



# **DYNAMOTIVE ENERGY SYSTEMS CORPORATION**

## **Unaudited Interim Consolidated Financial Statements**

For the three months ended March 31, 2008

(In U.S. Dollars)

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### **NOTICE TO READER**

The financial statements of Dynamotive Energy Systems Corporation and the accompanying interim consolidated balance sheet as at March 31, 2008 and the interim consolidated statements of loss, changes in shareholders' equity and cash flows for the three months period then ended are the responsibility of the Company's management. These consolidated financial statements have not been reviewed on behalf of the shareholders by the independent external auditors of the Company.

The interim consolidated financial statements have been prepared by management and include the selection of appropriate accounting principles, judgments and estimates necessary to prepare these financial statements in accordance with Canadian generally accepted accounting principles.

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# Dynamotive Energy Systems Corporation

## Unaudited Consolidated Balance Sheets

(expressed in U.S. dollars)

	March 31, 2008 (Unaudited) \$	December 31, 2007 (Audited) \$
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	16,647	1,796,822
Receivables	142,444	151,233
Government grants receivable	796,704	828,795
Prepaid expenses and deposits	345,389	503,268
<b>Total current assets</b>	<b>1,301,184</b>	<b>3,280,118</b>
Property, plant and equipment	53,698,063	53,754,874
Patents	251,882	269,568
Long-term loan receivable [Note 3]	520,000	346,666
Long-term investments [Note 4]	605,321	286,410
Long-term deferred assets [Note 5]	959,366	998,008
<b>TOTAL ASSETS</b>	<b>57,335,816</b>	<b>58,935,644</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities [Note 6]	6,452,361	6,268,664
Short-term debt	162,247	—
Current portion of long-term debt [Note 5]	35,900	35,900
<b>Total current liabilities</b>	<b>6,650,508</b>	<b>6,304,564</b>
Long-term debt [Note 5]	290,192	299,167
Asset retirement obligation liability [Note 7]	246,331	246,939
Deferred revenue [Note 8]	750,000	920,000
<b>Total liabilities</b>	<b>7,937,031</b>	<b>7,770,670</b>
<b>Shareholders' equity</b>		
Share capital [Note 9b]	110,332,662	109,133,395
Shares to be issued [Note 9c]	1,238,540	1,265,070
Contributed surplus	23,127,730	22,663,941
Accumulated other comprehensive income	3,452,855	5,422,751
Deficit	(88,753,002)	(87,320,183)
<b>Total shareholders' equity</b>	<b>49,398,785</b>	<b>51,164,974</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>57,335,816</b>	<b>58,935,644</b>

The accompanying notes are an integral part of these financial statements

Approved by:

"R. Andrew Kingston" President & CEO      "Richard C. H. Lin" Chairman

# Dynamotive Energy Systems Corporation

## Unaudited Consolidated Statements Of Loss and Comprehensive Loss

(expressed in U.S. dollars)

	Three Months Ended March 31,	
	2008	2007
	\$	\$
<b>REVENUES</b>		
License revenue <i>[Note 8]</i>	500,000	—
	<b>500,000</b>	<b>—</b>
<b>EXPENSES</b>		
Marketing and business development	319,252	346,228
Research and development	230,922	893,721
General and administrative expenses	2,452,647	2,093,740
Depreciation and amortization	37,165	30,206
Interest expense	17,738	53
Exchange (gain) loss	14,435	(16,642)
	<b>3,072,159</b>	<b>3,347,306</b>
<b>Loss from operations</b>	<b>(2,572,159)</b>	<b>(3,347,306)</b>
Interest and other income	1,357	79,234
Gain on reduction in bonus and vacation accrual <i>[Note 13b]</i>	1,137,983	—
<b>Loss before non-controlling interest</b>	<b>(1,432,819)</b>	<b>(3,268,072)</b>
<b>Non-controlling interest</b>	<b>—</b>	<b>28,975</b>
<b>Net loss for the period</b>	<b>(1,432,819)</b>	<b>(3,239,097)</b>
<b>Other comprehensive income/(loss)</b>		
Foreign currency translation adjustment	(1,969,896)	330,878
<b>Comprehensive loss</b>	<b>(3,402,715)</b>	<b>(2,908,219)</b>
<b>Weighted average number of common shares outstanding</b>		
	<b>208,008,571</b>	<b>177,602,251</b>
<b>Basic and diluted loss per common share</b>		
	<b>0.01</b>	<b>0.02</b>

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

*See accompanying notes*

# Dynamotive Energy Systems Corporation

## Unaudited Consolidated Statement Of Changes In Shareholders' Equity

(expressed in U.S. dollars)

	Share Capital	Shares To be Issued	Contributed Surplus	Cumulative Translation Adjustment	Accumulated Other Comprehensive Income	Deficit	Total
	\$	\$	\$	\$	\$	\$	\$
<b>Balance, January 1, 2007</b>	85,127,873	1,741,339	16,800,527	—	(789,471)	(73,099,779)	29,780,489
Issued for cash and proceeds received in prior year							
Pursuant to private placement, net of issuance costs	11,557,657	—	—	—	—	—	11,557,657
Pursuant to exercise of stock options	672,483	—	—	—	—	—	672,483
Pursuant to exercise of warrants	7,111,610	—	—	—	—	—	7,111,610
Issued for settlement of fees payable	1,565,152	—	—	—	—	—	1,565,152
Issued for services	1,058,620	—	—	—	—	—	1,058,620
Issued on purchase of interest in subsidiary	2,040,000	—	—	—	—	—	2,040,000
Net change in shares to be issued	—	(476,269)	—	—	—	—	(476,269)
Warrant compensation for private placement	—	—	2,744,520	—	—	—	2,744,520
Stock-based compensation expense	—	—	3,118,894	—	—	—	3,118,894
Net loss	—	—	—	—	—	(14,220,404)	(14,220,404)
Foreign currency translation adjustment	—	—	—	—	6,212,222	—	6,212,222
<b>Balance, January 1, 2008</b>	109,133,395	1,265,070	22,663,941	—	5,422,751	(87,320,183)	51,164,974
Issued for cash and proceeds received in prior year							
Pursuant to private placement, net of issuance costs	1,004,750	—	—	—	—	—	1,004,750
Pursuant to exercise of stock options	12,000	—	—	—	—	—	12,000
Pursuant to exercise of warrants	52,500	—	—	—	—	—	52,500
Issued for services	158,142	—	—	—	—	—	158,142
Shares to be released	(28,125)	—	—	—	—	—	(28,125)
Net change in shares to be issued	—	(26,530)	—	—	—	—	(26,530)
Warrant compensation for private placement	—	—	(36,594)	—	—	—	(36,594)
Stock-based compensation expense	—	—	500,383	—	—	—	500,383
Net loss	—	—	—	—	—	(1,432,819)	(1,432,819)
Foreign currency translation adjustment	—	—	—	—	(1,969,896)	—	(1,969,896)
<b>Balance, March 31, 2008</b>	110,332,662	1,238,540	23,127,730	—	3,452,855	(88,753,002)	49,398,785

