



**Third Quarter Report to Shareholders  
for the quarter ended September 30, 2013**



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"Westaim" or the "Company" in this Management's Discussion and Analysis ("MD&A") refers to The Westaim Corporation on a consolidated basis, where applicable. This MD&A, which has been approved by the Westaim Board of Directors, should be read in conjunction with Westaim's unaudited consolidated financial statements including notes for the nine months ended September 30, 2013 and 2012 as set out on pages 11 to 23 of this quarterly report. Financial data in this MD&A has been derived from the unaudited consolidated financial statements for the nine months ended September 30, 2013 and 2012 and is intended to enable the reader to assess Westaim's results of operations for the nine months ended September 30, 2013 and financial condition as at September 30, 2013. The Company reports its consolidated financial statements using accounting policies consistent with International Financial Reporting Standards ("IFRS"). All amounts are in Canadian dollars unless otherwise indicated. The following commentary is current as of November 8, 2013. Additional information relating to Westaim is available on SEDAR at [www.sedar.com](http://www.sedar.com). Certain totals, subtotals and percentages may not reconcile due to rounding.

**Non-GAAP measures**

Westaim uses both IFRS and non-generally accepted accounting principles ("non-GAAP") measures to assess performance. The Company cautions readers about non-GAAP measures that do not have a standardized meaning under IFRS and are unlikely to be comparable to similar measures used by other companies. Book value per share represents shareholders' equity at the end of the period, determined on an IFRS basis, divided by the total number of common shares plus preferred shares outstanding on the same date.

**Future Oriented Financial Information**

This MD&A may contain forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from these forward-looking statements as a result of various factors, including those discussed hereinafter or in the Company's 2012 Annual Information Form. Please refer to the cautionary note in Section 11 of this MD&A.

**The Westaim Corporation**  
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**1. THE COMPANY**

Westaim is a publicly traded Canadian-based company that invests directly and indirectly through acquisitions, joint ventures and other arrangements, with the objective of providing its shareholders with capital appreciation and real wealth preservation. Westaim's strategy is to pursue investment opportunities to grow shareholder value (as measured by book value per share) over the long term.

Until September 4, 2012, the Company held all the issued and outstanding shares of Jevco Insurance Company ("Jevco"), a leading Canadian property and casualty insurer. Section 3, *Sale of Jevco* of this MD&A provides details of the disposition of Jevco on September 4, 2012.

On October 1, 2013, the Company completed a 50:1 share consolidation of all of its outstanding common shares. All share capital, per share amounts, warrants and share-based awards in the current and comparative periods have been adjusted to reflect this change.

**2. OVERVIEW OF PERFORMANCE**

<b>Highlights</b> (millions except per share data)	Three months ended September 30		Nine months ended September 30	
	2013 <sup>(1)</sup>	2012 <sup>(1)</sup>	2013 <sup>(1)</sup>	2012 <sup>(1)</sup>
<b>Continuing operations</b>				
Revenue	\$ 0.1	\$ -	\$ 0.3	\$ 0.2
Expenses excluding share-based compensation	(0.5)	(5.7)	(2.0)	(12.3)
Share-based compensation	(0.1)	(10.7)	(0.1)	(20.3)
Income tax recovery	-	-	0.1	-
<b>Loss from continuing operations</b>	(0.5)	(16.4)	(1.7)	(32.4)
<b>Discontinued operations</b>				
Gain on sale of Jevco, net of income tax expense	-	108.1	-	106.7
Profit of discontinued operations, net of income tax expense	-	3.7	-	29.7
<b>Income from discontinued operations</b>	-	111.8	-	136.4
<b>Profit or loss and other comprehensive income</b>	\$ (0.5)	\$ 95.4	\$ (1.7)	\$ 104.0
<b>Earnings per share – basic and diluted</b>				
- Loss from continuing operations	\$ (0.04)	\$ (1.21)	\$ (0.12)	\$ (2.41)
- Profit from discontinued operations	\$ 0.00	\$ 8.22	\$ 0.00	\$ 10.15
- Profit or loss and other comprehensive income	\$ (0.04)	\$ 7.02	\$ (0.12)	\$ 7.74
<b>Book value per share - at September 30</b>			\$ 2.37	\$ 2.50

<sup>(1)</sup> Adjusted to reflect a 50:1 share consolidation completed on October 1, 2013.

For the three months ended September 30, 2013, the Company reported a loss of \$0.5 million, from continuing operations. For the three months ended September 30, 2012, the Company's consolidated profit was \$95.4 million, which comprised a loss from continuing operations of \$16.4 million, gain on sale of Jevco of \$108.1 million and a profit of discontinued operations of \$3.7 million.

For the nine months ended September 30, 2013, the Company reported a loss of \$1.7 million, from continuing operations. For the nine months ended September 30, 2012, the Company's consolidated profit was \$104.0 million, which comprised a loss from continuing operations of \$32.4 million, gain on sale of Jevco of \$106.7 million and a profit of discontinued operations of \$29.7 million.

**3. SALE OF JEVCO**

On May 2, 2012 the Company announced that it had entered into a definitive agreement (the "Agreement") with Intact Financial Corporation ("Intact") pursuant to which, subject to the terms and conditions of the Agreement, Intact agreed to purchase from the Company all of the issued and outstanding shares in the capital of Jevco for \$530.0 million in cash (the "Transaction").

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**3. SALE OF JEVCO (continued)**

Shareholder approval for the Transaction was received at a special meeting of shareholders on June 28, 2012. All regulatory approvals were received and other conditions of the Agreement were met during the third quarter of 2012 and the Transaction closed on September 4, 2012. The Transaction was reflected in Westaim's statements of financial position, profit or loss and other comprehensive income, equity and cash flow for the year ended December 31, 2012.

For the year ended December 31, 2012, a gain of \$106.7 million was realized on the sale of Jevco, after deducting the carrying value of Jevco of \$414.3 million, costs related to the sale of \$7.5 million and income tax of \$1.5 million.

In connection with the Transaction and as approved by the shareholders at the special meeting on June 28, 2012, Westaim completed a cash distribution by way of a return of capital to its common shareholders (the "Cash Distribution"). The Cash Distribution was made on September 28, 2012 to common shareholders of record on September 21, 2012 at \$37.50 per common share. The amount was determined by the Board of Directors based on the present and contingent liabilities of Westaim, as well as its future business objectives. The total amount of the Cash Distribution of \$521.4 million was recorded as a reduction of stated common share capital.

**4. ANALYSIS OF FINANCIAL RESULTS**

The Company's operating results include the results from continuing operations and discontinued operations.

**4.1 Continuing Operations**

Details of continuing operations are as follows:

<b>Continuing operations</b> (millions)	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
Revenue	\$ 0.1	\$ -	\$ 0.3	\$ 0.2
Expenses				
Salaries and benefits	0.2	0.2	0.9	0.4
Office expenses	0.1	-	0.6	0.5
Professional fees	0.2	0.1	0.5	3.0
Share-based compensation	0.1	10.7	0.1	20.3
Management services	-	5.4	-	8.4
Total expenses	0.6	16.4	2.1	32.6
Income tax recovery	-	-	0.1	-
Loss from continuing operations	\$ (0.5)	\$ (16.4)	\$ (1.7)	\$ (32.4)

*Revenue*

Revenue of continuing operations for the three and nine months ended September 30, 2013 of \$0.1 million and \$0.3 million (2012 - \$nil and \$0.2 million) consisted of interest on cash invested.

*Expenses*

Expenses for the three and nine months ended September 30, 2013 were \$0.6 million and \$2.1 million (2012 - \$16.4 million and \$32.6 million). The reduction in expenses of \$15.8 million in the third quarter of 2013 compared to the same period in the prior year and \$30.5 million in the nine months ended June 30, 2013 compared to the same period in 2012 was mainly due to fees for management services provided by Goodwood Management Inc. ("GMI") and share-based compensation incurred in 2012. In the three months ended September 30, 2012, the Company recorded an accounting charge of \$5.0 million when the management services agreement was extinguished upon the windup of GMI following the acquisition of GMI by the Company, and a share-based compensation expense of \$9.1 million reflecting the additional value of the restricted share units which were extinguished as a result of the windup of GMI. See further discussion in Section 9, *Related Party Transactions* of this MD&A. Employee salaries and benefits of \$0.2 million and \$0.9 million were incurred in the three and nine months ended September 30, 2013, and share-based compensation for the nine months ended September 30, 2013 was \$0.1 million.

