# Village Farms International, Inc.

## Condensed Consolidated Interim Financial Statements

## Three Months Ended

## March 31, 2014 and 2013

## (Unaudited)

## NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

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

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

**Village Farms International, Inc.**
**Condensed Consolidated Interim Statement of Financial Position**
**(In thousands of United States dollars)**

| | March 31, 2014 (Unaudited) | December 31, 2013 (Audited) |
|---|---|---|
| **ASSETS** | | |
| *Current assets* | | |
| Cash and cash equivalents | $ 6,350 | $ 18,668 |
| Trade receivables | 7,958 | 7,109 |
| Other receivables | 305 | 325 |
| Inventories (note 4) | 13,505 | 10,630 |
| Income taxes receivable | 36 | 36 |
| Prepaid expenses and deposits | 488 | 168 |
| Biological asset (note 5) | 7,481 | 3,732 |
| Total current assets | 36,123 | 40,668 |
| *Non-current assets* | | |
| Property, plant and equipment (note 7) | 99,613 | 96,709 |
| Intangible assets (note 8) | 965 | 991 |
| Other assets (note 9) | 1,557 | 1,537 |
| Total assets | $ 138,258 | $ 139,905 |
| **LIABILITIES** | | |
| *Current liabilities* | | |
| Trade payables | $ 6,212 | $ 7,063 |
| Accrued liabilities | 3,749 | 3,225 |
| Income taxes payable | - | 917 |
| Operating loan (note 10) | 1,000 | - |
| Current maturities of long-term debt (note 10) | 4,168 | 4,168 |
| Current maturities of capital lease obligations (note 12) | 25 | 25 |
| Total current liabilities | 15,154 | 15,398 |
| *Non-current liabilities* | | |
| Long-term debt (note 10) | 49,699 | 50,692 |
| Long-term maturities of capital lease obligations (note 12) | 55 | 61 |
| Deferred tax liability | 11,809 | 11,970 |
| Deferred compensation | 711 | 684 |
| Total liabilities | 77,428 | 78,805 |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital (note 21) | 24,850 | 24,850 |
| Contributed surplus | 803 | 749 |
| Accumulated other comprehensive income | 55 | 55 |
| Retained earnings | 35,122 | 35,446 |
| Total shareholders' equity | 60,830 | 61,100 |
| Total liabilities and shareholders' equity | $ 138,258 | $ 139,905 |

*The accompanying notes are an integral part of these condensed consolidated interim financial statements.*

**Village Farms International, Inc.**

**Condensed Consolidated Interim Statement of Changes in Shareholders' Equity**

**For the Three Months Ended March 31, 2014 and 2013**

**(In thousands of United States dollars, except for shares outstanding, unaudited)**

| | Number of Common Shares | Share Capital | Contributed Surplus | Accumulated Other Comprehensive Income | Retained Earnings | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| Balance at January 1, 2013 | 19,433,394 | $ 24,850 | $ 588 | $ 55 | $ 24,958 | $ 50,451 |
| Share-based compensation (note 24) | - | - | 48 | - | - | 48 |
| Net income and comprehensive income for the period ended March 31, 2013 | - | - | - | - | 2,608 | 2,608 |
| Balance at March 31, 2013 | 19,433,394 | 24,850 | 636 | 55 | 27,566 | $ 53,107 |
| Balance at January 1, 2014 | 38,707,345 | 24,850 | 749 | 55 | 35,446 | 61,100 |
| Share-based compensation (note 24) | - | - | 54 | - | - | 54 |
| Net loss and comprehensive loss for the period ended March 31, 2014 | - | - | - | - | (324) | (324) |
| Balance at March 31, 2014 | 38,707,345 | $ 24,850 | $ 803 | $ 55 | $ 35,122 | $ 60,830 |

*The accompanying notes are an integral part of these condensed consolidated interim financial statements.*

**Village Farms International, Inc.**
**Condensed Consolidated Interim Statements of Income and Comprehensive Income**
**For the Three Months Ended**
**(In thousands of United States dollars, except per share data, unaudited)**

| | March 31, 2014 | March 31, 2013 |
|---|---|---|
| Net sales | $ 24,004 | $ 25,385 |
| Cost of sales (note 16) | (21,717) | (23,025) |
| Insurance proceeds, net (note 6) | - | 5,264 |
| Change in biological asset (note 5) | 1,113 | 298 |
| Selling, general and administrative expenses (note 16) | (3,127) | (3,119) |
| Income from operations | 273 | 4,803 |
| Interest expense, net | 688 | 1,216 |
| Foreign exchange loss/(gain) | 38 | (7) |
| Amortization of intangible assets (note 8) | 26 | 26 |
| Gain on derivatives (note 11) | - | (106) |
| Other income, net | (17) | (46) |
| Gain on sale of assets | - | (6) |
| Income before income taxes | (462) | 3,726 |
| (Recovery of) Provision for income taxes | (138) | 1,118 |
| Net (loss) income and comprehensive (loss) income | $ (324) | $ 2,608 |
| Basic (loss) earnings per share (note 22) | $ (0.01) | $ 0.07 |
| Diluted (loss) earnings per share (note 22) | $ (0.01) | $ 0.07 |

