DIRTT Environmental Solutions Ltd.

Condensed Consolidated Financial Statements

For the three and nine months ended September 30, 2014 and 2013

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Condensed Consolidated Statements of Financial Position

(Unaudited - Stated in thousands of Canadian dollars)

As at	Notes	September 30, 2014 $	December 31, 2013 $
ASSETS			
Current Assets			
Cash and cash equivalents		24,999	34,373
Trade and other receivables		21,850	17,166
Inventory		11,240	11,376
Prepaids and other current assets		3,685	1,058
		61,774	63,973
Non-current Assets			
Long-term deposits		605	522
Property, plant and equipment		32,016	29,986
Intangible assets		11,733	10,112
Notes receivable	13	470	486
Deferred tax assets		2,308	1,967
Goodwill		1,845	1,845
		48,977	44,918
Total Assets		110,751	108,891
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current Liabilities			
Trade accounts payable and accrued liabilities		13,767	12,550
Customer deposits		4,490	8,370
Current portion of long-term debt	5	2,456	2,419
Provisions		637	469
Current tax liabilities		693	314
		22,043	24,122
Non-current Liabilities			
Deferred tax liabilities		375	592
Long-term debt	5	3,998	5,673
Convertible notes	6	-	9,904
		4,373	16,169
Shareholders' Equity			
Common share capital	7	138,989	123,127
Warrants		626	1,101
Equity component of convertible notes	6	-	57
Contributed surplus		5,810	6,192
Accumulated other comprehensive income		2,679	1,293
Accumulated deficit		(63,769)	(63,170)
		84,335	68,600
Total Liabilities and Shareholders' Equity		110,751	108,891

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

Condensed Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

(Unaudited - Stated in thousands of Canadian dollars, except per share amounts)

		For the three months ended		For the nine months ended	
		September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
	Notes	$	$	$	$
Revenue		46,651	36,708	129,384	105,593
Cost of goods sold		27,506	22,499	76,391	64,900
Gross profit		19,145	14,209	52,993	40,693
Selling, general and administrative		17,844	14,311	52,273	42,003
Operating income (loss)		1,301	(102)	720	(1,310)
Foreign exchange (gain) loss		(459)	(288)	(202)	610
Gain on sale of property, plant and equipment		(2)	-	(20)	-
Loss on derecognition of liability	6	154	-	307	-
Interest income		(54)	3	(181)	(3)
Finance costs	9	82	1,418	1,282	4,094
Income (loss) before tax		1,580	(1,235)	(466)	(6,011)
Current tax expense		47	63	591	561
Deferred tax expense (recovery)		7	(804)	(458)	(228)
		54	(741)	133	333
Net income (loss) for the period		1,526	(494)	(599)	(6,344)
Other comprehensive income (loss)					
Items that will not be reclassified to profit or loss:					
Exchange differences on translation of foreign operations, net of tax of $nil (2013 - $nil)		1,263	(596)	1,386	832
Total comprehensive income (loss) for the period		2,789	(1,090)	787	(5,512)
Income (loss) per share					
Basic and diluted	10	0.02	(0.01)	(0.01)	(0.17)

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

Condensed Consolidated Statements of Changes in Equity

(Unaudited - Stated in thousands of Canadian dollars)

	Common share capital	Preferred share capital	Warrants	Equity component of convertible notes	Contributed surplus	Accumulated other comprehensive income (loss)	Accumulated deficit	Total equity
	$	$	$	$	$	$	$	$
As at December 31, 2012	54,268	8,604	1,101	4,003	5,748	(318)	(46,675)	26,731
Net loss for the period	-	-	-	-	-	-	(6,344)	(6,344)
Other comprehensive income for the period, net of tax	-	-	-	-	-	832	-	832
Stock-based compensation	-	-	-	-	341	-	-	341
Issued on exercise of stock options	18	-	-	-	(5)	-	-	13
As at September 30, 2013	54,286	8,604	1,101	4,003	6,084	514	(53,019)	21,573
As at December 31, 2013	123,127	-	1,101	57	6,192	1,293	(63,170)	68,600
Net loss for the period	-	-	-	-	-	-	(599)	(599)
Other comprehensive income for the period, net of tax	-	-	-	-	-	1,386	-	1,386
Conversion of convertible notes to common shares	10,946	-	-	(57)	-	-	-	10,889
Issued on exercise of warrants	1,089	-	(475)	-	-	-	-	614
Stock-based compensation	-	-	-	-	770	-	-	770
Issued on exercise of stock options	3,827	-	-	-	(1,152)	-	-	2,675
As at September 30, 2014	138,989	-	626	-	5,810	2,679	(63,769)	84,335

