

ZTEST Electronics Inc.
Unaudited Condensed Interim Consolidated Financial Statements
December 31, 2017
(Stated in Canadian Dollars)

Notice To Reader

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the unaudited condensed interim consolidated financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

These unaudited condensed interim consolidated financial statements were approved by the Board of Directors on February 27, 2018. They have not been reviewed by the Company's auditors.

The accompanying unaudited condensed interim consolidated financial statements have been prepared by, and are the responsibility of, management. These condensed interim consolidated financial statements are presented on the accrual basis of accounting and accordingly, a precise determination of many assets and liabilities is dependent upon future events. Where necessary, management has made informed judgments and estimates in accounting for these assets and liabilities and for transactions which were not complete at the end of the reporting period. Recognizing that the Company is responsible for both the integrity and objectivity of the financial statements, management is satisfied that these unaudited condensed interim consolidated financial statements have been fairly presented.

ZTEST Electronics Inc.

Unaudited Condensed Interim Consolidated Statements of Financial Position

(Stated in Canadian Dollars)

December 31, 2017

	Dec. 31 2017	June 30 2017
Assets		
Current assets		
Cash and cash equivalents	\$ 66,129	\$ 186,994
Accounts receivable	499,056	643,966
Inventories (note 4)	437,510	512,026
Prepaid expenses	8,241	15,102
	1,010,936	1,358,088
Lease deposit (note 8)	35,000	35,000
Equipment (note 5)	353,413	390,424
	\$ 1,399,349	\$ 1,783,512
Liabilities		
Current liabilities		
Customer deposits	\$ 6,913	\$ 83,151
Accounts payable and accrued liabilities (note 10)	474,799	697,260
Current portion of long-term debt (note 7)	39,493	39,493
	521,205	819,904
Long-term debt (note 7)	23,037	42,784
	544,242	862,688
Commitment (note 8)		
Shareholders' equity		
Share capital (note 9)	22,465,999	22,418,782
Warrants (note 9)	101,157	105,376
Contributed surplus (note 9)	949,670	955,168
Deficit	(22,661,719)	(22,558,502)
	855,107	920,824
	\$ 1,399,349	\$ 1,783,512

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

Approved by the Board:

Signed: "William J. Brown"

Director

Signed: "Wojciech Drzazga"

Director

ZTEST Electronics Inc.**Unaudited Condensed Interim Consolidated Statements of Changes in Equity**

(Stated in Canadian Dollars)

December 31, 2017

	Share Capital	Warrants	Contributed Surplus	Deficit	Total
Balance, June 30, 2016	\$ 22,151,406	\$ 4,219	\$ 952,327	\$ (22,060,622)	\$ 1,047,330
Stock options exercised	36,245	-	(16,245)	-	20,000
Private placement	116,343	101,157	-	-	217,500
Shares issued as consideration for investment	69,562	-	-	-	69,562
Share-based payments	-	-	39,312	-	39,312
Net loss for the period	-	-	-	(295,586)	(295,586)
Balance, December 31, 2016	22,373,556	105,376	975,394	(22,356,208)	1,098,118
Stock options exercised	45,226	-	(20,226)	-	25,000
Net loss for the period	-	-	-	(202,294)	(202,294)
Balance, June 30, 2017	22,418,782	105,376	955,168	(22,558,502)	920,824
Stock options exercised	14,052	-	(6,552)	-	7,500
Warrants exercised	33,165	(3,165)	-	-	30,000
Warrants expired	-	(1,054)	1,054	-	-
Net loss for the period	-	-	-	(103,217)	(103,217)
Balance, December 31, 2017	\$ 22,465,999	\$ 101,157	\$ 949,670	\$ (22,661,719)	\$ 855,107

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

ZTEST Electronics Inc.**Unaudited Condensed Interim Consolidated Statements of Comprehensive Loss**

(Stated in Canadian Dollars)

