

METHES ENERGIES INTERNATIONAL LTD
Form 10-Q
October 15, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the Quarterly Period Ended August 31, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES
EXCHANGE ACT OF 1934

Commission File Number 001-35652

METHES ENERGIES INTERNATIONAL LTD.
(Exact name of registrant as specified in its charter)

NEVADA
(State of other
jurisdiction of
incorporation or
organization)

71-1035154
(I.R.S. Employer
Identification No.)

3651 Lindell Road, Suite D-272, Las Vegas, Nevada, 89103
(Address of principal executive offices)

(702) 932-9964
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, or

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a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer	<input type="radio"/>	Accelerated filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input checked="" type="radio"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

As of October 15, 2014, the registrant has 11,460,431 shares of Common Stock issued and outstanding.

METHES ENERGIES INTERNATIONAL LTD.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This Form 10-Q contains “forward looking information” within the meaning of applicable securities laws. Such statements include, but are not limited to, statements with respect to the Company’s beliefs, plans, strategies, objectives, goals and expectations, including expectations about the future financial or operating performance of the Company and its projects, capital expenditures, capital needs, government regulation of the industry, environmental risks, limitations of insurance coverage, and the timing and possible outcome of regulatory matters, including the granting of patents and permits. Words such as “expect,” “anticipate,” “intend,” “attempt,” “may,” “will,” “plan,” “believe,” “s,” “estimate” and variations of such words and similar expressions are intended to identify such forward looking information. These statements are not guarantees of future performance and involve assumptions, risks and uncertainties that are difficult to predict.

These statements are based on and were developed using a number of factors and assumptions including, but not limited to: stability in the U.S. and other foreign economies; stability in the availability and pricing of raw materials, energy and supplies; stability in the competitive environment; the continued ability of the Company to access cost effective capital when needed; and no unexpected or unforeseen events occurring that would materially alter the Company’s current plans. All of these assumptions have been derived from information currently available to the Company including information obtained by the Company from third party sources. Although management believes that these assumptions are reasonable, these assumptions may prove to be incorrect in whole or in part. As a result of these and other factors, actual results may differ materially from those expressed, implied or forecasted in such forward looking information, which reflect the Company’s expectations only as of the date hereof.

Factors that could cause actual results or outcomes to differ materially from the results expressed, implied or forecasted by the forward-looking information include risks associated with general business, economic, competitive, political and social uncertainties; risks associated with changes in project parameters as plans continue to be refined; risks associated with failure of plant, equipment or processes to operate as anticipated; risks associated with accidents or labor disputes; risks associated in delays in obtaining governmental approvals or financing, or in the completion of development or construction activities; risks associated with financial leverage and the availability of capital; risks associated with the price of commodities and the inability of the Company to control commodity prices; risks associated with the regulatory environment within which the Company operates; risks associated with litigation including the availability of insurance; and risks posed by competition. These and other factors that could cause actual results or outcomes to differ materially from the results expressed, implied or forecasted by the forward looking information are discussed in more detail in Item 1A under “Risk Factors” in Part I of our Annual Report on Form 10-K for the fiscal year ended November 30, 2013, as may be supplemented or amended from time to time and in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Part I, Item 2 in this document.

The Company does not intend to, and the Company disclaims any obligation to, update any forward-looking information (including any financial outlooks), whether written or oral, or whether as a result of new information, future events or otherwise, except as required by law.

All references in this Form 10-Q to “Company,” “Methes,” “we,” “us,” or “our” refer to Methes Energies International Ltd. and its wholly owned subsidiaries Methes Energies Canada Inc. and Methes Energies USA Ltd. unless the context otherwise indicates.

We have rights to the trademarks Methes Energies and Design, Methes, The Biodiesel Company and Denami.

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

METHES ENERGIES INTERNATIONAL LTD.

CONDENSED CONSOLIDATED BALANCE SHEETS AS OF NOVEMBER 30, 2013 AND AUGUST 31, 2014
(EXPRESSED IN US\$)

	November 30, 2013 (Unaudited)	August 31, 2014 (Unaudited)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 174,084	\$ 504,287
Accounts receivable, net (notes 14 and 16)	1,154,916	662,877
Inventories (note 4)	801,063	850,732
Prepaid expenses and deposits (note 5)	84,990	84,252
Fair value of derivative instruments (note 3)	—	13,311
Deferred financing fees	49,139	—
Total current assets	2,264,192	2,115,459
Deposits and employee loans	30,398	27,058
Property, plant and equipment, net (note 6)	8,178,694	7,950,587
Intangible assets, net	393,015	377,862
Total assets	\$ 10,866,300	\$ 10,470,966
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Credit facility (note 11)	\$ 1,019,513	\$ —
Accounts payable (note 14)	2,766,661	823,356
Accrued liabilities	211,296	378,778
Customer deposits (note 14)	8,185	152,186
Payable to related parties and others (note 7)	2,251,402	—
Short-term loans (note 8)	1,961,651	1,296,528
	8,218,708	2,650,848
Non-current liabilities		
Payable to related party (note 9)	—	759,010
Term loan (note 10)	—	1,752,415
Total non-current liabilities	—	2,511,425
Total liabilities	8,218,708	5,162,273
Stockholders' equity		
Preferred stock, \$0.001 par value, 10,000,000 shares authorized; 260,782 and 111,822 shares issued and outstanding as at November 30, 2013 and August 31, 2014, respectively (note 12)	261	112
	7,231	11,459

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Common stock, \$0.001 par value, 75,000,000 shares authorized; 7,231,417 and 11,460,431 shares issued and outstanding at November 30, 2013 and August 31, 2014, respectively (note 12)

Additional paid-in capital	18,532,803	26,285,441
Accumulated deficit	(15,892,703)	(20,988,319)
Total stockholders' equity	2,647,592	5,308,693

Total liabilities and stockholders' equity	\$ 10,866,300	\$ 10,470,966
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Commitments (note 15)

See accompanying notes to unaudited condensed consolidated financial statements

METHES ENERGIES INTERNATIONAL LTD.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
FOR THE THREE AND NINE MONTHS ENDED AUGUST 31, 2013 AND AUGUST 31, 2014
(EXPRESSED IN US\$)

	Three Months Ended August 31, 2013	Three Months Ended August 31, 2014	Nine Months Ended August 31, 2013	Nine Months Ended August 31, 2014
Revenue				
Biodiesel sales	\$ 1,528,152	\$ 2,115,715	\$ 3,738,892	\$ 2,741,546
Feedstock sales	52,104	52,310	137,092	148,651
Glycerin sales	30,074	33,671	66,515	57,517
Government incentives (note 16)	90,470	179,594	269,474	218,185
Equipment and part sales	3,112	—	5,769	1,397
Royalties	11,146	8,096	17,921	19,550
Others	32,146	11,261	50,006	31,682
	1,747,204	2,400,647	4,285,669	3,218,528
Cost of goods sold (note 3)	1,574,344	2,833,008	3,985,057	3,497,547
Gross profit	172,860	(432,361)	300,612	(279,019)
Operating expenses				
Selling, general and administrative expenses (notes 6, 12 and 13)				
	1,366,084	1,501,875	4,134,010	4,409,575
Loss before interest and taxes	(1,193,224)	(1,934,236)	(3,833,398)	(4,688,594)
Other expenses				
Interest expense (note 18)	(126,832)	(96,858)	(369,801)	(390,933)
Interest income	308	—	308	147
Net loss before income taxes	(1,319,748)	(2,031,094)	(4,202,891)	(5,079,380)
Income taxes				
	—	—	—	—
Net loss for the period	\$ (1,319,748)	\$ (2,031,094)	\$ (4,202,891)	\$ (5,079,380)
Net Loss Per Common Share - Basic and Diluted	\$ (0.19)	\$ (0.18)	\$ (0.61)	\$ (0.54)
Weighted average number of common shares - Basic and Diluted	6,981,854	11,443,673	6,854,869	9,436,267

See accompanying notes to unaudited condensed consolidated financial statements

METHES ENERGIES INTERNATIONAL LTD.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)
FOR THE YEAR ENDED NOVEMBER 30, 2013 AND THE NINE MONTHS ENDED AUGUST 31, 2014
(EXPRESSED IN US\$)

	Common Stock		Preferred Stock		Additional	Accumulated	Total
	Shares	Amount	Shares	Amount	Paid-in Capital	Deficit	
Balance at November 30, 2012	6,553,169	\$ 6,553	—	\$ —	\$ 16,033,123	\$ (10,241,029)	\$ 5,798,647
Issuance of common stock units under private placement	653,248	653	—	—	2,149,347	—	2,150,000
Issuance cost – common stock under private placement	—	—	—	—	(368,611)	—	(368,611)
Issuance of Common stock for services	25,000	25	—	—	51,975	—	52,000
Issuance of preferred stock units under private placements	—	—	260,782	261	622,239	—	622,500
Issuance cost – preferred stock under private placement	—	—	—	—	(149,330)	—	(149,330)
Stock-based compensation	—	—	—	—	155,578	—	155,578
Dividends payable on preferred stock units	—	—	—	—	—	(9)	(9)
Issuance of common stock options to employees and officer	—	—	—	—	38,482	—	38,482
Net loss for the period	—	—	—	—	—	(5,651,665)	(5,651,665)
	7,231,417	\$ 7,231	260,782	\$ 261	\$ 18,532,803	\$ (15,892,703)	\$ 2,647,592

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Balance at November 30, 2013							
Issuance of common stock units under private placement	1,081,161	1,081	—	—	2,161,240	—	2,162,321
Issuance of common stock under public offering	2,800,000	2,800	—	—	5,597,200	—	5,600,000
Issuance cost—common stock units under private placement	—	—	—	—	(949,358)	—	(949,358)
Issuance of common stock units for cash upon conversion of preferred stock units	148,960	149	(148,960)	(149)	—	—	—
Issuance of common stock upon conversion of dividends on preferred stock	7,205	7	—	—	16,229	(16,236)	—
Issuance of common stock units for cash	16,129	16	—	—	99,984	—	100,000
Issuance of common stock and units for services	133,871	134	—	—	489,616	—	489,750
Issuance of common stock units for loan settlement	34,688	34	—	—	127,965	—	127,999
Issuance of common stock upon conversion of placement agent warrants	7,000	7	—	—	13,993	—	14,000
Stock-based compensation	—	—	—	—	195,769	—	195,769
Net loss for the period	—	—	—	—	—	(5,079,380)	(5,079,380)

Balance at August 31, 2014	11,460,431	\$ 11,459	111,822	\$ 112	\$ 26,285,441	\$ (20,988,319)	\$ 5,308,693
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See accompanying notes to unaudited condensed consolidated financial statements

METHES ENERGIES INTERNATIONAL LTD.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
FOR THE NINE MONTHS ENDED AUGUST 31, 2013 AND AUGUST 31, 2014
(EXPRESSED IN US\$)