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

Condensed Consolidated Statements of Cash Flows

(Unaudited - Stated in thousands of Canadian dollars)

		For the three months ended		For the nine months ended	
		September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
	Notes	$	$	$	$
Cash flows from operating activities:					
Net income (loss) for the period		1,526	(494)	(599)	(6,344)
Items not affecting cash:					
Depreciation included in cost of goods sold		595	245	1,570	1,416
Depreciation and amortization included in selling, general and administrative		2,214	1,506	6,303	4,614
Stock-based compensation		667	69	770	341
Loss on derecognition of liability	6	154	-	307	-
Write-off of property, plant and equipment		-	(25)	-	192
Gain on sale of property, plant and equipment		(2)	-	(20)	-
Income tax provision		54	(741)	133	333
Finance cost	9	82	1,418	1,282	4,094
Non-cash foreign exchange loss (gain) on debt revaluation		26	(396)	50	800
Non-cash foreign exchange (gain) loss		571	(213)	617	253
Net change in non-cash working capital relating to operating activities	11	(5,208)	(5,072)	(9,753)	(6,355)
Cash taxes paid		(5)	-	(234)	-
Net cash flows provided by (used in) operating activities		674	(3,703)	426	(656)
Cash flows from investing activities:					
Purchase of property, plant and equipment		(2,452)	(302)	(6,626)	(2,237)
Capital expenditures on internally generated intangible assets		(1,469)	(1,077)	(4,071)	(3,286)
Proceeds from sale of property, plant and equipment		24	-	46	-
Receipt of proceeds from notes receivable		6	3	16	3
Net cash flows used in investing activities		(3,891)	(1,376)	(10,635)	(5,520)
Cash flows from financing activities:					
Issuance of share capital on exercise of stock options		1,914	-	2,675	13
Issuance of share capital on exercise of warrants		614	-	614	-
Interest paid on convertible notes	9	-	(412)	(413)	(1,241)
Proceeds of long-term debt		-	-	-	3,232
Repayment of long-term debt		(611)	(47)	(1,829)	(690)
Interest paid on long-term debt	9	(65)	(37)	(212)	(93)
Net cash flows provided by (used in) financing activities		1,852	(496)	835	1,221
Net decrease in cash and cash equivalents		(1,365)	(5,575)	(9,374)	(4,955)
Cash and cash equivalents, beginning of period		26,364	9,446	34,373	8,826
Cash and cash equivalents, end of period		24,999	3,871	24,999	3,871
Cash and cash equivalents consists of:					
Cash		2,518	3,871	2,518	3,871
Temporary investments		22,481	-	22,481	-
		24,999	3,871	24,999	3,871

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

Notes to the Condensed Consolidated Financial Statements

September 30, 2014
(Unaudited)

1. GENERAL INFORMATION

DIRTT Environmental Solutions Ltd. (“DIRTT” or the “Company”) is a leading technology-driven manufacturer of highly customized interiors. DIRTT combines its proprietary 3D design, configuration and manufacturing software (“ICE®” or “ICE Software”) with integrated in-house manufacturing of its innovative prefabricated interior construction solutions and an extensive Distribution Partner (“DP”) network serving five continents. ICE provides accurate design, drawing, specification, pricing and manufacturing process information, allowing rapid production of high-quality custom solutions using fewer resources than traditional manufacturing methods. ICE was developed by Ice Edge Business Solutions Ltd. (“ICE Edge”), a wholly owned subsidiary of DIRTT, and its wholly owned subsidiary, Ice Edge Business Solutions, Inc.

ICE is also licensed to unrelated companies and DPs through ICE Edge.

The address of DIRTT’s registered office is 7303 - 30th Street S.E., Calgary, AB, Canada T2C 1N6.

