MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management's discussion and analysis ("MD&A") of the operating results and financial position of DIRTT Environmental Solutions Ltd. and its subsidiaries ("DIRTT", the "Company", "we", "us" or "our") was prepared as of May 8, 2014, and should be read in conjunction with the Company's condensed consolidated financial statements and related notes for the three months ended March 31, 2014 compared to the three months ended March 31, 2013, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). Please refer to Note 2 of the consolidated financial statements for the 12 months ended December 31, 2013 for disclosure with respect to the Company's significant accounting policies. This discussion addresses matters we consider important for an understanding of our financial condition and results of operations as at and for the three months ended March 31, 2014. The Company's reporting currency is the Canadian dollar. This MD&A should also be read in conjunction with the Company's annual information form for the 12 months ended December 31, 2013 (the "AIF") and other public filings available on SEDAR at www.sedar.com.

This MD&A contains references to Canadian dollars and United States dollars. Canadian dollars are referred to as "$" and United States dollars are referred to as "US$". All amounts are expressed in thousands of Canadian dollars unless otherwise stated.

SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

Certain information and statements contained in this MD&A constitute "forward-looking information" and "forward-looking statements" (collectively, "Forward-Looking Information") as defined under applicable Canadian securities laws and the Company hereby cautions about important factors that could cause the Company's actual results or outcomes to differ materially from those projected in any Forward-Looking Information contained in this MD&A. Any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as "will likely result", "are expected to", "will continue", "is anticipated", "believes", "estimated", "intends", "plans", "projection" and "outlook"), are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in such Forward-Looking Information.

In particular and without limitation, this MD&A contains Forward-Looking Information pertaining to the following: comments with respect to our revenue, objectives and priorities for 2014 and beyond; project timetables; our growth strategies and opportunities; our ability to meet working capital requirements and financial obligations; the launch of the ESPP (as defined below); use of proceeds from the IPO (as defined below); and our outlook for our operations and the Canadian, United States (the "US") and international economies, and in particular, the US construction industry.

With respect to Forward-Looking Information contained in this MD&A, assumptions have been made regarding, among other things:

- our ability to manage our growth;
- competition in our industry;
- our ability to enhance current products and develop and introduce new products;
- our ability to obtain components and products from suppliers on a timely basis and on favourable terms;
- our ability to obtain qualified staff and equipment in a timely and cost-efficient manner;
- the regulatory framework governing taxes in Canada and the US and any other jurisdictions in which we may conduct our business in the future;
- future development plans for our assets unfolding as currently envisioned;
- future capital expenditures to be made by us;
- future sources of funding for our capital program;
- the impact of increasing competition on the Company; and
- our success in identifying risks to our business and managing the risks mentioned below.

The Company's actual results or outcomes could differ materially from those expressed in the Forward-Looking Information as a result of the risks normally encountered in its industry such as:

- maintaining and managing growth;
- history of losses;
- risks related to global financial crisis;
- risks related to new technology;
- competition risks;

- operating results and financial condition fluctuations on a quarterly and annual basis;
- risks related to intellectual property;
- risks related to additional capital requirements;
- customer base and market acceptance;
- software and product defects and design risks;
- availability of key supplies;
- dependence on key personnel and consultants;
- commodity price risk;
- risks related to restricted covenants;
- credit risk;
- the effect of government regulation;
- risks related to international expansion;
- risks related to physical facilities;
- legal risks;
- foreign currency and fiscal matters;
- risks related to future acquisitions;
- risks related to Forward-Looking Information;
- reliance on third parties; and
- conflicts of interest.

Please refer to the AIF for a detailed discussion of the risk factors.

Since actual results or outcomes could differ materially from those expressed in the Forward-Looking Information provided by or on behalf of the Company, investors and others should not place undue reliance on any such Forward- Looking Information.

DIRTT cautions that the foregoing lists of factors are not exhaustive. Further, Forward-Looking Information is made as of the date hereof, and the Company undertakes no obligation to update Forward-Looking Information to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, except as required by applicable Canadian securities laws. New factors emerge from time to time, and it is not possible for DIRTT's management to predict all of these factors and to assess in advance the impact of each such factor on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in Forward-Looking Information. No assurance can be given that these expectations will prove to be correct and such Forward-Looking Information contained in this MD&A should not be unduly relied upon. In addition, this MD&A may contain Forward-Looking Information attributed to third party industry sources.

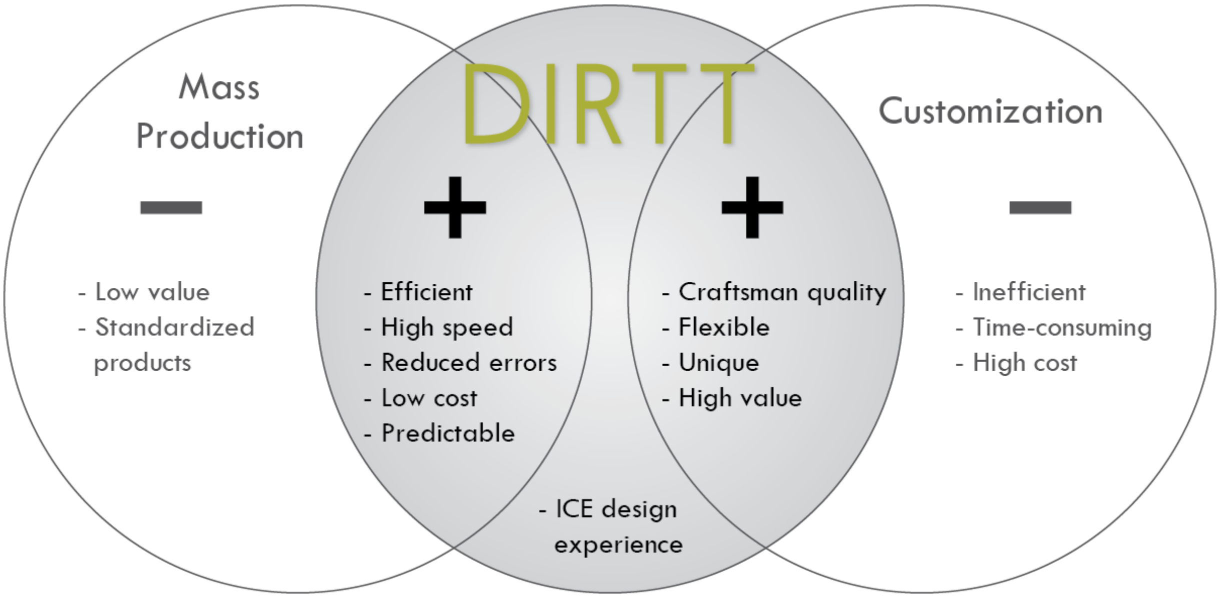
The Forward-Looking Information contained in this MD&A is expressly qualified by the foregoing cautionary statement. See "Risk Factors".