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**4. ANALYSIS OF FINANCIAL RESULTS (continued)**

4.2 Discontinued Operations

The profit from discontinued operations is summarized as follows:

Discontinued operations (millions)	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
Revenue	\$ -	\$ 80.5	\$ -	\$ 275.7
Expenses	-	(75.8)	-	(236.9)
Profit of discontinued operations before income tax	-	4.7	-	38.8
Income tax expense	-	(1.0)	-	(9.1)
Profit of discontinued operations	-	3.7	-	29.7
Gain on sale of discontinued operations	-	108.1	-	106.7
Profit from discontinued operations	\$ -	\$ 111.8	\$ -	\$ 136.4

The results of Jevco's operations prior to the sale of Jevco on September 4, 2012 are included in profit of discontinued operations. Revenue of discontinued operations includes unrealized gains and losses on available-for-sale investments as unrealized gains and losses of a subsidiary are considered realized and included in profit or loss with the sale of the subsidiary. Income tax expense includes income tax previously deducted to determine profit or loss and income tax on unrealized gains previously included in other comprehensive income. The Company disposed of Jevco for gross cash proceeds of \$530.0 million. A gain on sale of Jevco of \$106.7 million was recognized in the year ended December 31, 2012, after deducting the carrying value of Jevco of \$414.3 million, transaction costs comprising financial, legal and consulting fees of \$7.5 million and income tax of \$1.5 million.

**5. ANALYSIS OF FINANCIAL POSITION**

The Company's assets, liabilities and shareholders' equity comprise the following:

(millions)	September 30, 2013	December 31, 2012
<b>Assets</b>		
Cash and cash equivalents	\$ 36.2	\$ 39.2
Other assets	0.2	0.2
	<u>\$ 36.4</u>	<u>\$ 39.4</u>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	\$ 0.8	\$ 0.6
Income taxes payable	-	1.5
Site restoration provision	2.7	2.7
	<u>3.5</u>	<u>4.8</u>
Shareholders' equity	32.9	34.6
Total liabilities and shareholders' equity	<u>\$ 36.4</u>	<u>\$ 39.4</u>

5.1 Cash and Cash Equivalents

At September 30, 2013, the Company had cash and cash equivalents of \$36.2 million compared to \$39.2 million at December 31, 2012. See further discussion in Section 7, *Liquidity and Capital Resources* of this MD&A.

5.2 Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities were \$0.8 million at September 30, 2013 and \$0.6 million at December 31, 2012.

5.3 Income Taxes Payable

Income taxes accrued at December 31, 2012 of \$1.5 million were related to the Transaction and \$1.4 million was paid during the three months ended March 31, 2013, resulting in an income tax recovery of \$0.1 million.

**5. ANALYSIS OF FINANCIAL POSITION (continued)**

5.4 Site Restoration Provision

The site restoration provision of \$2.7 million at September 30, 2013 and December 31, 2012 relates to costs associated with soil and groundwater reclamation and remediation costs. The Company conducts periodic reviews of the underlying assumptions supporting the provision, including remediation costs and regulatory requirements. Reimbursements of costs resulting from indemnifications provided by previous owners of the industrial sites have not been recognized in these consolidated financial statements. Future reimbursements will be recorded when received.

5.5 Shareholders' Equity

The details of shareholders' equity are as follows:

(millions)	September 30, 2013	December 31, 2012
Common shares	\$ 203.6	\$ 203.6
Contributed surplus	12.9	12.9
Deficit	(183.6)	(181.9)
Shareholders' equity	<u>\$ 32.9</u>	<u>\$ 34.6</u>

The increase in deficit of \$1.7 million from December 31, 2012 to September 30, 2013 is due to the loss for the nine months ended September 30, 2013.

**6. OUTLOOK**

Westaim's management is continuing to pursue the Company's business strategy, by searching for and investigating potential investment opportunities to grow shareholder value (as measured by book value per share) over the long term.

**7. LIQUIDITY AND CAPITAL RESOURCES**

Capital Management Objectives

The Company's guiding principles for capital management are to maintain the stability and safety of the Company for its stakeholders through optimal capital mix and an adequate level of capital, maintain a strong balance sheet, ensure the return on capital meets the Board of Directors' expectations relative to the risk taken, and minimize the after-tax cost of capital.

Towards achieving these objectives, the Company employs a strong and efficient capital base and manages capital in accordance with policies established by the Board of Directors. These policies relate to capital strength and capital mix. The Company has a capital management process in place to measure, deploy and monitor its available capital to assess its adequacy on a continuous basis. Management develops the capital strategy and oversees the capital management processes of the Company. The Company's capital consists of its shareholders' equity.

Share Capital

The Company's authorized share capital consists of an unlimited number of common shares, Class A preferred shares and Class B preferred shares. On October 1, 2013, the Company completed a 50:1 share consolidation of all of its outstanding common shares. All share capital, per share amounts, warrants and share-based awards in the current and comparative periods have been adjusted to reflect this change. At September 30, 2013 and November 8, 2013, the Company had 13,902,937 common shares and 6,000 stock options outstanding. At those dates, there were no Class A or Class B preferred shares outstanding.

On September 4, 2012, 730,298 common shares were issued as partial consideration for the acquisition of GMI. In the year ended December 31, 2012, 544 common shares were issued upon the exercise of 544 stock options. DSUs vested upon the sale of Jevco, and certain directors of Westaim and Jevco and certain officers of Jevco elected to exercise their right to apply the cash compensation received to purchase common shares of Westaim. The Company issued 89,414 common shares as a result of these elected subscriptions. In September 2012, 200,000 warrants were exercised for 200,000 Series 1 Class A preferred shares and the resulting preferred shares totaling 1,477,058 were converted into common shares on a one for one basis.

## **7. LIQUIDITY AND CAPITAL RESOURCES (continued)**

The Series 1 Class A preferred shares are entitled to dividends as the directors may declare, provided that an equal dividend is declared on the common shares, and rank equally with the common shares with respect to liquidation proceeds. The Series 1 Class A non-voting preferred shares are convertible into common shares, on a one to one basis, subject to any adjustments resulting from subdivision or consolidation of the common shares.

### Cash Distribution and Stated Share Capital Reduction

In connection with the Transaction and as approved by the shareholders at the special meeting on June 28, 2012, Westaim completed the Cash Distribution to its common shareholders in the form of a return of capital. The Cash Distribution was made on September 28, 2012 to common shareholders of record on September 21, 2012 at \$37.50 per common share. The amount was determined by the Board of Directors based on the present and contingent liabilities of Westaim, as well as its future business objectives. The total amount of the Cash Distribution of \$521.4 million was recorded as a reduction of stated common share capital.

### Dividends

No dividends were paid in the nine months ended September 30, 2013 and 2012.

### Share-based Compensation Plans

On April 12, 2010, the Board of Directors of the Company approved the adoption of a comprehensive long-term equity incentive plan (the "Incentive Plan"), ratified at the Company's annual general meeting of shareholders held on May 12, 2010, designed to combine the Company's prior equity incentive plans, being the Employee and Director Stock Option Plan, the Directors and Officers Share Purchase Program, the Restricted Share Unit Plan, and the Deferred Share Unit Plan, collectively, the "Prior Plans". All awards granted under the Prior Plans remain in full force and effect in accordance with their terms, however, no additional grants will be made under the Prior Plans. See Note 7 to the unaudited consolidated financial statements for the nine months ended September 30, 2013.

On September 4, 2012, the Company purchased all the issued and outstanding shares of GMI for \$4.2 million cash and 730,298 common shares of the Company. GMI was the holder of all of the outstanding RSUs and Westaim had accrued a liability in respect of the RSUs. The share consideration paid for GMI reflected the fair value of the RSUs held by GMI at the time of the acquisition. Immediately following Westaim's acquisition of GMI, GMI was wound up into Westaim and an additional expense of \$9.1 million was recognized to reflect the additional value of the RSUs which were extinguished as a result of the windup of GMI.