December 31, 2017

	Three months ended		Six months ended	
	2017	2016	2017	2016
Product sales	\$ 800,502	\$ 668,803	\$ 1,945,537	\$ 1,496,503
Cost of product sales (note 4)	563,181	481,390	1,341,446	1,093,523
	237,321	187,413	604,091	402,980
Expenses				
Selling, general and administrative (note 11)	383,829	326,493	711,120	654,798
Share based payments (notes 9 and 10)	-	39,313	-	39,313
Interest expense - long term	844	1,192	1,758	2,496
Interest expense - other	142	139	609	277
Depreciation of equipment	1,315	1,435	2,578	2,870
Foreign exchange (gain) loss	(795)	(260)	(8,757)	720
	385,335	366,562	707,308	700,474
Loss before miscellaneous income and income taxes	(148,014)	(180,899)	(103,218)	(297,494)
Miscellaneous income	1	111	1	158
Loss before income taxes	(148,013)	(180,788)	(103,217)	(297,336)
Provision for income taxes	-	-	-	-
Comprehensive loss for the period	\$ (148,013)	\$ (180,788)	\$ (103,217)	\$ (297,336)
Comprehensive loss per share				
Basic	\$ (0.01)	\$ (0.02)	\$ (0.01)	\$ (0.03)
Fully diluted	\$ (0.01)	\$ (0.02)	\$ (0.01)	\$ (0.03)
Weighted average shares outstanding				
Basic	17,419,892	12,025,055	17,318,533	11,390,680
Fully diluted	17,419,892	12,025,055	17,318,533	11,390,680

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

ZTEST Electronics Inc.**Unaudited Condensed Interim Consolidated Statements of Cash Flows**

(Stated in Canadian Dollars)

December 31, 2017

	Three months ended		Six months ended	
	2017	2016	2017	2016
Cash flow from operating activities				
Net loss for the period	\$ (148,013)	\$ (180,788)	\$ (103,217)	\$ (297,336)
Items not involving cash				
Depreciation of equipment	19,383	23,384	38,714	46,739
Share based payments	-	39,313	-	39,313
Changes in non-cash working capital items:				
Accounts receivable	151,361	109,180	144,910	205,045
Inventories	(4,566)	(66,628)	74,516	(18,541)
Prepaid expenses	440	1,606	6,861	(2,107)
Customer deposits	(1,921)	936	(76,238)	1,397
Accounts payable and accrued liabilities	(130,847)	(24,092)	(222,461)	(90,851)
	(114,163)	(97,089)	(136,915)	(116,341)
Cash flow from investing activities				
Purchase of equipment	(801)	-	(1,703)	(20,082)
Acquisition of investment	-	(225,000)	-	(225,000)
	(801)	(225,000)	(1,703)	(245,082)
Cash flow from financing activities				
Repayment of long-term debt	(9,874)	(9,873)	(19,747)	(19,746)
Issuance of common shares	27,500	217,500	37,500	237,500
	17,626	207,627	17,753	217,754
Decrease in cash and cash equivalents	(97,338)	(114,462)	(120,865)	(143,669)
Cash and cash equivalents, beginning of period	163,467	264,436	186,994	293,643
Cash and cash equivalents, end of period	\$ 66,129	\$ 149,974	\$ 66,129	\$ 149,974

Supplemental Disclosure of Cash Flow Information:

During the period the Company had cash flows arising from interest and income taxes paid as follows:

Cash paid for interest	\$ 996	\$ 1,344	\$ 2,381	\$ 2,812
Cash paid for income taxes	\$ -	\$ -	\$ -	\$ -

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

ZTEST Electronics Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

(Stated in Canadian Dollars)

December 31, 2017

1. Business of the Company

ZTEST Electronics Inc. (ZTEST or the Company) amalgamated under the laws of Ontario and carries on business at 523 McNicoll Avenue, Toronto, Ontario designing, developing, and assembling printed circuit boards and other electronic equipment. The Company's shares trade on the Canadian Securities Exchange (CSE) under the symbol "ZTE".

2. Significant Accounting Policies

Statement of compliance

The Company has prepared these unaudited condensed interim financial statements in accordance with IAS 34, *Interim Financial Reporting*, employing all of the same accounting policies and methods of computation as disclosed in the annual financial statements as at June 30, 2017.