On November 28, 2013, DIRTT completed an initial public offering (“IPO”) and issued 15,000,000 shares for gross proceeds of $45.0 million and began trading on the Toronto Stock Exchange (“TSX”), under the symbol “DRT”.

2. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these condensed consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Statement of compliance

These condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting ("IAS 34"). Accordingly, certain information and footnote disclosure normally included in annual financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") have been omitted or condensed.

The condensed consolidated financial statements were approved by the Board of Directors and authorized for issue on November 6, 2014.

Basis of measurement

These condensed consolidated financial statements have been prepared using the same policies and methods as those used in the audited consolidated financial statements for the 12 months ended December 31, 2013, except for the impact of the adoption of accounting standards described below. These condensed consolidated financial statements should be read together with the annual consolidated financial statements for the 12 months ended December 31, 2013. The Company's condensed consolidated financial statements have been prepared on the historical cost convention except for certain financial instruments that are measured at fair value. Historical cost is generally based on the fair value of the consideration given in exchange of assets.

3. ADOPTION OF NEW AND REVISED IFRS

The Company has reviewed the impact of the new and revised accounting pronouncements outlined below, and has determined these standards did not have a material impact upon adoption on January 1, 2014.

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". The adoption of these amendments did not have an impact on the Company's financial position or performance.

3. ADOPTION OF NEW AND REVISED IFRS (CONTINUED)

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 of 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. The adoption of these amendments did not have an impact on the Company's financial position or disclosures.

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. The adoption of these amendments did not have an impact on the Company's financial position or performance.

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. The adoption of this standard did not have an impact on the Company's financial position or performance.

4. RECENT ACCOUNTING PRONOUNCEMENTS

The Company has 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 the Company:

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 2014, the IASB published the final version of IFRS 9, which replaced earlier versions of this standard and the project to replace IAS 39 is now complete. IFRS 9 is effective for annual periods beginning on or after January 1, 2018 with earlier application permitted. The Company is currently assessing the impact of this standard.

In May 2014, the IASB and the US Financial Accounting Standards Board issued their joint revenue recognition standard, IFRS 15 "Revenue from Contracts with Customers", which replaces all existing IFRS and US GAAP revenue requirements. The standard applies to all revenue contracts and provides a model for the recognition and measurement of sales of some non-financial assets (e.g. disposals of property, plant and equipment). IFRS 15 is effective for annual periods beginning on or after January 1, 2017 with early adoption permitted under IFRS. The Company is currently assessing the impact of this standard.

5. LONG-TERM DEBT

As at ($ thousands)	September 30, 2014 $	December 31, 2013 $
Capital financing facility, secured by a charge on all assets including manufacturing equipment, with 30 monthly payments of $143 plus interest at floating rate, which is based on the lender's Canadian prime rate plus 0.5% and 30 monthly payments of US$18 plus interest at floating rate, which is based on the lender's US prime rate plus 0.5%. Principal payments began in January 2014.	3,434	4,874
Term loan, secured by a charge on all assets including manufacturing equipment, with 60 monthly payments of US$21 plus interest at floating rate, which is based on the lender's prime rate plus 0.5%. Principal payments began in January 2014.	2,590	2,659
Finance lease, secured by a charge on specific manufacturing equipment, with 60 monthly payments of US$17 including interest.	421	538
Finance lease, secured by a charge on specific manufacturing equipment, with 36 monthly payments of US$1 including interest.	9	21
	6,454	8,092
Less: Current portion of long-term debt	(2,456)	(2,419)
Long-term debt	3,998	5,673

As at September 30, 2014 and December 31, 2013, the Company has an unused revolving operating facility of US$18.0 million.

6. CONVERTIBLE NOTES

($ thousands)	Equity component $	Debt component $
At December 31, 2013	57	9,904
Interest accretion	-	441
Conversion to common shares	(57)	(10,674)
Loss on conversion	-	307
Foreign exchange revaluation	-	22
At September 30, 2014	-	-

At the option of the holders, the convertible notes were convertible into the Company's common shares at a conversion rate of 472 common shares per US$1,000 principal amount of convertible notes representing a conversion price of approximately US$2.12 per common share, subject to adjustment in certain events.

