



# **DYNAMOTIVE ENERGY SYSTEMS CORPORATION**

## **Unaudited Interim Consolidated Financial Statements**

For the nine months ended September 30, 2009

(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 September 30, 2009 and the interim consolidated statements of loss, changes in shareholders' equity and cash flows for the nine 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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### **Contents**

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Consolidated Financial Statements	
Consolidated Balance Sheets	2
Consolidated Statements of Loss and Comprehensive Loss	3
Consolidated Statements of Changes in Shareholders' Equity	4
Consolidated Statements of Cash Flows	5
Notes to Consolidated Financial Statements	6 - 14

# Dynamotive Energy Systems Corporation

## Unaudited Consolidated Balance Sheets

(expressed in U.S. dollars)

	September 30, 2009 (Unaudited) \$	December 31, 2008 (Audited) \$
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	6,538	39,927
Receivables	61,060	20,339
Government grants receivable	46,633	336,265
Prepaid expenses and deposits	223,752	321,587
<b>Total current assets</b>	<b>337,983</b>	<b>718,118</b>
Property, plant and equipment	37,541,025	32,769,583
Patents	199,781	193,171
Long-term investments [note 4]	263,945	231,098
Long-term deferred assets [note 5]	694,892	608,413
<b>TOTAL ASSETS</b>	<b>39,037,626</b>	<b>34,520,383</b>
<b>LIABILITIES and SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities [note 6]	10,008,782	9,866,822
Short-term and related party debt	1,448,796	1,257,289
Current portion of long-term debt [note 5]	35,900	35,900
<b>Total current liabilities</b>	<b>11,493,478</b>	<b>11,160,011</b>
Long-term debt [note 5]	236,342	263,267
Asset retirement obligation liability [note 7]	287,659	229,312
Deferred revenue [note 8]	805,772	705,495
<b>Total liabilities</b>	<b>12,823,251</b>	<b>12,358,085</b>
<b>Shareholders' Equity</b>		
Share capital [note 9(b)]	116,607,622	112,883,411
Shares to be issued [note 9(c)]	1,514,675	1,837,398
Contributed surplus	26,611,906	24,729,955
Accumulated other comprehensive loss	1,488,061	(1,612,018)
Deficit	(120,007,889)	(115,676,448)
<b>Total shareholders' equity</b>	<b>26,214,375</b>	<b>22,162,298</b>
<b>TOTAL LIABILITIES and SHAREHOLDERS' EQUITY</b>	<b>39,037,626</b>	<b>34,520,383</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 September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>REVENUES</b>				
License revenue <i>[Note 8]</i>	—	—	—	500,000
				500,000
<b>EXPENSES</b>				
Marketing and business development	73,579	77,453	229,873	587,248
Research and development	309,585	483,682	788,666	1,031,826
General and administrative expenses	999,136	1,863,275	3,474,351	6,525,717
Depreciation and amortization	26,084	36,527	74,608	111,948
Interest expense	96,498	60,699	468,975	126,940
Exchange (gain) loss	(399,382)	116,714	(702,821)	229,932
	1,105,500	2,638,350	4,333,652	8,613,611
<b>Loss from operations</b>	<b>(1,105,500)</b>	<b>(2,638,350)</b>	<b>(4,333,652)</b>	<b>(8,113,611)</b>
Interest and other income	66	—	2,211	5,668
Loss on return of equipment deposit	—	(131,090)	—	(131,090)
Gain on reduction in bonus and vacation accrual	—	—	—	1,137,983
Capital taxes	—	—	—	(9,973)
<b>Net loss for the period</b>	<b>(1,105,434)</b>	<b>(2,769,440)</b>	<b>(4,331,441)</b>	<b>(7,111,023)</b>
<b>Other comprehensive income/(loss)</b>				
Foreign currency translation adjustment	2,100,000	(1,828,371)	3,100,079	(3,321,626)
<b>Comprehensive income/(loss)</b>	<b>994,566</b>	<b>(4,597,811)</b>	<b>(1,231,362)</b>	<b>(10,432,649)</b>
<b>Weighted average number of common shares outstanding</b>	<b>243,401,053</b>	<b>213,509,053</b>	<b>230,820,069</b>	<b>210,987,668</b>
<b>Basic and diluted (loss) per common share</b>	<b>(0.00)</b>	<b>(0.01)</b>	<b>(0.02)</b>	<b>(0.03)</b>

The accompanying notes are an integral part of these financial statements

# 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	Accumulated Other Comprehensiv e Income (loss)	Deficit	Total
	\$	\$	\$	\$	\$	\$
<b>Balance, January 1, 2008 (audited)</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 since prior year						
Pursuant to private placement, net of issuance costs	3,273,027	—	—	—	—	3,273,027
Pursuant to exercise of stock options	126,780	—	—	—	—	126,780
Pursuant to exercise of warrants	127,340	—	—	—	—	127,340
Issued for services	222,869	—	—	—	—	222,869
Net change in shares to be issued	—	572,328	—	—	—	572,328
Warrant allocation for private placement	—	—	413,173	—	—	413,173
Stock-based compensation expense	—	—	1,652,841	—	—	1,652,841
Net loss	—	—	—	—	(28,356,265)	(28,356,265)
Foreign currency translation adjustment	—	—	—	(7,034,769)	—	(7,034,769)
<b>Balance, December 31, 2008 (audited)</b>	112,883,411	1,837,398	24,729,955	(1,612,018)	(115,676,448)	22,162,298
Issued for cash and proceeds received in since prior year						
Pursuant to private placement, net of issuance costs	1,606,018	—	—	—	—	1,606,018
Pursuant to exercise of stock options	30,000	—	—	—	—	30,000
Issued for settlement of fees payable	1,175,995	—	—	—	—	1,175,995
Issued for services	912,198	—	—	—	—	912,198
Net change in shares to be issued	—	(322,723)	—	—	—	(322,723)
Warrant allocation for private placement	—	—	1,369,308	—	—	1,369,308
Stock-based compensation expense	—	—	512,643	—	—	512,643
Net loss	—	—	—	—	(4,331,441)	(4,331,441)
Foreign currency translation adjustment	—	—	—	3,100,079	—	3,100,079
<b>Balance, September 30, 2009 (unaudited)</b>	116,607,622	1,514,675	26,611,906	1,488,061	(120,007,889)	26,214,375