# Dynamotive Energy Systems Corporation

## Unaudited Consolidated Statements Of Cashflow

(expressed in U.S. dollars)

	Three Months Ended March 31,	
	2008	2007
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Loss for the period	(1,432,819)	(3,239,097)
Add items not involving cash:		
Amortization and depreciation	37,165	30,206
Recognition of deferred revenue	(500,000)	—
Accretion on ARO liability	9,162	—
Stock based compensation	672,013	835,254
Non-controlling interest	—	(28,975)
Translation (Gain) loss	14,435	(16,642)
Net change in non-cash working capital balances related to operations <i>[note 11]</i>	517,313	105,602
<b>Cash used in operating activities</b>	<b>(682,731)</b>	<b>(2,313,652)</b>
<b>FINANCING ACTIVITIES</b>		
Repayment of loan	(8,975)	—
Increase in short-term debt	162,247	—
Share capital issued	939,250	5,901,254
Shares to be issued	—	94,857
<b>Cash provided by financing activities</b>	<b>1,092,522</b>	<b>5,996,111</b>
<b>INVESTING ACTIVITIES</b>		
Increase in long term loan receivable	(173,334)	—
Purchase of capital assets (net of government grants)	(2,076,123)	(8,660,588)
<b>Cash used in investing activities</b>	<b>(2,249,457)</b>	<b>(8,660,588)</b>
<b>Decrease in cash and cash equivalents from continuing operations</b>	<b>(1,839,666)</b>	<b>(4,978,129)</b>
Effects of foreign exchange rate changes on cash	59,491	18,689
<b>Decrease in cash and cash equivalents during the period</b>	<b>(1,780,175)</b>	<b>(4,959,440)</b>
Cash and cash equivalents, beginning of period	1,796,822	9,346,534
<b>Cash and cash equivalents, end of period</b>	<b>16,647</b>	<b>4,387,094</b>

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

## Notes to Consolidated Financial Statements (Unaudited)

Three Months Ended March 31, 2008 and 2007

(in U.S. dollars)

### 1. DESCRIPTION OF BUSINESS

In this Report, unless the context otherwise requires, the terms the "Company" and "Dynamotive" refer to Dynamotive Energy Systems Corporation and its subsidiaries. The Company is listed on the over-the-counter bulletin board (OTCBB) under the symbol: DYMTF.OB. The executive office of the Company is Suite 230 – 1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia, Canada V6P 6G2 (Telephone: 1-604-267-6000).

Dynamotive was incorporated on April 11, 1991 under the laws of the Province of British Columbia. The Company changed its name from Dynamotive Technologies Corporation on June 26, 2001. Dynamotive is focused on the development of innovative energy solutions on its patented fast pyrolysis system. The Company's focus is to commercialize its patented BioOil production technology and establish this technology for production of BioOil clean fuels.

Dynamotive Energy Systems Corporation (the "Company" and or "Dynamotive") is commercializing a biomass-to-liquid fuel conversion using a process known as "Fast Pyrolysis" which uses biomass or biomass waste feedstocks to produce BioOil as a fuel and char. BioOil is a clean, renewable fuel which can replace natural gas, diesel and other fossil fuels in certain applications to produce power, mechanical energy and heat in industrial boilers, fuel gas turbines and fuel reciprocating engines. The Company aims to unleash significant amounts of energy production, in the form of BioOil fuels, based upon utilization of abundant biomass waste streams from agricultural and forest operations and other post-industrial biomass residues. The process of biomass to energy conversion is sustainable, renewable and greenhouse gas neutral, and competes with other renewable energy sources such as wind, hydro and solar. One significant advantage of biomass energy over other renewable forms of energy, is that biomass is capable of delivering energy on a 24/7 basis, whereas wind, hydro and solar energy sources are all subject to natural weather fluctuations.

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries Dynamotive Canada Inc., federally incorporated under the laws of Canada; Dynamotive Corporation, incorporated under the laws of Rhode Island, U.S.A.; Dynamotive USA Inc. incorporated under the laws of Delaware, U.S.A.; Dynamotive Latinoamericana S.A., incorporated under the laws of Buenos Aires, Argentina; First Resources Corporation, incorporated under the laws of British Columbia, Canada; Dynamotive Biomass Resource Corporation, incorporated under the laws of British Columbia, Canada. In addition, the Company maintains an 80% ownership interest in Dynamotive Europe Limited, formally known as Dynamotive Technologies (UK) Ltd, incorporated in the United Kingdom and owns a 99.98% interest in the West Lorne BioOil Co-Generation LP, formed under the laws of Ontario, Canada. Dynamotive Canada Inc. acts as the General Partner of the Limited Partnership, which operates the West Lorne BioOil and electricity generation plant.

These financial statements have been prepared on the going concern basis, which presumes the Company will be able to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future.

## Notes to Consolidated Financial Statements (Unaudited)

Three Months Ended March 31, 2008 and 2007

(in U.S. dollars)

### 2. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited balance sheet at March 31, 2008 and the unaudited interim statements of loss and deficit and cash flows for the three-month periods ended March 31, 2008 and 2007, in the opinion of management, have been prepared on the same basis as the audited consolidated financial statements of the Company for the year ended December 31, 2007. These interim financial statements include all adjustments necessary for the fair statement of results of the interim periods. The data disclosed in the notes to the interim consolidated financial statements for this period are also unaudited. Results for the three months ended March 31, 2008 are not necessarily indicative of the results to be expected for the full year. These interim consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2007, and the summary of significant accounting policies included therein.

The accounts of the Company and its consolidated subsidiaries are measured using the Canadian dollar as the functional currency. Monetary items denominated in foreign currencies are translated into Canadian dollars using exchange rates in effect at the balance sheet date and non-monetary items are translated using historical exchange rates. Exchange gains or losses arising on the translation or settlement of foreign currency denominated monetary items are included in the determination of net income.