OVERVIEW

We are a leading technology-driven manufacturer of highly customized interiors. We combine our proprietary ICE® 3D design, configuration and manufacturing software ("ICE" or "ICE Software") with integrated in-house manufacturing of our innovative prefabricated interior construction solutions and an extensive Distribution Partner ("DP") network across two continents. A DP is a third party who enters into a formal agreement to market and sell our products and solutions. DPs are required to invest in their own regional DIRTT team consisting of at least one DIRTT champion, a designer and a project manager; in a Green Learning Center ("GLC") to showcase the potential of DIRTT Solutions (as defined below) to clients in a design showroom; and to purchase an ICE Software package. As of the date hereof, we had 101 DPs in 184 locations selling in eight countries. We are underpinned by a strong entrepreneurial culture and provide a unique, end-to-end solution for the inefficient and fragmented interior construction industry.

DIRTT stands for: Doing It Right This Time.

Our goal is to build and deliver complete, engaging, well-designed, customized, sustainable, high-quality spaces faster and more efficiently than traditional construction methods which often entail cost overruns, inconsistent quality, delays and significant material waste. Our proprietary ICE Software delivers an automated manufacturing process that significantly decreases the construction timeframe (three-week target or better) compared to the conventional approach. Using ICE, we focus on revolutionizing the interior construction industry by combining the speed, cost certainty, sustainability and modularity of prefabrication with the custom dimensions, functionality and aesthetics of skilled trade construction. ICE enables us to deliver a superior client experience, while combining the low unit costs of mass production processes with the flexibility of individual customization. This mass customization, combined with our highly entrepreneurial and client-focused culture, is the foundation for our success.



DIRTT Solutions, including DIRTT Walls, DIRTT Power, DIRTT Networks, DIRTT Millwork and DIRTT Floors, address the challenges associated with traditional interior construction methods.

COMPARISON WITH CONVENTIONAL APPROACH

	DIRTT	Conventional Construction
Configuration Process	Automated	Manual
Quality	Errors virtually eliminated	Errors common
Cost	Generally lower	Typically higher
Delivery	Fast	Prone to delays
Flexibility	Completely customizable design	Difficult to accommodate changes
Efficiency	Minimal waste	Significant waste

We are not dependent on any one client, DP, industry or minimum job size. Our clients range from small owner-managed businesses to large multinational Fortune 500 corporations, in a diverse range of industries, including education, financial services, government and military, healthcare, manufacturing, non-profit, oil and gas, professional services, retail and technology. As at March 31, 2014, we had in excess of 3,300 clients. For the three months ended March 31, 2014, our average project size was approximately $75,000 (March 31, 2013 - $65,000), with the single largest project being $1.2 million (March 31, 2013 - $0.8 million). The largest individual project awarded in our company history was valued at US$19.4 million, which was completed in early 2013.

Historically, we have derived virtually all of our revenue from North America, with periodic international projects completed for North America-based DPs. Our two principal geographic locations are Canada and the US, and we have one operating segment. For the three months ended March 31, 2014, we reported revenue of $6.6 million (March 31, 2013 - $8.0 million) from Canada and $33.9 million (March 31, 2013 - $22.4 million) from the US. Included in the revenue amount reported from the US is $4.3 million (March 31, 2013 - $0.5 million) of projects for one of our US-based DPs whose healthcare-focused clients are located in the Middle East.

On November 28, 2013, we completed an initial public offering ("IPO") that resulted in the issuance of 15.0 million common shares ("Common Shares") for gross proceeds of $45.0 million, and began trading on the Toronto Stock Exchange ("TSX") under the symbol "DRT".

FIRST QUARTER 2014 HIGHLIGHTS

- Revenue increased by $10.1 million to $40.5 million or 33.3% over Q1 2013;
- Improvement in adjusted gross profit percentage (see "Non-IFRS Measures") by 9.8% from 33.7% to 43.5% over Q1 2013;
- Adjusted EBITDA (see "Non-IFRS Measures") increased by $4.1 million over Q1 2013 to $3.7 million;
- Signed five significant projects totalling more than $12.0 million, which are expected to be substantially completed in 2014;
- Introduced several new innovative solutions, including the Enzo™ Approach that enables increased flexibility, enhances aesthetic appeal, and is fully compatible with our existing solutions. The Enzo Approach and other innovations provide the opportunity to increase market penetration in all verticals, and is particularly compelling in healthcare and residential; and
- Adopted an Employee Share Purchase Plan ("ESPP") to be launched in the second quarter of 2014.