The notes to these unaudited condensed interim consolidated financial statements are intended to provide a description of events and transactions that are significant to an understanding of the changes in the Company's financial position and performance since June 30, 2017. Certain disclosures that appear in the annual financial statements have not been reproduced in these unaudited condensed interim consolidated financial statements and, in this regard only, these unaudited condensed interim financial statements do not conform in all respects to the requirements of IFRS for annual consolidated financial statements. Accordingly, these unaudited condensed interim consolidated financial statements should only be read in conjunction with the annual financial statements as at June 30, 2017.

These unaudited condensed interim consolidated financial statements were authorized for issuance by the Board of Directors of the Company on February 27, 2018.

Basis of presentation

These unaudited condensed interim consolidated financial statements have been compiled by management on a historical cost basis using the accrual basis of accounting, except for cash flow information.

Basis of consolidation

These unaudited condensed interim consolidated financial statements include the accounts of the Company as well as the following subsidiaries' assets and liabilities and the revenues and expenses arising, subsequent to the date of acquisition:

Permatech Electronics Corporation	- 100% owned
Northern Cross Minerals Inc.	- 66.7% owned (inactive)

Changes in accounting policies

The Company's accounting policies will typically change only when there is a relevant change in IFRS. There were no changes in IFRS during the current period that were required to be adopted by the Company.

Significant accounting judgments and estimates

The preparation of these unaudited condensed interim consolidated financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual outcomes could differ from these estimates. These unaudited condensed interim consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the unaudited condensed interim consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised, and also in future periods if the revision affects both current and future periods. These estimates are based on historical experience, current and future economic conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Significant estimates and judgments include, but are not limited to, the recoverability of inventory and the recognition and valuation of deferred tax amounts.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

(Stated in Canadian Dollars)

December 31, 2017

2. Significant Accounting Policies - continued

Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period.

The Company has assessed the assets of all its operating entities and has determined that there is no impairment of its financial assets.

Financial instruments recorded at fair value

Financial instruments recorded at fair value on the consolidated statement of financial position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- Level 3 valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

As of December 31, 2017, and June 30, 2017 cash and cash equivalents are measured at fair value and are classified within Level 1 of the fair value hierarchy.

Impairment of non-financial assets

At the end of each reporting period, the Company reviews the carrying amounts of its non-financial assets with finite lives to determine whether there is any indication that those assets have suffered an impairment loss.

The Company has assessed the assets of all its operating entities and has determined that there is no impairment of its non-financial assets.

Income (loss) per share

The Company presents basic and diluted income (loss) per share data for its common shares, calculated by dividing the income (loss) attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted income (loss) per share is determined by adjusting the income (loss) attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares.

Stock options and warrants outstanding are excluded in the computation of diluted earnings per share if their inclusion would increase the income per share, or decrease the loss per share, or if their exercise price exceeds the average market price for the period of the Company's shares.

Segment disclosure

The Company has a single location and operating segment. Accordingly, all revenues are generated in Canada and all assets are located in Canada.

Accounting standards effective for future periods

IFRS 9, *Financial Instruments*: effective for annual periods beginning on or after January 1, 2018, with early adoption permitted, establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of the financial statements for their assessment of the amounts, timing and uncertainty of future cash flows.

IFRS 15, *Revenue from Contracts with Customers*: effective for annual periods beginning on or after January 1, 2018, with early adoption permitted, replaces existing revenue standards and interpretations with a single standard and provides additional guidance on revenue recognition for contracts with customers.

Management anticipates that these standards will be adopted in the Company's financial statements for the year beginning July 1, 2018 and has not yet considered the potential impact of their adoption.

3. Cash and cash equivalents

Cash equivalents consist of fully cashable short-term, interest bearing, deposits held at the Company's financial institution. No cash equivalents were held at December 31, 2017 or June 30, 2017.