The Company uses the U.S. dollar as the reporting currency for its consolidated financial statements. Assets and liabilities are translated into U.S. dollars using current exchange rates in effect at the balance sheet date and revenue and expense accounts are translated using the average exchange rate during the three months. Gains and losses resulting from this process are recorded in shareholders' deficit as an adjustment to the cumulative translation adjustment account.

### 3. LOAN RECEIVABLE

On November 14, 2007, the Company and Biomass Worldwide Limited ("Biomass") and Anthony Pius Noll ("Guarantor") entered into a negotiation commitment and loan agreement where the Company will loan Biomass up to \$720,000 in five tranches (to be completed by April 12, 2008) on the understanding that if the parties are able to reach a definitive agreement in respect of an equity investment by the Company in Biomass, all the loan will be converted into not less than 30% of the equity of Biomass. If the Company concludes in its sole discretion that it will be unable to agree upon an equity conversion agreement with Biomass, 72% of the loan shall be repaid together with interest at 6% p.a. compounded semi-annually. The other 28% of the loan (plus interest at 6% p.a. compounded semi-annually) will, at the election of Biomass, be either (i) converted into equity of Biomass at "fair value" or (ii) converted into a 3% royalty on gross sales of any products or services of Biomass or the Guarantor which use or incorporate Biomass' or the Guarantor's intellectual property until the amount is repaid with interest. The due date for repayment of the loan shall be on demand any time on or after March 7, 2008. No loan repayments have been made to the period ended March 31, 2008. The loan is secured by a pledge of all of the assets of Biomass and by an unconditional guarantee of the Guarantor. As of March 31, 2008, the Company has loaned \$520,000 to Biomass.

## Notes to Consolidated Financial Statements (Unaudited)

Three Months Ended March 31, 2008 and 2007

(in U.S. dollars)

### 4. LONG TERM INVESTMENTS

- a. In April, 2006, the Company entered into a convertible loan agreement whereby it loaned \$250,000 to Rika Ukraina Ltd to fund its wholly owned subsidiary's (Rika Biofuels Ltd.) biomass development activities. In December, 2006, an additional \$80,000 was loaned under the same terms. The loan is unsecured and bears interest at 6% per annum. The principal and interest was originally due no later than July 15, 2006 however, the repayment was extended to May, 2007. Under the terms of the agreement, the Company has the option to convert the principal and any accrued interest into a 50% ownership interest in Rika Biofuels Ltd. at any time the loan is outstanding and it is the Company's intention to convert the loan. For the period ended March 31, 2008, the entire long-term advance of \$330,000 (2006 - \$330,000) remains outstanding.
- b. As at March 31, 2008, Dynamotive holds 3,874,139 (2007 - 2,658,994) common shares of Renewable Energy Corp ("ROC") incorporated in Victoria, Australia, a subsidiary of Enecon Pyrolysis Pty Limited. It represents an 8.0% (2007 - 6.2%) interest in the entity. For the period ended March 31, 2007 the entire \$100,000 long-term investment in ROC (which was previously offset against deferred revenue) has been reclassified as a long-term investment.

### 5. LONG TERM DEFERRED ASSET

In April 2007, the Company entered into amended agreements with Erie Flooring and Wood Products ("Erie") regarding the supply by Erie of wood chips to the West Lorne BioOil plant over the next 12 years at no charge and the provision of char from the BioOil plant to Erie at no charge. In relation to these agreements, Dynamotive has paid for the purchase and installation of a char based boiler system and related char delivery infrastructure at Erie. The asset will be amortized evenly over the life of the wood supply contract.

To facilitate the purchase of the boiler system, the Company borrowed \$359,000 from Erie. This amount is being repaid to Erie in equal monthly payments plus 8% interest over a 10-year period. The first payment was made in May 2007. As at March 31, 2008, the Company owed Erie \$326,092.

Long-term debt repayment schedule:

	2007	2006
	\$	\$
2008 - 2009 (Current)	35,900	—
2009 - 2010	35,900	—
2010 - 2011	35,900	—
2011 - 2012	35,900	—
2012 - 2013	35,900	—
Thereafter	146,592	—
	<b>326,092</b>	—

## Notes to Consolidated Financial Statements (Unaudited)

Three Months Ended March 31, 2008 and 2007

(in U.S. dollars)

### 6. GUARANTEE PROVIDED BY DYNAMOTIVE

In 2001, Border Biofuels Limited (“BBL”) a company 75% owned by Dynamotive, entered into a credit facility with Bank of Scotland for a maximum of \$397,060 (£200,000). The credit facility is denominated in British Pounds Sterling. Interest is charged at the bank’s base rate plus 3%. The credit facility is guaranteed by the Company. During 2002 BBL became insolvent. If the Bank is unable to realize on its security with BBL, it has the right to seek settlement from the Company for payment. Although there is currently no indication that the Bank will pursue the Company, the Company has recognized the full amount of the guarantee as a current liability and included the impact as part of the 2002 (December) loss from discontinued operations. As BBL remains in liquidation at March 31, 2008, there has been no change in status regarding the settlement of the credit facility.

### 7. ASSET RETIREMENT OBLIGATION

The Company expects that at the end of the life of its production plants, there will be residual obligations to remediate the sites and remove equipment. Although the timing and amount of the future obligations are uncertain, the Company has estimated the present value of these future obligations arising from its activities to March 31, 2008 to be \$246,331 (2007 - \$nil), being \$123,166 for West Lorne and \$123,165 for Guelph. The present value of the future obligations assumes a discount rate of 15%, an inflation rate of 2% and the commencement of reclamation activities in 15 years. The Company has commenced accretion of these obligations since January 1, 2008.

### 8. DEFERRED REVENUE

In 2006, the Company received a total of \$950,000 in non-refundable payments from three unrelated companies as licensing fees. \$500,000 from Rika Ltd. as payment for a Master License to develop project opportunities in the Ukraine and the Baltic republics using Dynamotive’s patented pyrolysis technology; \$150,000 from Classic Power Inc. as an initial payment on a Plant License for Guelph, Ontario, Canada; \$200,000 from Renewable Oil Corporation Pty Ltd. (“ROC”) for a Master License to develop project opportunities in Australia and \$100,000 from ROC as a deposit on an initial Plant License.

In the first quarter of 2008, the Company recognized Rika Ltd. master license fee of \$500,000 at the end of the agreement term, and this amount has been removed from the deferred revenue balance.

In 2007, deferred revenue was net of \$330,000 advanced to entities controlled by Rika Ltd. With recognition of the Rika payments as revenue in the first quarter of 2008, these amounts advanced to Rika are now classified as a long-term investment (note 4).