6. CONVERTIBLE NOTES (CONTINUED)

At the option of DIRTT, the convertible notes were convertible into the Company's common shares at the applicable conversion rate upon written notice to the holders if the closing price of the Company's common shares on the TSX is at least 135.0% of the conversion price for no less than 20 trading days in the 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).

On June 17, 2014, the Company completed a secondary offering of 7,155,594 common shares of the Company with a select group of shareholders at an offering price of $2.60 per common share. The Company did not receive any proceeds from the secondary offering, but incurred $0.5 million of transaction costs. In connection with the secondary offering, at the option of the holders, $5.3 million of principal and $0.2 million of accrued interest were converted into 2,430,595 common shares of DIRTT.

On July 9, 2014, the Company met the criteria noted above and converted the remaining balance of the convertible notes, $5.4 million of principal and $51,000 of accrued interest, into 2,380,006 common shares of DIRTT.

Due to the conversion of $10.7 million principal amount of the convertible notes into common shares, IAS 32 requires the Company to allocate the conversion amount to the liability and equity components using the same allocation method as the method for allocating the initial transaction price (i.e. determine fair value of the liability component), with the residual amount being allocated to equity. IAS 32 also requires any gain or loss resulting from the allocation of the conversion amount to be recognized in profit or loss relating to the liability component and to equity relating to the equity component.

As a result, $10.7 million was allocated to liability and $nil to equity. The carrying value related to the conversion amount prior to conversion was $10.4 million, and as a result, $0.2 million and $0.3 million was recognized as debt settlement expense in the statement of income (loss) and comprehensive income (loss) for three and nine months ended September 30, 2014. In addition, the remaining $57,000 in equity was reclassified to common share capital. As a result of the conversions, no convertible notes remain outstanding as of September 30, 2014.

7. SHAREHOLDERS' CAPITAL

Common Shares

($ thousands, except share amounts)	Number of shares		Amount $
At December 31, 2013	68,868,617	$	123,127
Conversion of convertible notes into common shares - principal	4,715,091		10,674
Conversion of convertible notes into common shares - accrued interest	95,510		215
Reclassification of equity component of convertible notes	-		57
Issued on exercise of Series A broker warrants	25,000		88
Issued on exercise of convertible notes warrants	502,708		1,001
Issued on exercise of stock options	1,188,422		3,827
At September 30, 2014	75,395,348	$	138,989

As previously discussed in Note 6, the conversion of $10.9 million principal amount of convertible notes and accrued interest resulted in an issuance of 4,810,601 common shares of DIRTT.

Warrants – Convertible Notes

($ thousands, except share amounts)	Number of warrants		Amount
At December 31, 2013	1,436,782	$	994
Exercised	(687,841)		(475)
At September 30, 2014	748,941	$	519

During the third quarter ended September 30, 2014, the Company received cash proceeds of $0.5 million from the exercise of 687,841 warrants.

Broker Warrants – Series A

($ thousands, except share amounts)	Number of warrants		Amount
At December 31, 2013	338,450	$	-
Exercised	(25,000)		-
At September 30, 2014	313,450	$	-

During the third quarter ended September 30, 2014, the Company received cash proceeds of $0.1 million from the exercise of 25,000 warrants.

8. SHARE-BASED TRANSACTIONS

The Company has a stock option plan which is approved by the Board of Directors whereby the aggregate number of shares reserved for issuance shall not exceed 10% of the issued and outstanding common shares as at the time of grant of any options. Options granted under the plan generally have a term of five years and vest 1/3 every year over a three-year period from the date of grant. For the nine months ended September 30, 2014, 2.7 million options were granted at a weighted average exercise price of $3.56 and 1.2 million options were exercised. For the nine months ended September 30, 2013, 20,000 options were granted at an exercise price of $2.00 and 8,334 options were exercised.

