# ZTEST Electronics Inc.

**Consolidated Financial Statements**

**June 30, 2018 and 2017**

**(Stated in Canadian Dollars)**

Wasserman
Ramsay

Chartered Accountants

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## Independent Auditors' Report

**To the Shareholders of ZTEST Electronics Inc.**

We have audited the accompanying consolidated financial statements of ZTEST Electronics Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at June 30, 2018 and June 30, 2017 and the consolidated statements of changes in equity, comprehensive loss and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of ZTEST Electronics Inc. and its subsidiaries as at June 30, 2018 and June 30, 2017 and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Wasserman Ramsay

Markham, Ontario
October 29, 2018

Chartered Accountants
Licensed Public Accountants

## ZTEST Electronics Inc.

**Consolidated Statements of Financial Position**
(Stated in Canadian Dollars)
*June 30, 2018 and 2017*

| | 2018 | 2017 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash | **$ -** | $ 186,994 |
| Accounts receivable | **479,621** | 643,966 |
| Inventories *(note 3)* | **563,237** | 512,026 |
| Prepaid expenses | **19,502** | 15,102 |
| | **1,062,360** | 1,358,088 |
| Equipment *(note 4)* | **321,012** | 390,424 |
| Investments *(note 5)* | **807,749** | - |
| Lease deposit *(note 8)* | **35,000** | 35,000 |
| | **$ 2,226,121** | $ 1,783,512 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Bank indebtedness *(note 6)* | **$ 157,374** | $ - |
| Accounts payable and accrued liabilities *(note 10)* | **546,845** | 697,260 |
| Customer deposits | **36,895** | 83,151 |
| Current portion of long-term debt *(note 7)* | **39,493** | 39,493 |
| | **780,607** | 819,904 |
| Long-term debt *(note 7)* | **3,291** | 42,784 |
| | **783,898** | 862,688 |
| **Commitment** *(note 8)* | | |
| **Shareholders' Equity** | | |
| Share capital *(note 9)* | **23,215,877** | 22,418,782 |
| Warrants *(note 9)* | **137,470** | 105,376 |
| Contributed surplus *(note 9)* | **1,531,134** | 955,168 |
| Deficit | **(23,442,258)** | (22,558,502) |
| | **1,442,223** | 920,824 |
| | **$ 2,226,121** | $ 1,783,512 |

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

Approved by the Board:

| | |
|---|---|
| *Signed: "William J. Brown"* | *Signed: "Steve Smith"* |
| Director | Director |

## ZTEST Electronics Inc.

**Consolidated Statement of Changes in Equity**
(Stated in Canadian Dollars)
*June 30, 2018*

| | 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 | 81,471 | - | (36,471) | - | 45,000 |
| Private placement, net | 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 year | - | - | - | (497,880) | (497,880) |
| Balance, June 30, 2017 | 22,418,782 | 105,376 | 955,168 | (22,558,502) | 920,824 |
| Stock options exercised | 37,085 | - | (17,085) | - | 20,000 |
| Warrants exercised | 165,131 | (39,131) | - | - | 126,000 |
| Warrants expired | - | (1,055) | 1,055 | - | - |
| Private placement | 405,679 | 72,280 | - | - | 477,959 |
| Shares issued as consideration for investment | 189,200 | - | - | - | 189,200 |
| Share-based payments | - | - | 591,996 | - | 591,996 |
| Net loss for the year | - | - | - | (883,756) | (883,756) |
| **Balance, June 30, 2018** | **$ 23,215,877** | **$ 137,470** | **$ 1,531,134** | **$ (23,442,258)** | **$ 1,442,223** |

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

## ZTEST Electronics Inc.

**Consolidated Statements of Comprehensive Loss**
(Stated in Canadian Dollars)
*For the years ended June 30, 2018 and 2017*