DSUs are granted at the market value of the Company's shares at the date of grant to non-executive directors of the Company in lieu of fees, and prior to the sale of Jevco, to non-executive directors, officers and employees of Jevco. Prior to January 1, 2013, directors could elect to receive DSUs in lieu of fees. Vested DSUs are paid out in cash when the participant ceases to be a director, officer or employee. All DSUs issued prior to the sale of Jevco vested and were paid out upon the sale of Jevco. As determined by Westaim's Board of Directors, in connection with the completion of the sale of Jevco, each holder of DSUs was entitled to receive a cash payment in consideration for relinquishing their rights in respect of each such DSU equal to the "market price" of the common shares (as determined in accordance with the terms of the Incentive Plan) immediately prior to the completion of the sale (being \$37.50) less any required withholdings, and could elect to apply all or a part of such cash payment to a subscription for common shares at the same price per share. An aggregate of 89,414 common shares were issued to the DSU holders in connection with the entitlements.

In July 2012, 544 stock options were exercised at \$11.00 per share.

On December 20, 2012, the long-term equity incentive plan was amended to, among other things, restrict the awards which may be granted under the plan to stock options and DSUs and to reduce the number of common shares issuable under the plan to not more than 10% of the aggregate number of common shares outstanding. At September 30, 2013 and November 8, 2013, the Company had 6,000 stock options and 113,200 DSUs outstanding.

### Volatility of Share Price

The price of the common shares may be volatile even though there have been no material changes in the Company's business or finances. In the past, securities class action litigation has often been brought against companies that experience volatility in the market price of their securities. Whether or not meritorious, litigation brought against the Company could result in substantial costs, divert management's attention and resources and harm the Company's financial condition and results of operations.



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**7. LIQUIDITY AND CAPITAL RESOURCES (continued)**

Market for Securities

On January 9, 2013, Westaim's common shares commenced trading on the TSX Venture Exchange ("TSX-V") under the symbol "WED". Until January 8, 2013, the common shares of Westaim were listed on the Toronto Stock Exchange (the "TSX") under the symbol "WED". The Westaim Board of Directors has determined that a listing with the TSX-V better suits the needs of the Company while providing continued trading liquidity for the Company's shareholders. The Company received approval of its listing on the TSX-V prior to voluntarily de-listing from the TSX.

Cash Flow Objectives

The Company manages its liquidity with a view to ensuring that there is sufficient cash to meet all financial commitments and obligations as they fall due. The Company believes its liquidity requirements for the next year will be met with the cash and cash equivalents on hand. Although the Company currently does not have any operating assets that generate revenue, the Company has sufficient funds to meet its financial obligations and pursue other opportunities. As part of pursuing one or more new opportunities, the Company may from time to time issue shares from treasury.

The following tables illustrate the duration of the financial assets of the Company compared to its financial obligations:

September 30, 2013 (millions)	One year or less	No specific date	Total
Financial assets:			
Cash and cash equivalents	\$ 36.2	\$ -	\$ 36.2
Other assets	0.2	-	0.2
Total financial assets	36.4	-	36.4
Financial obligations:			
Accounts payable and accrued liabilities	0.8	-	0.8
Site restoration provision	-	2.7	2.7
Total financial obligations	0.8	2.7	3.5
Financial assets net of financial obligations	\$ 35.6	\$ (2.7)	\$ 32.9

December 31, 2012 (millions)	One year or less	No specific date	Total
Financial assets:			
Cash and cash equivalents	\$ 39.2	\$ -	\$ 39.2
Other assets	0.2	-	0.2
Total financial assets	39.4	-	39.4
Financial obligations:			
Accounts payable and accrued liabilities	0.6	-	0.6
Income taxes payable	1.5	-	1.5
Site restoration provision	-	2.7	2.7
Total financial obligations	2.1	2.7	4.8
Financial assets net of financial obligations	\$ 37.3	\$ (2.7)	\$ 34.6

The Company's investment guidelines stress preservation of capital and market liquidity to support payment of liabilities. The matching of the duration of financial assets and liabilities is monitored to ensure that all obligations will be met.

## **8. RISKS**

Westaim is subject to a number of risks, including the risks described below. The risks and uncertainties described below are those believed to be material, but they may not be the only ones faced by Westaim. If any of these risks, or any other risks and uncertainties that have not yet been identified by Westaim or that Westaim currently considers not to be material, actually occur or become material risks, the business, prospects, financial condition, results of operations and cash flows of Westaim could be materially and adversely affected.

*The Company has no current business activities from which it earns revenues*

Following the completion of the sale of Jevco, the Company has no operations which generate revenues and its main assets are cash and cash equivalents. Accordingly, the Company does not anticipate that it will generate any significant earnings until such time as it deploys its cash and cash equivalents through one or more acquisitions, mergers, or other transactions. There is no guarantee that the Company will make such an investment or that any investment made will be profitable and will provide dividends to shareholders. Westaim has no current intention of paying dividends in the near future. There is no assurance that the Company will be able to obtain adequate financing needed for its future business or projects or if the terms of such financing will be favourable. Failure to obtain such additional financing could result in a delay in the future development of the Company.

The Company is relying solely on the past business success of its directors and officers to identify acquisitions. The success of the Company is dependent upon the efforts and abilities of its management team. The loss of certain members of the management team could have an adverse effect on the business and prospects of the Company. In such event, the Company will seek satisfactory replacements but there can be no guarantee that appropriate personnel can be found.

*Risks inherent in acquisitions*

The Company intends to actively pursue the acquisition of companies or businesses in Canada and/or internationally and may seek to acquire securities or other interests in other companies consistent with its investment and growth strategy. Such acquisitions involve inherent risks including but not limited to (a) unanticipated costs; (b) potential loss of key employees of the Company or the business acquired; (c) unanticipated changes in business, industry or general economic conditions that affect the assumptions underlying the acquisition; and (d) decline in the value of the acquired business or assets. Any one or more of these factors could cause the Company to not realize the anticipated benefits of the acquisition in question. In addition, the Company may be required to use available cash, incur debt, issue securities, or a combination of these in order to complete an acquisition. This could affect the Company's future flexibility and ability to raise capital, operate or develop its business and could dilute its existing shareholders' holdings as well as decrease the trading price of its common shares. There is no assurance that when evaluating a possible acquisition, the Company will correctly identify and manage the risks and costs inherent in the business or asset to be acquired.

*Volatile stock price*

The price of Westaim's common shares is expected to be highly volatile and will be drastically affected by various factors. Westaim cannot predict the timing of future acquisitions or other developments expected to take place in the future which will likely trigger major changes in the trading price of the common shares.

*Liquidity and financing risks*

As Westaim will have limited interest income from its cash and cash equivalents, its ability to continue its acquisition efforts will be largely reliant on its continued attractiveness to equity investors. Westaim will incur operating losses as it continues to expend funds to explore and develop future business. There is no guarantee that Westaim will be able to develop a profitable business that it may acquire as general economic conditions, regulatory requirements and other factors affect Westaim's operations and future performance. Many of these factors are beyond Westaim's control. Additionally, should Westaim require additional capital to continue its activities, failure to raise such capital could result in the Company going out of business. From time to time, Westaim may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed wholly or partially with debt, which may temporarily increase Westaim's debt levels above industry standards. Westaim cannot assure investors that it will be able to generate sufficient cash flow to pay the interest on any debt or that future working capital, borrowings or equity financing will be available to pay or refinance such debt.

*Income taxes*

The calculation of income taxes requires the use of estimates and judgment. The validity and measurement of tax benefits associated with various tax positions taken or expected to be taken in Westaim's tax filings are a matter of tax law and are subject to interpretation. The impact of the final determination of tax audits, appeals of decisions of a taxing authority, or tax litigation may be materially different from that reflected in the Company's financial statements. The assessment of additional taxes, interest and penalties could be materially adverse to Westaim's future results of operations and financial position.

**8. RISKS (continued)**

*Operational risks*

In connection with its operations, the Company is from time to time named as defendant in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome of the various proceedings at this time, such actions have generally been resolved with minimal expenses in excess of amounts provided for. The Company does not believe that it will incur any significant additional expenses in connection with such actions.

The Company has agreements to indemnify its officers and directors for certain events or occurrences while the officer or director is or was serving at the Company's request in such capacity. The maximum potential amount of future payments is unlimited. However, the Company maintains Director and Officer Liability insurance coverage that enables the Company to recover a portion of any future payments.