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

# Dynamotive Energy Systems Corporation

## Unaudited Consolidated Statements Of Cashflow

(expressed in U.S. dollars)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>OPERATING ACTIVITIES</b>				
Loss for the period	(1,105,434)	(2,769,440)	(4,331,441)	(7,111,023)
Add items not involving cash:				
Depreciation and amortization	26,084	36,527	74,608	111,948
Recognition of deferred revenue	—	—	—	(500,000)
Interest-accretion on ARO liability	7,869	8,835	23,606	27,110
Interest expenses-subscribed to private placement	—	—	97,390	—
Stock based compensation	153,699	373,191	838,278	1,657,660
Loss on return of equipment deposit	—	131,090	—	131,090
Translation (gain) loss	(399,382)	116,714	(702,821)	229,932
Net change in non-cash working capital balances related to operations <i>[Note 11]</i>	727,191	643,872	987,204	2,962,244
<b>Cash used in operating activities</b>	<b>(589,973)</b>	<b>(1,459,211)</b>	<b>(3,013,176)</b>	<b>(2,491,039)</b>
<b>FINANCING ACTIVITIES</b>				
Increase in short- term loan	200,000	511,651	1,344,949	1,725,514
Repayment of short-term loan	—	—	(1,153,442)	—
Decrease in government grants receivable	—	—	309,302	—
Repayment of loan	(8,975)	(8,975)	(26,925)	(26,925)
Share capital issued	100,000	908,839	2,280,000	2,537,339
Shares to be issued	207,218	100,000	207,218	100,000
<b>Cash provided by financing activities</b>	<b>498,243</b>	<b>1,511,515</b>	<b>2,961,102</b>	<b>4,335,928</b>
<b>INVESTING ACTIVITIES</b>				
Decrease in long-term loan receivable	—	520,000	—	346,666
Purchase of capital assets (net of government grants)	(27,084)	(524,616)	(44,513)	(3,897,344)
<b>Cash used in investing activities</b>	<b>(27,084)</b>	<b>(4,616)</b>	<b>(44,513)</b>	<b>(3,550,678)</b>
<b>Increase (decrease) in cash and cash equivalents from operations</b>	<b>(118,814)</b>	<b>47,688</b>	<b>(96,587)</b>	<b>(1,705,789)</b>
Effects of foreign exchange rate changes on cash	84,408	(23,837)	63,198	(55,163)
<b>Increase (decrease) in cash and cash equivalents during the period</b>	<b>(34,406)</b>	<b>23,851</b>	<b>(33,389)</b>	<b>(1,760,952)</b>
Cash and cash equivalents, beginning of period	40,944	12,019	39,927	1,796,822
<b>Cash and cash equivalents, end of period</b>	<b>6,538</b>	<b>35,870</b>	<b>6,538</b>	<b>35,870</b>

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

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

Nine Months Ended September 30, 2009 and 2008

(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 140 – 13091 Vanier Place, Richmond, British Columbia, Canada V6V 2J1 (Telephone: 1-604-295-6800).

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 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; Dynamotive Europe Limited, formally known as Dynamotive Technologies (UK) Ltd, incorporated in the United Kingdom; Dynamotive Biomass Resource Corporation ("DBRC"), incorporated under the laws of British Columbia and owns a 99.98% interest in the West Lorne BioOil Co-Generation LP, formed under the laws of Ontario, Canada.

All inter-company balances and transactions have been eliminated on consolidation.

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)

Nine Months Ended September 30, 2009 and 2008

(in U.S. dollars)

### 2. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited balance sheet at September 30, 2009 and the unaudited interim statements of loss and deficit and cash flows for the nine-month periods ended September 30, 2009 and 2008, 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, 2008. 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 nine months ended September 30, 2009 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, 2008, 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 nine months. Gains and losses resulting from this process are recorded in shareholders' deficit as an adjustment to the cumulative translation adjustment account.

### 3. CHANGE IN ACCOUNTING POLICY

Effective January 1, 2009, the Company adopted the CICA Handbook Section 3064 "Goodwill and Intangible Assets". This standard, which replaces Canadian GAAP section 3062, "Goodwill and Other Intangible Assets" and 3450, "Research and Development Costs" provides guidance relating to the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The adoption of this standard did not impact the Company's financial statements.

#### Future Accounting Changes

Transition to International Financial Reporting Standards ("IFRS")

In February 2008, the Canadian Accounting Standards Board confirmed that IFRS will replace Canadian GAAP for publicly accountable enterprises for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The standard also requires that comparative figures for 2010 be based on IFRS. The Company is currently assessing the future impact of IFRS adoption on its financial statements and will continue to invest in training and additional resources to ensure a timely conversion.

### 4. LONG TERM INVESTMENTS

As at September 30, 2009, Dynamotive holds 3,874,139 (2008 – 3,874,139) common shares of Renewable Energy Corp ("ROC") incorporated in Victoria, Australia, a subsidiary of Enecon Pyrolysis Pty Limited. It represents an 8.0% (2008 – 8.0%) interest in the entity.

## Notes to Consolidated Financial Statements (Unaudited)

Nine Months Ended September 30, 2009 and 2008

(in U.S. dollars)

### 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 remaining life of the wood supply contract commencing when the Company begins to amortize the West Lorne plant. In 2008 the Company conducted a review of realizable value from its property plant and equipment in West Lorne and Guelph and as a result has recorded an impairment provision of which \$196,855 was allocated to the long term deferred asset.

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 September 30, 2009, the Company owed Erie \$272,242 (2008 - \$308,142).

Long-term debt repayment schedule:

	<b>2009</b>
	<b>\$</b>
2009 – 2010 (Current)	<b>35,900</b>
2010 – 2011	<b>35,900</b>
2011 – 2012	<b>35,900</b>
2012 – 2013	<b>35,900</b>
2013 – 2014	<b>35,900</b>
Thereafter	<b>92,742</b>
	<b>272,242</b>

### 6. GUARANTEE PROVIDED BY DYNAMOTIVE

In 2001, Border Biofuels Limited (“BBL”) a company 75% owned by Dynamotive, entered into a credit facility with a UK bank (the “Bank”) for a maximum of \$328,980 (£200,000). The credit facility is denominated in British Pounds Sterling and is guaranteed by the Company. During 2002 BBL became insolvent. If the Bank is unable to realize on its collateral 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 in 2002 recognized the full amount of the guarantee as a current liability. BBL remains in liquidation at September 30, 2009 and there has been no change in status regarding the settlement of the credit facility.