| | 2018 | 2017 |
|---|---|---|
| **Product sales** | **$ 3,686,132** | $ 3,754,883 |
| **Cost of product sales** (*note 3*) | **2,564,147** | 2,637,434 |
| | **1,121,985** | 1,117,449 |
| **Expenses** | | |
| Selling, general and administrative *(note 11)* | **1,375,951** | 1,278,212 |
| Stock-based compensation *(notes 9 and 10)* | **591,996** | 39,312 |
| Interest expense - long-term debt | **3,092** | 4,505 |
| Interest expense - other | **4,034** | 858 |
| Depreciation of equipment | **5,208** | 5,843 |
| Foreign exchange gain | **(1,982)** | (7,705) |
| | **1,978,299** | 1,321,025 |
| **Loss before other income and provisions, and income taxes** | **(856,314)** | (203,576) |
| **Other income and provisions** | | |
| Interest income | **9** | 258 |
| Impairment provision *(note 5)* | **-** | (294,562) |
| Equity in loss of Conversance Inc. *(note 5)* | **(27,451)** | - |
| | **(27,442)** | (294,304) |
| **Loss before provision for income taxes** | **(883,756)** | (497,880) |
| Provision for income taxes *(note 12)* | **-** | - |
| **Net loss and comprehensive loss for the year** | **$ (883,756)** | **$** (497,880) |
| | | |
| **Net loss per share** | | |
| **Basic** | **$ (0.05)** | $ (0.04) |
| **Fully diluted** | **$ (0.05)** | $ (0.04) |
| | | |
| **Weighted average shares outstanding** | | |
| **Basic** | **18,611,710** | 14,158,696 |
| **Fully diluted** | **18,611,710** | 14,158,696 |

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

## ZTEST Electronics Inc.

**Consolidated Statements of Cash Flows**
(Stated in Canadian Dollars)
*For the years ended June 30, 2018 and 2017*

| | | 2018 | | 2017 |
|---|---|---|---|---|
| **Cash flow from operating activities** | | | | |
| Net loss for the year | **$** | **(883,756)** | $ | (497,880) |
| Items not involving cash | | | | |
| Stock-based compensation | | **591,996** | | 39,312 |
| Depreciation of equipment | | **78,188** | | 93,611 |
| Equity in loss of Conversance Inc. | | **27,451** | | - |
| Impairment provision | | **-** | | 294,562 |
| | | **(186,121)** | | (70,395) |
| Changes in non-cash working capital items | | | | |
| Accounts receivable | | **164,345** | | (117,214) |
| Inventories | | **(51,211)** | | (136,760) |
| Prepaid expenses | | **(4,400)** | | (321) |
| Customer deposits | | **(46,256)** | | 83,151 |
| Accounts payable and accrued liabilities | | **(150,415)** | | 157,661 |
| | | **(274,058)** | | (83,878) |
| **Cash flow from investing activities** | | | | |
| Purchase of equipment | | **(8,776)** | | (20,779) |
| Investment in Conversance | | **(646,000)** | | (225,000) |
| | | **(654,776)** | | (245,779) |
| **Cash flow from financing activities** | | | | |
| Proceeds from bank operating loan, net | | **110,000** | | - |
| Repayment of long-term debt | | **(39,493)** | | (39,492) |
| Proceeds from share issuances | | **623,959** | | 262,500 |
| | | **694,466** | | 223,008 |
| **Increase (decrease) in cash** | | **(234,368)** | | (106,649) |
| **Cash, beginning of year** | | **186,994** | | 293,643 |
| **Cash (deficiency), end of year** | **$** | **(47,374)** | $ | 186,994 |

**Supplemental Disclosure of Cash Flow Information:**
During the year the Company had cash flows arising from interest and income taxes paid as follows:

| | | | | |
|---|---|---|---|---|
| Interest | **$** | **7,197** | $ | 5,475 |
| Income taxes | **$** | **-** | $ | - |

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

## 1. Business of the Company

ZTEST Electronics Inc. ("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 consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). These consolidated financial statements were authorized for issuance by the Board of Directors of the Company on October 29, 2018.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

**Basis of presentation and going concern considerations**
These consolidated financial statements have been prepared on a historical cost basis using the accrual basis of accounting, except for cash flow information, and in accordance with IFRS applicable to a "going concern". Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due. If the going concern assumption were not appropriate for these consolidated financial statements then adjustments would be necessary in the carrying values of assets and liabilities, the reported revenues and expenses, and the statement of financial position classifications used.

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

| | | |
|---|---|---|
| Permatech Electronics Corporation ("PEC") | - 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 year that were required to be adopted by the Company.

**Significant accounting judgments and estimates**
The preparation of these 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 consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the 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 assessment of the Company as a going concern, recoverability of inventory, the inputs used in applying the Black-Scholes valuation model, and the recognition and valuation of deferred tax amounts.