*The accompanying notes are an integral part of these condensed consolidated interim financial statements.*

**Village Farms International, Inc.**
**Condensed Consolidated Interim Statements of Cash Flows**
**For the Three Months Ended**
**(In thousands of United States dollars, unaudited)**

| | March 31, 2014 | March 31, 2013 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net (loss) income | $ (324) | $ 2,608 |
| Adjustments to reconcile net (loss) income to net cash used in operating activities: | | |
| Depreciation and amortization | 1,826 | 1,838 |
| Gain on disposal/sale of assets | - | (6) |
| Gain on derivative | - | (106) |
| Foreign exchange loss/(gain) | 38 | (7) |
| Net interest expense | 698 | 1,216 |
| Share-based compensation | 54 | 48 |
| Deferred income taxes | (161) | 1,115 |
| Change in biological asset | (1,113) | (298) |
| Changes in non-cash working capital items (note 18) | (7,904) | (7,076) |
| Net cash used in operating activities | (6,886) | (668) |
| **Cash flows from investing activities:** | | |
| Purchases of property, plant and equipment | (4,704) | (428) |
| Proceeds from sale of property, plant, and equipment, net | - | 6 |
| Other noncurrent assets and liabilities, net | 56 | (503) |
| Net cash used in investing activities | (4,648) | (925) |
| **Cash flows from financing activities:** | | |
| Proceeds from operating loan | 1,000 | 3,028 |
| Payments on long-term debt, net | (1,042) | (310) |
| Interest paid on long-term debt, net | (698) | (1,216) |
| Payments on capital lease obligation | (6) | (5) |
| Net cash (used in) provided by financing activities | (746) | 1,497 |
| Effect of exchange rate changes on cash and cash equivalents | (38) | 7 |
| **Net decrease in cash and cash equivalents** | (12,318) | (89) |
| **Cash and cash equivalents, beginning of period** | 18,668 | 2,801 |
| **Cash and cash equivalents, end of period** | $ 6,350 | $ 2,712 |
| Supplemental cash flow information: | | |
| Income taxes paid | $ 1,009 | $ 1 |

*The accompanying notes are an integral part of these condensed consolidated interim financial statements.*

## 1 NATURE OF OPERATIONS

Village Farms International, Inc. ("VFF" the parent company and, together with its subsidiaries, the "Company") is incorporated under the *Canada Business Corporation Act*. VFF's principal operating subsidiaries at March 31, 2014 are Village Farms Canada Limited Partnership ("VFCLP"), Village Farms, L.P. ("VFLP") and Village Farms DR, SLR ("VFDR"). The address of the registered office of VFF is 4700 80$^{th}$ Street, Delta, British Columbia, Canada, V4K 3N3.

The Company is a publicly traded company, which is listed on the Toronto Stock Exchange under the symbol VFF.

The Company, through its subsidiaries VFCLP and VFLP, owns and operates sophisticated, highly intensive agricultural greenhouse facilities in British Columbia and Texas, where it produces, markets and sells premium-quality tomatoes, bell peppers, and cucumbers. The Company also markets and sells third party produce through its subsidiaries.

## 2 BASIS OF PRESENTATION

### Statement of Compliance

These unaudited condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standards 34, Interim Financial Reporting ("IAS 34") as issued by the International Accounting Standards Board ("IASB"). They do not include all of the information required for full annual financial statement disclosures, and should be read in conjunction with the Company's Consolidated Financial Statements for the year ended December 31, 2013.

### Basis of Presentation

The condensed consolidated interim financial statements are prepared on a going concern basis. The accounting policies have been applied consistently in all material respects. These condensed consolidated interim financial statements have been prepared by applying the same accounting policies, assessments of estimates and judgments, and methods of computation as compared with the most recent annual consolidated financial statements. Certain reclassifications have been made, where appropriate, to prior period financial statements to conform to the current period presentation.

### Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following material items in the statement of financial position:

- Derivative financial instruments are measured at fair value;
- Available-for-sale financial assets are measured at fair value; and
- Biological assets are measured at fair value less costs to sell.

### Functional and Presentation Currency

These condensed consolidated interim financial statements are presented in United States dollars ("U.S. dollars"), which is the Company's functional currency. All financial information presented in U.S. dollars has been rounded to the nearest thousands.

## 3 CHANGES IN ACCOUNTING POLICIES

The Company has adopted the following new and revised standards, along with any consequential amendments as at January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

- The Company assessed its consolidation conclusion and determined that the adoption of IFRS 10, *Consolidated Financial Statements*, did not result in any changes in the consolidation status of any of its subsidiaries.
- The Company adopted IFRS 13, *Fair Value Measurement*, on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments.