**9. RELATED PARTY TRANSACTIONS**

Management services agreement

Prior to September 4, 2012, the Company had a management services agreement ("MSA") with GMI to manage the day-to-day affairs of the Company and to present strategic investment opportunities for the Board of Directors to consider. GMI was required to provide certain services to the Company including the services of two directors, one of whom was also President and Chief Executive Officer, and a Chief Financial Officer. The MSA provided that GMI was paid an annual service fee designed to compensate GMI for the time and attention of its officers and employees incurred in furtherance of the Company's business as well as for the office space, equipment, supplies and other facilities made available by GMI to the Company. The amount of the services fee was based on a report prepared by an independent compensation consultant. GMI was also entitled to participate in an annual incentive bonus plan for the purpose of recognizing the contribution of GMI to the Company's business.

Prior to the purchase of GMI by the Company on September 4, 2012, GMI was controlled by corporations controlled by two directors of the Company. Upon the extinguishment of the MSA in September 2012, an expense of \$5.0 million was recognized in the statement of profit or loss and other comprehensive income. For the three and nine months ended September 30, 2012, GMI fee expense, inclusive of harmonized sales tax, was \$0.4 million and \$3.5 million.

All RSUs previously outstanding were held by GMI (details discussed under *Share-based Compensation Plans* in Section 7, *Liquidity and Capital Resources* of this MD&A).

Acquisition of GMI

On September 4, 2012, the Company purchased all the issued and outstanding shares of GMI for \$4.2 million in cash and 730,298 common shares of the Company. The consideration paid reflected the fair value of the assets and liabilities of GMI. As the fair value of the consideration paid was determined to be equal to the fair value of the assets and liabilities of GMI, no goodwill was recorded. Immediately following the acquisition, GMI was wound up into the Company.

Former employees of GMI who are now employees of the Company are considered key management personnel for related party disclosure purposes beginning on September 4, 2012.

Transactions with key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, including directors of the Company.

Compensation expenses related to key management personnel, including non-executive directors, are as follows:

(millions)	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
Salaries and benefits	\$ 0.2	\$ 0.2	\$ 0.9	\$ 0.4
Share-based compensation	0.1	-	0.1	1.1
	\$ 0.3	\$ 0.2	\$ 1.0	\$ 1.5

10. QUARTERLY FINANCIAL INFORMATION

(millions)	Q3 2013	Q2 2013	Q1 2013	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011
Revenue of continuing operations	\$ 0.1	\$ 0.1	\$ 0.1	\$ 0.1	\$ 0.1	\$ 0.1	\$ -	\$ 0.1
Expenses of continuing operations	0.6	0.8	0.5	1.1	16.5	9.6	6.5	4.3
Gain (loss) on sale of discontinued operations	-	-	-	-	108.1	(1.4)	-	-
Profit from discontinued operations	-	-	-	-	3.7	12.8	13.2	15.8
Profit or loss and other comprehensive income	(0.5)	(0.7)	(0.4)	(1.0)	95.4	1.9	6.7	11.6

Quarterly revenue from continuing operations includes miscellaneous investment income. Expenses of continuing operations vary from quarter to quarter mainly due to the share-based compensation expense which varies according to the market price of Westaim's common shares. In addition, costs of \$1.3 million were incurred in each of the first and second quarters of 2012 to investigate an acquisition which Westaim ultimately did not pursue.

Gain on sale of discontinued operations is the gain from the sale of Jevco. Expenses of \$1.4 million related to the sale were recorded in the second quarter of 2012.

Profit from discontinued operations for the third quarter of 2012 included two months of operating results from the Company's insurance business to the date of sale of Jevco on September 4, 2012. Profit from discontinued operations in the fourth quarter of 2011 included \$2.9 million relating to the recognition of deferred income tax assets for non-capital losses following an internal corporate reorganization.

11. CAUTIONARY NOTE REGARDING FUTURE ORIENTED FINANCIAL INFORMATION

Certain portions of this MD&A, as well as other public statements by the Company, contain forward-looking statements. In particular, the words "strategy", "may", "will", "continue", "developed", "objective", "potential", "exploring", "could", "expect", "expected", "expects", "tends", "indicates", and words and expressions of similar import, are intended to identify forward-looking statements. Such forward-looking statements include but are not limited to statements concerning: strategies, alternatives and objectives to maximize value for shareholders; expectations and assumptions relating to the Company's business plan; the effect of adverse changes in equity markets or the Company's operations; expectations regarding the Company's assets and liabilities; the Company's ability to retain key employees, management's belief that its estimates for determining the valuation of the Company's assets and liabilities are appropriate; the Company's views regarding potential future remediation costs; the effect of changes to interpretations of tax legislation on income tax provisions in future periods; and the Company's determination that the adoption of new accounting standards will not have a material impact on its consolidated financial statements.

These statements are based on current expectations that are subject to risks, uncertainties and assumptions and the Company can give no assurance that these expectations are correct. By their nature, these statements are subject to inherent risks and uncertainties that may be general or specific. A variety of material factors, many of which are beyond the Company's control, may affect the operations, performance and results of the Company and its business, and could cause actual results to differ materially from the expectations expressed in any of these forward-looking statements.

The Company's actual results could differ materially from those anticipated by these forward-looking statements for various reasons generally beyond the Company's control, including but not limited to: (i) difficult economic conditions or a prolonged economic downturn may adversely affect the Company's business; (ii) the Company may not be able to realize its investment objectives or its liquid assets may prove to be insufficient to meet future obligations; (iii) the Company may have undisclosed liabilities; (iv) the Company may require significant additional funding; and (v) other risk factors set forth herein or in the Company's Annual Information Form or other public filings. The Company disclaims any intention or obligation, except as required by law, to revise forward-looking statements, whether as a result of new information, future developments, or otherwise. All forward-looking statements are expressly qualified in their entirety by this cautionary statement.

**The Westaim Corporation**  
Consolidated Statements of Financial Position  
(unaudited)

(thousands of Canadian dollars)	September 30 2013	December 31 2012
<b>ASSETS</b>		
Current		
Cash and cash equivalents	\$ 36,185	\$ 39,164
Accounts receivable and other assets	192	202
	\$ 36,377	\$ 39,366
<b>LIABILITIES</b>		
Current		
Accounts payable and accrued liabilities	\$ 811	\$ 561
Income taxes payable (note 9)	-	1,530
	811	2,091
Site restoration provision (note 4)	2,684	2,663
	3,495	4,754
Commitments and contingent liabilities (note 5)		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 6)	203,640	203,640
Contributed surplus (note 2i)	12,890	12,890
Deficit	(183,648)	(181,918)
	32,882	34,612
	\$ 36,377	\$ 39,366

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

**The Westaim Corporation**

Consolidated Statements of Profit or Loss and Other Comprehensive Income  
(unaudited)

(thousands of Canadian dollars except share and per share data)	Three Months Ended September 30		Nine Months Ended September 30	
	2013	2012	2013	2012
<b>Continuing operations</b>				
Revenue				
Investment income	\$ 105	\$ 474	\$ 319	\$ 633
Realized gains and losses on sale of investments	-	(442)	-	(442)
	105	32	319	191
Expenses				
Salaries and benefits	219	265	918	383
Office expenses	147	(3)	615	424
Professional fees	187	126	534	2,967
Site restoration provision expense (note 4)	7	12	21	36
Share-based compensation (note 7)	85	10,675	85	20,302
Management services (note 8)	-	5,397	-	8,439
	645	16,472	2,173	32,551
Loss from continuing operations before income tax	(540)	(16,440)	(1,854)	(32,360)
Income tax recovery	-	-	124	-
Loss from continuing operations	(540)	(16,440)	(1,730)	(32,360)
Gain on sale of discontinued operations (note 14)				
Proceeds on sale of subsidiary	-	530,000	-	530,000
Carrying value of subsidiary	-	(414,289)	-	(414,289)
Transaction costs	-	(6,085)	-	(7,498)
Gain on sale of discontinued operations before income tax	-	109,626	-	108,213
Income tax expense	-	(1,530)	-	(1,530)
Gain on sale of discontinued operations	-	108,096	-	106,683
Discontinued operations (note 14)				
Revenue	-	80,459	-	275,740
Expenses	-	(75,758)	-	(236,903)
Profit of discontinued operations before income tax	-	4,701	-	38,837
Income tax expense	-	(997)	-	(9,170)
Profit of discontinued operations	-	3,704	-	29,667
Profit from discontinued operations	-	111,800	-	136,350
Profit or loss and other comprehensive income	\$ (540)	\$ 95,360	\$ (1,730)	\$ 103,990
Earnings per share (note 10)				
Loss from continuing operations - basic and diluted	\$ (0.04)	\$ (1.21)	\$ (0.12)	\$ (2.41)
Profit from discontinued operations - basic and diluted	\$ 0.00	\$ 8.22	\$ 0.00	\$ 10.15
Profit or loss and other comprehensive income - basic and diluted	\$ (0.04)	\$ 7.02	\$ (0.12)	\$ 7.74
Weighted average number of common and Series 1 Class A preferred shares outstanding (in thousands)				
Basic	13,903	13,160	13,903	12,976
Diluted	13,903	13,593	13,903	13,432