## 2. Significant Accounting Policies - continued

**Financial instruments**

The Company's financial instruments are comprised of the following:

| *Financial assets:* | *Classification* |
|---|---|
| Cash | Fair value through profit and loss |
| Accounts receivable | Loans and receivables |

| *Financial liabilities:* | *Classification* |
|---|---|
| Bank indebtedness | Other financial liabilities |
| Accounts payable and accrued liabilities | Other financial liabilities |
| Customer deposits | Other financial liabilities |
| Long-term debt | Other financial liabilities |

*Fair value through profit and loss:*

Financial assets are designated as fair value through profit and loss if they were acquired principally for the purpose of selling in the short term. Fair value through profit and loss assets are recognized and carried at their fair value.

*Loans and receivables:*

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

*Other financial liabilities:*

Other financial liabilities are recognized initially at fair value, net of any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial instrument and of allocating interest and any transaction costs over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial instrument to the net carrying amount on initial recognition. Other financial liabilities are de-recognized when the obligations are discharged, cancelled or expired.

*Impairment of financial assets:*

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the assets have been negatively impacted.

Evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

The carrying amount of financial assets is reduced by any impairment loss directly for all financial assets with the exception of accounts receivable, where the carrying amount is reduced through the use of an allowance account. When an account receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in income for the period.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through income for the period to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

## 2. Significant Accounting Policies - continued

**Financial instruments - continued**

*Financial instruments recorded at fair value*:
Financial instruments recorded at fair value 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 June 30, 2017, cash was measured at fair value and classified within Level 1 of the fair value hierarchy.

*Financial instruments recorded at amortized cost*:
Financial instruments recorded at amortized cost are amortized using the market rates of interest prevailing at the inception of the financial instrument applied to expected future cash flows. The amortized cost is recomputed in the event that the underlying terms, and therefore the expected future cash flows, of the financial instrument are altered with any change in the amortized cost being charged to income for the period.

**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.

Where such an indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss is recognized in the income for the period.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized immediately in income for the period.

**Inventories**

Inventories are valued at the lower of cost and net realizable value. Cost is determined using the weighted average cost method. Net realizable value is the amount, net of the estimated costs to complete assemblies and sell them, which the Company expects to realize from the sale of inventory in the ordinary course of business. An assessment of net realizable value is completed at the end of each reporting period and any resulting write-downs, or recovery of previous write-downs, are reflected in income for the period. Current assessments have determined that net realizable values equal or exceed the corresponding costs and accordingly all inventories are currently carried at cost.

**Investments**

Non-controlling interests, which are not financial instruments, and are less than a 20% ownership interest, are initially recorded at the cost of acquisition plus any directly attributable transaction costs. Subsequent to the acquisition date the investment is carried at amortized value, representing the initial carrying value net of any impairment provisions. An investment of this type is considered impaired when its carrying amount exceeds its recoverable amount.

## 2. Significant Accounting Policies - continued

**Investments - continued**

Non-controlling interests, which are not financial instruments, and are equal to or exceeding a 20% ownership interest (an equity instrument), are initially recorded at the cost of acquisition plus any directly attributable transaction costs. Subsequent to the acquisition date the investment is adjusted for the post-acquisition change in the investor's share of the investee's net assets and for any impairment provisions.

An equity instrument is considered impaired if, and only if, there is objective evidence of impairment as a result of one or more events that occur after the initial recognition of the asset (a 'loss event') and that loss event, or events, has an impact on the estimated future cash flows of the non-controlling interest that can be reliably estimated. Losses expected as a result of future events, no matter how likely, are not recognized.

Some items that may be taken into consideration in determining whether a loss event has occurred include significant financial difficulty of the investee, a breach of contract such as a default or delinquency in payments by the investee, it becomes probable that the investee will enter bankruptcy or other financial reorganization, or significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the investee operates, and such changes indicate that the cost of the equity instrument may not be recovered.

**Equipment**

Equipment is stated at cost. Depreciation is provided over the related assets' estimated useful lives using the following methods and annual rates:

| | | | |
|---|---|---|---|
| Computer equipment | - | 30% | declining balance |
| Office equipment | - | 20% | declining balance |
| Manufacturing equipment | - | 20% | declining balance |
| Leasehold improvements | - | 10 yrs | straight-line |

The Company reviews the estimated useful lives, residual values and depreciation method at the end of each reporting period, accounting for the effect of any changes in estimate on a prospective basis.