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

- The Company adopted the amendments to IAS 1, *Presentation of Financial Statements*. These amendments required the Company to group other comprehensive income items by those that may be recycled through net income and those that will not be recycled through net income. These changes did not result in adjustments to other comprehensive income.
- The Company adopted IFRS 11, *Joint Arrangements*, which redefined joint operations and joint ventures with a focus on the rights and obligations of an arrangement, rather than its legal form. The adoption of IFRS 11 did not have an impact on the Company's consolidated financial statements.
- The Company adopted the amended IAS 19R, *Employee Benefits*, which changed the recognition and measurement of defined benefit pension expense and termination benefits and enhanced the disclosure of all employee benefits. The adoption of IAS 19R did not result in any changes in the accounting of employee benefits.

**Accounting Standards Issued and Not Applied**

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 9, *Financial Instruments*, which addresses classification and measurement of financial assets and financial liabilities, and replaces the multiple category and measurement models in IAS 39, *Financial Instruments – Recognition and Measurement*. The required adoption date for IFRS 9 has been deferred and is not expected until January 1, 2017, with early adoption permitted. IFRS 9 is not expected to have a material impact on amounts recorded in the Company's consolidated financial statements.

Further details of new accounting Standards and potential impact on the Company can be found in the Company's Consolidated Financial Statements for the year ended December 31, 2013.

## 4 INVENTORIES

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Deferred crop costs | $17,774 | $12,200 |
| Purchased produce inventory | 465 | 528 |
| Biological asset adjustment (note 5) | (4,734) | (2,098) |
| | $13,505 | $10,630 |

The cost of inventories recognized as expense and included in cost of sales for the three months ended March 31, 2014 amounted to $17,420 (2013 – $18,525).

The biological asset adjustment reclassifies actual costs incurred for the biological asset from inventories to biological asset on the statement of financial position.

## 5 BIOLOGICAL ASSET

Information about the biological asset presented on the statement of financial position and in the statement of income is as follows:

| | March 31, 2014 | December 31, 2013 | March 31, 2013 |
|---|---|---|---|
| Estimated sales value - biological asset | $14,822 | $6,363 | $15,326 |
| Less | | | |
| Estimated remaining costs to complete | 6,510 | 2,216 | 6,828 |
| Estimated selling costs | 831 | 415 | 850 |
| Fair value of biological asset less costs to sell | 7,481 | 3,732 | 7,648 |
| Less actual costs (note 4) | 4,734 | 2,098 | 4,494 |
| Increase in fair value of biological asset over cost | 2,747 | 1,634 | 3,154 |
| Fair value over cost of harvested and sold biological asset – beginning of year | 1,634 | 2,856 | 2,856 |
| Change in biological asset | $1,113 | ($1,222) | $298 |

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

## 6 HAIL DAMAGE

On May 31, 2012, the Company suffered a hail storm that closed three of the Texas facilities. The Company was insured and as at quarter ended March 31, 2013, $5,264 was received for business interruption, net of fees. The insurance claim was settled and complete in September 2013. The Company received $15,658 from its insurance carrier for business interruption and $1,074 for property damage in 2013. Fees incurred associated with the recoveries for the year ended December 31, 2013 totaled $784, resulting in net proceeds of $15,948 for 2013. The Company's cumulative total proceeds received in 2012 and 2013 from its insurance carrier was $49,264, total fees incurred of $2,085, resulting in total net proceeds of $47,179.

## 7 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

| | Land | Leasehold and land improve-ments | Green-house buildings | Green-house equipment | Machinery and Equipment | Construction in process | Total |
|---|---|---|---|---|---|---|---|
| **At December 31, 2013** | | | | | | | |
| Cost | 5,027 | 3,471 | 73,205 | 50,544 | 4,803 | 4,451 | 141,501 |
| Accumulated depreciation | - | (1,707) | (21,870) | (17,793) | (3,422) | - | (44,792) |
| Net book value | $5,027 | $1,764 | $51,335 | $32,751 | $1,381 | $4,451 | $96,709 |
| **Three months ended March 31, 2014** | | | | | | | |
| Opening net book value | $5,027 | $1,764 | $51,335 | $32,751 | $1,381 | $4,451 | $96,709 |
| Additions/(transfers) | - | - | - | 170 | (170) | 4,704 | 4,704 |
| Placed in service | - | - | 505 | 85 | - | (590) | - |
| Depreciation expense | - | (38) | (858) | (840) | (64) | - | (1,800) |
| Closing net book value | $5,027 | $1,726 | $50,982 | $32,166 | $1,147 | $8,565 | $99,613 |
| **At March 31, 2014** | | | | | | | |
| Cost | 5,027 | 3,471 | 73,710 | 50,799 | 4,633 | 8,565 | 146,205 |
| Accumulated depreciation | - | (1,745) | (22,728) | (18,633) | (3,486) | - | (46,592) |
| Net book value | $5,027 | $1,726 | $50,982 | $32,166 | $1,147 | $8,565 | $99,613 |

As at March 31, 2014, total construction in process includes construction of the new Marfa facilities totaling approximately $6,800. Depreciation related to the greenhouse facilities and equipment is expensed in cost of sales.