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

**The Westaim Corporation**

Consolidated Statements of Changes in Equity  
(unaudited)

Nine months ended September 30, 2013

(thousands of Canadian dollars)	Share Capital	Warrants	Contributed Surplus	Deficit	Total Equity
Balance at January 1, 2013	\$ 203,640	\$ -	\$ 12,890	\$ (181,918)	\$ 34,612
Profit or loss and other comprehensive income	-	-	-	(1,730)	(1,730)
<b>Balance at September 30, 2013</b>	<b>\$ 203,640</b>	<b>\$ -</b>	<b>\$ 12,890</b>	<b>\$ (183,648)</b>	<b>\$ 32,882</b>

Nine months ended September 30, 2012

(thousands of Canadian dollars)	Share Capital	Warrants	Contributed Surplus	Deficit	Total Equity
Balance at January 1, 2012	\$ 687,402	\$ 1,900	\$ 12,890	\$ (284,929)	\$ 417,263
Profit or loss and other comprehensive income	-	-	-	103,990	103,990
Share capital issued and paid	30,745	-	-	-	30,745
Exercise of warrants	6,900	(1,900)	-	-	5,000
Return of capital	(521,407)	-	-	-	(521,407)
<b>Balance at September 30, 2012</b>	<b>\$ 203,640</b>	<b>\$ -</b>	<b>\$ 12,890</b>	<b>\$ (180,939)</b>	<b>\$ 35,591</b>

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

**The Westaim Corporation**  
Consolidated Cash Flow Statements  
(unaudited)

(thousands of Canadian dollars)	Nine Months Ended September 30	
	2013	2012
<b>Operating activities</b>		
Loss from continuing operations	\$ (1,730)	\$ (32,360)
Income tax recovery recognized in profit or loss	(124)	-
Income taxes paid	(1,406)	-
Share-based compensation	85	20,302
Net realized loss on investments	-	442
Extinguishment of management contract (note 8)	-	4,966
Net change in other non-cash balances	196	(1,792)
Cash used in operating activities of continuing operations	(2,979)	(8,442)
Discontinued operations operating activities	-	34,120
Cash (used in) provided from operating activities	(2,979)	25,678
<b>Investing activities</b>		
Purchase of subsidiary, net of cash acquired (note 8)	-	(4,155)
Proceeds from sale of discontinued operations	-	530,000
Cash of discontinued operations	-	(22,551)
Transaction costs incurred upon sale of discontinued operations	-	(7,498)
Discontinued operations investing activities	-	9,598
Cash provided from investing activities	-	505,394
<b>Financing activities</b>		
Issuance of share capital, net of cash issuance costs	-	8,359
Return of capital to common shareholders	-	(521,407)
Cash used in financing activities	-	(513,048)
Net (decrease) increase in cash and cash equivalents	(2,979)	18,024
Cash and cash equivalents, beginning of period	39,164	24,347
Cash and cash equivalents, end of period	\$ 36,185	\$ 42,371
Cash and cash equivalents is comprised of:		
Cash	\$ 36,185	\$ 42,371

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



**The Westaim Corporation**  
**Notes to Consolidated Financial Statements (unaudited)**  
**For the nine months ended September 30, 2013 and 2012**  
(Currency amounts in thousands of Canadian dollars unless otherwise indicated)

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**1 Nature of Operations and Basis of Preparation**

The Westaim Corporation (the "Company") was incorporated on May 7, 1996 by articles of incorporation under the Business Corporations Act (Alberta). The Company's registered office is located at 201-212 King Street West, Toronto, Ontario, Canada. These financial statements were authorized for issue by the Board of Directors of the Company on November 8, 2013.

On January 9, 2013, the Company's common shares commenced trading on the TSX Venture Exchange under the symbol WED. Until January 8, 2013, the Company's common shares were traded on the Toronto Stock Exchange under the symbol WED. Concurrent with the commencement of trading on the TSX Venture Exchange, the Company's common shares were voluntarily delisted from the Toronto Stock Exchange.

Until September 4, 2012, the Company operated in the insurance industry in Canada through its wholly-owned subsidiary, Jevco Insurance Company ("Jevco"). Jevco was sold on September 4, 2012. Note 14 *Sale of Subsidiary* provides information regarding the sale of the Company's investment in Jevco and Jevco's results of operations to the date of sale.

These financial statements also include, on a consolidated basis, the accounts of wholly-owned subsidiaries, Westaim Holdings Limited ("WHL"), 1685740 Alberta Ltd., 1685753 Alberta Ltd. and 1686581 Alberta Ltd. The Company amalgamated with WHL, 1685740 Alberta Ltd. and 1685753 Alberta Ltd. on July 1, 2012, and with 1686581 Alberta Ltd. on January 1, 2013.

On October 1, 2013, the Company completed a 50:1 share consolidation of all of its outstanding common shares. All share capital, per share amounts, warrants and share-based awards in the current and comparative periods have been adjusted to reflect this change.

These financial statements are prepared in compliance with International Financial Reporting Standards ("IFRS"), including International Accounting Standard ("IAS") 34 *Interim Financial Reporting*.

All currency amounts are expressed in thousands of Canadian dollars except earnings per share data, unless otherwise noted.

**2 Summary of Significant Accounting Policies**

The significant accounting policies used to prepare these financial statements are as follows:

*(a) Principles of consolidation*

The financial statements of entities which are controlled by the Company through voting equity interests, referred to as subsidiaries, are consolidated. The financial results of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Intercompany balances and transactions are eliminated upon consolidation.

*(b) Use of estimates*

The preparation of financial statements requires management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and changes in estimates are recorded in the reporting period in which they are determined. Key estimates are discussed in the following accounting policies and applicable notes.

*(c) Judgments made by management*

Key areas where management has made difficult, complex or subjective judgments in the process of applying the Company's accounting policies, often as a result of matters that are inherently uncertain, include: valuation techniques for fair value determination of investments, investment impairment, site restoration provision and income taxes. For additional information on these judgments, see note 4 for site restoration provision and note 9 for income taxes.

*(d) Foreign currency translation*

The Canadian dollar is the functional and presentation currency of the Company. Transactions in foreign currencies are translated into Canadian dollars at rates of exchange prevailing at the time of such transactions. Monetary assets and liabilities are translated at current rates of exchange at end of period.

*(e) Cash and cash equivalents*

Cash and cash equivalents consist of cash on deposit and highly liquid short-term investments with original maturities of 90 days or less.

## **2 Summary of Significant Accounting Policies (continued)**

Cash and cash equivalents are classified in the financial instrument category of loans and receivables for purposes of measurement. Cash and cash equivalents are valued at fair value at the issuance date and subsequently at amortized cost using the effective interest method. Carrying value is a reasonable approximation of fair value.

### *(f) Investments and investment income*

Investments are classified according to four accounting models: available-for-sale, fair value through profit or loss ("FVTPL"), held-to-maturity and cost. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Available-for-sale investments are carried at their fair value whereby the unrealized gains and losses are included in accumulated other comprehensive income until sale or impairment is recognized, at which time cumulative unrealized gains or losses are transferred to profit or loss. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect objective evidence of impairment in value are included in "realized gains and losses on sale of investments". Changes in the fair value of investments designated as FVTPL are charged or credited to investment income for the current reporting period. Held-to-maturity investments are carried at amortized cost using the effective interest method. When a reliable estimate of the fair value of unquoted investments cannot be determined, the investment is reported at cost.

The Company accounts for investments using settlement date accounting. Transaction costs for FVTPL investments are expensed as incurred. Transaction costs for all other categories of investments are capitalized and, when applicable, amortized over the expected life of the investment using the effective interest method.