In 2007, the Company received common shares of ROC with a fair value of \$300,000 as compensation for engineering services performed. The Company subsequently transferred common shares of ROC with a fair value of \$150,000 to a sub-contractor as partial settlement for services provided to ROC by the sub-contractor on behalf of the Company. These amounts are included in deferred revenue.

## Notes to Consolidated Financial Statements (Unaudited)

Three Months Ended March 31, 2008 and 2007

(in U.S. dollars)

### 9. SHARE CAPITAL

#### [a] Authorized share capital

The Company's authorized capital consists of an unlimited number of common shares with no par value and unlimited Class A preferred shares with no par value each having attached special rights and restrictions. No preferred shares were issued and outstanding at March 31, 2008.

#### [b] Issued and outstanding share capital

	March 31, 2008	December 31, 2007
	\$	\$
<b>Issued and outstanding</b>		
Common Shares 209,524,505 [December 31, 2007 – 207,749,673]	<b>110,332,662</b>	109,133,395
	\$	Number of Shares
<b>Common Share Issuance Summary for the Period</b>		
<b>Share Capital, December 31, 2007</b>	<b>109,133,395</b>	207,749,673
Private placement issued for cash, net of finder's fee	<b>1,004,750</b>	1,486,842
Share issued from exercised of option for cash	<b>12,000</b>	25,000
Share issued from exercised of warrants for cash	<b>52,500</b>	75,000
Share issued for services	<b>130,017</b>	187,990
<b>Share Capital, March 31, 2008</b>		
Common shares without par value	<b>110,332,662</b>	209,524,505

#### [c] Shares to be issued

At March 31, 2008, the Company has 1,441,508 common shares to be issued which are comprised of:

(i) 603,304 common shares which are to be issued to senior management, directors and non-employees for services rendered under compensation arrangements with a fair value of \$538,010; and

(ii) 838,204 common shares which are to be issued to directors and officers as bonuses for the previous years with a fair value of \$700,530.

## Notes to Consolidated Financial Statements (Unaudited)

Three Months Ended March 31, 2008 and 2007

(in U.S. dollars)

## 9. SHARE CAPITAL (CONT'D)

## [d] Stock options

At March 31, 2008, the following stock options to Directors, employees and others were outstanding:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at March 31, 2008	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Outstanding at March 31, 2008	Weighted-Average Exercise Price
\$0.20 - \$0.23	4,735,617	5.52 years	\$0.21	4,735,617	\$0.21
\$0.33 - \$0.48	8,078,500	5.60 years	\$0.46	8,078,500	\$0.46
\$0.50 - \$0.58	2,273,750	2.19 years	\$0.53	2,273,750	\$0.53
\$1.00 - \$1.31	3,404,000	2.35 years	\$1.20	3,084,000	\$1.21
\$1.50 - \$1.60	802,500	1.45 years	\$1.59	802,500	\$1.59
	19,294,367			18,974,367	

From time to time, the Company has provided incentives in the form of share purchase options to the Company's directors, officers, employees and others. The Company has reserved 31,428,676 (15%) of common shares for issuance upon the exercise of stock options of which at March 31, 2008, 12,134,309 are available to be granted. The exercise price and the vesting terms of the options are determined by the Compensation Committee. The exercise price will generally be at least equal to the market price of the common shares at the date of the grant. Stock options granted are also subject to certain vesting provisions as determined by the Compensation Committee.

Stock option transactions for the respective periods and the number of stock options outstanding are summarized as follows:

	No. Common Shares Issuable	Weighted Average Exercise Price
<b>Balance, December 31, 2007</b>	19,119,367	0.59
Options granted	400,000	0.48
Options forfeited or expired	(200,000)	0.50
Options exercised	(25,000)	0.48
<b>Balance, March 31, 2008</b>	19,294,367	0.58

**Notes to Consolidated Financial Statements (Unaudited)**

Three Months Ended March 31, 2008 and 2007

(in U.S. dollars)

**9. SHARE CAPITAL (CONT'D)**

**[e] Common share purchase warrants**

At March 31, 2008 the common share purchase warrants outstanding were as follows:

	No. of Common Shares Issuable	Exercise Price	Expiration Date
Series Q Warrants	374,195	\$0.20	August 31, 2008
Series R Warrants	500,000	\$0.20	August 31, 2008
Series S Warrants	6,872,690	\$0.50 to \$2.06	April 06, 2008 – September 27, 2010
Series U Warrants	946,348	\$0.46 to \$0.53	September 22, 2008 – June 21, 2009
Series V Warrants	4,998,372	\$1.06	October 3, 2012 – January 18, 2013
<b>Total</b>	<b>13,691,605</b>		

Summary of warrants exercised and issued during the three month period ending March 31, 2008:

	Number of Common Shares Issuable					Exercise Price
	at December 31, 2007	via Warrants Issued during the 3-month Period ending March 31, 2008	via Warrants exercised during the 3- month Period ending March 31, 2008	via Warrants cancelled during the 3- month Period ending March 31, 2008	at March 31, 2008	
Series Q Warrants	374,195	—	—	—	374,195	\$0.20
Series R Warrants	500,000	—	—	—	500,000	\$0.20
Series S Warrants	9,137,040	35,940	(75,000)	(2,225,290)	6,872,690	\$0.50 to \$2.06
Series U Warrants	946,348	—	—	—	946,348	\$0.46 to \$0.53
Series V Warrants	4,941,942	56,430	—	—	4,998,372	\$1.06
	<b>15,899,525</b>	<b>92,370</b>	<b>(75,000)</b>	<b>(2,225,290)</b>	<b>13,691,605</b>	

**[f] Stock appreciation rights**

In 1998, the Company established a stock appreciation rights plan whereby the participants will be entitled to require the Company to redeem the stock appreciation rights (“SA Rights”) for an amount equal to the excess of the market value of the underlying common shares over the initial value of the SA Right at the date of grant. The SA Rights have vested as the Company achieved stock value targets as defined in the agreement.

The Company also has the right to redeem the SA Rights at its option under certain circumstances. The Company has the sole exclusive election to redeem the SA Rights in cash, shares or in a combination of cash and shares. The number of SA Rights that can be granted under the plan until December 31, 2008 cannot exceed 2,500,000.

There were 300,000 SA Rights with an initial value of \$0.40 outstanding at December 31, 2007 and March 31, 2008. These SA Rights will expire on December 31, 2008.

