,970 |

### Geographical Segmentation

The Company operates in three principal geographical areas, Canada (Country of domicile), the United States and internationally, which represents wide distribution.

Sales reported by client location based on origin of purchase (i.e. domicile of contracting party, not final destination of equipment) are as follows.

| | Three months ended December 31, 2013 | | | |
|---|---|---|---|---|
| | Canada | Int'l | US | Total |
| Revenue | 6,693,005 | 776,473 | 155,293 | 7,624,771 |

| | Three months ended November 30, 2012 | | | |
|---|---|---|---|---|
| | Canada | Int'l | US | Total |
| Revenue | 5,576,442 | 698,465 | 34,063 | 6,308,970 |

### 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.

Innovation is found in both divisions and includes the development of new processes, new applications of technology, new tools and services. Two formidable examples include 1) the use of Unmanned Aerial Vehicles (UAV) for data collection. This tool when integrated into our geomatics data management and analysis provides low cost alternatives and a competitive advantage over traditional data-collection methods. The technology is most recently being applied in a wide variety of BluMetric services and business sectors. Examples including the Small Hydroelectric power generation business, baseline environmental and watershed assessment, agriculture, mining and bathymetric analysis using multi-spectral imaging and various sensors. BluMetric also relies on the development of alliances such as the one announced in the quarter with LG, utilizing their flat-sheet low-pressure membranes which, when integrated with BluMetric's other processes and products, give us reduced footprint, high effluent quality, and low energy alternatives to traditional waste water treatment approaches.

### 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 its cost structure with a view to optimising internal efficiency. The process will be undertaken in two phases to identify first where immediate cost savings can be achieved, and second where longer-term efficiencies can be realized through the use of software and other tools.

### Sales and Marketing

The Company's business has developed largely through existing client relationships, word-of-mouth, and marketplace presence. However, during the quarter, the Company has reached agreement in principal to engage the services of a seasoned marketing executive with extensive relevant expertise. Integration of the Marketing and Business Development functions remains a goal and a priority.

The Company's Corporate Development group has specific responsibility to guide the overall business development and growth initiatives (both organic and by merger and acquisition activities), and to introduce major sales opportunities to operating units, providing marketing materials, market research, and similar kinds of support. Specific initiatives currently in progress include internal consolidation and expansion of the Company's representative network in the U.S. where a significant upturn in business activity is underway, and the development of product agency agreements like one related to the supply of pumps for the water and waste water treatment equipment for BluMetric designs and third-party users in Canada and Latin America.

### Summary of Quarterly Results

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

| Quarter Ended | Dec 31 2013 | Sept 30[1] 2013 | May 31 2013 | Feb 28 2013 | Nov 30 2012 | Aug 31 2012 | May 31 2012 | Feb 28 2012 |
|---|---|---|---|---|---|---|---|---|
| Total revenue | 7,625 | 11,918 | 7,267 | 6,024 | 6,310 | 6,327 | 5,832 | 4,487 |
| Total cost of sales | 5,768 | 10,045 | 6,016 | 4,945 | 4,930 | 5,176 | 4,725 | 3,852 |
| Gross margin | 1,857 | 1,873 | 1,250 | 1,079 | 1,379 | 1,152 | 1,106 | 635 |
| GM % of total revenue | 24% | 16% | 17% | 18% | 22% | 18% | 19% | 14% |
| S,G &A Expenses | 1,720 | 2,663 | 1,723 | 1,331 | 1,028 | 654 | 977 | 1,023 |
| Interest expense | 119 | 196 | 52 | 73 | 36 | 32 | 18 | 15 |
| Net Income (loss) | 18 | (1,302) | (773) | (490) | 176 | 241 | 48 | (403) |
| Weighted Average Common Shares | 25,191,656 | 25,191,656 | 25,191,656 | 25,191,656 | 18,510,451 | 16,988,758 | 16,988,758 | 16,988,758 |
| Income (loss) per share [1] | $0.00 | $(0.05) | $(0.03) | $(0.02) | $0.01 | $0.01 | $0.00 | $(0.02) |

(1) 4 Month period

## Quarterly Trend Analysis

Quarterly trend analysis over the past eight quarters is affected by the completion of the reverse takeover during the quarter ended November 30, 2012. The three-month fiscal period ended December 31, 2013 reflects consolidated operations for the amalgamated entities for the entire period. Results for the three month period ended November 30, 2012 only include results for the former Seprotech from November 17 to November 30, 2012. The Corporation changed its year end from August 31 to September 30 and consequently the current and comparative quarters are misaligned by one month. As a result of all these factors, comparisons with prior periods may not provide a meaningful indication of relative performance. In addition, there are differences of a seasonal nature which are more prevalent in Professional Services than in Water/Wastewater Products, which further affects comparative analysis.