	Nine Months Ended August 31, 2013	Nine Months Ended August 31, 2014
Cash flows from operating activities:		
Net loss for the period	\$ (4,202,891)	\$ (5,079,380)
Adjustments to reconcile net loss to net cash used in operations		
Depreciation and amortization	353,488	333,287
Stock-based compensation	138,139	195,769
Unrealized foreign exchange gain	(104,633)	(49,209)
Deferred financing fees amortization	30,590	49,139
Accrued interest	117,506	127,118
Bad debts	25,970	35,662
Issuance of common stock/units for consulting services	—	459,337
Unrealized loss on call options (note 3)	—	11,169
Changes in operating assets and liabilities:		
Accounts receivable	64,251	456,377
Inventories	336,445	(49,670)
Prepaid expenses and deposits	27,597	31,153
Accounts payable and accrued liabilities	1,101,981	(1,775,824)
Customer deposits	115,341	144,002
Deposits and employee loans	—	3,340
Net cash used in operating activities	(1,996,216)	(5,107,730)
Cash flows from investing activity:		
Additions to property, plant and equipment	(378,868)	(90,027)
Additions to intangible assets	(191)	—
Purchase of call options (note 3)	—	(24,480)
Net cash used in investing activity	(379,059)	(114,507)
Cash flows from financing activities:		
Advances from (repayment of) credit facility	129,895	(1,019,513)
Advances from short-term loans	1,938,040	—
Repayments of short-term loans	(1,444,350)	(493,175)
Advances from long-term related party loans	—	172,000
Advances from related parties and others	519,258	—
Repayments to related parties and others	(33,835)	(33,835)
Deferred financing fees	(51,075)	—
Issuance of common stock/units under private placement	1,750,000	2,162,321
Issuance costs - common stock units under private placement	(330,611)	(949,358)
Issuance of common stock under public offering	—	5,600,000
Issuance of common stock/units for cash	—	100,000
Issuance of common stock upon conversion of placement agent warrants	—	14,000

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Net cash provided by financing activities	2,477,322	5,552,440
NET INCREASE IN CASH AND CASH EQUIVALENTS	102,047	330,203
Cash and cash equivalents, beginning of period	402,724	174,084
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 504,771	\$ 504,287
Supplemental disclosures of cash flow information		
Interest paid	\$ 238,206	\$ 255,212
Common shares issued as repayment of loan	\$ —	\$ 128,000

See accompanying notes to unaudited condensed consolidated financial statements

METHES ENERGIES INTERNATIONAL LTD.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Unaudited
As of August 31, 2014
(Expressed in US\$)

NOTE 1 - NATURE OF THE BUSINESS, FINANCING REQUIREMENTS AND BASIS OF PRESENTATION

Methes Energies International Ltd. ("Methes" or the "Company"), was incorporated on June 27, 2007 in the State of Nevada. Methes, through its operations in Canada and the United States, is a biodiesel processing equipment provider and a biodiesel producer. The Company has developed biodiesel processing equipment to produce biodiesel from recycled oils and virgin oils. The Company, through its wholly-owned subsidiary Methes Energies Canada Inc. ("Methes Canada"), owns two biodiesel manufacturing facilities; one is located in Mississauga, Ontario with a nameplate production capacity of 1.3 million gallons per year (mgy), which is currently idle, and the second facility is capable of producing 13.0 mgy of biodiesel located in Sombra, Ontario. In addition to Methes Canada, Methes Energies USA Ltd. ("Methes USA") was incorporated as the wholly-owned subsidiary of the Company on June 27, 2007. All references in this Form 10-Q to "Company," "Methes," "we," "us," or "our" refer to Methes Energies International Ltd. and its wholly owned subsidiaries Methes Canada and Methes USA unless the context otherwise indicates.

As at August 31, 2014, due in large part to the funds spent to develop, build and commission our Sombra facility as well as minimal sales of biodiesel, the Company had a working capital deficiency of \$535,389. During the nine months ended August 31, 2014, the Company incurred a loss of \$5,079,380 and had negative cash flows from operations of \$5,107,730. The Company anticipates that its Sombra facility will generate positive cash flows from operations and will operate profitably once full-scale commercial operations are achieved. In order to meet its development goals and ongoing operational requirements, the Company may require additional financing in the next 12 months. However, management believes that the anticipated positive cash flows from operations, the cash flow from the potential sale of the biodiesel equipment, and the cash flow from the additional financing completed in August 2014 and the anticipated additional financing will be sufficient to meet the Company's cash requirements for at least the next 12 months.

The condensed consolidated financial statements have been prepared by the Company without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted as permitted by such rules and regulations. All adjustments, consisting of normal recurring adjustments, have been included. Management believes that the disclosures are adequate to present fairly the financial position, results of operations and cash flows at the dates and for the periods presented. It is suggested that these interim financial statements be read in conjunction with the consolidated financial statements and the notes thereto appearing in the Company's latest annual report on Form 10-K. Results for interim periods are not necessarily indicative of those to be expected for the full fiscal year.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries Methes Canada and Methes USA. All significant inter-company transactions and balances have been eliminated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Deferred Financing Fees

Financing fees relating to other financing arrangements are deferred and amortized over the term of the respective loan.

Shipping and Handling Costs

The Company accounts for shipping and handling fees in accordance with FASB ASC 705 "Cost of Sales and Services". Shipping and handling costs for the three and nine months ended August 31, 2014 were \$96,362 and \$119,965, respectively (three and nine months ended August 31, 2013 was \$23,869 and \$199,125, respectively). Costs related to raw materials purchased, are included in inventory or cost of goods sold, as appropriate. While amounts charged to customers for shipping product are included in revenues, the related outbound freight costs are included in expenses as incurred.

Income Taxes and Uncertain Tax Positions

The Company accounts for income taxes under ASC 740 Accounting for Income Taxes. Under ASC 740, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the periods in which those temporary differences are expected to be recovered or settled. Under ASC 740, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. ASC 740-10-05, Accounting for Uncertainty in Income Taxes, prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return.

For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities.

The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Potential tax benefits from net operating losses and foreign tax credit carry forwards are not recognized by the Company until their realization is more likely than not. The Company assesses the validity of conclusions regarding uncertain tax positions on a quarterly basis to determine if facts or circumstances have arisen that might cause the Company to change their judgment regarding the likelihood of a tax position's sustainability under audit. The Company has determined that there were no material uncertain tax positions as at November 30, 2013 and August 31, 2014.

Per Share Data

Basic earnings per share ("EPS") is determined by dividing net earnings available to common stockholders (numerator) by the weighted average number of shares outstanding (denominator) during the period. In computing diluted EPS, the average number of shares of Common Stock outstanding is increased by Common Stock options and warrants outstanding if the exercise prices were lower than the average market price of Common Stocks using the treasury stock method. Diluted earnings per share exclude all potentially dilutive shares if their effect is anti-dilutive. Potentially dilutive shares include 2,192,012 warrants and 365,057 Common Stock options issued and outstanding as at August 31, 2013 and 3,923,149 warrants, 445,071 Common Stock options and 111,822 shares of Preferred Stock issued and outstanding as at August 31, 2014. All outstanding warrants, preferred shares and options have an anti-dilutive effect on the loss per share and are therefore excluded from the determination of the diluted loss per share calculation for the three and nine months ended August 31, 2013 and August 31, 2014.

Renewable Identification Numbers (RINs)

When the Company imports and sells a gallon of biodiesel into United States, 1.5 RINs per gallon are generated. RINs are used to track compliance with Renewable Fuel Standards (RFS2). RFS2 allows the Company to attach between zero and 2.5 RINs to any gallon of biodiesel. When the Company imports and sells a gallon of biodiesel, 1.5 RINs are generally attached. As a result, a portion of the selling price for a gallon of biodiesel is generally attributable to RFS2 compliance. However, RINs that the Company generates are a form of government incentive and not a result of the physical attributes of the biodiesel production. Therefore, no cost is allocated to the RIN when it is generated, regardless of whether the RIN is transferred with the biodiesel produced or held by the Company pending attachment to other biodiesel production sales.

The Company may, however, obtain RINs returned from its customers as part of the biodiesel sales terms after having separated the RINs from gallons of biomass-based diesel. From time to time, the Company holds varying amounts of these separated RINs for resale. RINs obtained from customers are initially recorded at fair value on the date received, and are subsequently revalued at fair value as of the last day of each accounting period. Fair value adjustments are reflected in costs of goods sold for the period. The value of RINs obtained from customers are reflected in "Inventories" on the consolidated balance sheet.

Derivative Instruments

Derivatives are recorded on the balance sheet at fair value with changes in fair value recognized in current period earnings. The Company accounts for derivative instruments under ASC Topic 815 - 40, "Derivatives and Hedging" or ASC 815 - 40. Under these standards, derivative instruments are recognized as either assets or liabilities in the balance sheet and are measured at fair value. The Company utilizes futures contracts and options to hedge feedstock purchases. The Company has designated the derivatives as non-hedge derivatives that are utilized to manage cash flow. Unrealized gains and losses on the futures contracts and options are therefore recognized as a component of biodiesel cost of goods sold, and are reflected in current results of operations.

New Accounting Pronouncements

In December 2011, the FASB issued ASU No. 2011-11, Disclosures about Offsetting Assets and Liabilities (Topic 210). The new disclosure requirements mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. In addition, the standard requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. The amendments are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual

periods. The disclosures required by the amendments are required to be applied retrospectively for all comparative periods presented. The Company adopted this statement effective December 1, 2013. The adoption of this statement did not have a material effect on the Company's unaudited condensed consolidated financial statements.

On May 28, 2014, the FASB issued a new financial accounting standard on revenue from contracts with customers, Update No. 2014-09, Revenue from Contracts with Customers (Topic 606). The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The accounting standard is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the impact of this accounting standard.

On August 27, 2014, the FASB issued a new financial accounting standard on going concern, Update 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The standard provides guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern. The amendments in this Update apply to all companies. They become effective in the annual period ending after December 15, 2016, with early application permitted. The Company is currently evaluating the impact of this accounting standard.

All other recent pronouncements issued by the FASB or other authoritative standards groups with future effective dates are either not applicable or are not expected to be significant to the condensed consolidated financial statements of the Company.

NOTE 3 – FAIR VALUE OF DERIVATIVE INSTRUMENTS

Fair value of derivative instruments represent the fair value of the outstanding call option contracts to hedge the Company's exposure to price risk related to feedstock oil to be purchased in September 2014. These call options were purchased for a cost of \$24,480. The fair value loss of \$11,169 (three months ended August 31, 2013, \$nil) was recorded as part of the cost of goods sold during the quarter.

During the quarter, the Company has entered into certain derivative contracts to hedge its exposure to price risk related to feedstock oil. The Company recorded realized losses of \$245,346 (three months ended August 31, 2013, \$ nil) as part of cost of goods sold upon settlement of these contracts during the quarter, however, the Company acquired the feedstock oil at a lower prices providing a better margin overall. As at August 31, 2014, no derivative futures contracts were outstanding.