DIRTT ADOPTS EMPLOYEE SHARE PURCHASE PLAN

On March 10, 2014, our Board of Directors (the "Board") approved the adoption of the ESPP to encourage employee ownership of Common Shares and to align the interests of staff more closely with those of shareholders. The adoption of the ESPP complements our unique culture and allows employees to further participate in the long-term success of the Company. All employees are eligible to participate in the ESPP. Pursuant to the ESPP, employees will be able to purchase Common Shares up to an aggregate amount of 10% of their base salaries and DIRTT will contribute an additional 50% of each such employee-contributed amount towards further purchases. All Common Shares will be purchased through the facilities of the Toronto Stock Exchange and all Common Shares purchased through DIRTT contributions will be required to be held for a minimum of one year from the date of purchase. Amounts paid by DIRTT will be a taxable benefit. The ESPP is expected to be launched during the second quarter of 2014.

SUBSEQUENT EVENT- DIRTT ADOPTS SHAREHOLDER RIGHTS PLAN

On April 3, 2014, we announced that the Board approved the adoption of a shareholder rights plan. The shareholder rights plan is subject to ratification by the shareholders of the Company at the annual and special meeting of shareholders scheduled for May 13, 2014.

RESULTS OF OPERATIONS

The following table sets forth a summary of DIRTT's results of operations for the three months ended March 31, 2014 and 2013.

	Three months ended	
	March 31, 2014	March 31, 2013
($ thousands, except per share amounts)	$	$
Revenue	40,515	30,391
Gross profit	17,090	9,641
Gross profit %	42.2%	31.7%
Adjusted gross profit % [(1)]	43.5%	33.7%
Selling, general and administrative	16,092	12,566
Operating income (loss)	998	(2,925)
Finance costs	616	1,316
Adjusted EBITDA [(1)]	3,715	(404)
Income tax expense	294	-
Net loss	(70)	(4,579)
Net loss per basic and diluted share:	(0.00)	(0.13)

Note:

[(1)] See "Non-IFRS Measures".

Revenue

Revenue increased by $10.1 million or 33.3% in the three months ended March 31, 2014 compared with the same period in 2013. The increase was mainly due to a general improvement in business levels in the period, resulting from a higher than normal number of project orders received late in the fourth quarter of 2013, during the traditionally slower holiday season, which drove strong revenue early in the first quarter of 2014.

While we experienced strong momentum in many markets, we had a growing presence in the Middle East. One of DIRTT's US DPs, whose primary market is Saudi Arabia, brought in $4.3 million (March 31, 2013 - $0.5 million) of revenue for DIRTT for healthcare-related projects.

As a significant amount of our revenue is generated by the US market we also benefitted from the strengthening of the US dollar during the current quarter.

Included in the total revenue reported for the three months ended March 31, 2014, was approximately one-third of the previously announced $12.0 million of significant projects for leading players in the energy, insurance and healthcare sectors that are scheduled to deliver through 2014 and into 2015.

Adjusted Gross Profit

Adjusted gross profit as a percentage of revenue increased by 9.8% from 33.7% to 43.5% in the three months ended March 31, 2014 compared with the same period in 2013. The increase was due to greater efficiencies driven by higher overall volumes in our production facilities, as well as by the fact that monthly revenue levels were relatively steady during the quarter. Higher production volumes enable better absorption of fixed costs included in cost of goods sold, including facilities costs and indirect labour costs. Consistent manufacturing throughput throughout the quarter also contributes to stronger gross profit, as this allows for more efficient operations over the period versus significant fluctuations in monthly manufacturing volumes. The strengthening of the US dollar also contributed to stronger adjusted gross profit in the quarter as the positive impact on US dollar revenue exceeded the negative impact on US dollar-based production costs.

Selling, General and Administrative (“SG&A”) Expenses

SG&A expenses increased by $3.5 million or 28.1% in the three months ended March 31, 2014 compared with the same period in 2013. The most significant change can be attributed directly to sales-related efforts as salaries and benefits and commission expense for our internal sales representatives and industry specific experts increased by $1.3 million and $0.7 million, respectively. These costs reflect personnel additions focused on generating and supporting higher business volumes, and are consistent with the use of proceeds as outlined in our prospectus filed in respect of our IPO. Included in the $1.3 million increase in salaries and benefits is $0.3 million in accrued bonuses for senior management in accordance with the Board-approved 2014 bonus pool. Higher commission costs are in line with the higher revenue volumes in the current quarter. Other increases in SG&A in the current quarter included travel and marketing expenses of $0.5 million, depreciation expense of $0.4 million, professional services fees of $0.2 million, public company reporting fees of $0.1 million, insurance expense of $0.1 million and $0.2 million in other miscellaneous items. The increase in professional service fees and insurance expense relates to DIRTT being a public company. The strengthening of the US dollar contributed to the overall increase in SG&A across the organization in the current quarter.

Adjusted EBITDA

Adjusted EBITDA increased by $4.1 million in the three months ended March 31, 2014 compared with the same period in 2013. The increase was mainly due to the $10.1 million improvement in revenue, and the resulting improved adjusted gross profit percentage which grew from 33.7% to 43.5%. These amounts were partially offset by increased SG&A of $3.5 million for the reasons discussed above.

Finance Costs

	Three months ended	
	March 31, 2014	March 31, 2013
($ thousands)	$	$
Accreted/ accrued interest (non-cash):		
Debt component of preferred shares	-	298
December 2012 Notes	287	479
Convertible notes - June 2012	-	100
December 2012 Notes	252	408
Credit facilities	77	31
	616	1,316

Finance costs decreased by $0.7 million in the three months ended March 31, 2014 compared with the same period in 2013. Finance costs for the three months ended March 31, 2014 were comprised of $0.3 million non-cash and $0.3 million cash compared to $0.9 million and $0.4 million, respectively, for the same period in 2013. In November 2013, upon completion of our IPO, the Class A preferred shares and the convertible notes issued in June 2012 were converted into Common Shares and as a result there were no accretion or accrued interest amounts reported during the first quarter of 2014 related to those items. Upon completion of the IPO, we also repaid US$10.0 million of the original principal US$20.0 million of convertible notes issued in December 2012 ("December 2012 Notes"). Under the terms of the note purchase agreement on the remaining US$10.0 million principal portion of the December 2012 Notes, the interest rate increased from 8% to 14% (12% cash and 2% non-cash) effective March 7, 2014. The 2% non-cash portion of the interest is included with the accretion expense in the accreted/ accrued interest (non-cash) section of the table above.