The following summarizes options granted, exercised, forfeited and expired during the period:

	Number of options	Weighted average exercise price $
Outstanding at December 31, 2013	4,315,867	2.33
Granted	2,741,650	3.56
Exercised	(1,188,422)	2.25
Forfeited	(56,868)	2.80
Expired	(38,750)	2.57
Outstanding at September 30, 2014	5,773,477	2.92
Exercisable at September 30, 2014	2,775,276	2.44

Range of exercise prices outstanding at September 30, 2014:

Range of exercise prices	Number outstanding	Weighted average remaining contractual years	Weighted average exercise price $	Number Exercisable	Weighted average exercise price $
$1.00 - $1.99	891,167	2.7	1.50	616,317	1.50
$2.00 - $2.99	1,523,817	1.1	2.49	1,389,883	2.45
$3.00 - $4.00	3,358,493	3.7	3.49	769,076	3.16

The fair value of each stock option was estimated on the date of grant, as determined by using the Black-Scholes option-pricing model with the following assumptions:

	For the nine months ended	
	September 30, 2014	September 30, 2013
Expected option term (years)	5	5
Weighted average expected volatility	51.54%	52.54%
Expected dividend yield	N/A	N/A
Weighted average risk-free interest rate	1.53%	3.00%
Expected forfeiture %	5%	0%
Weighted average fair value of option	$ 1.63	$ 0.97

9. FINANCE COSTS

Finance costs comprise the following amounts:

	For the three months ended		For the nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
($ thousands)	$	$	$	$
Accreted/ accrued interest (non-cash):				
Preferred shares	-	310	-	912
Convertible notes [1]	17	584	657	1,577
Convertible notes [2]	-	75	-	271
Convertible notes [1]	-	412	413	1,241
Credit facilities	65	37	212	93
	82	1,418	1,282	4,094

(1) Related to the US$20.0 million convertible notes issued in December 2012. Interest of 8% was paid quarterly up to March 6, 2014. Effective March 7, 2014, under the terms of the note purchase agreement, the interest rate was increased to 14% (12% cash and 2% non-cash). 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. As previously discussed in Note 6, the Company converted the remaining portion of these convertible notes in July 2014 and as a result, no convertible notes remain outstanding as of September 30, 2014.

(2) Related to the $5.0 million convertible notes issued in June 2012. Non-cash interest was accrued at 6% per annum up to November 28, 2013.

10. BASIC AND DILUTED INCOME (LOSS) PER SHARE

The calculation of basic and diluted income (loss) per share for the three and nine months ended September 30, 2014 was based on the net income of $1.5 million and net loss of $0.6 million, respectively (September 30, 2013 – net loss $0.5 million and $6.3 million, respectively), and a weighted average number of common shares outstanding of 74,313,939 and 70,876,573, respectively (September 30, 2013 – 36,288,612 and 36,283,209, respectively).

10. BASIC AND DILUTED INCOME (LOSS) PER SHARE (CONTINUED)

	For the three months ended		For the nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Weighted average shares outstanding	74,313,939	36,288,612	70,876,573	36,283,209
Stock options in the money	1,141,195	-	-	-
Convertible warrants	851,099	-	-	-
Fully diluted shares outstanding	76,306,233	36,288,612	70,876,573	36,283,209

As the Company was in a loss position for the nine months ended September 30, 2014 and three and nine months ended September 30, 2013, all convertible securities were excluded from the diluted weighted average number of common shares calculation as their effect would have been anti-dilutive. For the three months ended September 30, 2014, 1.1 million options were excluded from the diluted weighted average number of common shares calculation as their effect would have been anti-dilutive.

11. CHANGE IN NON-CASH WORKING CAPITAL

	For the three months ended		For the nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
($ thousands)	$	$	$	$
Trade and other receivables	1,028	2,200	(4,684)	1,821
Inventory	(1,531)	(758)	136	(1,700)
Prepaids and other current assets	(264)	(320)	(2,627)	(377)
Long-term deposits	(15)	(48)	(83)	45
Trade accounts payable and accrued liabilities	(3,779)	(3,439)	1,217	(1,479)
Customer deposits	(926)	(2,568)	(3,880)	(4,660)
Provisions	279	(139)	168	(5)
	(5,208)	(5,072)	(9,753)	(6,355)

12. SEGMENT REPORTING

The Company operates in two principal geographic locations, Canada and the United States, and has one operating segment.

The Company's revenue from continuing operations from external customers, based on location of operations; and information about its non-current assets, are detailed below.