NOTE 4 - INVENTORIES

Inventories consisted of the following:

	As at November 30, 2013	As at August 31, 2014
Raw materials	\$ 345,049	\$ 194,974
Finished goods	444,648	541,558
Equipment	11,366	11,366
K2 RINs	—	102,834
	\$ 801,063	\$ 850,732

K2 Renewable Identification Numbers are separated RINs that the Company intends to sell in the open market subsequent to the quarter end. K2 RINs were valued at market price of \$0.51 per gallon.

NOTE 5 - PREPAID EXPENSES AND DEPOSITS

Prepaid expenses and deposits includes investor relations consulting services amounting to \$30,413 as at August 31, 2014 (as at November 30, 2013, \$44,652) which were paid through issuance of shares of Common Stock of the Company.

NOTE 6 - PROPERTY, PLANT AND EQUIPMENT

	As at August 31, 2014			As at November 30, 2013
	Cost	Accumulated Depreciation	Net Book Value	Net Book Value
Sombra site:				
Land	\$ 409,134	\$ —	\$ 409,134	\$ 409,134
Building	2,944,356	297,116	2,647,240	2,702,446

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Equipment	775,865	465,848	310,017	390,465
Equipment - Denami 3000	4,254,995	316,489	3,938,506	3,975,441
Computer equipment	11,835	10,282	1,553	5,918
Vehicle	11,622	1,162	10,460	11,331
Mississauga site:				
Computer equipment	23,464	23,403	61	1,316
Leasehold improvements	102,201	63,403	38,798	46,591
Equipment and fixtures	255,463	197,434	58,029	77,662
Equipment - Denami 600	720,042	183,253	536,789	558,390
	\$ 9,508,977	\$ 1,558,390	\$ 7,950,587	\$ 8,178,694

Total depreciation expense included in selling, general and administrative expenses in the unaudited consolidated statements of operations related to property, plant and equipment for the three and nine months ended August 31, 2014 was \$106,039 and \$318,134, respectively (three and nine months ended August 31, 2013 was \$104,743 and \$338,335, respectively).

NOTE 7 - PAYABLE TO RELATED PARTIES AND OTHERS

Payable to related parties is comprised of the following:

	As at November 30, 2013	As at August 31, 2014
Michel G. Laporte (stockholder and Director) (reclassified to non-current, see note 9)	\$ 719,230	\$ —
Due to an unrelated corporation (reclassified to non-current, see note 10)	1,495,477	—
Other loan	36,695	—
	\$ 2,251,402	\$ —

NOTE 8 - SHORT-TERM LOANS

	As at November 30, 2013	Interest Accrued	Repayments	Foreign Exchange Adjustments	As at August 31, 2014
Term loan (July 2013)	\$ 1,506,560	\$ —	\$ (227,875)	\$ (37,090)	\$ 1,241,595
Promissory note (i)	52,533	2,400	—	—	54,933
Promissory note (ii)	402,558	4,099	(397,400)	(9,257)	—
	\$ 1,961,651	\$ 6,499	\$ (625,275)	\$ (46,347)	\$ 1,296,528

Term loan (July 2013)

On July 12, 2013, Methes Canada entered into a term loan facility agreement with a lender (the "Agreement") pursuant to which Methes Canada is able to borrow up to \$1,540,640 (\$1,600,000 CAD) for a term of 12 months at an interest rate of 12% per annum (the "July 2013 Facility"). Under the terms of the Agreement, interest is payable monthly and outstanding principal is due at maturity. Outstanding principal would be prepayable after six months upon 30 days' notice and payment of a penalty equal to one-month's interest. The July 2013 Facility is collateralized by a security agreement from Methes Canada on certain of its assets except for accounts receivable and inventory and a first collateral mortgage on its real property located at Sombra, Ontario. The July 2013 Facility prohibits payment of debt owed by the Company to certain of its stockholders, a director and an unrelated Corporation (see note 10) during the life of the facility and contains other customary debt covenants.

Interest expense incurred during the three and nine months ended August 31, 2014 was \$44,250 and \$131,818 (three and nine months ended August 31, 2013 - \$25,001 and \$25,001).

A partial payment of \$227,875 was made during the current quarter against the principal outstanding on the July 2013 Facility.

Subsequent to quarter end, Methes Canada signed a term sheet with a new lender for a mortgage loan of \$1,700,000 (see note 19). The proceeds from that loan will be used to repay the remaining balance on the July 2013 Facility.

The one year term loan agreement (December 2013) for \$1,834,200 bearing interest at 9% per annum was cancelled during the quarter ended August 31, 2014. The monies advanced from this loan of \$140,743 including interest was reclassified and set up as deposit on the potential sale of biodiesel equipment.

Promissory Notes:

- (i) In January 2010, the Company borrowed \$40,000 from a lender and issued to the lender a demand promissory note in the principal amount of \$40,000 bearing interest at 8% per annum. Repayment of the loan and payment of the accrued interest is due upon demand.

Interest expense incurred during the three and nine months ended August 31, 2014 was \$800 and \$2,400 (three and nine months ended August 31, 2013 - \$800 and \$2,400).

- (ii) On January 26, 2013, the Company borrowed \$397,400 (\$400,000 CAD) from a lender and issued to the lender a demand promissory note in the principal amount of \$397,400 bearing interest at 8% per annum (the "January 2013 Note"). Repayment of the loan and payment of the accrued interest is due upon demand.

During the nine months ended August 31, 2014, the January 2013 Note was repaid in full, which included total principal and interest payments of \$397,400 (\$400,000 CAD) and \$32,571 (\$34,057 CAD), respectively, as follows:

- On January 17, 2014, the Company converted \$128,000 of the outstanding principal due on the January 2013 Note into 34,688 shares of Common Stock based at the closing market price of \$3.69 per share of Common Stock on January 17, 2014 (refer to note 12 under section "Issuance of Common Stock for loan settlement").
- On January 30, 2014, the Company paid \$153,871 against the outstanding principal balance through borrowing a note payable from another lender.
- On May 30, 2014, the Company paid the remaining balance.

Interest expense incurred during the three and nine months ended August 31, 2014 was \$1,569 and \$4,099 (three and nine months ended August 31, 2013 - \$7,720 and \$18,296).

NOTE 9 – PAYABLE TO RELATED PARTY

Payable to related party includes promissory notes due to Michel Laporte, a stockholder and director of the Company. The promissory notes bear interest at 8% per annum, are unsecured and not payable until April 1, 2016.

The principal amount outstanding as at August 31, 2014 is \$663,000 and total accrued interest includes \$96,010 (as at November 30, 2013, principal of \$663,000 and interest of \$56,230).

Interest expense incurred during the three and nine months ended August 31, 2014 was \$13,260 and \$39,780 (three and nine months ended August 31, 2013 - \$12,000 and \$21,131).

NOTE 10 - TERM LOAN

Term loan includes promissory notes due to an unrelated Corporation. The promissory notes bear interest at 8% per annum, are unsecured and not due for payment until April 1, 2016.

The principal amount outstanding as at August 31, 2014 is \$1,452,000 and total accrued interest includes \$300,415 (as at November 30, 2013, principal of \$1,280,000 and total interest of \$215,477).

Interest expense incurred during the three and nine months ended August 31, 2014 was \$29,040 and \$84,938 (three and nine months ended August 31, 2013 - \$25,600 and \$73,600).

NOTE 11 - CREDIT FACILITY

Credit Facility No.1

On August 16, 2013, Methes Canada entered into and closed on a working capital loan facility from a Toronto, Ontario lending firm (the "Working Capital Facility"). Under the Working Capital Facility, Methes Canada may borrow up to \$1,500,000 for its Sombra, Ontario biodiesel manufacturing plant, of which up to \$750,000 may be from cash advances against Methes Canada's accounts receivables through factoring of accounts receivable with full recourse and up to an additional \$750,000 in cash advances for use exclusively to purchase feedstock for the production of biodiesel. The Working Capital Facility is secured by a pledge of the accounts receivable and inventory of Methes Canada and Methes USA.

In connection with all borrowings to purchase feedstock, Methes Canada issued a promissory note to the lender bearing a per annum interest rate equal to the Bank of Montreal Prime Rate plus sixteen percent (16%) and is due and payable upon the earlier of demand or August 13, 2014. The effective interest rate as of August 31, 2014 was 19% (16% plus 3% prime rate). Under the terms of the promissory note, interest only is payable monthly on the last business day of each calendar month.

Cash advances against accounts receivables are based on the amount of the receivables net of a purchase discount as agreed with the lender with an interest rate of Bank of Montreal Prime Rate plus three percent (3%). Effective interest rate as of August 31, 2014 was 6% (3% plus 3% prime rate). The balance outstanding as at November 30, 2013 of \$1,019,513 was fully repaid during the first quarter of fiscal 2014 through cash from operations.

Interest expense incurred under this credit facility during the three and nine months ended August 31, 2014 was \$nil and \$7,909 (three and nine months ended August 31, 2013 - \$nil and \$nil).

During the quarter ended August 31, 2014, the Working Capital Facility was discontinued and replaced with Credit Facility No. 2 (see below).

Credit Facility No.2

On August 28, 2014, the Company entered into a feedstock credit facility with a major provider of credit to the renewable fuels industry (the "Lender"), which will provide the Company all the feedstock that is required to run at full current capacity and allow the Company to fulfill future orders for biodiesel that it receives from its customers that have been approved by the credit department of the Lender. The Company had also agreed to a biodiesel sales contract subject to the Lender's approval and subject to a tripartite payment and Assignment Agreement. The facility bears interest at 5% per annum.

As referred to in note 3, the Company has also entered into certain derivative contracts with the Lender to hedge its exposure to price risk related to feedstock oil.

NOTE 12 - STOCKHOLDERS' EQUITY

COMMON STOCK

The Company is authorized to issue 75,000,000 shares of Common Stock with a par value of \$0.001 and had 7,231,417 and 11,460,431 shares of Common Stock issued and outstanding as of November 30, 2013 and August 31, 2014, respectively.

	No. of Shares	Price per Share
Common Stock		
Balance as at November 30, 2013	7,231,417	
Issuance of shares under private placement	1,081,161	\$2.00
Issuance of shares under public offering	2,800,000	\$2.00
Issuance of shares upon conversion of Preferred Stocks units	148,960	\$2.26
Issuance of shares upon conversion of accrued dividends on Preferred Stocks units	7,205	\$2.26
Issuance of shares for cash	16,129	See below
Issuance of shares for services	133,871	See below
Issuance of shares for loan settlement	34,688	\$3.69
Issuance of shares upon conversion of Placement Agent Warrant	7,000	\$2.00
Balance as at August 31, 2014	11,460,431	

Issuance of Common Stock units under Private Placement

During the month of December 2013 the Company issued a total of 1,081,161 units (each a "Unit") to accredited investors at a price of \$2.00 per Unit under a private placement and raised net proceeds of approximately \$1.87 million, after deducting the sales commission and fees (the "December 2013 Private Placement"). Each Unit consists of one share of Common Stock and one five year Common Stock Warrant to purchase one share of Common Stock at an exercise price of \$4.00 per share ("Common Stock Warrant"). (see Stock Warrant Table below).