Income Tax Expense

Income tax expense for the three months ended March 31, 2014 was $0.3 million compared to $nil for the same period in 2013, mainly reflecting the profitability of our US subsidiary during the current quarter.

Summary of Quarterly Results

($ thousands, except per share amounts)	Mar. 31, 2014 $	Dec. 31, 2013 $	Sept. 30, 2013 $	Jun. 30, 2013 $	Mar. 31, 2013 $	Dec. 31, 2012 $	Sept. 30, 2012 $	Jun. 30, 2012 $
Revenue	40,515	34,202	36,708	38,494	30,391	34,661	37,255	42,485
Adjusted gross profit %	43.5%	38.4%	39.4%	45.2%	33.7%	37.8%	39.0%	39.5%
Operating income (loss)	998	(2,958)	(102)	1,717	(2,924)	(763)	762	2,203
Net (loss) income attributable to common shareholders	(70)	(10,151)	(494)	(1,271)	(4,579)	(493)	(477)	647
Net (loss) income attributable to common shareholders per share:								
-basic and diluted	(0.00)	(0.25)	(0.01)	(0.04)	(0.13)	(0.01)	(0.01)	0.02

Trends

DIRTT's business typically demonstrates some seasonality. DIRTT experienced higher than normal sales volume late in the fourth quarter, which is traditionally a slower period, which positively impacted revenue early in the first quarter of 2014.

Due to the fixed nature of some of DIRTT's manufacturing costs, periods of higher revenue volume tend to generate higher gross profit and operating income. Additionally, quarters that contain consistent monthly manufacturing volumes tend to generate higher gross profit than those with more variable manufacturing levels from month to month.

Changes in Financial Position

The following is a discussion of changes in the condensed consolidated statements of financial position as at March 31, 2014.

Financial position at ($ thousands)	March 31, 2014 $	December 31, 2013 $	Change ($)	Change (%)	Explanation of changes
Current assets					
Cash and cash equivalents	30,322	34,373	(4,051)	(12%)	See "Liquidity and Capital Resources"
Trade and other receivables	17,789	17,166	623	4%	Reflects higher revenue during Q1 2014 and improved collection of trade receivables
Inventory	9,373	11,376	(2,003)	(18%)	Inventory levels dropped partially based on higher than normal manufacturing activity early in the first quarter of 2014
Prepaids and other current assets	1,986	1,058	928	88%	Mainly due to deposits on new manufacturing equipment as well as renewal and prepayment of liability insurance
Current liabilities					
Trade accounts payable and accrued liabilities	11,593	12,550	(957)	(8%)	Reflects improved payment timing
Customer deposits	3,978	8,370	(4,392)	(52%)	Poor weather conditions affected large parts of the continent throughout Q1 2014 which adversely impacted the timing of orders in the latter part of Q1 2014
Current portion of long-term debt	2,449	2,419	30	1%	Not a significant change
Provisions	531	469	62	13%	Not a significant change
Current tax liabilities	475	314	161	51%	Reflects taxable position in our US subsidiary
Working capital					
(Current assets subtracting Current liabilities)	40,444	39,851	593	1%	

Financial position at ($ thousands)	March 31, 2014 $	December 31, 2013 $	Change ($)	Change (%)	Explanation of changes
Non-current assets					
Long-term deposits	570	522	48	9%	Not a significant change
Property, plant and equipment	29,966	29,986	(20)	(0%)	Reflects net additions of $1.0 million (mostly GLCs and US manufacturing facility improvements) and foreign exchange gain of $0.7 million, more than offset by depreciation expense of $1.7 million
Intangible assets	10,691	10,112	579	6%	Reflects additions of $1.3 million (mostly capitalized salaries and benefits related to software and product development) and partially offset by amortization expense of $0.7 million.
Notes receivable	481	486	(5)	(1%)	Reflects scheduled repayments during Q1 2014
Deferred tax assets	2,106	1,967	139	7%	Partly due to the strengthening of the US dollar
Goodwill	1,845	1,845	-	-	-
Non-current liabilities					
Deferred tax liabilities	651	592	59	10%	General movement in temporary differences
Long-term debt	5,183	5,673	(490)	(9%)	Reflects repayments which began on January 1, 2014
December 2012 Notes	10,565	9,904	661	7%	Reflects accretion expense of $0.3 million and foreign exchange loss of $0.4 million
Shareholders' equity					
Common share capital	123,292	123,127	165	0%	Reflects stock option exercises during Q1 2014
Warrants	1,101	1,101	-	-	-
Equity component of December 2012 Notes	57	57	-	-	-
Contributed surplus	6,171	6,192	(21)	0%	Primarily stock-based compensation expense incurred and option exercises during Q1 2014
Accumulated other comprehensive income	2,323	1,293	1,030	80%	Reflects the strengthening of the US dollar on the translation of our US subsidiary operations
Accumulated deficit	(63,240)	(63,170)	(70)	0%	Net loss in Q1 2014

LIQUIDITY AND CAPITAL RESOURCES

Summary information – Condensed consolidated statements of cash flows

	Three months ended	
	March 31, 2014	March 31, 2013
($ thousands)	$	$
Cash flows from (used in) operating activities before changes in non-cash working capital [1]	4,061	(242)
Changes in non-cash working capital	(4,892)	(715)
Net cash flows used in operating activities	(831)	(957)
Less:		
Net cash flows used in investing activities	(2,377)	(1,854)
Net cash flows used in financing activities	(843)	(1,021)
Decrease in cash and cash equivalents	(4,051)	(3,832)
Cash and cash equivalents and restricted cash, beginning of period	34,373	8,826
Cash and cash equivalents, end of period	30,322	4,994

Note:

(1) See *"Non-IFRS Measures"*.