**Revenue recognition**

Revenue is recognized when the risks and rewards of ownership pass to the customer, the amount of revenue can be measured reliably, and the ability to collect is reasonably assured, which typically arises when the product is delivered.

**Share based payment transactions**

The fair value of share options granted to employees is recognized as an expense over the vesting period with a corresponding increase in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee, including directors of the Company.

The fair value is measured at grant date and recognized over the period during which the options vest. The fair value of the options granted is measured using the Black Scholes option pricing model, after considering the terms and conditions upon which the options were granted. At the end of each financial reporting period, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

**Foreign exchange**

As at the transaction date all asset, liability, revenue, and expense amounts denominated in foreign currencies are translated into Canadian dollars using the exchange rate in effect as at that date. At the end of each financial reporting period all monetary assets and liabilities are translated into Canadian dollars using the exchange rate in effect as at that date. The resulting foreign exchange gains and losses are included in income for the period.

(Stated in Canadian Dollars)

## 2. Significant Accounting Policies - continued

**Income taxes**
Income tax expense consists of current and deferred tax expense. Income tax expense is recognized in profit and loss except to the extent that it relates to items recognized directly in equity or other comprehensive income.

Current tax is recognized and measured at the amount expected to be recovered from or payable to the taxation authorities based on the income tax rates enacted or substantively enacted at the end of the reporting period and includes any adjustment to taxes payable in respect of previous years.

Deferred tax is recognized on any temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable earnings. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized and the liability is settled. The effect of a change in the enacted or substantively enacted tax rates is recognized in profit and loss and comprehensive (loss) income or in equity depending on the item to which the adjustment relates.
Deferred tax assets are recognized to the extent future recovery is probable. At the end of each financial reporting period, deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

**Loss per share**
The Company presents basic and diluted loss per share data for its common shares, calculated by dividing the loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the financial reporting period. Diluted loss per share is determined by adjusting the 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 from the computation of diluted loss 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 of the Company's shares for the financial reporting period.

**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 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, replaces existing revenue standards and interpretations with a single standard and provides additional guidance on revenue recognition for contracts with customers.

The Company has completed its assessment and there will be no material impact upon the financial statements when these standards are adopted for the year beginning July 1, 2018.

## 3. Inventories

The carrying value of inventories is comprised of:

| | **2018** | 2017 |
|---|---|---|
| Raw materials and supplies [(1)] | **$ 529,192** | $ 496,707 |
| Work in process | **17,060** | 9,155 |
| Finished goods | **16,985** | 6,164 |
| | **$ 563,237** | $ 512,026 |

(Stated in Canadian Dollars)

## 3. Inventories - continued

[1] Raw materials and supplies is presented net of provisions for obsolete and/or slow-moving items in the amount of $10,935 (2017 - $11,236). Management makes estimates of future demand when establishing appropriate provisions. To the extent that actual inventory losses differ from these estimates both inventories and net loss will be affected.

Inventory utilization during the year was as follows:

| | **2018** | 2017 |
|---|---|---|
| Raw materials and supplies used | **$ 1,672,413** | $ 1,712,277 |
| Labour costs | **730,614** | 688,893 |
| Depreciation | **72,980** | 87,767 |
| Repairs and maintenance | **17,594** | 52,296 |
| Stencils and tooling | **19,931** | 28,512 |
| Shipping costs | **58,757** | 49,050 |
| Packaging costs | **10,583** | 12,707 |
| Net change in finished goods and work in process | **(18,725)** | 5,932 |
| Cost of product sales | **$ 2,564,147** | $ 2,637,434 |

## 4. 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 | 697 | - | 20,082 | - | 20,779 |
| Balance, June 30, 2017 | 181,402 | 71,277 | 2,587,172 | 84,143 | 2,923,994 |
| Additions | 1,704 | - | 7,072 | - | 8,776 |
| Balance, June 30, 2018 | **$ 183,106** | **$ 71,277** | **$ 2,594,244** | **$ 84,143** | **$ 2,932,770** |