ZTEST Electronics Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

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4. Inventories

The carrying value of inventory is comprised of:

	Dec. 31 2017	June 30 2017
Raw materials and supplies ⁽¹⁾	\$ 414,509	\$ 496,707
Work in process	6,755	9,155
Finished goods	16,246	6,164
	\$ 437,510	\$ 512,026

⁽¹⁾ The raw materials and supplies is presented net of provisions for obsolete and/or slow-moving items in the amount of \$19,925 (June 2017 - \$11,236).

Inventory utilization during the period was as follows:

	Dec. 31 2017	Dec. 31 2016
Raw materials and supplies used	\$ 919,245	\$ 667,381
Labour costs	343,239	316,343
Depreciation	36,136	43,869
Other costs	50,508	70,625
Net change in finished goods and work in process	(7,682)	(4,695)
Cost of product sales	\$ 1,341,446	\$ 1,093,523

5. Equipment

	Computer Equipment	Office Equipment	Manufacturing Equipment	Leasehold Improvements	Total
Cost:					
Balance, June 30, 2016	\$ 180,705	\$ 71,277	\$ 2,567,090	\$ 84,143	\$ 2,903,215
Additions	-	-	20,082	-	20,082
Balance, Dec. 31, 2016	180,705	71,277	2,587,172	84,143	2,923,297
Additions	697	-	-	-	697
Balance, June 30, 2017	181,402	71,277	2,587,172	84,143	2,923,994
Additions	1,703	-	-	-	1,703
Balance, Dec. 31, 2017	\$ 180,705	\$ 71,277	\$ 2,587,172	\$ 84,143	\$ 2,925,697
Accumulated Depreciation:					
Balance, June 30, 2016	\$ (171,403)	\$ (69,256)	\$ (2,137,140)	\$ (62,160)	\$ (2,439,959)
Depreciation	(1,395)	(202)	(43,985)	(1,157)	(46,739)
Balance, Dec. 31, 2016	(172,798)	(69,458)	(2,181,125)	(63,317)	(2,486,698)
Depreciation	(1,500)	(202)	(44,013)	(1,157)	(46,872)
Balance, June 30, 2017	(174,298)	(69,660)	(2,225,138)	(64,474)	(2,533,570)
Depreciation	(1,167)	(162)	(36,228)	(1,157)	(38,714)
Balance, Dec. 31, 2017	\$ (175,465)	\$ (69,822)	\$ (2,261,366)	\$ (65,631)	\$ (2,572,284)
Carrying Amounts:					
June 30, 2016	\$ 9,302	\$ 2,021	\$ 429,950	\$ 21,983	\$ 463,256
December 31, 2016	\$ 7,907	\$ 1,819	\$ 406,047	\$ 20,826	\$ 436,599
June 30, 2017	\$ 7,104	\$ 1,617	\$ 362,034	\$ 19,669	\$ 390,424
December 31, 2017	\$ 7,640	\$ 1,455	\$ 325,806	\$ 18,512	\$ 353,413

ZTEST Electronics Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

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December 31, 2017

6. Bank operating loan

The Company has a line of credit, which can be drawn to a maximum of \$250,000, bears interest at the TD Bank prime lending rate plus 2.5%, is due upon demand, and is secured by a general security agreement covering the assets of PEC. No amounts were drawn upon this line of credit as at December 31, 2017 or June 30, 2017.

7. Long-Term Debt

	Dec. 31 2017	June 30 2017
Term loan bearing interest at the TD Bank prime lending rate plus 1.75% matures July 2019. Monthly payments of \$3,291 plus interest are required until maturity.	\$ 62,530	\$ 82,277
Less: Current portion	39,493	39,493
	\$ 23,037	\$ 42,784
The minimum annual future principal repayments are as follows:		
2018		\$ 39,493
2019		23,037
		\$ 62,530

8. Commitment

The Company leases its operating facility under a lease that is due to expire March 31, 2021. A lease deposit in the amount of \$35,000 has been paid and will be applied at the end of the lease. Minimum monthly rental payments ranging from \$8,752 to \$8,979 are required over the remaining term of the lease as follows:

2018	\$ 105,026
2019	107,743
2020	107,743
Remaining	26,936
	\$ 347,448

9. Share Capital

Authorized:

Unlimited Common shares

Unlimited Preferred shares in one or more series.