At March 31, 2014, we had $30.3 million in cash and cash equivalents as compared to $34.4 million at December 31, 2013. At March 31, 2014, we also have available to us a US$18.0 million revolving operating facility.

We believe with our current cash on hand, available credit facilities, and cash flow from operations there will be sufficient liquidity to meet our working capital requirements as well as our financial obligations. In addition, we generally require a 50% deposit on all orders which also provides additional up-front working capital. Exceptions are US government orders or special contractual situations.

Net cash flows used in operating activities

Net cash flows used in operating activities decreased by $0.1 million for the three months ended March 31, 2014 compared with the same period in 2013. The decrease included the following:

- Net loss improved by $4.5 million as a result of increased revenue of $10.1 million and improved gross profit % from 31.7% to 42.2% during the three months ended March 31, 2014 compared with the same period in 2013; and
- Net change in non-cash working capital relating to operating activities decreased by $4.2 million during the three months ended March 31, 2014 compared with the same period in 2013. This was due to two main factors: (i) decreased in customer deposits due to poor weather conditions that affected large parts of the continent throughout the first quarter of 2014. This adversely impacted the timing of orders in the latter part of the first quarter of 2014; and (ii) increased trade receivables due to increased revenue of $10.1 million during the three months ended March 31, 2014 compared with the same period in 2013.

Net cash flows used in investing activities

Net cash flows used in investing activities for the three months ended March 31, 2014 increased by $0.5 million compared with the same period in 2013. The majority of the increase relates to the first phase of leasehold improvements to our manufacturing facility in Savannah, Georgia to improve its functionality in the sales and marketing process. We are also continuing to invest in product and software development and our ongoing commitment to further enhance and expand our solutions such as the Enzo Approach, our recently released offering.

Net cash flows used in financing activities

Net cash flows used in financing activities for the three months ended March 31, 2014 decreased by $0.2 million compared with the same period in 2013. The decrease was mainly due to a reduction in interest payments relating to the December 2012 Notes as a result of the principal repayment of US$10.0 million in November 2013, and proceeds from stock option exercises during the 2014 period.

Non-IFRS Measures

Adjusted gross profit, adjusted gross profit %, EBITDA, Adjusted EBITDA, and cash provided by operating activities before changes in non-cash working capital are non-IFRS measures used by management to assess our performance and financial condition. Consequently, they do not have a standard meaning as prescribed by IFRS, and are therefore unlikely to be comparable to similar measures presented and calculated by other companies. We believe that the non-IFRS measures are useful supplemental measures that may assist investors in assessing the financial performance and the cash anticipated to be generated by DIRTT's business. The non-IFRS measures should not be considered as the sole measure of our performance and should not be considered in isolation from, or as a substitute for, analysis of our financial statements.

Adjusted gross profit and adjusted gross profit %

Adjusted gross profit is defined as gross profit before the deduction of the depreciation of equipment and tooling for manufacturing-related assets that is included in cost of goods sold. Adjusted gross profit % is calculated as adjusted gross profit divided by revenue. We use this measure as an indicator of cash generated from the production of goods and services that we sell. As manufacturing volumes and revenue rises, production synergies permit greater improvements in gross profit.

The following table reconciles adjusted gross profit to the condensed consolidated statements of loss and comprehensive loss.

	Three months ended	
	March 31, 2014	March 31, 2013
($ thousands, except %)	$	$
Revenue	40,515	30,391
Cost of goods sold	23,425	20,750
Gross profit	17,090	9,641
Gross profit %	42.2%	31.7%
Add back:		
Depreciation included in cost of goods sold	533	599
Adjusted gross profit	17,623	10,240
Adjusted gross profit %	43.5%	33.7%

EBITDA and Adjusted EBITDA

EBITDA represents an indication of the entity's capacity to generate income from operations before taking into account management's financing decisions and costs of consuming tangible and intangible capital assets, which vary according to their age, technological validity, and management's estimate of their useful life. Accordingly, EBITDA is earnings before interest, taxes, depreciation and amortization. Adjusted EBITDA is EBITDA plus non-cash foreign exchange gains or losses on debt revaluation; gains or losses on disposal of property, plant and equipment and intangible assets; write-off of property, plant and equipment and intangible assets; non-cash stock-based compensation expense; transaction costs; and any other non-recurring gains or losses. We use these measures to assess our ability to generate cash flows, service debt, pay current taxes, and fund capital expenditures. Readers are cautioned that EBITDA should not be considered as an alternative to profit as determined in accordance with IFRS.

The following table reconciles EBITDA and Adjusted EBITDA to the condensed consolidated statements of loss and comprehensive loss.

	Three months ended	
	March 31, 2014	March 31, 2013
($ thousands)	$	$
Net loss for the period	(70)	(4,579)
Add back (deduct):		
Finance costs	616	1,316
Interest income	(70)	(4)
Income tax provision	294	-
Depreciation included in cost of goods sold	533	599
Depreciation and amortization included in SG&A	1,952	1,578
EBITDA	3,255	(1,090)
Stock-based compensation	47	142
Non-cash foreign exchange loss on debt revaluation	413	544
Adjusted EBITDA	3,715	(404)

Cash provided by operating activities before changes in non-cash working capital

Cash provided by operating activities before changes in non-cash working capital is a non-IFRS performance measure that could provide an indication of our ability to generate cash flows from operations, and is calculated by adding back the change in non-cash working capital to "net cash flows used in operating activities" as presented on the condensed consolidated statements of cash flows.

The following table reconciles net cash flows from (used in) operating activities before changes in non-cash working capital to the condensed consolidated statements of cash flows.