Historically, the Company's business has followed a seasonal cycle which dictated that its former quarters ended February 28 and May 31, experienced relatively lower levels of activity when compared to the balance of the year. This seasonal cycle is partly weather-related, as it is 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 that quarter each year.

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.

In 2012, quarterly 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 revenue for the first quarter largely reflecting pre-RTO WESA performance, and a small profit of $176,000 reported compared with a loss of $428,000 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 group. Revenues of approximately $6.0 million reflected on-budget performance from the Water group, but below-target revenue in the Professional Services group. The net loss of $490,000 was comparable with the prior year interim period net loss of $403,000.

The third quarter 2013 results reflect strong revenue growth relative to both the same period in 2012 and also to the second quarter in 2013, with the Professional Services group moving closer to target as spring progressed. The Water group, 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 $773,000.

The fourth quarter ended September 30, 2013 was a four-month quarter; hence, the results reflect an extra month. The gross margin increased to $1.9 million in the period from $1.6 million in the prior period, but in percentage terms slipped from 23% to 16%. SG&A expenses continued to grow, from $1.5 million at the end of the prior period, to $2.4 million for the period ended September 30, 2013. The reduction in gross margin, when combined with the increase in SG&A expenses, resulted in a net loss for the quarter of $1.3 million, or a net loss of $0.05 per share.

First quarter fiscal 2014 results reflect consolidated revenue of $7,624,771, a $1,315,801 or 21% improvement over the $6,308,970 reported for the comparable prior period. The gross margin of $1,856,536 or 24% was a 2% improvement over the $1,379,093 reported for the first quarter of 2013.

SG&A expenses of $1,722,089 were $615,020 higher than for the comparable quarter in FY 2013. However, the prior quarter reflected post-RTO consolidation of Seprotech results only from November 18 to November 30, 2012. Also, the current quarter does not yet reflect the impact of staff reductions implemented early in December, 2013.

Management is focussed on ways to ensure that costs are in line with revenue on a go-forward basis, consistent with its growth strategy. In that regard, the Water group has a robust pipeline of projects, and the Professional Services group is continuing to ramp up its activities as is typical of the season. Early indications subsequent to the quarter end are encouraging.

## Liquidity

The Company had a working capital deficit of $1,410,137 at December 31, 2013, compared with a working capital deficit of $1,787,469 at September 30, 2013. The improvement reflects several factors:

- Significant reduction in payables during the quarter
- Significant reduction in credit facilities; and
- Positive earnings for the quarter

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 continues to be out of compliance with its bank covenants, but is working closely with the bank in efforts to return to a positive compliance position in 2014 and has achieved a modest operating profit for the interim period ended December 31, 2013 in this regard. The Company's inability to meet its bank covenants resulted in a cross default of term loans provided by the bank such that $1,124,103 has been re-classified as current liabilities, which contributed significantly to the working capital deficit of $1,410,137 at quarter end.

The Company's ability to continue operating is dependent upon increasing and sustaining operational profitability, raising additional capital and continuing to satisfy creditors. The Company continues to report significant stable revenues, and is working to control costs and restructure its operations. However, there can be no assurance it will be successful in these efforts.

The recurring seasonal/cyclical patterns of the business typically result in one unprofitable quarter (January – March), one roughly break-even quarter (April – June), and two successive profitable quarters

(July – December) 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.

## Business Outlook

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

The Company's operating performance is subject to internal factors, which can be controlled, and external factors, which are less controllable, but can in some cases be anticipated and corrective action taken.

### External Environment

The Company primarily operates in Canada and in South America, and is beginning to see signs of a significant increase in activity in the United States. The latter activity primarily comprises sale of wastewater treatment, and until recently water treatment facilities. Typical clients for wastewater treatment plants are municipalities in the U.S. and Canada; mines in remote locations; and resort complexes in Latin America. Typical clients for water treatment plants are industrial manufacturers who require clean water as part of their manufacturing process but are precluded from using the region's fresh-water resources for environmental reasons. Another potentially significant user of the Company's services is the industrial sector, which is actively pursuing water treatment for the beneficial re-use of waste water in their facilities. BluMetric processes and technologies include traditional (RO and ultrafiltration) and new products (membrane bioreactors and the specific application of resins) which are integral to this initiative

### Internal Environment

Significant changes have been introduced into how the Professional Services group is being conducted, including tighter management of field staff, more involvement in business planning from middle management, and focus on developing growth areas such as geomatics, as well as incremental opportunities which are expected to expand an existing strong presence in the Canadian north. As has been noted elsewhere, the winter months are typically the slowest months in the Professional Services group, however this has been somewhat mitigated in 2014 by the award of two large contracts which are providing revenue through this slower period.