## 8 INTANGIBLE ASSETS

VFCLP has an energy supply agreement with the operator of a cogeneration facility to purchase thermal energy required for one of VFCLP's greenhouses. The contract expires on July 31, 2023. VFCLP also has a right of first refusal with respect to any excess methane gas conveyed to the cogeneration plant from an adjacent landfill. The estimated fair value of the contract (discounted value of future after tax benefit) was recorded as an intangible asset and is being amortized on a straight-line basis over the life of the contract.

| | |
|---|---|
| **Year ended December 31, 2013** | |
| Opening book value | $1,094 |
| Amortization for the year | (103) |
| Closing net book value | 991 |
| **At December 31, 2013** | |
| Cost | 1,735 |
| Accumulated amortization | (744) |
| Net book value | 991 |

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

| | |
|---|---|
| **Three months ended March 31, 2014** | |
| Opening book value | 991 |
| Amortization for the year | (26) |
| Closing net book value | 965 |
| **At March 31, 2014** | |
| Cost | 1,735 |
| Accumulated amortization | (770) |
| Net book value | $965 |

## 9 OTHER ASSETS

The following table summarizes the components of other assets:

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Patronage stock | $437 | $437 |
| Note receivable (note 14) | 322 | 325 |
| Security deposits | 116 | 116 |
| Cash surrender value - insurance | 672 | 649 |
| Other | 10 | 10 |
| Total | $1,557 | $1,537 |

## 10 DEBT

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| **Long-term debt:** | | |
| Opening balance | $55,569 | $58,310 |
| Proceeds from Credit Facilities | - | 58,000 |
| Repayment of debt | (1,042) | (60,741) |
| Closing balance | $54,527 | $55,569 |
| Current portion | 4,168 | 4,168 |
| Non-current portion | 50,359 | 51,401 |
| | $54,527 | $55,569 |
| Less: | | |
| Unamortized deferred transaction costs | (660) | (709) |
| | $53,867 | $54,860 |

**Credit Facilities:**

On March 28, 2013, the Company entered into an agreement for new Term Loan financing with an existing Canadian creditor (the "Credit Facilities"). As part of the agreement, all prior term debt was repaid upon issuance of the new term loan financing. The non-revolving variable rate term loan has a maturity date of April 1, 2018 ("FCC Loan") and a balance of $54,527 as at March 31, 2014. The outstanding balance is repayable by way of monthly installments of principal and interest based on an amortization period of 14 years, with the balance and any accrued interest to be paid in full on April 1, 2018. Monthly principal payments are $347. As at March 31, 2014, borrowings under the FCC Loan agreement are subject to an interest rate of 5.2356% (December 31, 2013 – 5.2378%) . The Company's interest rate on the FCC Loan is determined based on the Company's Debt to EBITDA ratio and the applicable LIBOR rate.

In addition, the Company entered into a new line of credit agreement with a new creditor on August 30, 2013. The revolving operating loan of up to CA$10,000 is at variable interest rates with a maturity date on August 30, 2016 (the "Operating Loan"). The Operating Loan is subject to margin requirements stipulated by the bank. As at March 31, 2014, $1,000 was drawn on this facility (December 31, 2013 – $nil), which is available to a maximum of CA$10,000, less an outstanding letter of credit totaling $845.

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

The borrowings are subject to certain positive and negative covenants. As at March 31, 2014 and December 31, 2013, the Company was in compliance with all covenants on all of its Credit Facilities.

Accrued interest payable on the credit facilities and loans as at March 31, 2014 was $219 (December 31, 2013 – $229) and these amounts are included in accrued liabilities in the statement of financial position.

As security for the FCC Loan, the Company has provided promissory notes, a first mortgage on the greenhouse properties, and general security agreements over its assets. In addition, the Company has provided full recourse guarantees and has granted security therein. The carrying value of the assets and securities pledged as collateral as at March 31, 2014 was $138,258 (December 31, 2013 – $139,905).

Transaction costs incurred in connection with these financing activities are deferred and amortized over the terms of the related financing agreement. Total deferred financing costs, net of accumulated amortization, are netted against long term debt on the statement of financial position, and total $660 as at March 31, 2014 (December 31, 2013 – $709).

The aggregate annual maturities of long-term debt as at March 31, 2014 are as follows:

| | |
|---|---|
| Remaining 2014 | $ 3,126 |
| 2015 | 4,168 |
| 2016 | 4,168 |
| 2017 | 4,168 |
| 2018 | 38,897 |
| | $54,527 |

## 11 DERIVATIVE

During 2014, the Company has not entered into interest rate swap agreements. On January 25, 2013, the Company's interest rate swap agreement expired and a gain of $106 was recognized as at March 31, 2013, which represented the mark-to-market adjustment of the interest rate swap agreement. The Company did not designate the swap agreement as a hedge for accounting purposes.