The Company conducts quarterly reviews to identify and evaluate investments that show objective indications of possible impairment. For debt investments and available-for-sale equity investments, impairment exists when there is objective evidence that, as a result of one or more events occurring after initial recognition, the estimated future cash flows of the investment have been affected.

### *(g) Income taxes*

Income tax expense is recognized in the statement of profit or loss and other comprehensive income. Current tax is based on taxable income which differs from profit or loss and other comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible.

Deferred tax assets are generally recognized for all deductible temporary income tax differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets and liabilities are determined based on the enacted or substantively enacted tax laws and rates that are anticipated to apply in the year of realization. The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Company expects to recover or settle the carrying amount of the related assets and liabilities. The carrying amount of the deferred tax asset is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Income tax assets and liabilities are offset when the Company intends to settle on a net basis and there is a legally enforceable right to offset.

### *(h) Site restoration provision*

Future site restoration costs relate to industrial sites previously owned by the Company and are estimated taking into consideration the anticipated method and extent of the remediation consistent with regulatory requirements, industry practices, current technology and possible uses of the site. The estimated amount of future restoration costs is reviewed periodically based on available information. The amount of the provision is the present value of the estimated future restoration costs discounted using the rate of interest of a high quality government bond.

Recoveries of costs resulting from indemnifications provided by previous owners of the Company's industrial sites have not been recognized in these financial statements. Future recoveries of site restoration costs will be recorded when received.

### *(i) Contributed surplus*

The cost of stock options is recognized over the period from the issue date to the vesting date and recorded as contributed surplus. When share capital of the Company is repurchased by the Company, the amount by which the average carrying value of the shares exceeds the cost to repurchase the shares is removed from share capital and included in contributed surplus.

**The Westaim Corporation**  
**Notes to Consolidated Financial Statements (unaudited)**  
**For the nine months ended September 30, 2013 and 2012**  
(Currency amounts in thousands of Canadian dollars unless otherwise indicated)

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**2 Summary of Significant Accounting Policies (continued)**

*(j) Share-based compensation*

The Company maintains share-based compensation plans, which are described in note 7. Any consideration paid by stock option holders for the purchase of stock is credited to share capital. The cost of stock options is recognized over the period from the issue date to the vesting date and recorded as a component of equity in contributed surplus.

Obligations related to Deferred Share Units ("DSUs") are accrued as liabilities when a change in value occurs and recognized in compensation expense over the applicable vesting period.

*(k) Discontinued operations*

Results of discontinued operations are presented in the statement of profit or loss and other comprehensive income as profit from discontinued operations and comprise the revenues and expenses of Jevco and the gain on sale of Jevco, net of related income tax expense. In accordance with IAS 27 "Consolidated and Separate Financial Statements", gains and losses on available-for-sale investments are included in revenue from discontinued operations as these are considered realized due to the sale of Jevco. Income tax on unrealized gains and losses has been reclassified as income taxes on profit of discontinued operations.

*(l) Earnings per share*

Basic earnings per share is calculated by dividing profit or loss by the total of the weighted average number of common shares outstanding during the reporting period plus the weighted average number of preferred shares outstanding during the reporting period. Profit or loss equals profit or loss and other comprehensive income for the three and nine months ended September 30, 2013 and 2012. The preferred shares are considered in substance common shares.

Diluted earnings per share is calculated on the basis of the weighted average number of shares outstanding during the reporting period plus an estimate of the additional common shares that would have been outstanding if potentially dilutive common shares had been issued using the "treasury stock" method. No adjustments to profit or loss are required for dividends, interest or other changes in income for purposes of calculating diluted earnings per share.

**3 Accounting Standards Issued But Not Yet Applied**

IFRS 9 "Financial instruments" ("IFRS 9") was issued in November 2009 and will replace IAS 39 "Financial Instruments: Recognition and Measurement" ("IAS 39"). IFRS 9 prescribes a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules permissible under IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. IFRS 9 also requires a single impairment method to be used, replacing the multiple impairment methods permissible under IAS 39. The Company has not yet determined the impact of IFRS 9 on its financial statements. IFRS 9 is effective for years beginning on or after January 1, 2015.

**4 Site Restoration Provision**

The Company has provided indemnifications to third parties with respect to future site restoration costs to be incurred on industrial sites formerly owned by the Company. The site restoration provision is based on periodic independent estimates of costs associated with soil and groundwater reclamation and remediation of these industrial sites. The ultimate environmental costs are uncertain as they are dependent on the future use of the land and future laws and regulations.

The change in the site restoration provision for the nine months ended September 30, 2013 is as follows:

Balance at January 1, 2013	\$	2,663
Changes due to passage of time		21
Balance at September 30, 2013	\$	2,684

Estimates of future expenditures could change as a result of periodic reviews of the underlying assumptions supporting the provision, including remediation costs and regulatory requirements. The Company does not expect to settle any portion of the site restoration provision within twelve months after September 30, 2013.

**The Westaim Corporation**  
**Notes to Consolidated Financial Statements (unaudited)**  
**For the nine months ended September 30, 2013 and 2012**  
(Currency amounts in thousands of Canadian dollars unless otherwise indicated)

**4 Site Restoration Provision (continued)**

Cash flows are estimated to take place over the next 150 years, with the majority to take place later than 50 years after September 30, 2013. To calculate the site restoration provision, the estimated cash flows were adjusted for inflation and discounted to September 30, 2013. For inflation and discounting calculations, all cash flows later than 50 years are treated as if the cash flow would occur at 100 years. Inflation is estimated at 1.2% per annum over the next 100 years. Discount rates are based on risk free rates which range from 1.1% to 2.4% over the next 30 years. The 30-year risk free rate is used for discounting cash flows that are estimated to occur later than 30 years after September 30, 2013.

Reimbursements of future costs resulting from indemnifications provided by previous owners of the industrial sites have not been recognized in these financial statements. Future reimbursements will be recorded when received.

**5 Commitments and Contingent Liabilities**

- (a) In connection with the sale of the operations and assets of WHL in 2009, WHL agreed to indemnify the purchaser against certain liabilities or losses as described in the asset purchase agreement to an aggregate maximum of US\$11,000, subject to certain exclusions. The Company also agreed to indemnify the purchaser and the purchaser's directors, officers and employees, for an indefinite period, from certain environmental liabilities and costs relating to the premises formerly leased by WHL in Fort Saskatchewan, Alberta. No claims have been made under, and no amounts have been accrued related to, these indemnities. The Company does not expect any claims within twelve months after September 30, 2013.
- (b) The Company has operating leases in Toronto with remaining lease terms of up to 7 years. At September 30, 2013, the Company had a total commitment of \$302 for future minimum lease payments including payments due not later than one year of \$99, payments due later than one year and not later than five years of \$190, and payments due later than five years of \$13.

**6 Share Capital and Warrants**

**Share Capital**

The Company's authorized share capital consists of an unlimited number of common shares with no par value, Class A preferred shares with no par value and Class B preferred shares with no par value.

On October 1, 2013, the Company completed a 50:1 share consolidation of all of its outstanding common shares. All share capital, per share amounts, warrants and share-based awards in the current and comparative periods have been adjusted to reflect this change.

Changes in the Company's share capital for the nine months ended September 30, 2013 and the year ended December 31, 2012 are as follows:

Common shares (thousands)	Nine months ended September 30, 2013 <sup>(1)</sup>		Year ended December 31, 2012 <sup>(1)</sup>	
	Number	Stated Capital	Number	Stated Capital
Outstanding at January 1	13,903	\$ 203,640	11,606	\$ 656,618
Issued	-	-	820	30,745
Conversion of Series 1 Class A preferred shares	-	-	1,477	37,684
Return of capital	-	-	-	(521,407)
	13,903	\$ 203,640	13,903	\$ 203,640

<sup>(1)</sup> Adjusted to reflect a 50:1 share consolidation completed on October 1, 2013.

Series 1 Class A preferred shares (thousands)	Nine months ended September 30, 2013		Year ended December 31, 2012 <sup>(1)</sup>	
	Number	Stated Capital	Number	Stated Capital
Outstanding at January 1	-	\$ -	1,277	\$ 30,784
Exercise of warrants	-	-	200	6,900
Conversion to common shares	-	-	(1,477)	(37,684)
	-	\$ -	-	\$ -

<sup>(1)</sup> Adjusted to reflect a 50:1 share consolidation completed on October 1, 2013.