## Notes to Consolidated Financial Statements (Unaudited)

Three Months Ended March 31, 2008 and 2007

(in U.S. dollars)

### 10. RELATED PARTY TRANSACTIONS

The transactions with related parties are in the normal course of operations and are recorded at amounts established and agreed between the related parties. The Company had the following transactions with related parties during the quarter:

Consulting fees and salaries of \$303,800 for the quarter (2007 - \$306,438) have been accrued and paid to Directors (or companies controlled by Directors) of the Company. Included in the amount above, is \$37,375 (2007 - \$3,903) paid by stock based compensation.

The amounts due from/to related parties, which are non-interest bearing, unsecured and due on demand, are comprised of the following:

	2008	2007
	\$	\$
Receivable		
Due from directors and officers	<b>7,909</b>	23,436
Payable		
Due to directors and officers	<b>1,026,416</b>	1,387,338

### 11. SUPPLEMENTARY CASH FLOW INFORMATION

Components of changes in non-cash balances related to operations are:

	Three Months Ended	
	March 31,	
	2008	2007
	\$	\$
<b>Net change in non-cash working capital</b>		
Account receivable	<b>3,466</b>	<b>(349,801)</b>
Prepaid expenses and deposits	<b>146,003</b>	<b>222,812</b>
Accounts payable and accrued liabilities	<b>367,844</b>	<b>232,591</b>
	<b>517,313</b>	<b>105,602</b>

## Notes to Consolidated Financial Statements (Unaudited)

Three Months Ended March 31, 2008 and 2007

(in U.S. dollars)

### 12. SEGMENTED FINANCIAL INFORMATION

In 2008 and 2007, the Company has only one reportable segment, BioOil Power Generation. The BioOil Power Generation segment relates to the biomass-to-energy technology. Substantially all of the Company's operations and assets are in Canada and are solely focused on the development and commercialization of its Fast Pyrolysis technology. BioOil Power Generation is a biomass-to-energy technology that converts low value forest waste and agricultural by-products into BioOil for use in power generation or other industrial energy purposes.

All of the loss for the three month periods ended March 31, 2008 (\$1,432,819) and March 31, 2007 (\$3,239,097) is attributable to the BioOil segment.

### 13. SUBSEQUENT EVENTS

- a. A small fire in an isolated area of the West Lorne Plant occurred on April 10th 2008. There were no injuries and there was no need to evacuate the plant. No significant damage to the plant is reported, and product storage areas were not affected. Repairs are expected to take approximately two months. While the total cost of the repairs cannot be precisely estimated at this time, it is expected that the majority of any costs will be covered by insurance.
- b. On May 29, 2008 the Company's Compensation Committee agreed with the motion of certain Company executives to reduce the bonus and vacation accrual by \$1,137,983. These amounts were previously accrued as at December 31, 2007 and included in results to that time. This adjustment has been included in the March 31, 2008 financial results.

**DynaMotive Energy Systems Corp.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007

## **1.1 Date**

This "Management's Discussion And Analysis" should be read in conjunction with the unaudited interim Consolidated Financial Statements and Notes of the Company included in this Quarterly Report, and with the audited Consolidated Financial Statements and Notes, included in the Company's Annual Report for the year ended December 31, 2007.

The following sets out management's discussion and analysis of our financial position and results of operations for the three months ended March 31, 2008 and 2007.

All financial information is reported in U.S. dollars unless otherwise noted.

## **1.2 Overview**

Dynamotive Energy Systems Corporation (the "Company" and or "Dynamotive") is commercializing a biomass-to-liquid fuel conversion using a process known as "Fast Pyrolysis" which uses biomass or biomass waste feedstocks to produce BioOil as a fuel and char. BioOil is a clean, renewable fuel which can replace natural gas, diesel and other fossil fuels in certain applications to produce power, mechanical energy and heat in industrial boilers, fuel gas turbines and fuel reciprocating engines. The Company aims to unleash significant amounts of energy production, in the form of BioOil fuels, based upon utilization of abundant biomass waste streams from agricultural and forest operations and other post-industrial biomass residues. The process of biomass to energy conversion is sustainable, renewable and greenhouse gas neutral, and competes with other renewable energy sources such as wind, hydro and solar. One significant advantage of biomass energy over other renewable forms of energy, is that biomass is capable of delivering energy on a 24/7 basis, whereas wind, hydro and solar energy sources are all subject to natural fluctuations often entailing downtime.

Dynamotive is attempting to establish its patented technology as the industry standard for the production of liquid biomass based fuels (other than ethanol and biodiesel), in competition with other pyrolysis technologies, and other biomass to energy applications. The Company's fast pyrolysis process converts raw biomass or biomass wastes into three fuel types: Liquid (BioOil), Solid (char) and Gas (non-condensable gases). The non-condensable gases are used to fuel the pyrolysis process. The entire system is a closed loop with low emissions and virtually no waste by-products. The principal by-product, char, has commercial applications.

The Company and its partners are also engaged in research and development on a range of derivative products that, if successful, could further enhance the market and value for BioOil as an alternative fuel and product source.

The Company was incorporated on April 11, 1991 in the Province of British Columbia, Canada, under the name of Dynamotive Canada Corporation. In October 1995, the shareholders approved a change of name to Dynamotive Technologies Corporation and in June 2001, the shareholders approved a change of name to the Company's current name.

As at March 31, 2008, the Company had six wholly-owned subsidiaries Dynamotive Canada Inc., federally incorporated under the laws of Canada in 2000; Dynamotive Corporation, incorporated under the laws of Rhode Island, U.S.A in 1990; Dynamotive USA Inc. incorporated under the laws of Delaware, U.S.A. in 2006; Dynamotive Latinoamericana S.A., incorporated under the laws of Buenos Aires, Argentina in 2006; First Resources Corporation, incorporated under the laws of British Columbia,

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007

Canada in 2006; and Dynamotive Biomass Resource Corporation, incorporated under the laws of British Columbia, Canada in 2006. In addition, the Company maintains an 80% ownership interest in Dynamotive Europe Limited, formally known as Dynamotive Technologies (UK) Ltd, incorporated in the United Kingdom in 1996 and owns a 99.98% interest in the West Lorne BioOil Co-Generation LP, formed under the laws of Ontario, Canada in 2003. Dynamotive Canada Inc. acts as the General Partner of the Limited Partnership, which operates the West Lorne BioOil and electricity generation plant.

In this report, unless the context otherwise requires, the terms the "Company" and "Dynamotive" refer to Dynamotive Energy Systems Corporation and its subsidiaries. The Company is currently listed on the over-the-counter bulletin board (OTCBB) under the symbol: DYMTF.OB.