Issued:

	Dec. 31 2017	June 30 2017
Common shares	\$ 22,465,999	\$ 22,418,782
Common shares	Number of Shares ⁽¹⁾	Amount
Balance June 30, 2016	10,648,696	\$ 22,151,406
Exercise of stock options	300,000	36,245
Private placement	4,500,000	116,343
Investment	1,325,000	69,562
Balance December 31, 2016	16,773,696	22,373,556
Exercise of stock options	400,000	45,226
Balance June 30, 2017	17,173,696	\$ 22,418,782

ZTEST Electronics Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

(Stated in Canadian Dollars)

December 31, 2017

9. Share Capital - continued

Issued - continued:

Common shares	Number of Shares ⁽¹⁾	Amount
Balance June 30, 2017	17,173,696	\$ 22,418,782
Exercise of stock options	50,000	14,052
Exercise of warrants	300,000	33,165
Balance December 31, 2017	17,523,696	\$ 22,465,999

⁽¹⁾ Following the 2013 conversion of Class A Special Shares to common shares, 8,246 common shares remain reserved to be issued if and when the remaining Class A shareholders identify themselves to the Company.

Details of warrants outstanding:

	Number of Warrants	Amount
Balance June 30, 2016	400,000	\$ 4,219
Warrants issued via private placement	4,500,000	101,157
Balance December 31, 2016 and June 30, 2017	4,900,000	105,376
Warrants exercised	(300,000)	(3,165)
Warrants expired	(100,000)	(1,054)
Balance December 31, 2017	4,500,000⁽¹⁾	\$ 101,157

⁽¹⁾ 1,600,000 of these warrants were exercised subsequent to December 31, 2017.

The following weighted average assumptions were used to calculate the fair value of the warrants issued during the period:

	Dec. 31 2017	June 30 2017
Dividend yield	None issued	Nil
Risk free interest rate (%)	None issued	1.20
Expected stock volatility (%)	None issued	130.19
Expected life (years)	None issued	5

	Number of Warrants	Weighted Average Price per Warrant	Weighted Average Expiry Date
Beginning of period	4,900,000	\$ 0.06	Aug. 14, 2021
Exercised during the period	(300,000)	\$ 0.10	Oct. 31, 2017
Expired during the period	(100,000)	\$ 0.10	Oct. 31, 2017
End of year	4,500,000	\$ 0.06	Dec. 15, 2021

Details of options outstanding:

	Common Shares Under Option	Number of Options Vested	Exercise Price	Expiry Date
Granted December 31, 2013	300,000 ⁽¹⁾	300,000	\$ 0.10	Dec. 31, 2018
Granted Mar. 3, 2016	500,000 ^(1,2)	500,000	\$ 0.05	Mar. 3, 2021
Granted December 21, 2016	150,000 ⁽¹⁾	150,000	\$ 0.15	Dec. 21, 2021
Granted December 21, 2016	100,000 ⁽³⁾	100,000	\$ 0.15	Dec. 21, 2021

⁽¹⁾ Directors and/or Officers of the Company hold these options.

⁽²⁾ 100,000 of these options were exercised subsequent to the financial reporting date.

⁽³⁾ 50,000 of these options were exercised subsequent to the financial reporting date.

On January 12, 2018 the Company granted 600,000 options to Directors and/or Officers of the Company which will expire January 12, 2023, 320,000 options to a public relations firm which will expire January 12, 2020, and 120,000 options to a consultant which will expire February 12, 2019. Each option has an exercise price of \$0.95.