	Three months ended	
	March 31, 2014	March 31, 2013
($ thousands)	$	$
Net cash flows used in operating activities	(831)	(957)
Changes in non-cash working capital	4,892	715
Net cash flows from (used in) operating activities before changes in non-cash working capital	4,061	(242)

CAPITAL RESOURCES AND MANAGEMENT

We aim to manage our capital resources to ensure financial strength and to maximize our financial flexibility by maintaining strong liquidity and by utilizing alternative sources of capital including equity, debt and bank loans or lines of credit in order to fund continued growth.

We set the amount of capital in proportion to risk and based on the availability of funding sources. We manage the capital structure and make adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

As a young growth company, to date, issuance of equity has been our primary source of capital. The IPO provided us with net proceeds of $39.8 million. However, additional debt and/or equity financing may be pursued in the future as deemed appropriate in order to balance debt and equity. In order to maintain or adjust the capital structure, we may return capital to shareholders, issue new shares, take on additional debt or sell assets to reduce debt.

We are in compliance with all of our lending institutions' debt covenants at each of the respective reporting periods as set out below:

At March 31, 2014 and December 31, 2013	
Fixed Charge Coverage Ratio [1]	minimum 1.00:1
Leverage Ratio [1]	maximum 3.50:1
Minimum Tangible Net Worth	44,000,000

Note:

(1) Terms of the lending institutions' debt covenants require that the Company be in compliance with stated thresholds for four out of the last five consecutive quarterly measurement periods.

CONTRACTUAL OBLIGATIONS

During the three months ended March 31, 2014, we entered into a five-year lease agreement for a new manufacturing and storage facility in Calgary, Alberta with monthly lease payments of approximately $35,000 commencing on August 1, 2014. We also entered into two additional smaller lease agreements for a new GLC in Toronto, Canada and London, England.

OUTSTANDING SHARE DATA

The total number of fully diluted outstanding and issuable Common Shares is as follows:

As at	May 8, 2014	March 31, 2014
Common shares	68,996,064	68,914,831
Stock options [(1)]	4,276,553	4,361,702
December 2012 Notes [(1) (2)]	4,715,081	4,715,081
Convertible note warrants [(1)]	1,436,782	1,436,782
Broker warrants - Series A [(1)]	338,450	338,450
Broker warrants - Series B [(1)]	130,500	130,500
Other warrants [(1)]	100,000	100,000
Total	79,993,430	79,997,346

Note:

(1) Assuming full conversion and ignoring exercise prices.

(2) At the option of the holders, the December 2012 Notes are convertible into Common Shares at a conversion rate of 472 Common Shares per US$1,000 principal amount of December 2012 Notes representing a conversion price of approximately US$2.12 per Common Share, subject to adjustment in certain events. At the option of DIRTT, the December 2012 Notes are convertible into Common Shares at the applicable conversion rate upon written notice to the holders if the closing price of the Common Shares on the TSX is at least 135.0% of the applicable conversion price for no less than 20 trading days in a period of 30 consecutive trading days and the Common Shares held by the holders are not subject to any restrictions, encumbrances or prohibitions on transfer, legal or otherwise (including any lock-up agreements).

TRANSACTIONS BETWEEN RELATED PARTIES

At March 31, 2014, notes receivable of $0.5 million (December 31, 2013 - $0.5 million) are due from Mogens Smed ("Mr. Smed"), a shareholder and an officer and a director of DIRTT. The notes receivable bear interest at 5% with monthly payments of $3,750, including interest, commencing in August 2013, and are secured by a pledge of 250,000 Common Shares held by Mr. Smed. The notes receivable were advanced to Mr. Smed to enable Mr. Smed to meet certain personal financial obligations after Mr. Smed, at the request of DIRTT, agreed to be issued Common Shares rather than cash on maturity of $0.5 million principal amount of convertible debentures issued to Mr. Smed on February 1, 2005. The $0.5 million advanced to DIRTT by Mr. Smed, and evidenced by the convertible debentures, was used by us to meet certain financial obligations.

During the three months ended March 31, 2014, we recorded revenue of $2.1 million (March 31, 2013 - $0.6 million) from a DP which is owned by one of our directors. At March 31, 2014, the outstanding balance in accounts receivable was $0.1 million (December 31, 2013 - $0.2 million), and is included in trade and other receivables. In addition, at March 31, 2014, the outstanding balance in customer deposits received was $0.1 million (December 31, 2013 - $0.4 million).

All transactions with related parties have occurred in the normal course of operations, except for the notes receivable, and are measured at the exchange amounts, which are the amounts of consideration established and agreed to by the related parties.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Our activities expose us to a variety of financial risks: credit risk, liquidity risk, market risk, interest rate risk, foreign exchange risk and commodity price risk. Our overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on our financial performance.

Credit risk

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Financial instruments exposed to credit risk include cash and cash equivalents, trade and other receivables and notes receivable. The credit risk on cash and cash equivalents is limited because the counterparties are chartered banks with high credit ratings assigned by national credit-rating agencies. Our credit risk is primarily concentrated in our trade receivables. The amounts disclosed in the consolidated statement of financial position are net of allowances for doubtful accounts, estimated by management based on previous experience with customers and their assessment of the current economic environment and specific customer circumstances. In order to reduce our risk, management maintains credit policies that include regular review of credit limits of individual customers and the use of accounts receivable insurance for a significant portion of trade receivables. Aging of trade receivables is systematically monitored by management. Trade balances are spread amongst a broad customer base which is geographically dispersed.

We do not have significant exposure to any individual customer. A number of factors are considered in determining the likelihood of impairment. We also have a contract with Export Development Canada ("EDC"), Canada's export credit agency, whereby some of our trade receivables are insured. EDC determines the coverage amount, if any, on a customer-by-customer basis. Based on our trade receivables balance as at March 31, 2014, 58.3% (December 31, 2013 – 58.8 %) of that balance is covered by EDC. Substantially all of the remaining balance is less than 90 days old and is owed by a small number of DIRTT's strong-performing DPs, on which the Company has a high level of confidence of collectability. As a result, we believe that our exposure to credit risk is limited.