The Water group has made significant progress in getting costs under control, partly by better aligning headcount with orders on hand and also by rationalizing occupancy costs. This activity will continue into 2014. This group's activities in 2014 will focus on pushing higher value-add products into existing and new markets. South and Central America are being targeted geographically, with the previously announced Panama Canal project being a case in point.

### Corporate Focus

In the coming quarters, the Company is targeting organic revenue growth and in the longer term, growth through acquisitions. This will require:

- Improving margins and tightly managing overhead, and careful cost structure in existing operations and branch offices
- Maintaining and increasing the existing client base;
- Expanding its geographic reach, particularly in the U.S. through development of the BluMetric representative network;
- Selectively increasing staff complement in existing operations and branch offices, especially for operations in the Windsor to Quebec City corridor, to assist in increasing revenue and gross margin and growing earnings;
- Addition of new branch offices in strategically important locations;
- In the longer term, 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.

## Capital Resources

The Company had positive shareholder equity as at December 31, 2013. However, in light of the diminished working capital position, in the near term, management will continue to explore cost-effective opportunities to raise additional capital to support the corporate growth strategy.

While ongoing fixed asset 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 in the longer term. Accordingly, and as stated above, the Company may opportunistically approach the capital markets for additional equity funding if conditions are favourable.

## Business Risks

The Company is subject to a number of risks and uncertainties in the normal course of business which could materially affect 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 control costs and to return to consistently generating positive and increased profit margins;
- Reliance on key personnel.
- The ability to grow revenue through a network of sales representatives, particularly in the United States;
- The ability to maintain the working capital line of credit at the current level;

- Competition from companies which are better-financed; and
- Sustained economic recovery in the United States.

## Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

## Transactions with Related Parties

All related-party transactions are conducted under terms and conditions reflecting prevailing market conditions at the transaction date and are recorded at fair market value.

On November 15, 2012, the Company reached agreement with a number of creditors with respect to repayment terms for outstanding amounts payable, in the aggregate amount of $958,285. Of this amount, $666,771 is owed to related parties. The agreement requires the Company to repay this amount on a monthly basis, with blended payments of $22,947 principal and interest at 7% per annum such that repayment in full will be effected in four years. A gain on restructuring was recognized in the thirteen-month period ended September 30, 2013 of $133,754. Effective March 1, 2013, payments were suspended and the outstanding balances have been postponed in favour of the Company's bank.

## Proposed Transactions

As at December 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 Technologias S.A. de C.V., located in El Salvador.

## Summary of Outstanding Shares and Dilutive Instruments

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

| | |
|---|---|
| Shares: | 25,191,656 common shares |
| Convertible debentures: | $1,430,000 |
| Warrants: | 198,059 broker warrants |
| Options: | 2,071,300 options |

## Additional Information

Additional information on the Company can be found at www.blumetric.ca and at www.sedar.com

## Management's Responsibility for Financial Reporting

The consolidated financial statements of BluMetric Environmental Inc. ("BluMetric" – formerly Seprotech Systems Incorporated) and all the information in this annual financial report have been prepared by management, which is solely responsible for the integrity and fairness of the data presented, including the many amounts, which due to necessity, are based on estimates and judgments. The accounting policies followed in the preparation of these consolidated financial statements conform to International Financial Reporting Standards. When alternative accounting methods exist, management has chosen those that it deems most appropriate in the circumstances. Financial information presented throughout this report is consistent with that in the consolidated financial statements.

BluMetric maintains systems of internal accounting and administrative controls to provide reasonable assurance that the financial information is relevant, reliable and accurate and that transactions are authorized, assets are safeguarded and proper records are maintained.

The Board of Directors is responsible for ensuring that management fulfills its responsibility principally through its Audit Committee.

| | |
|---|---|
| Roger M. Woeller<br>Co-Chief Executive Officer | Ian W. Malone<br>Chief Financial Officer |