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Notes to Unaudited Condensed Interim Consolidated Financial Statements

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December 31, 2017

9. Share Capital - continued

Details of options outstanding - continued:

	Common Shares Under Option	Weighted Average Price per Option	Weighted Average Expiry Date
Balance, beginning of the period	1,230,000	\$ 0.09	June 20, 2020
Exercised during period	(50,000)	\$ 0.15	Dec. 21, 2021
Expired during period	(130,000)	\$ 0.10	Sept. 14, 2017
Balance, end of the period	1,050,000	\$ 0.09	Sept. 27, 2020

The following weighted average assumptions were used to calculate the fair value of the stock options granted during the period:

	Dec. 31 2017	June 30 2017
Dividend yield	None issued	Nil
Risk free interest rate (%)	None issued	1.19
Expected stock volatility (%)	None issued	135.35
Expected life (years)	None issued	5

Share based payment transactions and contributed surplus

The Company has a stock option plan. The aggregate number of common shares reserved for issuance under this plan cannot exceed 20% of the aggregate number of common shares of the Company that are issued and outstanding. The Company has granted options for the purchase of common shares to employees, directors, officers and other service providers. The fair values of stock options granted have been determined using the Black-Scholes model and are added to contributed surplus as follows:

	Dec. 31 2017	June 30 2017
Contributed surplus, beginning of period	\$ 955,168	\$ 952,327
Stock options granted	-	39,312
Stock options exercised	(6,552)	(36,471)
Warrants expired during the year	1,054	-
Contributed surplus, end of period	\$ 949,670	\$ 955,168

10. Related Party Transactions

All expenses and year end balances with related parties are at exchange amounts established and agreed to by the related parties. All transactions with related parties are in the normal course of operations and have been carried out on the same terms as those accorded to unrelated parties.

The Company had the following transactions during the period with key management personnel:

	Dec. 31 2017	Dec. 31 2016
Employee and consultant compensation	\$ 211,695	\$ 183,652
Professional fees	38,361	18,966
Legal fees included as share issuance costs	-	7,500
Legal fees included as investment acquisition costs	-	15,000
	\$ 250,056	\$ 225,118
Stock-based compensation	\$ -	\$ 26,208

As at December 31, 2017 \$183,099 (June 30, 2017 - \$154,136) was payable to key management personnel and included in accounts payable and accrued liabilities.

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Notes to Unaudited Condensed Interim Consolidated Financial Statements

(Stated in Canadian Dollars)

December 31, 2017

11. Selling, general and administrative expenses

Selling, general and administrative expenses are comprised of the following amounts:

	Dec. 31 2017	Dec. 31 2016
Employee and consultant compensation (note 10)	\$ 455,391	\$ 421,454
Occupancy costs	138,557	132,959
Professional fees (note 10)	52,957	37,098
Shareholder services	17,181	15,816
Insurance	15,088	14,943
Other	31,946	32,528
	<u>\$ 711,120</u>	<u>\$ 654,798</u>

12. Income Taxes

Deferred Tax

The following table summarizes the components of deferred tax:

	Dec. 31 2017	June 30 2017
Deferred tax assets:		
Non-capital losses carried forward	\$ 9,800	\$ 5,675
Deferred tax liabilities:		
Property, plant and equipment	(9,800)	(5,675)
Net deferred tax liabilities	<u>\$ -</u>	<u>\$ -</u>

Unrecognized Deferred Tax Assets

Deferred taxes are provided as a result of temporary differences that arise due to the differences between the income tax values and the carrying amount of assets and liabilities. Deferred tax assets have not been recognized in respect of the following deductible temporary differences:

	Dec. 31 2017	June 30 2017
Inventory	\$ 19,925	\$ 11,236
Share issuance costs	6,000	6,000
Intangible assets	32,376	32,376
Property, plant and equipment	35,238	35,146
Resource related expenditures	349,050	349,050
Scientific research and experimental development	1,050,618	1,050,618
Non-capital loss carry-forwards	1,540,635	1,503,663
Net capital loss carry-forwards	<u>15,592,989</u>	<u>15,592,989</u>

Share issue costs expire in 2021. The net capital loss carry-forwards may be carried forward indefinitely, but can only be used to reduce capital gains. The remaining deductible temporary differences, except for non-capital loss carry-forwards, may be carried forward indefinitely. Deferred tax assets have not been recognized in respect of these items because it is not probable that future taxable profit will be available against which the group can utilize the benefits therefrom.