The principal executive office of the Company is Suite 230 - 1700 West 75<sup>th</sup> Avenue, Vancouver, British Columbia, Canada V6P 6G2 (Telephone: 604-267-6000).

### **1.3 Selected Annual Information**

All financial information is reported in U.S. dollars unless otherwise noted. Our audited consolidated interim financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP).

	As at December 31, 2007	As at December 31, 2006	As at December 31, 2005
(US Dollars)	\$	\$	\$
Results of operations:			
Revenue	—	—	—
Loss from operations	(14,415,849)	(14,319,641)	(11,822,274)
Loss from continuing operations	(14,220,404)	(14,252,382)	(11,997,344)
Net loss	(14,220,404)	(14,252,382)	(11,997,344)
Net loss per share	(0.08)	(0.09)	(0.11)
Net loss from continuing operation per share	(0.08)	(0.09)	(0.11)
Financial position at year-end:			
Total assets	58,935,644	38,193,699	16,962,573
Total liabilities	7,770,670	7,058,287	8,670,165
Non-controlling interest, Cdn GAAP	—	1,354,923	—
Shareholder's equity	51,164,974	29,780,489	8,292,408
Deficit	(87,320,183)	(73,099,779)	(58,847,397)
Common shares issued	207,749,673	171,765,776	123,211,875

## **1.4 Results of Operations**

### Revenue

Revenue for the quarter ending March 31, 2008 was \$500,000 compared to \$nil for the same quarter in 2007. The increased revenue for 2008 were due to the Company recognized Rika Ltd. master license fee of \$500,000 at the end of the agreement term.

Interest and other income decreased to \$1,357 in the first quarter of 2008 compared to \$79,234 in the same quarter in 2007. The decrease in 2008 was due mainly to lower cash balances and therefore decreased in interest income from investments in short-term money market deposits.

### Expenses

During the quarter ended March 31, 2008, the Company recorded a net loss of \$1,432,819, while the net loss for the same quarter in 2007 amounted to \$3,239,097. The decrease in loss was primarily attributable to (i) a decrease in marketing and business development related expenses; (ii) a decrease in research and development expenses; (iii) an increase in license revenue of \$500,000; and by (iv) an increase in gain on reduction in bonus and vacation accrual. The Company recorded a gain on reduction in bonus and vacation accrual of \$1,137,983 during the quarter ended March 31, 2008. On May 29, 2008 the Company's Compensation Committee agreed with the motion of certain Company executives to make this reduction in the accrual. These amounts were previously accrued as at December 31, 2007 and included in results to that time.

The basic and diluted loss per common share for the quarter was \$0.01 per share compared to \$0.02 for the same quarter in 2007. The decrease in basic and diluted loss per share for the current periods was due to a combination of the decrease in the operating loss and the increase in the weighted average number of Common Shares outstanding. The weighted average number of Common Shares for the quarter increased to 208,008,571 shares for the quarter ended March 31, 2008 from 177,602,251 for the quarter ended March 31, 2007.

Marketing and business development expenses for the first quarter of 2008 decreased to \$319,252 from \$346,228 for the same quarter in 2007. These decreases were due to decreases in business development activities and participation in a major environmental conference during the 2007 period.

For first quarters 2008 and 2007, the Company had expended research and development activities on a quarterly basis \$246,397 and \$906,396 respectively. In the first quarter 2008, the Company also offset product sales of \$15,475 (2007 - \$12,675) against research and development expenses, which are considered incidental sales of BioOil until such time as the Company's plant has reached commercial production levels. The level of research and development expenditure has decreased in the first quarter 2008 compared to the same quarter in 2007. The decrease was due to reduced activity in engineering development of the commercial scale plant and other product development activities.

General and administrative salaries and benefits in the first quarter of 2008 increased to \$2,452,647 from \$2,093,740 for the same quarter in 2007. The increase in 2008 was mainly due to an increase in the Company's development activities with its 200 tpd plant in Guelph, Ontario, and the establishment of new offices in the U.S. and Argentina.

**DynaMotive Energy Systems Corp.**  
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Three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007

Amortization and depreciation expenses increased slightly to \$37,165 in the first quarter of 2008 from \$30,206 in the same quarter in 2007.

Interest expenses increased in the quarter to \$17,738 from \$53 in the same quarter in 2007. The interest expenses incurred in the first quarter 2008 were due mainly to the accretion of the asset retirement obligation liability and expenses incurred on the long-term debt.

Currency exchange loss in the quarter amounted to \$14,435 compared to the gain \$16,642 in the same quarter in 2007. These non-cash changes were due to the depreciation of the US dollar. For further explanation on foreign exchange accounting practice, please refers to Note 2 to the unaudited interim financial statements for the quarter.

**1.5 Summary of Quarterly Results (Unaudited)**

The following table provides summary financial data for the last eight quarters:

	Three months ended			
	Mar 31 2008	Dec 31 2007	Sep 30 2007	Jun 30 2007
<b>(US Dollars)</b>	\$	\$	\$	\$
Revenue	500,000	—	—	—
Net loss from continuing operations	(1,432,819)	(4,299,404)	(3,179,667)	(3,502,236)
Net loss per share	(0.01)	(0.02)	(0.02)	(0.02)
Net loss	(1,432,819)	(4,299,404)	(3,179,667)	(3,502,236)
Net loss per share	(0.01)	(0.02)	(0.02)	(0.02)
Weighted average common shares outstanding in the period	208,008,571	205,329,005	189,679,200	185,378,751
	Mar 31 2007	Dec 31 2006	Sep 30 2006	Jun 30 2006
	\$	\$	\$	\$
Revenue	—	—	—	—
Net loss from continuing operations	(3,239,097)	(4,111,675)	(3,086,964)	(3,755,849)
Net loss per share	(0.02)	(0.02)	(0.02)	(0.02)
Net loss	(3,239,097)	(4,111,675)	(3,086,964)	(3,755,849)
Net loss per share	(0.02)	(0.02)	(0.02)	(0.02)
Weighted average common shares outstanding in the period	177,602,251	168,463,261	162,278,171	151,402,079

**DynaMotive Energy Systems Corp.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007

## **1.6 Liquidity**

The Principal sources of liquidity during the quarter ended March 31, 2008 were (i) \$939,250 in net proceeds after deducting related issue costs and expenses from private placement offerings of the Company's Common Shares and the exercise of Common Share options and warrants for cash, and (ii) \$162,247 increase in short term debts.

The Principal sources of liquidity during the quarter ended March 31, 2007 were (i) \$5,901,254 in net proceeds after deducting related issue costs and expenses from private placement offerings of the Company's Common Shares and the exercise of Common Share options and warrants for cash, (ii) \$94,857 in deposits for Common Shares to be issued in 2007 pursuant to the exercise of warrants.