## Notes to Consolidated Financial Statements (Unaudited)

Nine Months Ended September 30, 2009 and 2008

(in U.S. dollars)

### 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 September 30, 2009 to be \$287,659 (2008 - \$256,262), being \$143,829 (2008 - \$128,131) for West Lorne and \$143,830 (2008 - \$128,131) 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 from January 1, 2007. The total undiscounted amount of the future obligation is \$2,000,000. For the period ended September 30, 2009, the Company recorded \$23,606 (2008 - \$27,110) in accretion expense which was charged to the Consolidated statement of loss.

The Company is currently reviewing scenarios including the possibility of relocating one of its plants this year. Although the likelihood of relocation cannot be determined at this time, the total undiscounted amount of future obligations associated with a relocation this year would be \$745,760 and had been included in the asset retirement obligation at its discounted value.

### 8. DEFERRED REVENUE

In 2006, the Company received a total of \$950,000 in non-refundable payments from Six 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. In the fourth quarter of 2008 the Company decided to write-off against this revenue the related loan to entities controlled by Rika of \$330,000 (\$321,894 after foreign exchange effects). These amounts have been removed from the deferred revenue balance. In 2007, deferred revenue was net of the \$330,000 loan to entities controlled by Rika Ltd.

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.

Differences between the amounts described above and deferred revenue per the Balance Sheet result from the Company's foreign exchange translation policy.

## Notes to Consolidated Financial Statements (Unaudited)

Nine Months Ended September 30, 2009 and 2008

(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 September 30, 2009.

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

	September 30, 2009	December 31, 2008
	\$	\$
<b>Issued and outstanding</b>		
Common Shares 244,073,879 [December 31, 2008 – 221,312,201]	<b>116,607,622</b>	112,883,411
	\$	Number of Shares
<b>Common Share Issuance Summary for the Period</b>		
<b>Share Capital, December 31, 2008</b>	<b>112,883,411</b>	221,312,201
Pursuant to private placement, net of issuance costs	<b>1,606,018</b>	11,400,130
Pursuant to exercise of stock options	<b>30,000</b>	150,000
Issued for settlement of amounts payable	<b>1,175,995</b>	9,356,475
Share issued for commercial services	<b>912,198</b>	1,855,073
<b>Share Capital, September 30, 2009</b>		
Common shares without par value	<b>116,607,622</b>	244,073,879

#### [c] Shares to be issued

At September 30, 2009, the Company has 3,638,696 common shares to be issued which are comprised of:

- [i] 3,217,579 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 \$1,146,372.
- [ii] 421,117 common shares which are to be issued to directors and officers as bonuses for the previous years with a fair value of \$368,303.

## Notes to Consolidated Financial Statements (Unaudited)

Nine Months Ended September 30, 2009 and 2008

(in U.S. dollars)

## 9. SHARE CAPITAL (CONT'D)

## [d] Stock options

At September 30, 2009, the following stock options to Directors, employees and others were outstanding:

Range of Exercise Prices	Number Outstanding at Sep 30, 2009	Options Outstanding		Options Exercisable	
		Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Outstanding at Sep 30, 2009	Weighted-Average Exercise Price
\$0.19 - \$0.24	8,630,973	2.63 years	\$0.21	8,630,973	\$0.21
\$0.30 - \$0.48	10,123,333	3.68 years	\$0.42	10,123,333	\$0.42
\$0.50 - \$0.88	5,755,000	2.54 years	\$0.61	3,738,334	\$0.57
\$1.00 - \$1.31	5,186,000	1.50 years	\$1.21	5,186,000	\$1.21
\$1.50 - \$1.60	80,000	1.02 years	\$1.50	80,000	\$1.50
	29,775,306			27,758,640	

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 36,611,082 (15%) of common shares for issuance upon the exercise of stock options of which at September 30, 2009, 6,835,776 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, 2008</b>	25,841,218	0.66
Options granted	6,632,588	0.24
Options forfeited or expired	(2,548,500)	0.97
Options exercised	(150,000)	0.20
<b>Balance, September 30, 2009</b>	29,775,306	0.54

## Notes to Consolidated Financial Statements (Unaudited)

Nine Months Ended September 30, 2009 and 2008

(in U.S. dollars)

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

#### [e] Common share purchase warrants

At September 30, 2009 the common share purchase warrants outstanding were as follows:

	No. of Common Shares Issuable	Exercise Price	Expiration Date
Series S Warrants	17,563,981	\$0.01 to \$1.35	October 22, 2009 – July 24, 2012
Series V Warrants	4,998,372	\$0.20	October 3, 2012 – January 18, 2013
Total	22,562,353		

In 2008 the Company entered into subscription agreements under a private placement including warrants to be issued with an exercise price of \$0.20. Due to existing agreements, this resulted in a re-pricing of the 4,998,372 Series V Warrants from an exercise price of \$1.06 to an exercise price of \$0.20. As the re-pricing resulted from an anti-dilution provision, no adjustment to the financial statements has been recorded.

Summary of warrants exercised and issued during the nine month periods ending September 30, 2009:

	Number of Common Shares Issuable					Exercise Price
	at December 31, 2008	via Warrants Issued during the 9- month Period ending September 30, 2009	via Warrants exercised during the 9- month Period ending September 30, 2009	via Warrants cancelled during the 9- month Period ending September 30, 2009	at September 30, 2009	
Series S Warrants	8,289,610	10,678,302	—	(1,403,931)	17,563,981	\$0.01 to \$1.35
Series U Warrants	239,096	—	—	(239,096)	—	\$0.46 to \$0.53
Series V Warrants	4,998,372	—	—	—	4,998,372	\$0.20
	13,527,078	9,678,302	—	(1,530,717)	22,562,353	

## Notes to Consolidated Financial Statements (Unaudited)

Nine Months Ended September 30, 2009 and 2008

(in U.S. dollars)

### 10. RELATED PARTY TRANSACTIONS

The transactions with related parties are recorded at amounts established and agreed between the related parties. In addition to the transactions described in note 9, the Company had the following transactions with related parties during the quarter:

- a. Consulting fees and salaries of \$310,012 for the quarter (2008 - \$259,711) have been accrued or paid to Directors (or companies controlled by Directors) of the Company. Included in the amount above, is \$513 (2008 - (\$4,325)) paid by stock based compensation. For the nine months ended September 30, 2009 consulting fees and salaries of \$958,819 (2008 - \$904,364) have been accrued or paid to Directors (or companies controlled by Directors) of the Company. Included in the amount above, is \$18,334 (2008 - \$76,242) paid by stock based compensation.
- b. In December 2008, the Company entered into loan agreements with certain directors and officers. As of September 30, 2009, the short-term and related party debt outstanding balance was \$1,448,796 (2008 - \$1,725,514). Of this amount, \$570,000 was from an unrelated party. The loans are due on demand and bear interest at 8% p.a. annum. One of the major loan agreements to a director of the Company is secured by a General Security Agreement as a floating charge over the Company's assets.
- c. The amounts due from/to related parties, which are non-interest bearing, unsecured and due on demand, are comprised of the following:

	2009	2008
	\$	\$
Receivable		
Due from directors and officers	<b>9,349</b>	—
Payable		
Due to directors and officers	<b>\$2,253,797</b>	1,831,776

Note: Of the total amount \$2,253,797 (2008 - \$1,831,776) due to directors and officers, \$533,779 (2008 - \$998,878) was recorded in the shares to be issued account and \$1,720,018 (2008 - \$832,898) was recorded as accrued payables.

### 11. SUPPLEMENTARY CASH FLOW INFORMATION

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
Net change in non-cash working capital	2009	2008	2009	2008
	\$	\$	\$	\$
Account receivable	<b>18,440</b>	<b>100,296</b>	<b>(18,501)</b>	<b>50,896</b>
Prepaid expenses and deposits	<b>56,001</b>	<b>(157,291)</b>	<b>127,600</b>	<b>51,042</b>
Accounts payable and accrued liabilities	<b>652,750</b>	<b>700,867</b>	<b>878,105</b>	<b>2,860,306</b>
	<b>727,191</b>	<b>643,872</b>	<b>987,204</b>	<b>2,962,244</b>

## Notes to Consolidated Financial Statements (Unaudited)

Nine Months Ended September 30, 2009 and 2008

(in U.S. dollars)

### 12. SEGMENTED FINANCIAL INFORMATION

In 2009 and 2008, 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 assets and the large majority of its operations are in Canada and are solely focused on the development and commercialization of its 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 revenue and loss for the nine month periods ended September 30 2009 (\$4,331,441) and September 30, 2008 (\$7,111,023) is attributable to the BioOil segment.

### 13. SUBSEQUENT EVENTS

Subsequent to September 30, 2009 the Company has approved the following resolutions on November 5, 2009.

- a). Continued deferral of income of officers and employees of the Company

In the appreciation and support of the continued salary deferral of officers and employees of the Company until December 31, 2009, the Company approved the allotment and award of 7,230,943 two-year stock options exercisable at \$0.214 to the officers and employees who continue to defer their salaries until December 31, 2009, pursuant to the terms and conditions as previously approved by the Committee on December 9, 2008.

- b). Award of warrants to certain investors of the Company

Certain Investors of the Company have been firm on their commitment not to call their demand loans and have continued to demonstrate their support of the Company. In this respect, the Company approved the award of 1,335,244 2-year warrants exercisable at \$0.25 per share, pro rata to the amount of loan outstanding.

- c). Award of stock options to a former Company officer

Pursuant to the terms of a former Company officer's employment agreement, they are entitled to receive outstanding salary, bonus and severance at termination. As a result of the Company's current financial condition, the Company is not currently in a position to settle outstanding amounts. The Company approved the award of 2,156,167 2-year stock options exercisable at \$0.214 to \$0.25 per share as partly settlement related to outstanding salaries, bonus and severance owing.

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

## **1.1 Date**

This Management's Discussion and Analysis of financial condition and results of operations ("MD&A") is dated November 30, 2009 and 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, 2008.

The following sets out management's discussion and analysis of our financial position and results of operations for the nine months ended September 30, 2009 and 2008.

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 feedstock 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.

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.

### **Plant Operations**

The Company's operating results for 2008 and early 2009 have fallen short of expectations for a number of reasons. The Company experienced a small fire at the West Lorne plant in April 2008, resulting in a shut-down for repairs of over three months. Also, the investigation of the fire lead to some recommended changes that were incorporated into the West Lorne plant and were also implemented in Guelph. Production at West Lorne continues and sales have totaled \$154,784 for the first nine months of 2009 (2008 - \$158,310).

At Guelph, the changes resulting from the West Lorne fire were implemented and tested, however, due to financial limitations and feedstock issues, the Guelph plant has been maintained on a shut down basis for the balance of 2008 and into 2009. Prior to shut down the Guelph plant was handling a number of different feedstocks, including construction wood waste material. This material was found to have an

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

excess of foreign substances which caused fouling and other operational difficulties. The Company is currently investigating a number of alternative financing, business structures and potential feedstock supplies to utilize the plant and to bring it into regular operation.

In addition, the difficult financial market combined with the fall in the price of petroleum products have made marketing and development of the Company's products and plants more challenging. In response to these challenges, the Company is focused on achieving higher operating rates and stable production and is being very careful to control costs where possible. We are continuing to advance a number of attractive projects and are working with our development partners to ensure that a realistic structure is in place to ensure that attractive projects do proceed.

Dynamotive has an existing power purchase agreement with the Ontario Power Authority for the output from the West Lorne 2.5 megawatt generator output at a rate of \$110 per megawatt hour. There has been minimal operation of the turbine during 2009 to date.

Operations in Guelph have been temporarily shut down in recognition of the incident at West Lorne. Due to the fire incident at West Lorne, additional fire preventive measures were incorporated in Guelph based on what we have learned. The Company is currently focusing its efforts on the West Lorne operations.

#### Project Development

The Company continues with a significant number of project developments in multiple markets, though activity slowed during 2008 and early 2009 due first to the required repairs in West Lorne as a result of the fire and the subsequent shut down of Guelph and due to financial constraints. Following the restart of operations (in West Lorne), the Company has received renewed expressions of interest for both its products and plant developments.

We are also working with First Nations communities through our subsidiary First Resources Corporation which is involved in development activities on projects in Canada and the US to establish BioOil plants on traditional aboriginal territory. Work in these areas has been reduced during 2009 due to business development resource limitations.

In the United States, the Company plans, subject to availability of financing, to invest US \$24 to \$30 million to build the first fully commercial industrial biofuel plant in the U.S., to be followed by plants at other advanced locations. Negotiations on agreements continue to progress. The Company announced that it has secured a long term supply contract for biomass for a proposed facility in southern Arkansas and is working with the El Dorado Arkansas Chamber of Commerce on this development. Although the site of the first plants are not yet certain, we are also working to establish facilities in Willow Springs, Missouri, and North Webster Parish, Louisiana.