Non-capital Loss Carry-Forwards

The potential income tax benefits resulting from the application of income tax losses have not been recognized in these unaudited condensed interim consolidated financial statements. The following losses, which may be subject to verification by Canada Revenue Agency, include 100% of the respective losses of the subsidiary companies and will expire at the end of the taxation years as follows:

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Notes to Unaudited Condensed Interim Consolidated Financial Statements

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12. Income Taxes - continued

Non-capital Loss Carry-Forwards - continued

Year	
2027	\$ 209,777
2030	174,603
2031	577,958
2032	14,862
2033	76,561
2034	168,430
2035	136,504
2036	69,013
2037	184,366
	<u>\$ 1,612,074</u>

13. Capital disclosures

The Company's objective when managing capital is to ensure its ability to meet operating commitments as they become due and to provide return for shareholders. This is achieved by continuously monitoring actual and projected cash flows and making adjustments to capital as necessary. Except for the repayment terms associated with long-term debt instruments, there are no externally imposed capital requirements.

Management includes the following items in its definition of capital:

	Dec. 31 2017	June 30 2017
Long-term debt	\$ 62,530	\$ 82,277
Share Capital	22,465,999	22,418,782
Warrants	101,157	105,376
Contributed surplus	949,670	955,168
Deficit	(22,661,719)	(22,558,502)
Net capital under management	<u>\$ 917,637</u>	<u>\$ 1,003,101</u>

14. Financial risk factors

The Company is exposed in varying degrees to the following financial instrument related risks:

Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company's primary exposure to credit risk is in its accounts receivable. In an effort to mitigate this risk, management actively manages and monitors its receivables and obtains pre-payments where warranted. It has been determined that no allowance is required, as all amounts outstanding are considered collectible. No bad debts were recognized during the period ended December 31, 2017 (December 31, 2016 - \$1,286).

Concentration of credit risk

Concentration of credit risk arises when one or more customers, defined as a major customer, individually account for 10% or more of the Company's revenues during a reporting period. During the six-month period ended December 31, 2017 the Company had 2 major customers who represented 15% and 12% of total revenues. In the comparative period, there was 1 major customer which represented 12% of revenues. Amounts due from major customers represented 8% of accounts receivable at December 31, 2017 (Dec. 2016 - Nil%). The loss of a major customer, or significant curtailment of purchases by such customer, could have a material adverse effect on the Company's results of operations and financial condition. The Company monitors the relationship with all customers closely and ensures that every customer is subject to the same risk management criteria.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

(Stated in Canadian Dollars)

December 31, 2017

14. Financial risk factors - continued

Market risks

The Company is exposed to interest rate risk due to obligations that have floating interest rates as well as currency risk related to cash, accounts receivable, prepaid expenses, customer deposits, and accounts payable denominated in US dollars. Market risks give rise to the potential for future cash flows to fluctuate because of changes in interest rates or foreign exchange rates. Market risks are closely monitored and attempts are made to match foreign cash inflows and outflows. During the current fiscal period the Company realized a gain on foreign exchange in the amount of \$8,757 (Dec. 2016 ó loss of \$720).

Sensitivity to market risks

At December 31, 2017, the Company had a term loan balance of \$62,530 (June 30, 2017 ó \$82,277) which bears interest at the TD Bank prime lending rate plus 1.75%. A 1% increase in the TD Bank prime lending rate as at the financial reporting date would result in additional interest expense of \$444 over the next 12-month period.

At December 31, 2017, the Company had US\$22,675 (June 2017 ó US\$46,339) included in cash. A 5% increase in the value of the Canadian dollar relative to the US dollar would result in a reduction of \$1,429 in carrying value.

At December 31, 2017, the Company had US\$49,075 (June 2017 ó US\$46,339) included in accounts receivable. A 5% increase in the value of the Canadian dollar relative to the US dollar would result in a reduction of \$3,094 in future cash inflow.

At December 31, 2017 the Company had US\$2,401 (June 30, 2017 ó US\$3,488) included in prepaid expenses. A 5% increase in the value of the Canadian dollar relative to the US dollar would result in recognition of \$151 in additional future expenses.