## 12 COMMITMENTS

### Obligations Under Capital Leases

The Company has a capital lease to purchase greenhouse equipment. Future minimum lease payments are as follows:

| | |
|---|---|
| Remaining 2014 | $22 |
| 2015 | 29 |
| 2016 | 29 |
| 2017 | 7 |
| Total minimum lease payments | 87 |
| Less amount representing interest | (7) |
| | 80 |
| Less current portion | (25) |
| Long-term portion | $55 |

The lease has an interest rate of 5.5%, with equipment having a cost of $139. The Company made principal payments of $6 during the three months ended March 31, 2014 (2013 – $5). Interest paid on the capital lease amounted to $1 during the three months ended March 31, 2014 (2013 – $2).

### Operating Leases

The Company has entered into certain operating lease commitments for land, office space and equipment through 2022. The future minimum lease payments as at March 31, 2014 are as follows:

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

| | March 31, 2014 |
|---|---|
| Remaining 2014 | $1,184 |
| 2015 | 1,429 |
| 2016 | 1,192 |
| 2017 | 1,155 |
| 2018 | 1,123 |
| Thereafter | 1,794 |
| | $7,877 |

The Company made lease payments of $595 during the three months ended March 31, 2014 (2013 – $605). Payments include common area amounts and fees paid to the lessors.

## 13 FINANCIAL INSTRUMENTS

The following table summarizes the carrying and fair value of the Company's financial instruments:

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Cash and cash equivalents | $6,350 | $18,668 |
| Trade receivables | 7,958 | 7,109 |
| Other receivables | 1,100 | 1,123 |
| Other financial liabilities | 65,619 | 66,835 |

Interest income, expense and gains and losses from loans, receivables and other financial liabilities are recognized in the statement of income. The following table summarizes interest income and expense for the three months ended March 31:

| | 2014 | 2013 |
|---|---|---|
| Interest income earned on cash and cash equivalents | $0 | $1 |
| Interest expense from other financial liabilities | $688 | $1,217 |

The company classifies financial assets and liabilities that are recognized on the statement of financial position at fair value in a hierarchy that is based on significance of the inputs used in making the measurements. The levels in the hierarchy are:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices)
- Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

## Management of financial risks

The Company, through its financial assets and liabilities, is exposed to various risks. The following provides a measurement of some of these risks as at March 31, 2014.

i) Credit risk

Credit risk is the risk that the Company will incur a loss due to the failure by its customers or other parties to meet their contractual obligations. Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents, trade receivables and other receivables.

The Company limits its exposure to credit risk by placing its cash and cash equivalents with high credit quality financial institutions.

The Company's trade receivables had two customers that represented more than 10% of the balance of trade receivables, representing 16.1% and 10.8% of the balance of trade receivables as at March 31, 2014 (2013 – two customers, 12.4% and 12.3%). The Company believes that its trade receivables risk is limited due to the high credit quality of its customers and the protection afforded to the Company by the *Perishable Agricultural Commodities Act* (the "PACA") for its sales in the United States, which represent approximately 80% annually of the Company's sales. The PACA protection gives a claim filed under the PACA first lien on all PACA assets (which include cash and trade receivables). The PACA fosters trading practices in the marketing of fresh and frozen fruits and vegetables in interstate and foreign commerce. It prohibits unfair and fraudulent practices and provides a means of enforcing contracts. Historical write-offs have represented less than one-half of one percent of sales. The maximum amount of credit risk exposure is limited to the carrying amount of the balances on the financial statements.

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

Trade receivables for each customer were evaluated for collectability and an allowance for doubtful accounts has been estimated. At March 31, 2014, the allowance for doubtful accounts balance was $50 (December 31, 2013 – $50). The Company has not recorded a bad debt expense during the three months ended March 31, 2014 (2013 – $nil).

At March 31, 2014, 97.2% (December 31, 2013 – 89.9%) of trade receivables were outstanding less than 30 days, 2.1% (December 31, 2013 – 9.3%) were outstanding for between 30 and 90 days and the remaining 0.7% (December 31, 2013 – 0.8%) were outstanding for more than 90 days. Trade receivables are considered past due based on the contract terms agreed to with a customer. Aged receivables that are past due are not considered impaired unless customer specific information indicates otherwise.

ii) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company is exposed to interest rate risk on its long-term debt, for which the interest rates charged fluctuate based on the 90-day LIBOR rate.

If interest rates had been 50 basis points higher (lower), the net income during the three months ended March 31, 2014 would have been higher (lower) by ($275). This represents $275 in increased interest expense (2013 – ($291)).

iii) Foreign exchange risk

At March 31, 2014, the Canadian/U.S. foreign exchange rate was CA$1.00 = US$0.9039 (December 31, 2013 – US$0.9349). Assuming that all other variables remain constant, an increase of $0.10 in the Canadian dollar would have the following impact on the ending balances of certain statement of financial position items at March 31, 2014 and December 31, 2013 with the net foreign exchange gain or loss directly impacting net income for the year.