Revenue from external customers

	For the three months ended		For the nine months ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
($ thousands)	$	$	$	$
Canada	13,247	6,286	32,340	20,464
USA	33,404	30,422	97,044	85,129
	46,651	36,708	129,384	105,593

Selected Consolidated Statement of Financial Position Information – Non-current assets

As at	September 30, 2014	December 31, 2013
($ thousands)	$	$
Canada	28,452	25,343
USA	17,747	17,122
	46,199	42,465

The amounts above exclude notes receivable and deferred tax assets.

13. TRANSACTIONS AND BALANCES WITH RELATED PARTIES

Notes receivable are due from an individual who is a shareholder and an officer and director of the Company, bear interest at 5% with monthly payments of $3,750 including interest (commencing in August 2013), and are secured by 250,000 common shares of the Company. At September 30, 2014 the balance outstanding was $0.5 million (December 31, 2013 - $0.5 million).

During the three and nine months ended September 30, 2014, the Company recorded revenue of $0.9 million and $3.9 million, respectively (September 30, 2013 - $0.8 million and $1.9 million, respectively) from a DP which is owned by a director of the Company. At September 30, 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 September 30, 2014, the outstanding balance in customer deposits received was $nil (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.

14. CAPITAL MANAGEMENT

The Company has $84.3 million (December 31, 2013 - $68.6 million) of total capital resources, comprised of Shareholders' Equity. The Company also has total debt of $6.5 million (December 31, 2013 - $18.0 million), comprised of current and long-term debt of $6.5 million (December 31, 2013 - $8.1 million), and a debt component of convertible notes of $nil (December 31, 2013 - $9.9 million).

The Company aims to manage its capital resources to ensure financial strength and to maximize its financial flexibility by maintaining strong liquidity and by utilizing alternative sources of capital including equity, debt and bank loans or lines of credit to fund continued growth.

The Company sets the amount of capital in proportion to risk and based on the availability of funding sources. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

14. CAPITAL MANAGEMENT (CONTINUED)

As a young growth company, issuance of equity has been the primary source of capital to date. Additional debt and/or equity financing may be pursued in future as deemed appropriate to balance debt and equity. In order to maintain or adjust the capital structure, the Company may return capital to shareholders, issue new shares, take on additional debt or sell assets to reduce debt.

As previously discussed in Note 6, the Company converted all of its remaining convertible notes into common shares of DIRTT in July 2014 and as a result eliminated the related covenants. As at September 30, 2014, the Company was in compliance with its lending institution's debt covenant. The covenant threshold is detailed below:

At September 30, 2014	
Minimum Tangible Net Worth	44,000,000

As at December 31, 2013, the Company was in compliance with its lending institutions' debt covenants. The covenant thresholds are detailed below:

At 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

[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.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Credit risk

The Company's principal financial assets are cash and cash equivalents, trade and other receivables, and notes receivable.

The Company's credit risk is primarily concentrated in its trade receivables. The amounts disclosed in the condensed consolidated statement of financial position are net of allowances for doubtful accounts, estimated by the management of the Company based on previous experience with customers and their assessment of the current economic environment and specific customer circumstances. In order to reduce its 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. The Company does not have significant exposure to any individual customer. A number of factors are considered in determining the likelihood of impairment. Bad debt expense, net of recovery, for the three and nine months ended September 30, 2014 was $nil and $18,721, respectively (September 30, 2013 - $0.3 million and $0.4 million, respectively).

The Company also has a contract with Export Development Canada ("EDC"), Canada's export credit agency, whereby some of its trade receivables are insured. EDC determines the coverage amount, if any, on a customer-by-customer basis. Based on the Company's trade receivables balance as at September 30, 2014, 45.0% (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, the Company believes that its exposure to credit risk is limited.

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.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Credit risk (Continued)

The carrying amount of financial assets represents the maximum credit exposure and therefore the credit risk at the reporting date was:

As at	September 30, 2014	December 31, 2013
($ thousands)	$	$
Cash and cash equivalents	24,999	34,373
Trade and other receivables	21,850	17,166
	46,849	51,539

Liquidity risk

The Company's objective is to have sufficient liquidity to meet its liabilities when due. The Company monitors its cash balances and cash flows generated from operations to meet its requirements.