In connection with the December 2013 Private Placement, the Company issued compensatory warrants (the "Placement Agent Warrant") to the Placement Agents for the offering exercisable for an aggregate of 108,116 Units. Each of these warrants is exercisable to acquire a Unit at an exercise price of \$2.00 per Unit. The fair value of these warrants at the grant date was \$257,553. This amount was estimated using the Black-Scholes option pricing model with an expected life of 5 years, risk free interest rates between 1.66% and 1.74%, a dividend yield of 0%, and an expected volatility of 75%. (see Stock Warrant Table below).

Issuance of Common Stocks under Public Offering

On May 27, 2014, the Company closed an underwritten public offering of 2,500,000 shares of Common Stock and raised net proceeds of \$4.5 million, after deducting Underwriter's fees and estimated offering expenses. Under the terms of the Underwriting Agreement, the Underwriter had an option through June 26, 2014, to purchase up to an additional 375,000 shares of Common Stock under the same terms as the public offering to cover over-allotments (the "Over-Allotment Option"), if any.

On May 28, 2014, the Underwriter partially exercised the Over-Allotment Option for 300,000 shares of Common Stock raising approximately \$550,000 of additional net proceeds for the Company.

Issuance of Common Stocks upon conversion of Preferred Stocks units and accrued dividends

i) Series A-2 Preferred Stock Conversions

On March 13, 2014, two holders of our Series A-2 Convertible Preferred Stock ("Series A-2 Preferred") converted 20,876 shares of outstanding Series A-2 Preferred including with an aggregate stated value of approximately \$49,139 (including accrued dividends of \$1,750 or 772 stocks) into 21,648 shares of Common Stock at a price of \$2.27 per share.

On May 9, 2014, a holder of our Series A-2 Preferred converted 10,438 shares of outstanding Series A-2 Preferred with an aggregate stated value of approximately \$26,250 (including accrued dividends of \$1,250 or 551 stocks) into 10,989 shares of Common Stock at a price of \$2.27 per share.

ii) Series A-1 Preferred Stock Conversions

On March 17, 2014, two holders of our Series A-1 Convertible Preferred Stock ("Series A-1 Preferred") converted 117,646 shares of outstanding Series A-1 Preferred with an aggregate stated value of approximately \$293,235 (including accrued dividends of \$13,235 or 5,882 stocks) into 123,528 shares of Common Stock at a price of \$2.25 per share.

Issuance of Common Stock for cash and services rendered

On January 3, 2014, the Company issued 25,000 shares of Common Stock in the second installment quarterly payment of consulting fees for services to be rendered by a consultant for over a year which were valued at \$87,250, based on the closing market price of \$3.49 per share on the day of issuance. On May 1, 2014, the Company issued 25,000 shares of Common Stock in the third quarterly installment payment of consulting fees for services to be rendered by the consultant which were valued at \$61,250, based on the closing market price of \$2.45 per share on the date of issuance.

On January 10, 2014, the Company sold 50,000 Units to an accredited investor in a private placement for a purchase price of \$125,000 (or \$2.50 per Unit) of which \$100,000 was paid in cash and \$25,000 was settled through services rendered to the Company, which was included in the selling, general and administrative expenses. The aggregate fair value of the Units sold in this offering was \$310,000 (or \$6.20 per Unit), based on the closing market price of \$3.58 per share of Common Stock on the day of issuance, and the fair value of the Common Stock Warrants of \$2.62 per warrant. The Common Stocks allocated to cash portion was 16,129 Common Stocks ($\$100,000/\$310,000 \times 50,000$ units) and the services portion allocated is 33,871 Common Stocks. The fair value of the Common Stock Warrants was estimated using the Black-Scholes option pricing model with an expected life of 5 years, risk free interest rates of 1.64%, a dividend yield of 0%, and an expected volatility of 100%. The excess of the estimated fair value over the

purchase price in the amount of \$185,000 is included in the selling, general and administrative expenses. (see Stock Warrant Table below).

On January 28, 2014, the Company issued 25,000 shares of Common Stock in payment of consulting fees for services to be rendered by a consulting corporation for a term of six months. These shares of Common Stock were valued at \$88,750, based on the closing market price of \$3.55 per share on the date of issuance.

On August 1, 2014, the Company issued 25,000 shares of Common Stock in the final quarterly installment payment of consulting fees for services to be rendered by the consultant which were valued at \$42,500, based on the closing market price of \$1.70 per share on the date of issuance, of which \$30,413 is included in prepaid expenses as at August 31, 2014 (see note 5).

Issuance of Common Stock for loan settlement

On January 17, 2014, the Company issued 34,688 shares of Common Stock to a note holder at \$3.69 per share of Common Stock in conversion of \$128,000 of a note payable by the Company (See note 8(ii)).

Issuance of Common Stocks upon conversion of Placement Agent Warrants

On May 9 and 19, 2014, two holders of Placement Agent Warrants exercised their warrants for an aggregate of 7,000 Units at a price of \$2.00 per Unit or an aggregate stated value of \$14,000, which included 7,000 shares of Common Stock and 7,000 Warrants (each at an exercise price of \$4.00).

PREFERRED STOCK

The Company is also authorized to issue up to 10,000,000 shares of preferred stock with a par value of \$0.001 per share, from time to time in one or more series, without shareholder approval, when authorized by its board of directors (the "Board"). As of each of November 30, 2013 and August 31, 2014, the Board has designated 152,519 shares of Series A-1 Preferred and 134,341 shares of Series A-2 Preferred. As of November 30, 2013, 138,654 shares of Series A-1 Preferred and 122,128 shares of Series A-2 Preferred were issued and outstanding (for a total of 260,782 shares outstanding as of November 30, 2013). During the nine months ended August 31, 2014, 117,646 shares of Series A-1 Preferred and 31,314 shares of Series A-2 Preferred were converted into shares of Common Stock. As of August 31, 2014, 21,008 shares of Series A-1 Preferred and 90,814 shares of Series A-2 Preferred were issued and outstanding (for a total of 111,822 shares outstanding as of August 31, 2014). Collectively, the Series A-1 Preferred and the Series A-2 Preferred are referred to herein as the "Series A Preferred Stock."

As at August 31, 2014, on the Series A Preferred Stock had total accumulated dividends of \$23,004, none of which have been declared by the Board or accrued (August 31, 2013 - \$nil).

STOCK WARRANT TABLE:

	Grant Date	Exercise Period	No of Warrants	Exercise Price per share	Fair Value of Broker Warrants
Balance as at November 30, 2013			2,678,872		
Common Stock Warrants issued – Private Placement	Dec. 20, 2013	5 years from grant date	1,081,161	\$ 4.00	
Placement Agent Warrant – Private Placement	Dec. 20 2013	5 years from grant date	108,116	\$ 2.00	\$ 257,553
Placement Agent Warrant – Private Placement (November 27, 2013)	Dec. 20 2013	5 years from grant date	5,000	\$ 2.00	\$ 6,403
Common Stock Warrant issued-accredited investor	Jan. 10, 2014	5 years from grant date	50,000	\$ 4.00	
Placement Agent Warrant exercise			(7,000)	\$ 2.00	
Common Stock Warrant issued upon exercise of Placement Agent Warrant	May 9 and 14, 2014	Dec. 20, 2018	7,000	\$ 4.00	
Balance as at August 31, 2014			3,923,149		

NOTE 13 - STOCK-BASED COMPENSATION

The Company's Amended and Restated the 2008 Directors, Officers and Employees Stock Option Plan, which was originally approved by the stockholders at the annual general meeting of the Company held on December 5, 2007, and subsequently amended by the stockholders on July 23, 2008. This plan was established to enable the Company to attract and retain the services of highly qualified and experienced directors, officers, employees and consultants and to give such persons an interest in the success of the Company and its subsidiaries. The total number of shares currently authorized under the plan is 391,134. The options and awards will be granted at the discretion of the Board of Directors. Options issued under the plan that are deemed to be incentive stock options will be priced at not less than 100% of the fair market value of the common shares at the date of the grant, subject to certain limitations for 10 percent stockholders. The fair value of each option granted was estimated at the time of grant using the Black-Scholes option pricing model. There were no options granted during the nine months ended August 31, 2013 and 2014.

All the grants vest quarterly over a two year period and expire on the tenth anniversary of the grant date. The following table summarizes the stock option activities of the Company.

	Number of options
Outstanding as of November 30, 2012	383,310
Granted	10,000
Exercised	—
Cancelled/forfeited	(27,379)
Outstanding as of November 30, 2013	365,931
Granted	—
Exercised	—
Cancelled/forfeited	(20,860)
Outstanding as of August 31, 2014	345,071

The stock-based compensation for the three and nine months ended August 31, 2014 was \$2,051 and \$9,747 (three and nine months ended August 31, 2013 - \$9,870 and \$76,502). The Company recorded this in selling, general and administrative expenses with the corresponding credit to additional paid-in capital.

As of November 30, 2013 the Company has a total of 365,931 options outstanding to purchase Common Stock held by employees, directors and advisory board members, of which 353,922 are vested and exercisable. All of these outstanding stock options have an exercise price above the average market price. As of November 30, 2013, the total fair value of the options granted to employees at the respective grant dates was \$1,476,973, of which the unrecognized portion of \$13,088 related to the unvested shares associated with these stock option grants will be recognized over a period of two years.

As of August 31, 2014 the Company has a total of 345,071 options outstanding to purchase Common Stock held by employees, directors and advisory board members, of which 340,071 are vested and exercisable. All of these outstanding stock options have an exercise price above the average market price. As of August 31, 2014, the total fair value of the options granted to employees at the respective grant dates was \$1,476,973, of which the unrecognized portion of \$3,341 related to the unvested shares associated with these stock option grants will be recognized over a period of 15 months.

2012 Option Plan:

Under the Company’s 2012 Directors, Officers and Employees Stock Option Plan (the “2012 Plan”), the Company granted a total of 100,000 options to purchase Common Stock to its four independent directors and chief financial officer on April 2, 2013. The total number of shares currently authorized under the plan is 400,000. The options and awards will be granted at the discretion of the Board. Options issued under this plan that are deemed to be incentive stock options will be priced at not less than 100 percent of the fair market value of the shares of Common Stock underlying the options at the date of the grant, subject to certain limitations for 10 percent stockholders. The fair value of each option granted was estimated at the time of grant using the Black-Scholes option pricing model.

All the options granted under the 2012 Plan, vest yearly at the rate of one-third per year, starting on the first year anniversary of the grant date and expire on the fifth anniversary of the grant date. On August 5, 2014, vesting period was amended and all the options are fully vested and exercisable. The following table summarizes the stock option activities of the Company.