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| **Financial assets** | | |
| Cash and cash equivalents | $38 | $165 |
| Trade receivables | 126 | 76 |
| **Financial liabilities** | | |
| Trade payables and accrued liabilities | (227) | (223) |
| **Net foreign exchange (loss) gain** | ($63) | $ 18 |

iv) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due. The following are the contractual maturities of financial liabilities as at March 31, 2014:

| Financial liabilities | **Total** | **Less than 1 year** | **2-3 years** | **4-5 years** | **More than 5 years** |
|---|---|---|---|---|---|
| Long-term debt, net of fees | $53,867 | $4,168 | $7,676 | $42,023 | $- |
| Operating loan | 1,000 | 1,000 | - | - | - |
| Trade payables | 6,212 | 6,212 | - | - | - |
| Accrued liabilities and taxes | 3,749 | 3,749 | - | - | - |
| Obligation under capital lease | 80 | 25 | 55 | - | - |
| Other liabilities | 711 | - | 711 | - | - |
| Total | $65,619 | $15,154 | $8,442 | $42,023 | $- |

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

It is the Company's intention to meet these obligations through the collection of current accounts receivable and cash from sales. If the current resources and cash generated from operations are insufficient to satisfy its obligations, the Company may seek to issue additional equity or to arrange debt or other financing. In addition, the Company has available an operating loan of up to CA$10,000, less an outstanding balance of $1,000 and an outstanding letter of credit totaling $845.

v) Fair values

The carrying amount of short-term financial instruments, less provisions for impairment if applicable, is consistent with the fair value of such instruments. The Company's debt bears a variable interest rate and therefore its carrying value approximates its fair value. There were no derivatives held at March 31, 2014 (December 31, 2013 - $nil).

## 14 RELATED PARTY TRANSACTIONS AND BALANCES

Included in other assets as at March 31, 2014, is a $322 (December 31, 2013 – $325) promissory note from an employee of the Company in connection with a relocation at the request of the Company. The note is secured by real property. It is a non-interest bearing note to be paid from proceeds on the sale of the real property that secures the note. The $322 balance represents the unpaid amount the Company advanced on this employee's behalf in connection with the relocation.

## 15 COMPENSATION OF KEY MANAGEMENT

Key management includes the Company's officers and senior vice presidents:

| | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Salaries and other employee benefits | $387 | $361 |
| Share-based payments | 24 | 16 |
| | $411 | $377 |

## 16 EXPENSES BY NATURE

The following table outlines the Company's significant expenses by nature:

| *Cost of sales* | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Purchased produce | $ 6,658 | $ 5,801 |
| Raw materials and consumables used | 3,149 | 4,730 |
| Depreciation and amortization | 1,745 | 1,740 |
| Transportation and storage | 3,637 | 3,872 |
| Employee compensation and benefits | 6,528 | 6,882 |
| | $21,717 | $23,025 |

| *Selling, general and administrative expenses* | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Employee compensation and benefits | $ 1,830 | $ 1,804 |
| Marketing | 92 | 65 |
| Professional services | 395 | 263 |
| Office expenses | 482 | 473 |
| Other | 328 | 514 |
| | $ 3,127 | $ 3,119 |

| *Employee compensation and benefits* | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Salaries and short-term employee benefits | $ 8,304 | $ 8,638 |
| Share-based compensation | 54 | 48 |
| | $ 8,358 | $ 8,686 |

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

## 17 DEFERRED INCOME TAXES

Income tax expense is recognized based on management's best estimate of the weighted average annual income tax rate expected for the full financial year. The estimated average annual rate used for the three months ended March 31, 2014 was 30% and the three months ended March 31, 2013 was 30%.

## 18 CHANGES IN NON-CASH WORKING CAPITAL

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| Trade receivables | ($849) | ($1,330) |
| Inventories | (2,875) | (767) |
| Inventories reclassified to biological asset | (2,636) | (2,592) |
| Other receivables | 20 | (3,201) |
| Prepaid expenses and deposits | (320) | (490) |
| Trade payables | (851) | 393 |
| Accrued liabilities and taxes | (393) | 911 |
| | ($7,904) | ($7,076) |

## 19 GEOGRAPHIC INFORMATION

The Company operates as one reporting segment as it produces, markets, and sells only one product group which consists of premium quality tomatoes, bell peppers and cucumbers. The Company's primary operations are in the United States and Canada. Net sales by the countries in which its customers are located are as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| United States | $22,540 | $23,372 |
| Canada | 1,454 | 1,963 |
| Other | 10 | 50 |
| | $24,004 | $25,385 |

The Company's property, plant and equipment, net of accumulated depreciation, are located as follows:

| | March 31, 2014 | December 31,2013 |
|---|---|---|
| United States | $ 61,134 | $ 57,863 |
| Canada | 38,053 | 38,408 |
| Dominican Republic | 426 | 438 |
| | $ 99,613 | $ 96,709 |

## 20 CONTINGENCIES

In the normal course of business, the Company receives notice of potential legal proceedings or is named as a defendant in legal proceedings. Management is of the opinion that the outcome of these uncertainties will not have a material adverse effect on the Company's financial position.