The Company has the following financial liabilities at the reporting date:

	Carrying amount	Contractual cash flows	Less than 1 year	1 to 2 years	2 to 5 years	Greater than 5 years
As at September 30, 2014 ($ thousands)	$	$	$	$	$	$
Trade accounts payable and accrued liabilities	13,767	13,767	13,767	-	-	-
Customer deposits	4,490	4,490	4,490	-	-	-
Current and long-term debt	6,454	6,666	2,535	2,030	2,101	-
	24,711	24,923	20,792	2,030	2,101	-

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 the Company's financial liabilities are subject to interest charges at floating rates, and are exposed to fluctuations in interest rates. At September 30, 2014, term loans totalling $6.0 million (December 31, 2013 - $7.5 million) are subject to floating interest rates. An increase (decrease) in overall interest rates by 0.5% would increase (decrease) interest expense related to these items and increase (decrease) net income (loss) and comprehensive income (loss) by $7,530 and $22,590 for the three and nine months ended September 30, 2014, respectively (September 30, 2013 - $6,070 and $18,209, respectively). An equal decrease in rates would generate an equal amount of interest savings.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Foreign exchange risk

The Company's financial instruments are exposed to currency fluctuations as it purchases a portion of its inventory in foreign currencies. A significant weakening of the US dollar ("USD") against the Canadian dollar could result in a revaluation of inventory as a large portion of the inventory is purchased in USD. This risk is mitigated as the Company's business does not require high levels of inventory on hand. Quick turnover of inventory minimizes the effect of any such changes in exchange rates.

The Company's financial instruments are exposed to fluctuations in the USD. The table below details the Company's exposure to currency risk at the reporting dates and a sensitivity analysis to changes in currency. (A 2.5% change in foreign currency was used for obligations that would be retired in six months or less and a 10% change in foreign currency for obligations that would be retired in greater than six months.) The sensitivity analysis includes USD-denominated monetary items and adjusts their translation at period end for their respective change in the USD. For the respective weakening of the USD, there would be an equal and opposite impact on net income (loss) and comprehensive income (loss).

	Amount (USD)	Change in currency	Effect of net income (loss) and comprehensive income (loss) for the nine months ended September 30, 2014
($ thousands)	$	%	$
Cash and cash equivalents	10,859	2.5	271
Trade and other receivables, net of deposits	11,538	2.5	288
Trade accounts payable and accrued liabilities	(6,980)	2.5	(175)
Current portion of debt (less than six months)	(334)	2.5	(8)
Long-term portion of debt (greater than six months)	(2,751)	10.0	(275)
	12,332		101

At September 30, 2014 and December 31, 2013, the Company held no USD forward foreign exchange contracts.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Commodity price risk

The Company consumes raw materials such as aluminum, hardware, wood and veneer, plastic, electrical, paint and powder, and fabric and vinyl. Aluminum represents the largest component of the Company's raw materials consumption. Generally, the Company's aluminum inventory is low as it has a fast turnaround time for the majority of its projects. This is a low risk to DIRTT but aluminum prices can fluctuate and represents approximately 20% of its 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 or 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 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 derived from valuation techniques that include inputs for the financial asset or liability which are not based on observable market data (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.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

Fair value of financial instruments (Continued)

The fair values of the Company's financial instruments were determined as follows:

a) 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;

b) The carrying amount of notes receivable approximates fair value as they bear interest at a market rate, and have reasonable repayment terms;

c) The Company's 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 the Company 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;

d) 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 the Company with similar terms and periods to maturity. The discount rate used in determining fair value was 12.1%. The carrying amount of these instruments approximates fair value.

16. COMMITMENTS

Operating leases

The Company rents facilities and capital assets under operating lease commitments with respect to certain premises, equipment and vehicles, and has continuing contractual commitments for operating expenses. During the nine months ended September 30, 2014, the Company signed a five-year lease on a new manufacturing and storage facility located in Calgary, Alberta with monthly lease payments of approximately $35,000 commencing on August 1, 2014.

17. COMPARATIVE FIGURES

The Company disclosed cash flows from interest paid on convertible notes and long-term debt of $0.4 million and $37,000 respectively as financing activities for the three months ended September 30, 2013. Corresponding amounts for the nine months ended September 30, 2013 were $1.2 million and $0.1 million respectively. These figures were disclosed to conform to current year's presentation.