Outstanding as of November 30, 2012	—
Granted	100,000
Exercised	—
Cancelled/forfeited	—
Outstanding as of November 30, 2013 and August 31, 2014	100,000

The share-based compensation for the three and nine months ended August 31, 2014 was \$97,970 and \$186,022 (three and nine months ended August 31, 2013 - \$61,637 and \$61,637). The Company recorded this in selling, general and administrative expenses with the corresponding credit to additional paid-in capital.

As of November 30, 2013 the Company has granted options to purchase a total of 100,000 shares of Common Stock at an exercise price of \$3.94 per share, to its four independent directors and chief financial officer, all of which are currently outstanding and are vested and exercisable. All of these outstanding stock options have an exercise price equal to the fair market price on the date of grant. As of November 30, 2013, the total fair value of the options granted to the independent directors and chief financial officer at the respective grant dates was \$292,174, of which the unrecognized portion of \$186,022 related to the unvested shares associated with these stock option grants will be recognized over a period of three years.

As of August 31, 2014 the Company has granted a total of 100,000 options to purchase Common Stock to employees, directors and advisory board members, all of which are currently outstanding and fully vested and exercisable. All of these outstanding stock options have an exercise price above the average market price. As of August 31, 2014, the total fair value of the options granted at the respective grant dates was \$292,174, all of which has been recognized as fully vested.

NOTE 14 - FAIR VALUE MEASUREMENTS, CONCENTRATIONS AND RISK

a) The Company's cash and cash equivalents, which are carried at fair values, are classified as a level 1 financial instrument at November 30, 2013 and August 31, 2014.

b) The Company is exposed to the following concentrations of risk:

Major Customers

Two major customers comprised 77% and 72% of total revenue for the three and nine months ended August 31, 2014 (three and nine months ended August 31, 2013 - two major customers comprised 21% and 64% of total revenue).

As at August 31, 2014, accounts receivable balances of the two major customers were \$22,290 and \$58,453, respectively (as at August 31, 2013 - \$nil and \$26,083, respectively). As at August 31, 2014, customer deposit by the two major customers were \$nil and \$nil, respectively (as at August 31, 2013 - \$115,341 and \$nil, respectively). As at November 30, 2013, accounts receivable balances of the two major customers were \$685,986.

Major Vendors

The Company has an exclusive agreement to manufacture biodiesel processor equipment with a third party equipment manufacturer. During the three and nine months ended August 31, 2014, the Company made purchases of \$nil and \$nil (three and nine months ended August 31, 2013 - \$nil and \$45,893) from this equipment manufacturer. As of November 30, 2013 and August 31, 2014, the Company had accounts payable of \$21,856 and \$6,837 owing to this equipment manufacturer, respectively.

The Company's major purchases of feedstock oil and biodiesel from third parties for the three and nine months ended August 31, 2014 were \$2,549,354 and \$2,549,354 that consisted of only one new major vendor for feedstock oil (three and nine months ended August 31, 2013 - three major vendors comprising total purchases of \$661,625 and \$2,228,543).

As at November 30, 2013, the accounts payable balance to the three major vendors were \$1,053,480, \$575,043 and \$nil.

As at August 31, 2014, the accounts payable balance from the one new feedstock oil vendor was \$91,176. The three major vendors from fiscal year 2013 were fully paid in the 2014 nine month period (payment included interest incurred on outstanding balance of \$97,973).

Economic and Political Risks

The Company faces a number of risks and challenges as a result of having primary operations and marketing in Canada and sales in the United States. Changing political climates in Canada and the United States could have a significant effect on the Company's business.

c) The Company's financial instruments are exposed to certain financial risks, including credit risk, currency risk and liquidity risk.

Credit Risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's cash and cash equivalents and trade accounts receivable. The Company places its cash and cash equivalents with institutions of high creditworthiness. The carrying value of the financial assets represents the maximum credit exposure.

The Company minimizes credit risk by routinely reviewing the credit risk of the counterparty to the arrangement and has maintained an allowance for doubtful accounts of \$65,662 related to credit risk as at August 31, 2014 (as at November 30, 2013 - \$30,000), which is considered adequate.

Currency Risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company's functional currency is U.S. dollars. A significant change in the currency exchange rates between the U.S. dollar relative to the Canadian dollar could have an effect on the Company's results of operations, financial position and cash flows. The Company has not entered into any derivative financial instruments to manage exposures to currency fluctuations.

Included in selling, general and administrative expenses are foreign currency gains (losses) for the three and nine months ended August 31, 2014 of \$2,822 and \$33,031 (three and nine months ended August 31, 2013 of \$30,120 and \$106,079).

The Canadian dollar balances and exchange differences are as follows:

	CDN\$	USD\$ Historical	USD –August 31, 2014
Note 8: Term loan (“July 2013”) - Principal	\$1,600,000	\$1,540,640	\$1,467,360
Note 8: Term loan (“July 2013”) - Partial payment	(250,000)	(227,875)	(225,765)
Note 16: Canadian Incentive - Mississauga facility - Total Incentive per Agreement	5,410,000	NA	4,975,577
Note 16: Canadian Incentive - Sombra facility - Total Incentive per Agreement	14,785,200	NA	13,597,948

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company has a planning and budgeting process in place to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its expansionary plans. The Company ensures that there are sufficient funds to meet its short-term business requirements, taking into account its anticipated cash flows from operations and its holdings of cash.

As at August 31, 2014, due in large part to the funds spent to develop and build the Sombra facility as well as minimal sales of biodiesel, the Company had a working capital deficiency of \$535,389.

The Company anticipates that its Sombra facility will generate positive cash flows from operations and will operate profitably once full-scale commercial operations are achieved. In order to meet its development goals and ongoing operational requirements, the Company may require additional financing in the next 12 months. However, management believes that the anticipated positive cash flows from operations, the potential sale of biodiesel equipment, and the cash flow from the additional financing completed in August 2014 and the anticipated additional

financing will be sufficient to meet the Company's cash requirements for at least the next 12 months.

As at August 31, 2014, the Company received customer deposits of \$152,186 (November 30, 2013 - \$8,185) against potential sale of biodiesel equipment.

NOTE 15 - COMMITMENTS

Building Leases:

Methes Canada is a party to a lease agreement for the Mississauga facility and to a sublease agreement for a unit adjacent to its Mississauga facility. On September 28, 2012, the Company re-negotiated and renewed a combined five year lease term for both of these facilities starting from January 1, 2013 to December 31, 2017. The renewed lease term provides for a two month rent free period in 2013.

As at August 31, 2014, Methes Canada must pay, in addition to other amounts such as it's pro rata share of taxes, the following amounts over the term of the lease:

	Annual Minimum Rent
2014	\$ 33,235
2015	\$ 132,941
2016	\$ 132,941
2017	\$ 132,941
2018	\$ 11,078

Railroad Car Leases:

As at August 31, 2014, the Company is a party to the following lease agreements for railcars at its Sombra facility:

	Start Date	End Date	Term
Four railcars at \$3,100 per month	August 1, 2013	July 31, 2018	60 months
Four railcars at \$3,100 per month	April 1, 2013	March 31, 2018	60 months
Four railcars at \$ 3,600 per month	July 1, 2013	June 30, 2018	60 months
Four railcars at \$3,140 per month	December 1, 2011	November 30, 2016	60 months
One railcar at \$575 per month	January 1, 2012	December 31, 2016	60 months
One railcar at \$575 per month	May 1, 2012	June 30, 2015	36 months
Ten railcars at \$8,460 per month	May 1, 2013	April 30, 2018	60 months
Ten railcars at \$8,510 per month	May 1, 2013	April 30, 2018	60 months

	Annual Minimum Rent
2014	\$ 93,180
2015	\$ 369,845
2016	\$ 359,495
2017	\$ 321,240
2018	\$ 147,250

NOTE 16 - CONTRIBUTION AGREEMENTS WITH MINISTER OF NATURAL RESOURCES OF CANADA

Mississauga Facility:

In 2009, the Company entered into a Non-Refundable Contribution Agreement with the Minister of Natural Resources of Canada for the Mississauga facility under the ecoENERGY for Biofuels program. Under this agreement, the Company may receive up to \$4,975,577 - in the years from 2009 to 2016 from the Canadian government in biodiesel production incentives when biodiesel is produced and sold. The contribution from the Canadian Government is non-refundable by the Company.

For the three and nine months ended August 31, 2014, the Company claimed incentives of \$nil and \$nil (three and nine months ended August 31, 2013 - \$nil and \$10,171). Since entering into the program to August 31, 2014, the Company has claimed and received total incentives of \$1,485,285.

Included in accounts receivable as at November 30, 2013 and August 31, 2014, is an amount receivable of \$nil and \$nil, respectively, due from the Minister of Natural Resources of Canada.

Sombra Facility:

In 2010, the Company applied for an incentive under the ecoENERGY for Biofuels program for its Sombra facility and was approved by the Canadian government. The final Contribution Agreement with the Minister of Natural Resources of Canada for the Sombra facility under the ecoENERGY for Biofuels program was signed by the Company and the Canadian Government on December 6, 2011. Under this agreement as amended, the Company may receive up to \$13,597,948 - for the years 2012 to 2017 from the Canadian government in biodiesel production incentives when biodiesel is produced and sold. The contribution from the Canadian Government is non-refundable by the Company.

For the three and nine months ended August 31, 2014, the Company claimed incentives of \$179,594 and \$218,185 (three and nine months ended August 31, 2013 - \$90,470 and \$259,303). Since entering into the program to August 31, 2014, the Company has claimed total incentives of \$755,060 and has received a total of \$575,466.

Included in accounts receivable as at November 30, 2013 and August 31, 2014, is an amount receivable of \$277,573 and \$179,594, respectively, due from the Minister of Natural Resources of Canada.

NOTE 17 - SEGMENT INFORMATION

The Company reports a single operating segment, being a producer and seller of biodiesel fuel and biodiesel processing equipment.

Geographic segments:

The Company's assets and operating facilities, other than cash balances of \$16,066 at November 30, 2013 and \$43,889 at August 31, 2014, are all located in Canada. The Company services the majority of its customers in the United States. The Company derives its revenue geographically as follows:

	Three Months Ended August 31, 2013	Three Months Ended August 31, 2014	Nine months Ended August 31, 2013	Nine months Ended August 31, 2014
Revenue				
United States	\$ 1,510,501	\$ 2,137,870	\$ 3,681,634	\$ 2,708,390
Canada	236,703	262,777	604,035	510,138
	\$ 1,747,204	\$ 2,400,647	\$ 4,285,669	\$ 3,218,528

NOTE 18 – INTEREST EXPENSE

Interest expense table as follows:

	Three Months Ended August 31, 2013	Three Months Ended August 31, 2014	Nine months Ended August 31, 2013	Nine months Ended August 31, 2014
Interest accrued on promissory notes	\$ 46,868	\$ 43,100	\$ 116,910	\$ 127,118
Interest paid on term loan	66,483	44,250	236,051	131,816
Interest paid on vendor payables	215	6,401	2,155	123,395
Financing fees	13,266	3,107	14,685	8,604
Total expense	\$ 126,832	\$96,858	\$ 369,801	\$ 390,933

NOTE 19 - SUBSEQUENT EVENT

On September 18, 2014, Methes Canada signed a term sheet with a new lender providing for \$1,700,000 CAD mortgage loan, which will be used to repay the outstanding balance on the July 2013 Facility (the "September 2014 Loan"). The salient terms of the September 2014 Loan include, but are not limited to 24 months term, an interest rate of 12.5% per annum, payable monthly, and the outstanding principal due at maturity. The September 2014 Loan will be collateralized by a security agreement from Methes Canada on certain of its assets, a first collateral mortgage on its real property located at Sombra, Ontario, a promissory note in the amount of \$1,700,000 CAD, and a guarantee of repayment by the Company.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and related notes included elsewhere in this report. Some of the statements in this discussion and elsewhere in this report constitute forward-looking statements within the meaning of Section 21E of the Securities and Exchange Act of 1934. See "Cautionary Statement Regarding Forward-Looking Information" following the Table of Contents of this report. Because this discussion involves risk and uncertainties, our actual results may differ materially from those anticipated in these forward-looking statements.