## 21 SHARE CAPITAL AND EQUITY

The following is a summary of share capital:

| | The VFF Common Shares | |
|---|---|---|
| | # of Shares | Amount |
| Share capital–January 1, 2013 | 19,433,394 | $24,850 |
| Conversion of special shares to common shares | 19,273,951 | $ - |
| Share capital–March 31, 2014 and December 31, 2013 | 38,707,345 | $24,850 |

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

| | The VFF Special Shares | |
|---|---|---|
| | # of Shares | Amount |
| Share capital–January 1, 2013 | 19,273,951 | $ - |
| Conversion of special shares to common shares | (19,273,951) | $ - |
| Share capital– March 31, 2014 and December 31, 2013 | - | $ - |

VFF is authorized to issue an unlimited number of common shares, special shares and preferred shares, issuable in series. These shares have no par value.

(i) Special shares:

The special shares were issued to VF U.S. Holdings Inc. ("U.S. Holdings") for the benefit of the holders of the Participating Preferred Shares ("PPS") of U.S. Holdings. The PPS were issued in connection with the business combination between U.S. Holdings and Hot House Growers Income Trust in October 2006. The special shares entitled the holder to exercise voting and other rights as a shareholder of VFF as though the holder held the number of shares that would be owned by the holders of the PPSs assuming the exercise in full of the PPS Exchange Rights; provided that in no event shall the votes attached to the special shares exceed 45% of the votes otherwise attached to the common shares and the special shares of VFF then outstanding. The combination of the PPS and special shares were the economic equivalent of common shares. For financial reporting purposes, the special shares have been treated as common shares and are included in the Company's share capital and in the calculation of earnings per share. During 2013, the remaining Participating Preferred Shares ("PPS") shareholders issued conversion notices to the Company to exchange 19,273,951 Special Shares for 19,273,951 Common Shares of the Company pursuant to the Securityholders' Agreement. No Special Shares were outstanding at March 31, 2014, nor can any Special Shares be issued at a future date.

(ii) Common shares:

The common shares entitle the holders thereof to one vote per share at all shareholder meetings of VFF. The holders of the common shares are entitled to receive any dividend declared by VFF on the common shares.

Subject to the rights, privileges, restrictions and conditions attached to any other class of shares of VFF, the holders of the common shares are entitled to receive, pro rata, the remaining property or assets of VFF upon its dissolution, liquidation or winding-up.

(iii) Preferred shares:

The preferred shares may be issued in one or more series, with such rights and conditions as may be determined by resolution of the directors of VFF who shall determine the designation, rights, privileges, conditions and restrictions to be attached to the preferred shares of such series. There are no voting rights attached to the preferred shares except as prescribed by law. In the event of the liquidation, dissolution or winding-up of VFF, or any other distribution of assets of VFF among its shareholders for the purpose of winding-up its affairs, the holders of the preferred shares of each series are entitled to receive, among other things, with priority over the common shares and any other shares ranking junior to the preferred shares of VFF, an amount equal to any cumulative dividends, whether or not declared, or declared thereon but unpaid and no more. The preferred shares for each series are also entitled to such other preferences over the common shares and any other shares ranking junior to the preferred shares as may be determined as to their respective series authorized to be issued. The preferred shares of each series shall be on a parity basis with the preferred shares of every other series with respect to payment of dividends and return of capital. There are no preferred shares currently issued and outstanding.

## 22 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net income attributable to owners of the Company by the weighted average number of common shares in issue during the year excluding common shares purchased by the Company and held as treasury shares.

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

| | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Net (loss) income attributable to owners of the Company | ($324) | $2,608 |
| Weighted average number of common shares and special shares outstanding (thousands) | 38,707 | 38,707 |
| Basic (loss) earnings per share | ($0.01) | $0.07 |

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares. The Company's share options are potentially dilutive to common shares. A calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average market share price of the Company's shares for the year) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated above is compared with the number of shares that would have been issued assuming the exercise of the share options. If dilutive effect is less than zero, then issuance is anti-dilutive and is excluded from dilutive earnings per share calculation.

| | Three Months Ended March 31, 2014 | Three Months Ended March 31, 2013 |
|---|---|---|
| Net (loss) income attributable to owners of the Company | ($324) | $2,608 |
| Weighted average number of common shares and special shares outstanding (thousands) | 38,707 | 38,707 |
| Adjustment for: | | |
| Share options (thousands) | 377 | 67 |
| Weighted average number of common shares and special shares outstanding for diluted earnings per share (thousands) | 39,084 | 38,774 |
| Diluted (loss) earnings per share | ($0.01) | $0.07 |

## 23 CAPITAL DISCLOSURES

The Company's objectives when managing capital are to safeguard its assets and maintain a competitive cost structure, continue as a going concern and provide returns to its shareholders. In addition, the Company works with all relevant stakeholders to ensure the safety of its operations and employees and remain in compliance with all environmental regulations.