Dynamotive USA has begun evaluating engineering contractors to provide construction management for the U.S. BioOil projects. Subject to agreements being completed and confirmation of financing, the Company expects to launch engineering phase of the first US project in 2010. Also, a number of field trials for BioOil and Char were completed during recent months.

In Argentina, progress has been slower than expected due to the fire in West Lorne, due to financial limitations and due to the political situation in Argentina. The Company has executed contracts for the provision of biomass for two of its proposed plants in the Province of Corrientes, as has been previously announced. A total of 2.5 million tons has been secured over 10 years from the municipality of Virasoro.

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

Dynamotive Latinoamericana SA has been offered a site for the project within the Municipality of Virasoro. Negotiations in regard to the project are progressing. The development plan envisages further potential within the Province of Corrientes. Financing discussions are also continuing.

Dynamotive and regional partners are also investigating other regional opportunities in Uruguay, Chile, Dominican Republic, Panama and Brazil.

In Asia, Dynamotive signed a cooperation agreement with Marketech International Corporation to jointly review the commercial feasibility and, if warranted, develop and construct the first two commercial BioOil plants in Taiwan. The companies also entered into a memorandum to explore further cooperation to potentially develop BioOil projects in the Greater China area. Several projects are currently under review.

In China, the Company has signed an agreement to assist Hubei Xinda Biooil Technology Co to build the first Chinese BioOil project in the province of Henan, where Dynamotive will provide process and engineering support. Also, Dynamotive has worked with the China National Development and Reform Commission on a BioOil feasibility study for two years. This is a major policy advisory and administrative division of the Chinese government which can assist in obtaining government subsidies for BioOil projects in China. With the study completed, NDRC is very supportive of BioOil production in China.

In Europe, the Company is working with Prius Developments and continues negotiations with several interested groups in Canton of Fribourg, Switzerland. Discussions in relation to project opportunities in France and Bulgaria are also occurring. Beyond these opportunities, Dynamotive is currently in the process of evaluating project opportunities in the Ukraine, the Netherlands, the U.K., Spain and Portugal.

In Australia, ROC has scaled back operations while it focuses on confirming financing, while they continues to make limited progress on its flagship project. The first plant site has been identified and preliminary work has been completed on permits and approvals. Negotiations are ongoing with several groups interested in output from the first plant. A joint venture has been formalized with a major recycling group for certain feed types and co-funding of plants. Further progress is subject to the availability of project and corporate finance. Financing applications have been submitted and are under discussion. Some government assistance has been received in support of development efforts and additional government assistance applications are under review.

All of the above opportunities are progressing. However, additional development and access to project finance is expected to progress slowly until additional long term operating results are available from the West Lorne plant.

#### Research and Development

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.

We continue our work in upgrading BioOil. We believe that beyond the direct substitution of heating oil # 2, there is a wider market in the potential refining of BioOil. Our research team is working on a number of paths that could prove commercially viable and, if successful, would expand the market for our technology and fuel exponentially. Bench scale tests of upgrading BioOil to "UBA" and "UBB", for

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

advanced industrial use and transportation use respectively, have been successfully completed. The Company intends to build a pilot scale facility to produce UBA and UBB which have neutral acidity and much lower water and oxygen content compared to BioOil.

In addition to Dynamotive working in this area of research, there are strong efforts from energy companies and government sponsored research in the U.S. and in Europe.

The Company is also investigating a number of market opportunities for its pyrolytic char. The company is participating in a number of studies and field tests on the use of Char ("CQuest™") as a soil enhancer and announced additional successful results from its tests with Blueleaf Inc. showing a 16% increase in crop yields. Dynamotive considers the production of its BioChar to be a high value opportunity.

### Corporate Information

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 September 30, 2009, the Company had six wholly-owned subsidiaries Dynamotive Canada Inc., federally incorporated under the laws of Canada in 2000; 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, Canada in 2006; Dynamotive Biomass Resource Corporation, incorporated under the laws of British Columbia, Canada in 2006; and Dynamotive Europe Limited (formally known as Dynamotive Technologies (UK) Ltd.), incorporated in the United Kingdom in 1996. In addition, the Company 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 140 - 13091 Vanier Place, Richmond, British Columbia, Canada V6V 2J1 (Telephone: 604-295-6800).

### 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).

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

	As at December 31, 2008	As at December 31, 2007	As at December 31, 2006
<b>(US Dollars)</b>	\$	\$	\$
Results of operations:			
Revenue	178,106	—	—
Loss from operations	(13,279,325)	(14,415,849)	(14,319,641)
Net loss	(28,356,265)	(14,220,404)	(14,252,382)
Net loss per share	(0.13)	(0.08)	(0.09)
Financial position at year-end:			
Total assets	34,520,383	58,935,644	38,193,699
Total liabilities	12,358,085	7,770,670	7,058,287
Non-controlling interest, Cdn GAAP	—	—	1,354,923
Shareholder's equity	22,162,298	51,164,974	29,780,489
Deficit	(115,676,448)	(87,320,183)	(73,099,779)
Common shares issued	221,312,201	207,749,673	171,765,776

**Dynamotive Energy Systems Corp.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

**1.4 Results of Operations**

Revenue

Revenue for the third quarters of 2009 and 2008 were \$nil. Revenue for the first nine months of 2009 was \$nil compared to \$500,000 for the same period in 2008. The revenue for the first quarter of 2008 was due to the Company recognizing the Rika Ltd. master license fee of \$500,000. During the fourth quarter of 2008, the revenue of \$500,000 was netted against \$330,000 (\$321,894 after foreign exchange effects) by writing down the outstanding loan due from Rika Ukraina Ltd. at the end of the two year agreement term.

During the third quarter of 2009, the Company netted \$75,457 (2008 - \$82,799) of product service sales against research and development expenses. During the first nine months of 2009, the Company netted \$154,784 (2008 - \$158,310) of product and service sales against research and development expenses, which are considered incidental sales of BioOil, char and electricity until such time as the Company's plants have reached commercial production levels. Commercial production levels are reached when the plant is producing a positive cash-flow and operations are considered to be sustainable at that level.