**The Westaim Corporation**  
**Notes to Consolidated Financial Statements (unaudited)**  
**For the nine months ended September 30, 2013 and 2012**  
(Currency amounts in thousands of Canadian dollars unless otherwise indicated)

**6 Share Capital and Warrants (continued)**

The Company's share capital consisted of 13,902,937 common shares with stated capital of \$203,640 at September 30, 2013 and 13,902,940 common shares with stated capital of \$203,640 at December 31, 2012. In the nine months ended September 30, 2013, 3 common shares were cancelled.

At a special meeting of the Company's shareholders on June 28, 2012, the shareholders voted in favour of a special resolution to reduce the stated capital of the common shares of the Company through a return of capital in the form of a cash distribution. The amount of the cash distribution was determined by the Board of Directors of the Company and the distribution was made on September 28, 2012 at \$37.50 per common share for a total of \$521,407. The return of capital was recorded as a reduction in the stated capital of the common shares.

There were no Series 1 Class A preferred shares outstanding during the nine months ended September 30, 2013. The Series 1 Class A preferred shares rank equally with the common shares with respect to liquidation proceeds and are entitled to dividends as the directors may declare, provided that an equal dividend is declared on the common shares. All the issued Series 1 Class A preferred shares previously outstanding were held by one shareholder (the "Holder"). Series 1 Class A preferred shares are non-voting and convertible into common shares, on a one to one basis. The Series 1 Class A preferred shares initially prohibited conversion of such shares where the conversion would result in the Holder exercising control or direction over greater than 40% of the common shares. At the special meeting of the Company's shareholders on June 28, 2012, an amendment to the Company's articles was approved by a special resolution which, upon completion of the sale of Jevco, permitted Series 1 Class A preferred shares to be converted to common shares while permitting the Holder to exceed an ownership of 40% of the common shares. In anticipation of this special resolution, the Company and the Holder entered into a voting agreement ("Voting Agreement") on May 25, 2012 to provide comparable protection to the common shareholders as was provided by the conversion restrictions which were in place prior to the special resolution. Pursuant to the Voting Agreement, the Holder agreed to vote the shares over which it exercises control or discretion and which represent in excess of 40% of the issued and outstanding common shares, in such manner as the Company's Board of Directors specifies or directs. On September 11, 2012, 200,000 Series 1 Class A preferred shares were issued upon the exercise of 200,000 warrants. All Series 1 Class A preferred shares were converted to common shares prior to the cash distribution.

There were no Class B preferred shares outstanding during the nine months ended September 30, 2013 and 2012. No shares of the Company are held by the Company.

**Warrants**

200,000 warrants to purchase an equal number of Series 1 Class A preferred shares of the Company at an exercise price of \$25.00 per share were exercised on September 11, 2012 for cash consideration of \$5,000. The fair value of the warrants at the time of issuance on February 9, 2010 was \$1,900, which was estimated using the Black-Scholes option pricing model assuming a risk-free interest rate of 1.59% and a volatility of 30.0%. This amount was reclassified to share capital upon the exercise of the warrants.

**7 Share-based Compensation**

Under the Company's comprehensive long-term equity incentive plan, as approved by the Board of Directors and ratified by the shareholders, the Company may grant share-based awards for 1,390,293 common shares of the Company.

**Stock Options** - Changes to the number of stock options for the nine months ended September 30, 2013 and 2012 are as follows:

	Nine months ended September 30, 2013 <sup>(1)</sup>		Nine months ended September 30, 2012 <sup>(1)</sup>	
	Number (thousands)	Weighted Average Exercise Price in dollars	Number (thousands)	Weighted Average Exercise Price in dollars
Common share stock options				
Outstanding at January 1	7.46	\$ 153.50	9.50	\$ 165.00
Exercised	-	-	(0.54)	\$ 11.00
Expired and forfeited	(1.46)	\$ 104.00	(1.50)	\$ 280.00
Outstanding at September 30	6.00	\$ 165.25	7.46	\$ 153.50

<sup>(1)</sup> Adjusted to reflect a 50:1 share consolidation completed on October 1, 2013.

Stock options outstanding are exercisable at prices ranging from \$61.50 to \$309.00 and at September 30, 2013 had an average remaining contractual life of 2.0 years.

**The Westaim Corporation**  
**Notes to Consolidated Financial Statements (unaudited)**  
**For the nine months ended September 30, 2013 and 2012**  
(Currency amounts in thousands of Canadian dollars unless otherwise indicated)

**7 Share-based Compensation (continued)**

**Deferred Share Units** - DSUs are granted to non-executive directors of the Company and, prior to the sale of Jevco, also to non-executive directors, officers and employees of Jevco, and are issued at the market value of the Company's shares at the date of grant. Prior to January 1, 2013, directors could elect to receive DSUs in lieu of fees. Thereafter, all fees are payable in cash only. Vested DSUs are paid out in cash when the participant ceases to be a director, officer or employee. All DSUs issued prior to the sale of Jevco vested and were paid out upon the sale of Jevco (note 14).

Changes to the number of DSUs for the nine months ended September 30, 2013 and 2012 are as follows:

DSUs (thousands)	Nine months ended September 30	
	2013 <sup>(1)</sup>	2012 <sup>(1)</sup>
Outstanding at January 1	113.20	110.76
Granted	-	12.24
Exercised and cancelled	-	(123.00)
Outstanding at September 30	113.20	-

<sup>(1)</sup> Adjusted to reflect a 50:1 share consolidation completed on October 1, 2013.

For the three and nine months ended September 30, 2013, compensation expense relating to DSUs was \$85 (2012 - \$nil and \$1,131). At September 30, 2013, a liability of \$226 (December 31, 2012 - \$141) has been accrued with respect to outstanding DSUs.

**Restricted Share Units** – Restricted Share Units ("RSUs") vested over three years, one third on each of the one year, two year and three year anniversary of the grant date, and were payable in cash when vested. The holder could elect to apply all or part of such cash payment to a subscription for common shares of the Company. Upon a change of control of the Company or the sale of substantially all of the assets of the Company, RSUs vested immediately.

For the three and nine months ended September 30, 2012, compensation expense with respect to RSUs was \$1,554 and \$10,050. Upon the acquisition of Goodwood Management Inc. ("GMI") by the Company on September 4, 2012, an expense of \$9,121 was recognized to reflect the value of the RSUs which were extinguished as a result of the subsequent windup of GMI (note 8).

On December 20, 2012, the long-term equity incentive plan was amended to, among other things, restrict the awards which may be granted under the plan to stock options and DSUs and to reduce the number of common shares issuable under the plan to not more than 10% of the aggregate number of common shares outstanding. Accordingly, no additional RSUs may be issued under the plan and no RSUs are currently outstanding.

**8 Related Party Transactions**

*Management services agreement*

Prior to September 4, 2012, the Company had a management services agreement ("MSA") with GMI to manage the day-to-day affairs of the Company and to present strategic investment opportunities for the Board of Directors to consider. GMI was required to provide certain services to the Company including the services of two directors, one of whom was also President and Chief Executive Officer, and a Chief Financial Officer. The MSA provided that GMI was paid an annual service fee designed to compensate GMI for the time and attention of its officers and employees incurred in furtherance of the Company's business as well as for the office space, equipment, supplies and other facilities made available by GMI to the Company. The amount of the services fee was based on a report prepared by an independent compensation consultant. GMI was also entitled to participate in an annual incentive bonus plan for the purpose of recognizing the contribution of GMI to the Company's business.

Prior to the purchase of GMI by the Company on September 4, 2012, GMI was controlled by corporations controlled by two directors of the Company.

For the three and nine months ended September 30, 2012, GMI fee expense, inclusive of harmonized sales tax, was \$431 and \$3,473. Upon the extinguishment of the MSA, an expense of \$4,966 was recognized in the statement of profit or loss and other comprehensive income.

All RSUs previously outstanding were held by GMI (note 7).

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**8 Related Party Transactions (continued)**

*Acquisition of GMI*

On September 4, 2012, the Company purchased all the issued and outstanding shares of GMI for \$4,190 in cash and 730,298 common shares of the Company. The consideration paid reflected the fair value of the assets and liabilities of GMI. As the fair value of the consideration paid was determined to be equal to the fair value of the assets and liabilities of GMI, no goodwill was recorded. Immediately following the acquisition, GMI was wound up into the Company.

Former employees of GMI who are now employees of the Company are considered key management personnel for related party disclosure purposes beginning on September 4, 2012.