Liquidity risk

Our objective is to maintain sufficient cash and to ensure we have sufficient authorized credit facilities as financing sources in order to reduce liquidity risk. We had unused credit facilities of US$18.0 million as at March 31, 2014 and December 31, 2013. We monitor our cash balances and cash flows generated from operations in order to meet our requirements. Our financial liabilities include trade accounts payable and accrued liabilities, customer deposits, long-term debt, and the December 2012 Notes. The ability to pay our obligations relies on the collection of our trade receivables in a timely manner. We believe our cash and cash equivalents on hand, cash flows generated from operations, combined with our available credit facilities will provide sufficient funding to meet our obligations.

Market risk

Market risk is the risk that changes in market prices, such as foreign currency exchange rates and interest rates, will affect the Company's income or the value of the financial instruments held.

Interest rate risk

Certain of our financial liabilities are subject to interest charges at floating rates, and are exposed to fluctuations in interest rates. At March 31, 2014, term loans totalling $7.1 million (December 31, 2013 - $7.5 million) are subject to floating interest rates. A 0.5% increase (decrease) in the market rate of interest would result in an (increase) decrease in loss before tax by $8,878 for the three months ended March 31, 2014 (March 31, 2013 - $8,081).

Foreign exchange risk

We are mainly exposed to fluctuations between the US dollar and the Canadian dollar, DIRTT's functional currency. A portion of our revenue and operating costs are realized in US dollars. In addition, some of our monetary assets, such as cash and cash equivalents, trade receivables and inventory and monetary liabilities, such as trade accounts payable and accrued liabilities, customer deposits and the December 2012 Notes, are denominated in the US dollar. As a result, we are exposed to currency risk from the translation of these transactions and balances at each reporting period. Our objective in managing currency risk is to minimize our exposure to the US dollar. A significant weakening of the US dollar against the Canadian dollar could result in a revaluation of inventory. This risk is mitigated due to the fact that our business does not require us to carry high levels of inventory. Quick turnover of inventory minimizes the effect of any such changes in exchange rates. As at March 31, 2014 and December 31, 2013, we held no US dollar forward foreign exchange contracts. We purchase a large portion of our inventory in US dollars. For the three months ended March 31, 2014, with a 2.5% change in the US dollar (for obligations that would be retired in six months or less) and a 10% change in the US dollar (for obligations that would be retired in greater than six months), the impact to the net loss and comprehensive loss would be a decrease/increase of $0.4 million (March 31, 2013 -$2,393).

Commodity price risk

In our business, we consume raw materials such as aluminum, hardware, wood and veneer, plastic, electrical, paint and powder, and fabric and vinyl. Aluminum represents the largest component of our raw materials consumption. Generally, our aluminum inventory is low as we have a fast turnaround time for the majority of our projects. This is a low risk to DIRTT but aluminum prices can fluctuate and represents approximately 15% of our overall cost of goods sold.

Fair value of financial instruments

This analysis is based on the degree to which the fair value is observable and grouped into categories accordingly:

- Level 1 financial instruments are those which can be derived from quoted market prices (unadjusted) in active markets for similar financial assets and liabilities. Level 1 financial instruments include cash and cash equivalents.

- Level 2 financial instruments are those which can be derived from inputs that are observable for the financial asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). Level 2 financial instruments include trade and other receivables, notes receivable, trade accounts payable and accrued liabilities, customer deposits, current and long-term debt, and convertible notes.
- Level 3 financial instruments are those which can be derived from valuation techniques that include inputs for the financial asset or liability which are not based on observable market rate (unobservable inputs). The Company does not have any level 3 financial instruments.
- Fair value is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of interest-bearing financial assets and liabilities is determined by discounting the contractual principal and interest payments at estimated current market interest rates for the instrument. Current market rates are determined by reference to current benchmark rates for similar term and current credit spreads for debt with similar terms and risk. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in estimates could significantly affect fair values. The fair values of our financial instruments were determined as follows:
  (i) The carrying amounts of cash and cash equivalents, trade and other receivables, trade accounts payable and accrued liabilities, and customer deposits approximate fair value due to their short-term nature;
  (ii) The carrying amount of notes receivable approximates fair value as they bear interest at a market rate, and have reasonable repayment terms;
  (iii) The current and long-term debts are carried at amortized cost. The fair values of these instruments are estimates made at a specific point in time, based on relevant market information. These estimates are based on quoted market prices for the same or similar issues or on the current rates offered to us for similar financial instruments subject to similar risks and maturities. The carrying amounts of these instruments approximates fair value due to their respective floating interest rates;
  (iv) The fair values of the debt component of the convertible notes are determined using discounted cash flow analyses whereby the contractual payments are discounted at a discount rate reflective

of market rates for instruments held by us with similar terms and periods to maturity. The carrying amounts of these instruments approximates fair value.

RISK FACTORS

Please refer to the AIF for a brief discussion of those distinctive or special characteristics of our operations and industry that may have a material impact on, or constitute risk factors in respect of, our operations and future financial performance.

OUTLOOK

Construction is a major global industry and consists of building new structures, making additions and modifications to existing structures, as well as conducting maintenance, repair and leasehold improvements on existing structures. The total US construction market was US$900 billion in 2013, of which US$562 billion was attributable to non-residential building [*Source: US Census Bureau*]. This includes both new building and renovation projects. Total US non-residential construction spending is forecasted to grow to US$714 billion in 2017 *[Source: FMI US Markets Construction Overview 2014].* We believe conventional construction activities are fraught with challenges including cost overruns, quality issues and time delays and increasingly organizations are looking for a better way to build out their interior spaces, whether for new buildings or renovations. Our increasing roster of repeat clients is a strong testament to the benefits of technology-enabled prefabricated solutions.