Overview

We are a renewable energy company that offers an array of products and services to a network of biodiesel fuel producers. We also market and sell in the U.S. and Canada biodiesel fuel produced at our production facility in Sombra, Ontario, Canada. We began commercial operation at the Sombra plant in November 2012. The two Denami 3000 processors at Sombra, designed to produce up to 6.5 million gallons each per year, or mgy, of biodiesel, were placed in substantially full time production in August 2014 and we produced over 775,000 gallons of biodiesel at our Sombra facility in our third quarter. However, while that was a record high level of production for our third quarter, it was still substantially below capacity and resulted in significant under-utilization of our Sombra plant, negative gross profit and a net loss. Continued production at August levels should result in improved future financial results.

During the quarter ended August 31, 2014, our largest source of revenue was from the sale biodiesel fuel. Among other services, we sell feedstock to our network of biodiesel producers, sell their output in the U.S. and Canada, provide them with proprietary software used to operate and control their processors, remotely monitor the quality and characteristics of their output, upgrade and repair their processors, and advise them on adjusting their processes to use varying feedstock and improve their output. Through the accumulation of production data from our network, we are equipped to provide consulting services to network members and other producers for operating their facilities, maintaining optimum production and solving production problems. For our network services and the license of our operating and communications software, we receive a royalty from network members based on the gallons of biodiesel they produced.

Our revenue sources include the sale of biodiesel produced at our own facility, the sale of biodiesel that we purchase from network members and other third-party producers, the sale of biodiesel equipment, the sale of feedstock to network members and other third-party biodiesel producers, Canadian government incentive payments, royalties from our network members, and revenue from other services we provide related to the production of biodiesel.

On August 28, 2014, we launched, via a webinar hosted by Biodiesel Magazine, a new and what we believe to be a more efficient way to pre-treat oils for the production of biodiesel. This new technology adds to our current product offering and is expected to start generating revenues in fiscal 2015.

As of August 31, 2014, due in large part to our investment of capital to develop, build and commission our Sombra facility as well as minimal sales of biodiesel, we had a working capital deficiency of \$535,389. During the nine months ended August 31, 2014, we incurred a loss of \$5,079,380 and had negative cash flow from operations of \$5,107,730. Our Sombra facility is approved by the U.S. Environmental Protection Agency ("EPA") as a Foreign Renewable Fuel Producer and as a result the biodiesel produced at this facility is eligible for export to the United States. Obtaining this approval from the EPA enables us to sell our biodiesel into the U.S., and provides our U.S. importers, including our U.S. wholly-owned subsidiary, the ability to generate Renewable Identification Numbers ("RINs"). RINs are used in the U.S. to track compliance with Renewable Fuel Standard 2 ("RFS2") and are generated when a gallon of biodiesel is produced in or imported to the U.S.

Subsequent to the consummation of our initial public offering (“IPO”) on October 30, 2012, we have raised aggregate net proceeds of approximately \$9.5 million from the sale of our equity securities including the following:

net proceeds of approximately \$1.5 million from a private placement completed in February 2013;

net proceeds of approximately \$50,000 from a Regulation S private placement completed in August 2013;

net proceeds of approximately \$473,000 from a private placement of Series A Preferred Stock completed in October 2013;

net proceeds of approximately \$2.24 million from a private placement completed in December 2013;

net proceeds of approximately \$125,000 (including, \$25,000 of services rendered to us) from a private placement completed in January 2014; and

net proceeds of approximately \$5.05 million from a public offering completed in May 2014.

Factors Influencing Our Results of Operations

The principal factors affecting our results of operations are as follows:

Biodiesel and feedstock price fluctuations

Biodiesel is a low carbon, renewable alternative to petroleum-based diesel fuel and is primarily sold to the end user after it has been blended with petroleum-based diesel fuel. Biodiesel prices have historically been correlated to petroleum-based diesel fuel prices. Accordingly, biodiesel prices have generally been affected by the same factors that affect petroleum prices, such as worldwide economic conditions, wars and other political events, OPEC production quotas, changes in refining capacity and natural disasters. Recently enacted U.S. government requirements and incentive programs, such as RFS2 and the blenders' tax credit, which expired on December 31, 2013, have reduced this correlation, although it remains a significant factor in the market price of our product.

Our operating results also generally reflect the relationship between the price of biodiesel and the price of the feedstock used to produce biodiesel. Spot market prices for virgin vegetable oil or used vegetable oil or rendered animal fat may increase, which would adversely affect our gross margins. The price of vegetable oil, as with most other products made from crops, is affected by weather, disease, changes in government incentives, demand and other factors. A significant reduction in the supply of vegetable oil because of weather or disease, or increases in the demand for vegetable oil, could result in higher feedstock prices. The price of vegetable oil and other feedstock has fluctuated significantly in the past and may fluctuate significantly in the future.

Government programs related to biodiesel production and use

Biodiesel has been more expensive to produce than petroleum-based diesel fuel and as a result the industry depends on Canadian and U.S. federal and, to a lesser extent, provincial and state usage requirements and tax incentives.

On July 1, 2010, RFS2 was implemented, stipulating Renewable Volume Obligations (“RVOs”) requirements for the amount of biomass-based diesel that must be utilized in the United States each year. Under RFS2, obligated parties, including petroleum refiners and fuel importers, must show compliance with these standards. The RFS2 program required the domestic use of 800 million gallons of biodiesel in 2011, one billion gallons in 2012 and 1.28 billion gallons in 2013. The 2014 RVO was set at 1.7 billion gallons under RFS2 but the EPA is considering keeping the 2014 and 2015 RVOs at 1.28 billion gallons. The delay by the EPA in establishing the 2014 RVOs has greatly affected the demand for biodiesel so far this year. According to the National Biodiesel Board (“NBB”), 57% of their biodiesel producing members were not producing as of early June 2014.

Renewable Identification Numbers (“RINs”)

RINs are used to track compliance with RFS2 and are generated when a gallon of biodiesel is produced in or imported to the U.S. In late 2011 and early 2012 the EPA announced that some U.S. producers had generated and sold invalid RINs. The loss of integrity and confidence in the RINs market affected the demand as well as the price of biodiesel. As a result, the demand for RINs from small and medium size biodiesel producers declined dramatically. As a small and medium size producer, we and our existing customers have been directly affected by this situation. A portion of the price of a gallon of biodiesel includes a dollar value attributed to RINs. If a buyer of biodiesel cannot verify the integrity of the RINs attached to the biodiesel the buyer might not want to purchase or might ask for a discount creating a situation for the producer where it is not profitable to produce biodiesel.

In February 2013, the EPA introduced a new Quality Assurance Program (“QAP”) that would allow for buyers of RINs to verify their validity. The QAP provides a clear path and system for independent third parties, approved by the EPA,

to audit and monitor, on an ongoing basis, the production of biodiesel and verify that RINs have been correctly generated. The QAP, once fully in place, will be retroactive to January 1, 2013. In September 2014, we attained the Quality Assurance Plan (QAP-B) RINs assurance status which will allow buyers to verify the validity of our RINs.

Seasonal fluctuations

Our operating results are influenced by seasonal fluctuations in the price of biodiesel. Our sales tend to decrease during the winter season due to perceptions that biodiesel will not perform adequately in colder weather. Colder seasonal temperatures can cause the higher cloud point biodiesel we make from inedible animal fats to become cloudy and eventually gel at a higher temperature than petroleum-based diesel or lower cloud point biodiesel made from soybean, canola or inedible corn oil. Reduced demand in the winter for our higher cloud point biodiesel may result in excess supply of such higher cloud point biodiesel or lower prices for such higher cloud point biodiesel. In addition, our production facilities are located in Canada and our costs of shipping biodiesel to warmer climates generally increase in cold weather months.

Dependence on significant customers

A large part of our revenue is generated from a few large customers. The sales to these customers are made at spot market prices, and we have no binding purchase agreements for our biodiesel, which could affect the consistency of our revenues. Potential customers for biodiesel regularly bid for biodiesel in the spot market at prices that are quoted on a daily basis. As a matter of convenience, we prefer to deal with customers with whom we have had a past relationship, although the specific customers to whom we sell have varied over time. The loss of one or more customers who have been among our largest customers historically would not have a material adverse effect on our business because we believe that a customer or customers could be replaced by one or more new customers regularly bidding for biodiesel, and we believe this will continue to be the case. For example, in the nine months ended August 31, 2014, 61% of our total revenue was from one major customer who was also our largest customer during the year ended November 30, 2013. This customer accounted for 67% of our total revenue during the same period in fiscal 2013.

Lengthy sales cycle

The sale of one of our Denami processors in a particular financial period would have a significant effect on our quarter-to-quarter and year-to-year results. The purchase of our Denami processors involves a significant commitment of capital by customers, with the attendant delays frequently associated with large capital expenditures. For these and other reasons, the sales cycle associated with our Denami processors is typically lengthy, varying from 6 to 18 months. The lengthy sales cycles of our equipment sales, as well as the size and timing of orders, make it difficult to forecast our future results of operations.

Three and nine months ended August 31, 2013 compared to the three and nine months ended August 31, 2014

Revenue. Our total revenues for the three months ended August 31, 2013 and August 31, 2014 were \$1.75 million and \$2.4 million, respectively, representing an increase of \$650,000 thousand or 37%. Our total revenues for the nine months ended August 31, 2013 and August 31, 2014 were \$4.28 million and \$3.22 million, respectively, representing a decrease of \$1.06 million or 25%. The reasons for these fluctuations are outlined below.