Interest and other income were \$66 in the third quarter of 2009 compared to \$nil in the same quarter in 2008. Interest and other income decreased to \$2,211 in the first nine months of 2009 from \$5,668 in the same period in 2008. The decrease in 2009 was due mainly to lower cash balances and therefore decreased interest income from investments in short-term money market deposits.

Expenses

During the third quarter ended September 30, 2009, the Company recorded a net loss of \$1,105,434, while the net loss for the same quarter in 2008 amounted to \$2,769,440. During the first nine months of 2009, the Company recorded a net loss of \$4,331,441, while the net loss for the same period in 2008 amounted to \$7,111,023. The decrease in operating loss was primarily attributable to (i) a decrease in marketing and business development related expenses; (ii) a decrease in research and development expenses; (iii) a decrease in general and administrative expenses; (iv) a decrease in license revenue of \$500,000; (v) no loss on return of equipment deposit in 2009; and partially offset by (vi) an increase in interest expense and foreign exchange gain.

The basic and diluted loss per common share for the third quarter was \$0.00 per share compared to \$0.01 for the same quarter in 2008. The basic and diluted loss per common share the first nine months of 2009 decreased to \$0.02 compared to \$0.03 for the same period in 2008. The basic and diluted loss per share for the first nine months of 2009 was lower because of the decrease in operating loss and the increase in the weighted average number of Common Shares outstanding. The weighted average number of Common Shares increased to 243,401,053 shares for the third quarter ended September 30, 2009 from 213,509,053 for the same quarter in 2008. The weighted average number of Common Shares increased to 230,820,069 shares for the first nine month period ended September 30, 2009 from 210,987,668 for the same period in 2008.

Marketing and business development expenses for the third quarter of 2009 decreased to \$73,579 from \$77,453 for the same quarter in 2008. Marketing and business development expenses for the first nine months of 2009 decreased to \$229,873 from \$587,248 for the same period in 2008. These decreases were due to decreases in business development activities and participation in a major environmental conference during the 2008 period.

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

For the third quarters of 2009 and 2008 the Company expended \$385,042 and \$566,481 respectively, on research and development. In the third quarter 2009, the Company also offset product sales of \$75,457 (2008 - \$82,799) 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. For the first nine months in 2009 and 2008 the Company expended \$943,450 and \$1,190,136 respectively, on research and development. These amounts were net of \$154,784 (2008 - \$158,310) of product sales. These decreases in research and development expenses were due to reduced activity in engineering development of the commercial scale plant partially offset by increased activity in product development.

General and administrative expenses in the third quarter of 2009 decreased to \$999,136 from \$1,863,275 for the same quarter in 2008. General and administrative expenses in the first nine months of 2009 decreased to \$3,474,351 from \$6,525,717 for the same period in 2008. The decrease in 2009 was a combination of decreased activity in the general and administrative area and management of the Company's development activities related to its 200 tpd plant in Guelph, Ontario and a decrease in non-cash compensation expenses.

Amortization and depreciation decreased slightly to \$26,084 in the third quarter of 2009 from \$36,527 in the same quarter in 2008. Depreciation and amortization expenses decreased to \$74,608 in the first nine months of 2009 from \$111,948 in the same period in 2008.

Interest expenses increased in the third quarter of 2009 to \$96,498 from \$60,699 in the same quarter in 2008. Interest expenses increased in the first nine months of 2009 to \$468,975 from \$126,940 in the same period in 2008. The increase in interest expense in 2009 was due mainly to interest incurred on the long-term debt and the short-term debt with company's directors, officers and shareholders and the accretion of the asset retirement obligation liability.

Currency exchange gain in the third quarter amounted to \$399,382 compared to the loss of \$116,714 in the same quarter in 2008. Currency exchange gain in the first nine months of 2009 amounted to \$702,821 compared to the loss of \$229,932 in the same period in 2008. These non-cash changes were due to the exchange rate fluctuations of the US/Canadian dollar exchange rate. For further explanation on foreign exchange accounting practice, please refers to Note 2 to the unaudited interim financial statements for the quarter.

The Company recorded a gain on reduction in bonus and vacation accrual of \$1,137,983 during the first quarter of 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.

Going forward, the Company expects to have increased sales and project development activities, both in North America and overseas. With West Lorne increasing production, product sales should increase through the remainder of 2009 and beyond. Also, successful operation of the plants should lead to additional project development activity.

The Company's main commitments going forward are the residual capital expenditures for the completion of the steam system at the Erie Flooring plant in West Lorne. These amounts total approximately \$0.6 million.

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

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

The Company's administrative operations and overhead have been reduced over the past eight quarters, as administrative staff levels were reduced. Activities throughout the period were focused on commissioning of the plants in West Lorne and in Guelph (in the early part of this period) and on the increasing operation of the West Lorne plant in the latter part of this period, plus ongoing business development and research activities. However, in the first quarter of 2008, the recognition of \$500,000 of revenue and the realization of a \$1.1 million gain on reduction in bonus and vacation accrual resulted in a lower loss for the three month period ended March 31, 2008. Also, beginning in 2008, lower research and development expenditures as the plants in Ontario progressed through commissioning also contributed towards a lower operating loss.

With the small fire in West Lorne in April 2008, operations were suspended in both West Lorne (for repair and to install preventative changes) and in Guelph (to install the same preventative changes). Operations re-started in West Lorne in July 2008.

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

	Sep 30 2009	Three months ended		Dec 31 2008
	\$	Jun 30 2009	Mar 31 2009	\$
<b>(US Dollars)</b>				
Revenue	—	—	—	(321,894)
Net loss	(1,105,434)	(1,534,811)	(1,691,199)	(21,245,243)
Net (loss) per share	(0.00)	(0.01)	(0.01)	(0.10)
Weighted average common shares outstanding in the period	243,401,053	226,929,640	221,893,163	214,647,877
	Sep 30 2008	Jun 30 2008	Mar 31 2008	Dec 31 2007
	\$	\$	\$	\$
Revenue	—	—	500,000	—
Net loss	(2,769,440)	(2,908,763)	(1,432,819)	(4,299,404)
Net income/(loss) per share	(0.01)	(0.01)	(0.01)	(0.02)
Weighted average common shares outstanding in the period	213,509,053	209,570,784	208,008,571	205,329,005

There were no discontinued operations or extraordinary items during the past eight quarters. Loss per share on a fully diluted basis is equal to the loss per share as stated above as the exercise of outstanding options and warrants would be anti-dilutive.