Our growth strategy consists of five key areas: (1) increase penetration of existing markets by providing continued support and increased investment to our existing DPs throughout North America; (2) continue to invest in ICE and new innovative interior construction solutions; (3) capitalize on recent and continued investment in new industry verticals such as healthcare; (4) capitalize on recent and continued investment alongside new international DPs such as the Middle East; and (5) penetrate new industries such as the hospitality and residential sectors.

We believe DIRTT Solutions are a superior alternative to conventional construction in all sectors of the construction industry, and that a continued increase in construction activity can be expected to result in an ongoing improvement in our revenue. We plan to invest additional resources, including the further development of ICE and the development of new DIRTT Solutions and test projects, in order to pursue further opportunities in healthcare, education and government, and new opportunities in the hospitality and residential sectors of the construction industry. Our product development team has been, and will continue to be, expanded to address industry-specific challenges and opportunities.

In the first quarter of 2014, adverse weather conditions affected businesses across much of North America. On a month-by-month basis, revenue was stronger earlier in the quarter, tailing off toward quarter end. We expect there could be significant variability in monthly revenue in the second quarter of 2014 as the impact of the adverse weather conditions experienced in the first quarter fully play out. Regular business activities on the part of our clients, including placing orders, could have been impacted or delayed, potentially significantly. Prospects for growth in Canada and the US remain positive and we believe each country has the potential to recover fairly promptly.

USE OF PROCEEDS

The Company received net proceeds of $39.8 million from the IPO completed in November 2013. The following table compares the intended use of the net proceeds with the actual expenditures as at March 31, 2014, by which time the net proceeds from the IPO were partially expended.

(in thousands)	Estimated per Prospectus	Actual spending up to March 31, 2014	Future estimated spending
Product development	$ 7,960	$ 618	$ 7,342
New sales and business development initiatives	3,980	542	3,438
ICE software development	2,388	1,059	1,329
Pre-payment of US$10.0 million December 2012 Notes	14,300	14,300	-
	28,628	16,519	12,109
Working capital purposes - including temporary investments	11,172	23,281	(12,109)
Total (Estimated/Actual)	$ 39,800	$ 39,800	$ -

Although the Company intends to expend the remainder of the net proceeds set forth above based on the current knowledge and planning by the Company's management, there may be circumstances where for sound business reasons, a reallocation of funds may be deemed prudent or necessary, and may vary materially from that set forth above.

As at March 31, 2014, pending the use of the remaining proceeds, the Company held $28.0 million in short-term interest-bearing deposits at a Canadian financial institution.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenue and expenses during the reporting period. The estimates and associated assumptions are continuously evaluated and are based on historical experience and various other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates.

There have been no significant changes in our critical accounting estimates since December 31, 2013.

ADOPTION OF NEW AND REVISED IFRS

We have reviewed the impact of the following new and revised accounting pronouncements and have determined these standards did not have a material impact upon adoption on January 1, 2014.

International Accounting Standards ("IAS") 32, "Financial Instruments: Presentation" was amended by the International Accounting Standards Board ("IASB") in December 2011 and is effective for annual periods beginning on or after January 1, 2014, with retrospective application required. The amendments to IAS 32 clarify existing application issues relating to the offset of financial assets and financial liabilities requirements. Specifically, the amendments clarify the meaning of "currently has a legally enforceable right of set-off" and "simultaneous realization and settlement".

IAS 36, "Impairment of Assets" was amended by the IASB in May 2013 and is effective for annual periods beginning on or after January 1, 2014. The overall effect to the amendments to IAS 36 is to reduce the circumstances in which the recoverable amount of assets or cash generating units is required to be disclosed, clarify the disclosures required, and to introduce an explicit requirement to disclose the discount rate used in determining impairment (or reversals) where recoverable amount (based on fair value less costs of disposal) is determined using a present value technique.

IAS 39, "Financial Instruments: Recognition and Measurement" was amended by the IASB in June 2013 and is effective for annual periods beginning on or after January 1, 2014, with earlier application being permitted. The objective of the amendments is to avoid any impact on an entity's hedge accounting from derecognizing the derivative, following its novation. A novation indicates an event where the original parties to a derivative agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties.

In May 2013, the IASB issued IFRS Interpretations Committee ("IFRIC ") 21, "Levies", an interpretation on the accounting for levies imposed by governments. IFRIC 21 provides guidance on accounting for levies in accordance with IAS 37, "Provisions, contingent liabilities and contingent assets". The interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. IFRIC 21 is effective for annual periods beginning on or after January 1, 2014.

FUTURE ACCOUNTING PRONOUNCEMENTS

We have reviewed new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on our financial statements:

The IASB has undertaken a three-phase project to replace IAS 39 "Financial Instruments: Recognition and Measurement" with IFRS 9 "Financial Instruments". In November 2009, the IASB issued the first phase of IFRS 9, which details the classification and measurement requirements for financial assets. Requirements for financial liabilities were added to the standard in October 2010. The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. In November 2013, the IASB issued the third phase of IFRS 9 which details the new general hedge accounting model. Hedge accounting remains optional and the new model is intended to allow reporters to better reflect risk management activities in the financial statements and provide more opportunities to apply hedge accounting. In July 2013, the IASB deferred the mandatory effective date of IFRS 9 and has left this date open pending the finalization of the impairment and classification and measurement requirements. IFRS 9 is still available for early adoption. The full impact of the standard on the Company's financial statements will not be known until the project is complete.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for the design and operating effectiveness of internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements in accordance with IFRS. Based on a review of the Company's internal control procedures, management believes its internal controls and procedures are appropriately designed as at March 31, 2014.

There were no significant changes in the Company's internal control over financial reporting that occurred during the three months ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

DISCLOSURE CONTROLS

Management is also responsible for the design and effectiveness of disclosure controls and procedures to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to the Company's certifying officers. The Company's Chief Executive Officer and Chief Financial Officer have each evaluated the design of the Company's disclosure controls and procedures as at March 31, 2014 and have concluded that it is appropriate.