At December 31, 2017 the Company had US\$5,483 (June 30, 2017 ó US\$63,707) included in customer deposits. A 5% increase in the value of the Canadian dollar relative to the US dollar would result in a reduction of \$346 in future revenue.

At December 31, 2017, the Company had US\$76,109 (June 2017 ó US\$195,669) included in accounts payable. A 5% decrease in the value of the Canadian dollar relative to the US dollar would result in an increase of \$4,798 in future cash outflow.

Based upon observations of recent market trends management believes that each of these outcomes is possible but most likely exceed the Company's immediate market risk exposures.

15. Subsequent events

Subsequent to December 31, 2017 the following transactions occurred:

Conversance Inc.

In December 2016 the Company entered into a Subscription Agreement with Conversance Inc. (Conversance), a Waterloo based private company focused on developing and marketing proprietary Artificial Intelligence supported distributed ledger technologies. Pursuant to this subscription agreement, ZTEST acquired 155,000 Class A shares, representing a 15.05% interest, by making a cash payment of \$210,000 and issuing 1,325,000 common shares.

In January 2018, in accordance with an amendment to the Subscription Agreement, the Company increased its ownership interest in Conversance to 19.91%, by making a cash payment of \$140,000 and issuing 275,000 common shares to acquire 62,500 Class A shares.

In February 2018, the Company entered into a Further Investment Agreement whereby it obtained the following two options to add to its ownership in Conversance, and placed restrictions on any further issuance of securities by Conversance, contingent upon the exercise of these options:

ZTEST Electronics Inc.

Notes to Unaudited Condensed Interim Consolidated Financial Statements

(Stated in Canadian Dollars)

December 31, 2017

15. Subsequent events - continued

Conversance Inc. - continued

1. ZTEST may earn up to an additional 10.09% interest in Conversance, thereby increasing its interests to 30%, by acquiring up to 157,500 Class A shares, at the rate of \$6.3492 per share, in exchange for a cash payment of \$1,000,000. To exercise this 30% Option, payment as to \$500,000 is to be made on or before February 28, 2018 in exchange for 78,750 Class A shares. A further payment of up to \$500,000 is required on or before April 20, 2018 for up to 78,750 Class A shares. The payment of the first \$500,000 on February 28, 2018 has been approved by the ZTEST Board which, once paid, will raise the ZTEST interest in Conversance to 25.29%.
2. Provided the 30% Option is exercised in its entirety, ZTEST may then earn an additional 4.99% in the capital of Conversance, thereby increasing its interests to 34.99%, by acquiring up to 96,000 Class A shares in exchange for a cash payment of up to \$1,000,000 on or before June 15, 2018.

The subscription agreement, and the Further Investment Agreement, grant the Company the pre-emptive right to maintain its equity interest by participating in further funding of Conversance.

Conversance has not yet generated any cash flows as it continues the development of its technology. The absence of cash flow makes it difficult to objectively measure the value of Conversance. Accordingly, the carrying value of the original 15.05% interest was reduced to \$Nil. A new value assessment will be completed at the end of the next financial reporting period to determine the carrying value, if any, of these new investments.

Private Placement

The Company announced a non-brokered private placement financing for the sale of up to 1,600,000 working capital units, at \$0.85 per unit, for proceeds of up to \$1,360,000. Each unit consists of 1 common share and ½ common share purchase warrant. Each full common share purchase warrant entitles the holder to acquire 1 additional common share of the Company at a price of \$1.10 until January 31, 2019. In the event that the closing price, on the CSE, for the Company's common shares is at least \$2.00 for 20 consecutive trading days, and that 20th day is at least 4 months after the financing closes, the expiry date for the warrants will be reduced to the date that is 30 days after that 20th trading day.

A first closing under this financing resulted in the issuance of 625,000 working capital units for gross proceeds of \$531,250. The Company paid finders' fees of \$37,188, incurred other costs estimated at \$16,000, and issued 43,750 broker warrants in connection with this closing. Each broker warrant entitles the holder to acquire 1 common share of the Company for \$0.85 until January 30, 2019. The securities issued pursuant to this closing are subject to a statutory hold period expiring on May 31, 2018.