Biodiesel. Biodiesel sales for the three months ended August 31, 2013 and August 31, 2014, excluding government incentives, were \$1.53 million and \$2.12 million respectively, an increase of approximately \$590,000 or 39%. For the three months ended August 31, 2013 and August 31, 2014, our resales of biodiesel purchased from third party producers were \$431,000 and \$nil, respectively, a decrease of approximately \$431,000 or 100%. Revenue from our internal production, excluding government incentives, for the three months ended August 31, 2013 and August 31, 2014 was \$1.10 million and \$2.12 million, respectively, an increase of \$1.02 million or 93%. For the three months ended August 31, 2013 and August 31, 2014, our average sales price per gallon for 100 percent biodiesel ("B100") was \$4.56 and \$3.33, respectively, a decrease of \$1.23 per gallon, or 27%. Gallons sold for the three months ended August 31, 2013 and 2014 were 335,031 and 635,057 gallons, respectively, an increase of 300,025 gallons, or 90%. Biodiesel sales for the nine months ended August 31, 2013 and August 31, 2014, excluding government incentives, were \$3.74 million and \$2.74 million, respectively, a decrease of approximately \$1 million or 27%. For the nine months ended August 31, 2013 and August 31, 2014, our resales of biodiesel purchased from third party producers were \$894,616 and \$124,764, respectively, a decrease of approximately \$769,616, or 86%. Revenue from our internal production, excluding government incentives, for the nine months ended August 31, 2013 and August 31, 2014 was \$2.84 million and \$2.62 million, respectively, a decrease of \$220,000, or 8%. For the nine months ended August 31, 2013 and August 31, 2014, our average sales price per gallon for B100 was \$4.30 and \$3.54, respectively, a decrease of \$0.76 per gallon, or 18%. Gallons sold for the nine months ended August 31, 2013 and 2014 were 870,479 and 773,586 gallons, respectively, a decrease of 96,893 gallons, or 11%.

The blender's tax credit ("BTC") provided a \$1.00 refundable tax credit per gallon of 100% pure biodiesel, or B100, to the first blender of biodiesel with petroleum-based diesel fuel until its expiration on December 31, 2013. The expiration of the BTC had a negative effect on biodiesel production and sales in 2014. Its reinstatement would have a positive effect on the biodiesel industry and on our financial results. However, while reinstatement is being urged by the biodiesel industry and some policy makers, reinstatement remains uncertain.

The overall decrease in revenue from the sales of our biodiesel and the resales of biodiesel purchased from others was primarily due to a very low demand as a result of the expiration of the BTC on December 31, 2013 which, combined with an extremely cold winter, reduced the demand for biodiesel in the first half of 2014. Furthermore, the delay, by the EPA, in establishing the 2014 RVOs has greatly affected the demand for biodiesel so far this year. According to the National Biodiesel Board ("NBB"), 57% of their biodiesel producing members were not producing as of early June 2014. For the current quarter the revenue from the sales of our biodiesel increased as a result of increased demand and increased production at our Sombra facility. Furthermore, in the event that the BTC is reinstated retroactively to January 1, 2014, we have been successful at negotiating for a share of the BTC to be paid back to us. As of the end of this quarter the amount of the BTC that we would receive from customers, if the BTC is reinstated retroactively, stands at \$573,420. This amount has not been recognized in our books.

Feedstock. For the three months ended August 31, 2013 and August 31, 2014, feedstock sales were \$52,104 and \$52,310, respectively, an increase of \$206, or 0.3%. For the nine months ended August 31, 2013 and August 31, 2014, feedstock sales were \$137,092 and \$148,651, respectively, an increase of \$11,559, or 8%. In the more recent period, with some variations in quantities, we were able to source additional feedstock as well as other products related to the production of biodiesel on the spot market that we resold immediately to our customers in Canada at a profit. We intend to continue with this strategy as opportunities arise to generate additional profit.

Glycerin. For the three months ended August 31, 2013 and August 31, 2014, Glycerin sales were \$30,074 and \$33,671, respectively, an increase of \$3,597. For the nine months ended August 31, 2013 and August 31, 2014, Glycerin sales were \$66,515 and 57,517, respectively, a decrease of \$8,998.

Government incentives. For the three months ended August 31, 2013 and August 31, 2014 we received \$99,470 and \$179,594, respectively, an increase of \$80,124, or 80%. This increase was related to the increase in the sales volume of biodiesel in the third quarter. For the nine months ended August 31, 2013 and August 31, 2014 we received \$269,474 and \$218,185, respectively, a decrease of \$51,289, or 24%.

Equipment sales. For the three months ended August 31, 2013 and August 31, 2014 we generated \$3,112 and \$nil, respectively, from equipment sales. For nine months ended August 31, 2013 and August 31, 2014 we generated \$5,769 and \$1,397, respectively, from equipment sales. Effective January 30, 2014, we entered into a sale and licensing agreement with an Aruba company pursuant to which they agreed to the purchase of a Denami 600 processor and license our software and monitoring system. We believe that the Denami 600 will be used for the local production of biodiesel in Aruba and is expected to be built and delivered to Aruba in fiscal 2015.

Royalties. For the three months ended August 31, 2013 and August 31, 2014 we received royalties of \$11,146 and \$8,096, respectively. For nine months ended August 31, 2013 and August 31, 2014 we received royalties of \$17,921 and \$19,550, respectively. Our customers own the Denami 600 processors, but license the software and monitoring system from us in exchange for an ongoing royalty payment of \$0.11 per gallon of biodiesel produced by their Denami 600 processors.

Other. Other revenue for the nine months ended August 31, 2013 and August 31, 2014 was \$32,146 and \$11,261, respectively, a decrease of \$20,885, or 64%. Other revenue for the nine months ended August 31, 2013 and August 31, 2014, was \$50,006 and \$31,682, respectively, a decrease of \$18,324, or 58%, the fluctuation is due to recovery of accounts receivable previously written-off. Other revenue includes recovery of prior bad debts and other miscellaneous sales.

Cost of goods sold. Our cost of goods sold for the three months ended August 31, 2013 and August 31, 2014 were \$1.57 million and \$2.83 million, respectively, an increase of \$1.26 million, or 80%. This increase was primarily due to higher sales volume in current quarter as demand increased. Our cost of goods sold for the nine months ended August 31, 2013 and August 31, 2014 were \$3.99 million and \$3.5 million, respectively, a decrease of \$487,500, or 12%. This decrease was primarily due to lower sales of biodiesel in the nine months ended August 31, 2014.

Biodiesel cost of goods sold increased by \$1.24 million to \$2.64 million, or 89%, for the three months ended August 31, 2014 compared to cost of goods sold of \$1.4 million for the three months ended August 31, 2013. If the average feedstock price and the price paid for biodiesel purchased from other biodiesel producers in Canada remained constant for the three months ended August 31, 2014 compared to the same fiscal period in 2013, the increase in gallons of biodiesel sold would have resulted in \$1.22 million increase in the related biodiesel cost of goods sold. For the three months ended August 31, 2014, the increase in cost of goods sold was also because of a \$20,000 increase in average feedstock oil prices. We produced over 775,000 gallons of biodiesel at our Sombra facility in our third quarter. However, while that was a record high level of production for our third quarter, it was still substantially below capacity and resulted in significant under-utilization of our Sombra plant, negative gross profit and a net loss. Continued production at August levels should result in improved future financial results.

Biodiesel cost of goods sold decreased by \$370,000 to \$3.06 million, or 11%, for the nine months ended August 31, 2014 compared to cost of goods sold of \$3.43 million for the nine months ended August 31, 2013. If the average feedstock price and the price paid for biodiesel purchased from other biodiesel producers in Canada remained constant for the nine months ended August 31, 2014 compared to the same fiscal period in 2013, the decrease in gallons of biodiesel sold would have resulted in \$412,000 decrease in the related biodiesel cost of goods sold. For the nine months ended August 31, 2014, the increase in cost of goods sold was lower because of a \$41,000 increase in average feedstock prices, and \$3,800 increase in the price paid for biodiesel purchased from others.

All other costs of goods sold, excluding biodiesel cost of goods sold, for the three months ended August 31, 2013 and August 31, 2014 were \$170,918 and \$189,967, respectively, and for the nine months ended August 31, 2013 and August 31, 2014 were \$555,715 and \$316,032, respectively. The decrease was mainly due to lower sales of feedstock as a result of lower feedstock demand.

Selling, general and administrative expenses. Our selling, general and administrative expenses for the three months ended August 31, 2013 and August 31, 2014, were \$1.37 million and \$1.5 million, respectively, an increase of \$130,000, or 9%. This increase was mainly related to an increase in professional fees of \$82,000 as a result of an increase in investor relations consulting services and audit fees, an increase in stock option expense of \$29,000, an increase in currency gains of \$27,000 which was offset by a decrease in salaries and wages of \$8,000 as a result of layoffs.

Our selling, general and administrative expenses for the nine months ended August 31, 2013 and August 31, 2014, were \$4.13 million and \$4.41 million, respectively, an increase of \$280,000, or 7%. This increase was mainly related to an increase in professional fees of \$571,000 as a result of an increase in investors relation consulting services and audit fees which was offset by a decrease in operating expenses including, but not limited to, a decrease in salaries and wages of \$180,000, decrease in utilities of \$93,000, and a decrease in shop supplies of \$63,000.

Other expenses and income. For the three months ended August 31, 2013 and August 31, 2014, we incurred interest expenses of \$126,832 and \$96,858, respectively. These amounts relate to accruals for interest expense associated with our outstanding loans. The decrease in interest expense was due to a decrease in interest rate on our term loan from 23% in 2013 to 12% in the same period in 2014. For the three months ended August 31, 2013 and August 31, 2014, we paid term loan interest of \$66,483 and \$44,249, respectively.

For the nine months ended August 31, 2013 and August 31, 2014, we incurred interest expenses of \$369,801 and \$390,933, respectively. These amounts relate to accruals for interest expense associated with our outstanding loans. The increase in interest expense in the nine months of 2014 was mainly due to the interest of \$97,000 on feedstock oil payable to a vendor which was offset by a decrease in the interest rate on our term loan from 23% in fiscal 2013 to 12% in fiscal 2014. For the nine months ended August 31, 2013 and August 31, 2014, we paid term loan interest of \$236,051 and \$131,818, respectively.

Income taxes. No income tax expense or benefit was recorded during the three and nine months ended August 31, 2013 and August 31, 2014 due to ongoing taxable losses. As of August 31, 2014, we were not subject to any uncertain tax exposures.

Net loss. For the three months ended August 31, 2014, our net loss increased by \$710,000 to \$2.03 million from \$1.32 million for the three months ended August 31, 2013. The increase in net loss for the three months ended August 31, 2014 was primarily due to the decrease in gross profit of \$605,000 and an increase of \$135,000 of selling, general and administrative expenses, which was offset by a decrease of \$30,000 in interest expenses. For the nine months ended August 31, 2014, our net loss increased by approximately \$880,000 to \$5.08 million from \$4.2 million for the nine months ended August 31, 2013. The increase in net loss for the nine months ended August 31, 2014 was primarily due to the decrease in gross profit by \$580,000, an increase in selling, general and administrative expenses by \$275,000 and interest expense by \$21,000, respectively.