The Company's main objectives when managing capital are:

- to structure the repayment of obligations in line with the expected lives of the Company's principal revenue generating assets;
- to ensure the Company has access to capital to fund contractual obligations as they become due and to ensure adequate cash levels to withstand the impact of unfavorable economic conditions;
- to maintain the Company's credit ratings to facilitate access to capital markets at competitive interest rates; and
- to access capital markets to fund its growth initiatives.

The Company's capital comprises of net debt and equity:

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Total bank debt | $55,527 | $55,569 |
| Less cash and cash equivalents | (6,350) | (18,668) |
| Net debt | 49,177 | 36,901 |
| Total equity | 60,830 | 61,100 |
| | $110,007 | $98,001 |

It is the Company's intention to meet its obligations through the collection of current accounts receivable and cash. As at March 31, 2014, the Company has an available operating loan up to CA$10,000, less $1,000 drawn on the loan and $845 outstanding on the letter of credit (as at December 31, 2013, $nil was outstanding on the operating loan, and $1,645 was utilized on a letter of credit). As at March 31, 2014, the operating loan borrowing base was $5,648 based on a percentage of the Company's outstanding accounts receivable less the current advance and issued letter of credit. If the current resources and cash generated from operations are insufficient to satisfy its obligations, the Company may seek to issue additional equity or to arrange debt or other financing.

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

## 24 SHARE-BASED COMPENSATION PLAN

The Company has a share-based compensation plan. The maximum number of common shares that can be issued upon the exercise of options granted is equal to 10% of the aggregate number of common shares issued and outstanding from time to time. The term during which an option may be exercised is 10 years from the date of the grant. Options vest at a rate of 33% per year, beginning one year following the grant date of the options. Share-based compensation expense for the three months ended March 31, 2014 of $54 (2013 – $48) was recorded in selling, general and administrative expenses and the corresponding amount credited to contributed surplus.

The following table presents the assumptions used to establish the fair value assigned to the options issued using the Black-Scholes valuation model:

| | March 2014 | September 2013 | March 2013 | 2012 |
|---|---|---|---|---|
| Expected volatility | 57.0% | 56.4% | 46.4% | 54.5% |
| Dividend | $nil | $nil | $nil | $nil |
| Risk-free interest rate | 1.52% | 1.52% | 2.04% | 2.14% |
| Expected life | 6.5 years | 6.5 years | 6.5 years | 6.5 years |
| Fair value | $0.822 | $0.606 | $0.410 | $0.694 |

Expected volatility was based on three years of historical data.

The following table summarizes stock options granted during the year. There were no forfeitures of stock options for the three months ended March 31, 2014.

| | For the Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2014 | | 2013 | |
| | Stock options | Weighted average exercise price | Stock options | Weighted average exercise price |
| Beginning of period | 1,454,999 | CA$1.06 | 1,164,999 | CA$1.08 |
| Granted | 410,000 | CA$1.48 | 100,000 | CA$0.85 |
| End of period | 1,864,999 | CA$1.15 | 1,264,999 | CA$1.06 |

The following table summarizes stock options outstanding and granted as at March 31, 2014:

| Exercise price | Number outstanding | Remaining contractual life (years) | Number of exercisable options |
|---|---|---|---|
| CA$0.70 | 349,999 | 5.8 | 349,999 |
| CA$1.24 | 615,000 | 7.1 | 410,000 |
| CA$1.27 | 150,000 | 8.0 | 100,000 |
| CA$0.85 | 100,000 | 9.0 | 33,333 |
| CA$1.10 | 240,000 | 9.5 | Nil |
| CA$1.48 | 410,000 | 10.0 | Nil |
| | 1,864,999 | | |

(In thousands of United States dollars, except per share amounts and unless otherwise noted)

No options were exercised for the three months ended March 31, 2014 and 2013. Share options outstanding as at March 31, 2014 have the following expiry dates and exercise prices:

| | Exercise price in CA$ per share | March 31, 2014 | December 31, 2013 |
|---|---|---|---|
| Expire date - January 13, 2020 | 0.70 | 349,999 | 349,999 |
| Expire date - May 20, 2021 | 1.24 | 615,000 | 615,000 |
| Expire date - March 13, 2022 | 1.27 | 150,000 | 150,000 |
| Expire date - March 13, 2023 | 0.85 | 100,000 | 100,000 |
| Expire date - September 26, 2023 | 1.10 | 240,000 | 240,000 |
| Expire date - March 18, 2024 | 1.48 | 410,000 | - |
| | | 1,864,999 | 1,454,999 |