*Transactions with key management personnel*

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, including directors of the Company.

Compensation expenses related to key management personnel for the three and nine months ended September 30, 2013 and 2012 are as follows:

	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
Salaries and other short-term employee benefits	\$ 219	\$ 265	918	\$ 383
Share-based compensation	85	-	85	1,131
	\$ 304	\$ 265	\$ 1,003	\$ 1,514

**9 Income Taxes**

Income taxes are recognized for deferred income taxes attributed to estimated differences between the financial statement carrying values of assets and liabilities and their respective income tax bases.

As the realization of any related tax benefits is not probable, no deferred income tax assets have been recognized for the following:

	September 30, 2013	December 31, 2012
Non-capital loss carry-forwards	\$ 47,376	\$ 44,404
Capital loss carry-forwards	6,987	6,640
Deductible temporary differences	4,944	6,064
Corporate minimum tax credits	1,406	1,530
Investment tax credits	9,633	9,633

The unrecognized non-capital losses and investment tax credits will expire at various times to the end of 2033, as follows:

Non-capital losses by year of expiry:		Investment tax credits by year of expiry:	
2026	\$ 7,883	2016	\$ 961
2027	6,151	2017	3,241
2028	9,048	2018	888
2029	103	2019	961
2030	610	2020	823
2031	20,609	2021	643
2033	2,972	Beyond 2021	2,116
	\$ 47,376		\$ 9,633

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**9 Income Taxes (continued)**

The following is a reconciliation of income taxes calculated at the statutory income tax rate to the income tax expense included in the statements of profit or loss and other comprehensive income:

	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
Loss from continuing operations before income tax	\$ (540)	\$ (16,440)	\$ (1,854)	\$ (32,360)
Gain on sale of discontinued operations before income tax	-	109,626	-	108,213
Profit or loss on continuing operations and gain on sale of discontinued operations, before income tax	(540)	93,186	(1,854)	75,853
Statutory income tax rate	26.5%	26.5%	26.5%	26.5%
Income taxes at statutory income tax rate	(143)	24,694	(491)	20,101
Variations due to:				
Non-deductible and non-taxable items	-	(10,588)	-	(9,709)
Unrecognized temporary differences	(83)	1,922	(297)	1,840
Unrecognized tax losses	226	(16,028)	788	(12,232)
Adjustment to prior year provision	-	-	(124)	-
Corporate minimum tax	-	1,530	-	1,530
Income tax expense (recovery) on continuing operations and gain on sale of discontinued operations	\$ -	\$ 1,530	\$ (124)	\$ 1,530

Income tax expense is recognized in the statements of profit or loss and other comprehensive income as follows:

	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
Income tax expense (recovery) on:				
Continuing operations	\$ -	\$ -	\$ (124)	\$ -
Gain on sale of discontinued operations	-	1,530	-	1,530
Income tax expense (recovery) on continuing operations and gain on sale of discontinued operations	-	1,530	(124)	1,530
Income tax expense on profit of discontinued operations	-	997	-	9,170
Total income tax on continuing and discontinued operations	\$ -	\$ 2,527	\$ (124)	\$ 10,700

**10 Earnings per Share**

The Company uses the treasury stock method to calculate diluted earnings per share. Following the treasury stock method, the numerator for the Company's diluted earnings per share calculation remains unchanged from the basic earnings per share calculation, as the assumed exercise of the Company's restricted share units, warrants and stock options does not result in an adjustment to profit or loss.

The reconciliation from the basic number of shares to the diluted number of shares used in the denominators to calculate basic and diluted earnings per share, as presented in the statements of profit or loss and other comprehensive income, is as follows:

	Three months ended September 30		Nine months ended September 30	
	2013 <sup>(1)</sup>	2012 <sup>(1)</sup>	2013 <sup>(1)</sup>	2012 <sup>(1)</sup>
Number of common shares and Series 1 Class A preferred shares (in thousands)				
Number of shares for basic earnings per share	13,903	13,160	13,903	12,976
Effect of dilutive securities:				
- restricted share units	-	379	-	403
- warrants	-	54	-	53
Number of shares for diluted earnings per share	13,903	13,593	13,903	13,432

<sup>(1)</sup> Adjusted to reflect a 50:1 share consolidation completed on October 1, 2013.

The Series 1 Class A preferred shares are considered in substance common shares and are included in the calculation of earnings per share.

Stock options to purchase 6,000 common shares were outstanding at September 30, 2013 (December 31, 2012 - 7,456). These stock options were excluded in the calculation of diluted earnings per share because the exercise price of the stock options was greater than the weighted average market value of the common shares in the three and nine months ended September 30, 2013 and 2012.



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**11 Capital Management**

The Company's capital consists of its shareholders' equity. The Company's objectives when managing capital are to maintain a strong balance sheet and maximize shareholder value. In order to achieve the Company's capital management objectives, it employs a strong and efficient capital base and manages capital in accordance with policies established by the Board of Directors. These policies relate to capital strength, capital mix, dividends and return on capital. The Company has a capital management process in place to measure, deploy and monitor its available capital to assess its adequacy on a continuous basis. Management develops the capital strategy and oversees the capital management processes. Capital is managed using internal metrics. There are no internal or external restrictions on the Company's capital.

At the special meeting of the Company's shareholders on June 28, 2012, the shareholders voted in favour of a special resolution to reduce the stated capital of the common shares of the Company through a return of capital in the form of a cash distribution. The amount of the cash distribution was determined by the Board of Directors of the Company and the distribution was made on September 28, 2012 at \$37.50 per common share for a total of \$521,407.

**12 Risk Management**

The Company's statement of financial position at September 30, 2013 consists of short-term financial assets and financial liabilities with maturities of less than one year, other than the site restoration provision discussed in note 4 and the commitments in note 5(b). The most significant identified risks which arise from holding financial instruments include credit risk, market risk and liquidity risk. As at September 30, 2013, the Company's exposure to credit and market risk is nominal as the Company's financial assets consisted of cash and cash equivalents held with a Schedule 1 bank in Canada. Additionally, at September 30, 2013 the Company's financial assets were significantly higher than its financial liabilities resulting in minimal liquidity risk. Overall, the Company has a comprehensive risk management framework to monitor, evaluate and manage the risks assumed in conducting its business.

**13 Operating Segment**

Prior to the sale of Jevco, the Company had one reportable segment which comprised the Company's property and casualty insurance business carried on through Jevco. All other revenues, expenses, assets and liabilities are related to corporate activities. The reportable segment is presented in accordance with the Company's accounting policy for discontinued operations as described in note 2(k). Segment profit or loss and other comprehensive income represents segment profit or loss and other comprehensive income without allocation of certain administration costs.

	Three months ended September 30, 2013			Three months ended September 30, 2012		
	Insurance segment	All other	Total	Insurance segment	All other	Total
Revenue of continuing operations	\$ -	\$ 105	\$ 105	\$ -	\$ 474	\$ 474
Profit or loss and other comprehensive income:						
From continuing operations	-	(540)	(540)	-	(16,440)	(16,440)
From discontinued operations	-	-	-	3,704	108,096	111,800
Total	-	(540)	(540)	3,704	91,656	95,360

	Nine months ended September 30, 2013			Nine months ended September 30, 2012		
	Insurance segment	All other	Total	Insurance segment	All other	Total
Revenue of continuing operations	\$ -	\$ 319	\$ 319	\$ -	\$ 633	\$ 633
Profit or loss and other comprehensive income:						
From continuing operations	-	(1,730)	(1,730)	-	(32,360)	(32,360)
From discontinued operations	-	-	-	29,667	106,683	136,350
Total	-	(1,730)	(1,730)	29,667	74,323	103,990

**14 Sale of Subsidiary**

On May 2, 2012, the Company announced it had entered into an agreement with an unrelated party to sell all the issued and outstanding shares in the capital of Jevco to the purchaser for \$530,000 in cash. On June 28, 2012, at the special meeting of the Company's shareholders, a special resolution in favour of the agreement was approved by shareholder vote. The sale of Jevco was concluded on September 4, 2012 after all regulatory approvals were received. In the third quarter of 2012, a gain on sale of Jevco of \$106,683 was realized after deducting the carrying value of Jevco of \$414,289, costs related to the sale of \$7,498, and income tax of \$1,530.

The insurance segment presented in note 13 *Operating Segment* consists solely of Jevco.

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