Liquidity and Capital Resources

Sources of liquidity. Since inception, a significant portion of our operations was financed through the sale of our capital stock. At November 30, 2013 and August 31, 2014, we had cash and cash equivalents of \$174,084 and \$504,287, respectively.

Subsequent to the consummation of our IPO on October 30, 2012, we have raised aggregate net proceeds of approximately \$9.5 million from the sale of our equity securities including the following (also, see note 12 of the unaudited condensed consolidated financial statements elsewhere in this report):

net proceeds of approximately \$1.5 million from a private placement completed in February 2013;

net proceeds of approximately \$50,000 from a Regulation S private placement completed in August 2013;

net proceeds of approximately \$473,000 from a private placement of Series A Preferred Stock completed in October 2013;

net proceeds of approximately \$2.24 million from a private placement completed in December 2013;

net proceeds of approximately \$125,000 (including, \$25,000 of services rendered to us) from a private placement completed in January 2014;
and

net proceeds of approximately \$5.05 million from a public offering completed in May 2014.

On July 12, 2013, Methes Canada entered into a term loan facility agreement with a lender (the "Agreement") pursuant to which Methes Canada is able to borrow up to \$1,540,640 (\$1,600,000 CAD) for a term of 12 months at an interest rate of 12% per annum (the "July 2013 Facility"). Under the terms of the Agreement, interest is payable monthly and outstanding principal is due at maturity. Outstanding principal would be prepayable after six months upon 30 days' notice and payment of a penalty equal to one-month's interest. The July 2013 Facility is collateralized by a security agreement from Methes Canada on certain of its assets except for accounts receivable and inventory and a first collateral mortgage on its real property located at Sombra, Ontario. The July 2013 Facility prohibits payment of debt owed by us to certain of our stockholders, a director and an unrelated Corporation (see note 9 and 10) during the life of the facility and contains other customary debt covenants. Interest expense incurred during the three and nine months ended August 31, 2014 was \$44,250 and \$131,818 (three and nine months ended August 31, 2013 - \$25,001 and \$25,001).

During the current quarter ended August 31, 2014, we made a partial payment of \$227,875 against the principal outstanding on the July 2013 Facility.

On August 16, 2013, Methes Canada entered into and closed on a working capital loan facility from a Toronto, Ontario lending firm (the "Working Capital Facility"). Under the Working Capital Facility, Methes Canada was able to borrow up to \$1,500,000 for its Sombra, Ontario biodiesel manufacturing plant, of which up to \$750,000 may be from cash advances against Methes Canada's accounts receivables through factoring of accounts receivable with full recourse and up to an additional \$750,000 in cash advances for use exclusively to purchase feedstock for the production of biodiesel. The Working Capital Facility was secured by a pledge of the accounts receivable and

inventory of Methes Canada and Methes USA. The balance outstanding as of November 30, 2013 of \$1,019,513 was fully repaid during the first quarter of fiscal 2014 with factoring of accounts receivable and cash from operations. Accordingly, as of August 31, 2014 the balance outstanding was \$nil. During the quarter ended August 31, 2014, the Working Capital Facility was discontinued.

On August 28, 2014, we entered into a feedstock credit facility with a major provider of credit to the renewable fuels industry (the "Lender"), which will provide us all the feedstock that is required to run at full current capacity and allow us to fulfill future orders for biodiesel from customers that have been approved by the credit department of the Lender (the "Feedstock Credit Facility"). The facility bears interest at 5% per annum.

Subsequent event

On September 18, 2014, Methes Canada signed a term sheet with a new lender providing for a \$1,700,000 CAD mortgage loan, which will be used to repay the outstanding balance on the July 2013 Facility (the "September 2014 Loan"). The salient terms of the September 2014 Loan include, but are not limited to, a 24 month term, an interest rate of 12.5% per annum, payable monthly, and the outstanding principal due at maturity. The September 2014 Loan will be collateralized by a security agreement from Methes Canada on certain of its assets, a first collateral mortgage on its real property located at Sombra, Ontario, a promissory note in the amount of \$1,700,000 CAD, and our guarantee of repayment.

Cash flow. The following table presents information regarding our cash flows and cash and cash equivalents for the nine months ended August 31, 2013 and August 31, 2014:

	(Amounts rounded to nearest thousands)	
	Nine months Ended August 31	
	2013	2014
Net cash flows used in operating activities	\$ (1,996)	\$ (5,108)
Net cash flows used in investing activities	(379)	(114)
Net cash flows provided by financing activities	2,477	5,552
Net change in cash and cash equivalents	(102)	330
Cash and cash equivalents, end of period	\$ 504	\$ 504

Operating activities. Net cash used in operating activities was \$1.99 million for the nine months ended August 31, 2013. For the nine months ended August 31, 2013, the net loss was \$4.2 million, which includes total non-cash items for depreciation, amortization, stock compensation expense, unrealized foreign exchange gain, deferred financing fees amortization, accrued interest, bad debts and issuance of common stock/unit, for consulting services of \$561,060. The net cash used in operating activities included a net working capital increase of \$1,645,615. Working capital increases were a result of an increase in accounts payable and accrued liabilities of \$1,101,981 and an increase in inventories of \$336,445. The net result was cash used in operations of \$1.99 million.

Net cash used in operating activities was \$4.83 million for the nine months ended August 31, 2014. For the nine months ended August 31, 2014, the net loss was \$5.08 million, which includes total non-cash items for depreciation, amortization, stock compensation expense, unrealized foreign exchange gain, deferred financing fees amortization, accrued interest, bad debts and issuance of common stock for services of \$1,444,289. The net cash used in operating activities included a net working capital decrease of \$1,190,622. Working capital decreases were a result of a decrease in accounts payable and accrued liabilities (one-time event payments of old payables) of \$1,775,824 offset by an increase in accounts receivable of \$456,377, increase in inventories of \$49,670, increase in deposit and employee loan of \$31,153 and increase in customer deposits of \$144,002. Our current operating cash requirement is approximately \$314,000 per month. However, once our Sombra facility commences full-scale production, we expect to generate positive cash flow from operations.

Investing activities. Net cash used in investing activities for the nine months ended August 31, 2013 was \$379,059, consisting of additions to property, plant and equipment, mainly representing costs related to our Sombra facility. Net cash used in investing activities for the nine months ended August 31, 2014 was \$359,853, consisting of additions to property, plant and equipment, mainly representing costs related to our Sombra facility and investment in derivative instruments.

Financing activities. Net cash provided from financing activities for the nine months ended August 31, 2013 was \$2.48 million, which mainly included advances from short term loans of \$1,938,040 and issuance of common stock/units for cash of \$1,419,389 offset by repayments of short-term loans of \$1,444,250. Net cash provided by financing activities for the nine months ended August 31, 2014 was \$5.52 million, which mainly included issuance of common stock/units under private placement, net of issuance costs of \$2,162,321 and issuance of common stock under public offering of \$5,600,000 offset by payment of financing from credit facility of \$1.02 million.

As of August 31, 2014, due in large part to the funds spent to develop, build and commission our Sombra facility as well as minimal sales of biodiesel, we had a working capital deficiency of \$535,389.

During the nine months ended August 31, 2014, we took steps to improve our cash and working capital positions by: (i) raising net cash proceeds of approximately \$5.62 million from the issuance of common stock/units under private placement; and (iii) converting \$128,000 USD of the outstanding principal due on the January 2013 Note (see note 6 of the unaudited consolidated financial statements elsewhere in this report) into 34,688 shares of Common Stock based on the closing market price of \$3.69 per share of Common Stock on January 17, 2014.

We anticipate that our Sombra facility will generate positive cash flow from operations and will operate profitably once sufficient levels of commercial operation is achieved in the next six months. It is management's opinion that our cash and cash equivalents, the anticipated additional financing and the anticipated positive cash flow from operations will be sufficient to meet our cash requirements for at least the next 12 months.

Capital Expenditures. We have expended \$8.48 million to purchase our Sombra facility, retrofit that facility and equip it so it can begin full scale production of biodiesel. These funds were expended as follows: \$2.03 million for the original purchase price of the facility; \$1.56 million for the costs of retrofitting and \$4.89 million for Denami 3000 processors, storage tanks and other production equipment. The funds used to purchase and complete the Sombra facility were provided by the cash proceeds from sale of our equity securities, monies borrowed from a stockholder and a term loan.

Future commitments. We have no material commitments for future capital expenditures.

Off-Balance Sheet Arrangements

We have no off-balance sheet financing commitments.

Recent Accounting Pronouncements

For a discussion of new accounting pronouncements affecting the Company, refer to “Note 2 - Summary of Significant Accounting Policies” to our unaudited condensed consolidated financial statements included elsewhere in this report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company we are not required to provide the information required by this Item.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of both of our chief executive officer and chief financial officer, carried out an evaluation of the effectiveness of our “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934 (the “Exchange Act”) Rules 13a-15(e) and 15-d-15(e)) as of the end of the period covered by this report (the “Evaluation Date”). Based upon that evaluation, our chief executive officer and chief financial officer each concluded that as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported, within the time periods specified in the U.S. Securities and Exchange Commission’s (SEC) rules and forms and (ii) is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 5. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Recent Sales of Unregistered Securities

Unless otherwise stated, the sales of the securities described below were deemed to be exempt from registration under the Securities Act in reliance upon Section 4(a)(2) and 4(a)(5) of the Securities Act (or Regulation D or Regulation S promulgated thereunder), or Rule 701 promulgated under Section 3(b) of the Securities Act as transactions by an issuer not involving any public offering or pursuant to benefit plans and contracts relating to compensation as provided under Rule 701. The purchasers of the securities in each of these transactions represented their intentions to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof, and, other than with respect to the non-transferable options, appropriate legends were placed on the securities issued in these transactions. All purchasers had adequate access, through their relationships with us, to information about our company. The sales of these securities were made without any general solicitation or advertising.

Private Placements

As of August 1, 2014, we issued 25,000 shares of Common Stock in the third quarterly installment payment of consulting fees for services to be rendered by a consultant, which were valued at \$47,500, based on the closing market price of \$1.70 per share on the date of issuance, of which \$31,413 is included in prepaid expenses as at August 31, 2014.

ITEM 6. EXHIBITS

Exhibit

Number	Description
<u>31.1</u>	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
<u>31.2</u>	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
<u>32.1</u>	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
<u>32.2</u>	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101.INS	XBRL Instance Document***
101.SCH	XBRL Taxonomy Extension Schema Document***
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document***
101.LAB	XBRL Taxonomy Extension Label Linkbase Document***
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document***
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document***

* Filed herewith.

** Furnished, not filed, in accordance with item 601(32)(ii) of Regulation S-K.

*** Furnished with this report. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Methes Energies International Ltd.

Dated: October 15, 2014

/s/ Michel G. Laporte
Michel G. Laporte, Chief Executive
Officer
(Principal Executive Officer)

Dated: October 15, 2014

/s/ Edward A. Stoltenberg
Edward A. Stoltenberg, Chief
Financial Officer
(Principal Financial Officer)