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

## **1.6 Liquidity**

During the third quarter ended September 30, 2009, the Company generated cash from financing activities of \$498,243 and used cash in operating activities and investing activities of \$589,973 and \$27,084, respectively. During the first nine months ended September 30, 2009, the Company generated cash from financing activities of \$2,961,102, and used cash in operating activities and investing activities of \$3,013,176 and \$44,513, respectively.

The Principal sources of liquidity during third quarter ended September 30, 2009 were (i) \$200,000 increase in short term loans with the Company's directors, officers and shareholders; (ii) \$207,218 in deposits for Common Shares to be issued in 2009 pursuant to the Company's recent private placement; (iii) \$100,000 in proceeds from private placement offerings of the Company's Common Shares; and offset by (iv) \$8,975 in repayment of loan. Principal sources of liquidity during the first nine months ended September 30, 2009 were (i) \$1,344,949 increase in short term loans with the Company's directors, officers and shareholders; (ii) \$2,280,000 in proceeds from private placement offerings of the Company's Common Shares; (iii) \$207,218 in deposits for Common Shares to be issued in 2009 pursuant to the Company's recent private placement; (iv) \$309,302 decrease in government grants receivable; and offset by (v) \$26,925 in repayment of long-term loan and (vi) \$1,153,442 in repayment of short-term loan.

The Principal sources of liquidity during third quarter ended September 30, 2008 were (i) \$511,651 increase in short term loans with the Company's directors, officers and shareholders; (ii) \$100,000 in deposits for Common Shares to be issued in 2008 pursuant to the Company's recent private placement; (iii) \$908,839 in net proceeds after deducting related issue costs and expenses from private placement offerings of the Company's Common Shares and exercise of warrants for cash; and offset by (iv) \$8,975 in repayment of loan. Principal sources of liquidity during the first nine months ended September 30, 2008 were (i) \$1,725,514 increase in short term loans with the Company's directors, officers and shareholders; (ii) \$2,537,339 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, (iii) \$100,000 in deposits for Common Shares to be issued in 2008 pursuant to the Company's recent private placement; and offset by (iv) \$26,925 in repayment of loan.

Overall change in cash position during the third quarter of 2009 was a decrease in cash of \$34,406 as compared to an increase of \$23,851 during the same period in 2008. Overall change in cash position during the first nine months of 2009 was a decrease in cash of \$33,389 as compared to a decrease in cash of \$1,760,952 during the same period in 2008. Overall cash flows decreased during the first nine months of 2009 due to significantly decreased financing activities, operating activities and investing activities.

The net amount of cash used in operating activities in the third quarter of 2009 decreased to \$589,973 from cash used of \$1,459,211 in the same quarter of 2008. Cash used in operating activities consisted primarily of a net loss from operations for the third quarter 2009 of \$1,105,434, less non-cash expenses of (i) equity compensation expenses of \$153,699, (ii) amortization of \$26,084, (iii) accretion interest on ARO liability of \$7,869, (iv) a net change in non-cash working capital balances related to operations of \$727,191, and (v) translation gain of \$399,382. Cash used in operating activities consisted primarily of a net loss from operations for the third quarter 2008 of \$2,769,440, less non-cash expenses of (i) equity compensation expenses of \$373,191, (ii) amortization of \$36,527, (iii) accretion interest on ARO liability of \$8,835, (iv) a net change in non-cash working capital balances related to operations of \$643,872, (v) a loss from return of equipment deposit of \$131,090, and (vi) translation loss of \$116,714.

The net amount of cash used in operating activities in the first nine months of 2009 increased to \$3,013,176 from cash used of \$2,491,039 in the first nine months of 2008. Cash used in operating activities consisted primarily of a net loss from operations for the first nine months of 2009 of

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

\$4,331,441, less non-cash expenses of (i) equity compensation expenses of \$838,278, (ii) amortization of \$74,608, (iii) accretion interest on ARO liability of \$23,606, (iv) a net change in non-cash working capital balances related to operations of \$987,204, and (v) translation gain of \$702,821. The net amount of cash used in operating activities in the first nine months of 2008 decreased to \$2,491,039 from cash used of \$5,279,074 in the first nine months of 2007. Cash used in operating activities consisted primarily of a net loss from operations for the first nine months of 2008 of \$7,111,023, and the recognition of (non-cash) deferred revenue of \$500,000, less non-cash expenses of (i) equity compensation expenses of \$1,657,660, (ii) amortization of \$111,948, (iii) accretion interest on ARO liability of \$27,110, (iv) a net change in non-cash working capital balances related to operations of \$2,962,244, (v) a loss from return of equipment deposit of \$131,090, and (vi) translation loss of \$229,932.

Financing activities during the third quarter 2009 generated a net increase in cash of \$498,243, primarily from the short-term debt with the Company's directors, officers and shareholders of \$200,000 and the Company's private placements of Common Shares. Financing activities during the third quarter 2008 generated a net increase in cash of \$1,511,515, primarily from the Company's private placements of Common Shares.

Financing activities during the first nine months of 2009 generated a net increase in cash of \$2,961,102, primarily from net proceeds of \$191,507 of the short-term debt with the Company's directors, officers and shareholders; a decrease of \$309,302 in government grants receivable; and from the Company's private placements of Common Shares. Financing activities during the first nine months of 2008 generated a net increase in cash of \$4,335,928, primarily from the short-term debt with the Company's directors, officers and shareholders of \$1,725,514 and the Company's private placements of Common Shares.

Investing activities in the third quarter 2009 resulted in a use of cash, in the amount of \$27,084. This amount comprised of the acquisition of capital assets (corporate and research and development). Investing activities in the third quarter 2008 resulted in a decrease of cash, in the amount of \$4,616. This amount comprised of the acquisition of capital assets (Guelph and West Lorne plants) of \$524,616 offset by repayment of the Company's \$520,000 loan to Worldwide Biomass Limited.

Investing activities in the first nine months of 2009 resulted in use of cash, in the amount of \$44,513. This amount was incurred in the acquisition of capital assets (corporate, research and development and West Lorne plant). Investing activities in the first nine months of 2008 resulted in use of cash, in the amount of \$3,550,678. This amount was incurred in the acquisition of capital assets (Guelph and West Lorne plants) of \$3,897,344 and a decrease of long-term loan receivable of \$346,666.

## **1.7 Capital Resources**

As at September 30, 2009, the Company had working capital deficiency of \$11,155,495, has an accumulated deficit of \$120,007,889 and has incurred a net loss of \$4,331,441 for the nine months period ended September 30, 2009.