Overall change in cash position during the first quarter of 2008 was a decrease in cash of \$1,780,175 as compared to a decrease of \$4,959,440 during the same quarter in 2007. Overall cash flows decreased during first quarter 2008 due to significantly decreased financing activities, operating activities and investing activities.

The net amount of cash used in operating activities during the first quarter of 2008 decreased to \$682,731 from cash used of \$2,313,652 in the first quarter of 2007. Cash used in operating activities consisted primarily of a net loss for the first quarter 2008 of \$1,432,819 and the recognition of deferred revenue of \$500,000, less non-cash expenses of (i) amortization of \$37,165, (ii) equity compensation expenses of \$672,013, and (iii) a net change in non-cash working capital balances related to operations of \$517,313. The net amount of cash used in operating activities during the first quarter of 2007 increased to \$2,313,652 from cash used of \$1,394,185 in the first quarter of 2006. Cash used in operating activities consisted primarily of a net loss for the first quarter 2007 of \$3,239,097, \$28,975 of non-controlling interest and \$16,642 of translation gain that were offset by (i) non-cash equity compensation expenses, \$835,254, (ii) amortization of non-cash items in the sum of \$30,206, and (iii) a net change in non-cash working capital balances related to operations of \$105,602.

Financing activities during the first quarter 2008 generated a net increase in cash of \$1,092,522, primarily from the Company's private placements of Common Shares. Financing activities during the first quarter 2007 generated a net increase in cash of \$5,996,111, primarily from the Company's private placements of Common Shares.

Investing activities in the first quarter 2008 resulted in use of cash, in the amount of \$2,249,457. This amount was incurred in the acquisition of capital assets (Guelph and West Lorne plants) of \$2,076,123 and an increase of long term loan receivable of \$173,334. Investing activities in the first quarter 2007 resulted in use of cash, in the amount of \$8,660,588. This amount was incurred in the acquisition of capital assets.

## **1.7 Capital Resources**

As at March 31, 2008, the Company had working capital deficiency of \$5,349,324 and incurred a net loss of \$1,432,819 for the quarter-ended March 31, 2008, and has an accumulated deficit of \$88,753,002.

In the quarter ended March 31, 2008, the Company recorded \$500,000 license revenue. Sales revenue going forward is uncertain and the Company is therefore dependent on its financing activities to fund its operations. The proceeds from the recent equity financing, together with Industrial Technologies Office

**DynaMotive Energy Systems Corp.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007

("ITO") (formerly known as Technology Partnerships Canada ("TPC")) funding receivable, will be applied to finance the Company's ongoing research and development and commercial demonstration activities and to support its efforts to obtain the award of customer contracts. Dynamotive will be required to raise sufficient additional funds to finance its commercialization strategy. The raising of additional finance to fund operations is subject to uncertainty. There is no assurance that such financing will be available on commercially reasonable terms, if at all. Dynamotive's operations are subject to all of the risks inherent in the establishment of a new business enterprise and in particular Dynamotive will require significant additional financing in the future to develop and market its technology to its full potential.

In addition to equity offerings during 2007, the Company has been able to draw significantly from government grant and loan facilities, including the Government of Canada's ITO program both for expenditures made in 2005 and technical and project related expenditures in 2006. The Company's agreement with Industrial Technologies Office pertains to maximum funding of US\$8.2 million (C\$8.235 million), of which \$7.3 million (C\$ 7.4 million) has been received as of March 31, 2008 and \$0.8 million is included in government grants receivable.

During the first quarter of 2008, the Company raised subscription funds of \$1.0 million relating to the private placement commenced during the first quarter of 2008 at subscription price \$0.65 per share. 1.48 million shares and 56,430 Common Share Purchase Warrants were issued as a result of this funding.

With the current cash on hand, anticipated cash flow from product sales and the potential to secure equity and debt financing, the Company anticipates that it will have sufficient cash resources and available financing to satisfy its cash requirements for the next 12 months. The Company expects to require additional funding for the commercial expansion of its technologies through the year 2008 and beyond. Given market conditions and other factors, there can be no guarantee that the Company will be successful in securing additional finance. If adequate funds are not available on acceptable terms when needed, the Company may be required to delay, scale-back or eliminate the manufacturing, marketing or sales of one or more of its products or research and development programs. The outcome of these matters cannot be predicted at this time. The Company's future operations are dependent on the market's acceptance of its products in order to ultimately generate future profitable operations, and the Company's ability to secure sufficient financing to fund future operations. There can be no assurance that the Company's products will be able to secure market acceptance. Management plans to raise additional equity financing to enable the company to complete its development plans.

The Company's 2008 financing plan is structured to enable completion, commissioning and ramp-up of the Company's two production plants: The first 200 tonne per day ("tpd") BioOil manufacturing facility (in Guelph, the plant is to be owned 100% by the Company and leased to Evolution Biofuels Inc., a company owned 20% by the Dynamotive); and in West Lorne, where the Company is completing an upgrade and expansion of the plant and related char boiler system. The core of the strategy surrounds market and project based equity financing that minimizes equity dilution while raising sufficient capital for operations and projects. In addition, the Company will seek asset backed debt financing if such facilities are available on reasonable commercial terms.

In connection with the Company's West Lorne project upgrade and construction advances related to the 200 tpd plants, the Company has committed to outstanding construction commitments of approximately \$2.0 million at March 31, 2008.

**DynaMotive Energy Systems Corp.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007

The Company's funding plan for 2008 is structured so that equity placements explained above will maintain Company and project operations. Additionally, the Company contemplates a private placement and project finance strategy which, with other project funding and sales, are expected to fund the 200 tpd project and the West Lorne Upgrade which are expected to be completed during 2008. Any delay in securing project funding for a project will delay the commissioning of that project.

### **1.8 Off-Balance Sheet Arrangements**

None.

### **1.9 Transactions with Related Parties**

The transactions with related parties are in the normal course of operations and are recorded at amounts established and agreed between the related parties. The Company had the following transactions with related parties during the quarter:

Consulting fees and salaries of \$303,800 for the quarter (2007 - \$306,438) have been accrued and paid to Directors (or companies controlled by Directors) of the Company. Included in the amount above, is \$37,375 (2007 - \$3,903) paid by stock based compensation.

As at March 31, 2008, there was \$7,909 (2007 - \$23,436) due from related parties and \$1,026,416 (2007 - \$1,387,338) due to related parties, which amounts are non-interest bearing, unsecured and due on demand.