In the quarter ended September 30, 2009, the Company recorded \$nil license revenue. Sales revenue going forward is uncertain and the Company is therefore dependent on its financing activities to fund its operations. 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

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

enterprise and in particular Dynamotive will require significant additional financing in the future to develop and market its technology to its full potential.

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 2009 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 expects to spend approximately \$4 million to \$6 million in its operations in the next 12 months and has capital expenditure commitments of approximately \$0.6 million. The Company does expect to have increases in product sales and licenses over the coming months and years, but these are not expected to cover operating requirements in the near future.

In recognition of our liquidity and capital resources, our independent public accountants have included a comment in their report on our accompanying consolidated financial statements for the year ended December 2008, that expresses substantial doubt as to our ability to continue as a going concern.

The Company's 2009/2010 financing plan is structured to include completion of the char boiler at the West Lorne plant. 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 char boiler system project, the Company has committed to approximately \$0.6 million of further construction as at September 30, 2009.

The Company's funding plan for 2009/2010 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(s) which are expected to be developed. Any delay in securing project funding for a project will delay the construction and commissioning of that project. As mentioned previously, there is no assurance however that the Company will obtain positive cash flow from product sales or be able to obtain sufficient equity or debt financing to satisfy its cash requirements for the next 12 months.

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

None.

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

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

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 three month period ended September 30, 2009:

- 1) Paid or accrued management compensation of \$270,895 (2008 - \$219,209) to directors and officers of the Company;
- 2) Paid or accrued consulting fees of \$38,091 (2008 - \$39,653) to a director of the Company. These fees arise from contractual arrangements based on a fixed monthly fee and stock based compensation. These expenses have been included in research and development expense in Statement of Loss.
- 3) Paid or accrued director fees of \$1,026 (2008 - \$849) to directors of the Company.

The Company had the following transactions with related parties during the nine month period ended September 30, 2009:

- 4) Paid or accrued management compensation of \$810,828 (2008 - \$721,994) to directors and officers of the Company;
- 5) Paid or accrued consulting fees of \$111,323 (2008 - \$111,212) to a director of the Company. These fees arise from contractual arrangements based on a fixed monthly fee and stock based compensation. These expenses have been included in research and development expense in Statement of Loss.
- 6) Paid or accrued director fees of \$36,668 (2008 - \$71,157) to directors of the Company.

In December 2008, the Company entered into loan agreements with certain of its directors and officers. As of September 30, 2009, the short-term and related party debt outstanding balance was \$1,448,796 (2008 - \$1,725,514). Of this amount, \$570,000 was from an unrelated party. The loans are due on demand and bear interest at 8% p.a. annum. One of the major loan agreements to a director of the Company is secured by a General Security Agreement as a floating charge over the Company's assets.

As at September 30, 2009, there was \$9,349 (2008 - \$nil) due from related parties and \$2,253,797 (2008 - \$1,831,776) due to related parties. The amounts receivable in 2009 were non-interest bearing, unsecured and due on demand. Of the total amount payable of \$2,253,797 (2008 - \$1,831,776) due to directors and officers, \$533,779 (2008 - \$998,878) was recorded in the shares to be issued account and \$1,720,018 (2008 - \$832,898) was recorded as accrued payables.

### **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**

#### **New Accounting Policies**

Effective January 1, 2009, the Company adopted the CICA Handbook Section 3064 "Goodwill and Intangible Assets". This standard, which replaces Canadian GAAP section 3062, "Goodwill and Other Intangible Assets" and 3450, "Research and Development Costs" provides guidance relating to the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The adoption of this standard did not impact the Company's financial statements.

#### **Transition to International Financial Reporting Standards ("IFRS")**

In February 2008, the Canadian Accounting Standards Board confirmed that IFRS will replace Canadian GAAP for publicly accountable enterprises for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The standard also requires that comparative figures for 2010 be based on IFRS. The Company is currently assessing the future impact of IFRS adoption on its financial statements and will invest in training and additional resources to ensure a timely conversion.

### **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.

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

(b) expensed research and development costs;

**Research and Development Expenses**

Breakdown by major category:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2009</b>	2008	<b>2009</b>	2008
	<b>\$</b>	\$	<b>\$</b>	\$
Material	<b>38,591</b>	31,418	<b>100,785</b>	97,673
Salary and benefits	<b>214,124</b>	157,138	<b>467,713</b>	420,579
Engineering and consulting fees	<b>78,441</b>	109,683	<b>227,230</b>	229,819
Miscellaneous costs	<b>53,886</b>	268,242	<b>147,722</b>	442,065
	<b>385,042</b>	566,481	<b>943,450</b>	1,190,136
Less: Product and services sales	<b>(75,457)</b>	(82,799)	<b>(154,784)</b>	(158,310)
	<b>309,585</b>	483,682	<b>788,666</b>	1,031,826

(c) deferred development costs;

Not applicable.

(d) general and administration expenses;

Breakdown by major category:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2009</b>	2008	<b>2009</b>	2008
	<b>\$</b>	\$	<b>\$</b>	\$
Office supplies, telephone, and insurance	<b>130,931</b>	153,362	<b>349,902</b>	542,779
Professional fees	<b>95,072</b>	280,132	<b>252,268</b>	1,019,175
Rent	<b>43,886</b>	127,694	<b>204,116</b>	373,720
General and admin. salaries and benefits	<b>729,247</b>	1,302,087	<b>2,668,065</b>	4,590,043
	<b>999,136</b>	1,863,275	<b>3,474,351</b>	6,525,717

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

None.

**1.15.3 Disclosure of Outstanding Share Data**

As at November 30, 2009, the Company's outstanding share data was as follows:

Common shares outstanding:	248,296,345
Stock options:	28,985,990
Share purchase warrants:	22,554,007

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.

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

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 2008 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 September 30, 2009, at the reasonable assurance level, because of the material weaknesses described in Management's Report on Internal Control over Financial Reporting.

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).

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

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

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 September 30, 2009, 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 September 30, 2009.

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 September 30, 2009, 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, 2008 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 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, 2008 consolidated financial statements.

**Dynamotive Energy Systems Corp.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Nine-month period ended September 30, 2009 compared to the nine-month period ended September 30, 2008

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, 2008.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2008 has been audited by BDO Dunwoody, the Company's independent registered public accounting firm, as stated in their report which appears therein.

**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 third quarter year ended September 30, 2009, there were no 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.