### **1.10 Fourth Quarter**

Not applicable.

### **1.11 Proposed Transaction**

Not applicable.

### **1.12 Critical Accounting Estimates**

Not applicable. The Company is a venture issuer.

### **1.13 Changes in Accounting Policies including Initial Adoption**

Not applicable.

### **1.14 Financial Instruments and Other Instruments**

None.

## 1.15 Other MD&A Requirements

### 1.15.1 Other MD&A Requirements

Not applicable.

### 1.15.2 Additional Disclosure for Venture Issuers Without Significant Revenue

(a) Capitalized or expensed exploration and development costs;

Not applicable.

(b) expensed research and development costs;

**Research and Development Expenses**

Breakdown by major category:

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
	\$	\$
Material	—	<b>188,311</b>
Salary and Benefits	<b>157,880</b>	<b>11,074</b>
Consulting	<b>36,275</b>	<b>701,846</b>
Miscellaneous Costs	<b>52,242</b>	<b>5,165</b>
	<b>246,397</b>	<b>906,396</b>
Less: Product & services sales	<b>(15,475)</b>	<b>(12,675)</b>
	<b>230,922</b>	<b>893,721</b>

(c) deferred development costs;

Not applicable.

(d) general and administration expenses;

Breakdown by major category:

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
	\$	\$
Office supplies, telephone, and insurance	<b>194,566</b>	<b>134,432</b>
Professional fees	<b>307,206</b>	<b>315,488</b>
Rent	<b>144,397</b>	<b>87,338</b>
General and admin. salaries and benefits	<b>1,806,478</b>	<b>1,556,482</b>
	<b>2,452,647</b>	<b>2,093,740</b>

(e) any material costs, whether capitalized, deferred or expensed, not referred to in (a) through (d);

None.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

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### 1.15.3 Disclosure of Outstanding Share Data

The required disclosure is presented in the Notes to Consolidated Financial Statements.

All financial information is reported in U.S. dollars unless otherwise noted. Our unaudited consolidated interim financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). Certain statements in this report may constitute "forward-looking" statements within the meaning of the "safe harbor" provisions of the U.S. Private Securities Litigation Reform Law of 1995. Such forward-looking statements are based on management's current expectations, beliefs, intentions or strategies for the future, which are indicated by words such as "may, expects, intends, anticipates, believes, estimates and forecasts" and other similar words. All forward-looking statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. Such factors include, among other things: technological changes or changes in the competitive environment adversely affecting the products, markets, revenues or margins of our business; changes in general economic, financial or business conditions adversely affecting the business or the markets in which we operate; our ability to attract and retain customers and business partners; the ability to provide capital requirements for product development, operations and marketing; and, our dependency on third party suppliers. Investors are encouraged to review the section in Management's Discussion and Analysis in the 2007 Annual Report on Form 20-F entitled "Risk Factors" for a more complete discussion of factors that could affect Dynamotive's future performance.

## 1.16 Corporate Governance

### Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") that are designed to ensure that information required to be disclosed in its reports filed or submitted under the Exchange Act is processed, recorded, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this Annual Report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were not effective as December 31, 2007, at the reasonable assurance level, because of the material weaknesses described in Management's Report on Internal Control over Financial Reporting.

**DynaMotive Energy Systems Corp.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007

Notwithstanding the existence of the material weaknesses described below, management has concluded that the consolidated financial statements in this Form 20-F fairly present, in all material respects, the Company's financial position, results of operations and cash flows for the periods presented.

**Management's Annual Report on Internal Control over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the preparation and fair presentation of published consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles (Canadian GAAP), including a reconciliation of net loss to US Generally Accepted Accounting Principles (US GAAP).

The Company's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the consolidated financial statements.

Internal controls over financial reporting, no matter how well designed, have inherent limitations. Therefore, internal control over financial reporting determined to be effective can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2007, based on the criteria set forth in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The objective of this assessment was to determine whether the Company's internal control over financial reporting was effective as of December 31, 2007.

A material weakness, as defined by the Securities and Exchange Commission rules, is a significant deficiency, or combination of significant deficiencies, such that there is a reasonable possibility that material misstatements of the annual or interim consolidated financial statements will not be prevented or detected. In its assessment of the effectiveness of internal control over financial reporting as of December 31, 2007, management determined that there were control deficiencies that constituted material weaknesses, as described below.

The Company does not have sufficient personnel with experience in the application of US GAAP. Specifically, the Company's entity level controls initially failed to identify the impact of new accounting pronouncements on the disclosures in the US GAAP reconciliation note. These errors were corrected by management prior to the issuance of the Company's December 31, 2007 consolidated financial statements.

Management performs an oversight function with regard to meeting the Company's tax obligations. This includes preparation of tax returns, monitoring of new tax requirements for changes in the Company's

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Three-month period ended March 31, 2008 compared to the three-month period ended March 31, 2007

operations and preparation of tax disclosures for income tax, commodity taxes and other tax-related matters. Staff involved in the Company's tax function have some knowledge and experience with tax requirements but are not experts in all the tax regulations to which the company is subject. External tax experts are engaged by the Company to deal with tax matters, but there is a reasonable possibility that a material misstatement could occur in the Company's tax note or regulatory obligations with regard to tax could arise due to management's limited expertise with regard to tax requirements.

The Company did not maintain effective control in preparing financial statement disclosures in income taxes. Specifically, management initially failed to apply the correct future enacted tax rate to its future income tax assets in accordance with CICA HB 3465, "Income Taxes." This error was corrected by management prior to the issuance of the Company's December 31, 2007 consolidated financial statements.

Based on our assessment and because of the material weaknesses described above, management has concluded that our internal control over financial reporting was not effective as of December 31, 2007.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2007 has been audited by BDO Dunwoody, the Company's independent registered public accounting firm, as stated in their report which appears herein.

**Remediation to Address Material Weakness**

The Company will enhance its staff training and improve controls with regard to US GAAP and taxation matters. The Company will expand the use of outside consultants with expertise in the application of US GAAP and requisite knowledge of tax regulations in the jurisdictions in which the Company operates. Management will also implement an improved consultation process with external auditors in the above areas.

**Changes in Internal Control over Financial Reporting**

During the fiscal year ended December 31, 2007, there were changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the registrant's internal control over financial reporting, as follows:

The Company has enhanced its internal control over financial reporting, including improving the dissemination of corporate governance policies to employees, performing more formal variance analysis of financial statement line items and strengthening the documentation with regard to company credit card transactions.