| | Computer Equipment | Office Equipment | Manufacturing Equipment | Leasehold Improvements | Total |
|---|---|---|---|---|---|
| Accumulated Depreciation: | | | | | |
| Balance, June 30, 2016 | $ (171,403) | $ (69,256) | $ (2,137,140) | $ (62,160) | $ (2,439,959) |
| Depreciation | (2,895) | (404) | (87,998) | (2,314) | (93,611) |
| Balance, June 30, 2017 | (174,298) | (69,660) | (2,225,138) | (64,474) | (2,533,570) |
| Depreciation | (2,387) | (323) | (73,164) | (2,314) | (78,188) |
| Balance, June 30, 2018 | **$ (176,685)** | **$ (69,983)** | **$ (2,298,302)** | **$ (66,788)** | **$ (2,611,758)** |
| Carrying Amounts: | | | | | |
| June 30, 2017 | $ 7,104 | $ 1,617 | $ 362,034 | $ 19,669 | $ 390,424 |
| June 30, 2018 | **$ 6,421** | **$ 1,294** | **$ 295,942** | **$ 17,355** | **$ 321,012** |

(Stated in Canadian Dollars)

## 5. Investments

The Company holds a non-controlling interest in Conversance Inc., a private Canadian technology company. The shares of Conversance Inc. are subject to a hold period and, unless permitted under securities legislation, the shares may not be traded before the date that is four months and a day after the issuer becomes a reporting issuer in any province or territory.

Conversance Inc. is engaged in the development of its proprietary technology and has not yet produced any revenues. The timing of such revenues, if any, is not currently determinable.

The Company has determined as at June 30, 2018 that there has been no loss event and accordingly no test for impairment was completed. At June 30, 2017 it was determined that the carrying amount of the investment exceeded the recoverable amount resulting in an impairment provision of $294,562.

| | | **2018** | | 2017 |
|---|---|---|---|---|
| 155,000 Class A common shares representing a 15.05% interest (1) | **$** | **294,562** | $ | 294,562 |
| 62,500 Class A common shares representing a 4.86% interest (2) | | **330,450** | | - |
| 78,750 Class A common shares representing a 5.38% interest (3) | | **504,750** | | - |
| Investment representing a 25.29% interest (June 30, 2017 – 15.05%) | | **1,129,762** | | 294,562 |
| Impairment provision | | **(294,562)** | | (294,562) |
| Equity in post-acquisition loss | | **(27,451)** | | - |
| Aggregate investment | **$** | **807,749** | $ | - |

(1) The Company paid $210,000, issued 1,325,000 common shares at a value of $0.0525 per share, and incurred costs of $15,000 to acquire this investment.

(2) The Company paid $140,000, issued 275,000 common shares at a value of $0.6880 per share, and incurred costs of $1,250 to acquire this investment.

(3) The Company paid $500,000 and incurred costs of $4,750 to acquire this investment.

## 6. Bank indebtedness

| | | **2018** | | 2017 |
|---|---|---|---|---|
| Cash deficiency, inclusive of outstanding payments | $ | **47,374** | $ | - |
| 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. | | **110,000** | $ | - |
| | **$** | **157,374** | $ | - |

## 7. Long-Term Debt

| | | **2018** | | 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. | $ | **42,774** | $ | 82,277 |
| Less: Current portion | | **39,493** | | 39,493 |
| | **$** | **3,281** | $ | 42,784 |

| | | |
|---|---|---|
| The minimum annual future principal repayments are as follows: | | |
| 2019 | $ | 39,493 |
| 2020 | | 3,291 |
| | $ | 42,774 |

(Stated in Canadian Dollars)

## 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 was 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:

| | |
|---|---|
| 2019 | $ 106,385 |
| 2020 | 107,743 |
| 2021 | 80,807 |
| | $ 294,935 |

## 9. Share Capital

**Authorized:**

Unlimited Common shares
Unlimited Preferred shares in one or more series.

**Issued:**

| | **2018** | 2017 |
|---|---|---|
| Common shares | **$ 23,215,877** | $ 22,418,782 |

| **Common shares:** | Number of Shares (1) | Amount |
|---|---|---|
| Balance June 30, 2016 | 10,648,696 | $ 22,151,406 |
| Exercise of stock options | 700,000 | 81,471 |
| Private placement | 4,500,000 | 116,343 |
| Investment in Conversance Inc. *(note 5)* | 1,325,000 | 69,562 |
| Balance June 30, 2017 | 17,173,696 | 22,418,782 |
| Exercise of stock options | 200,000 | 37,085 |
| Exercise of warrants | 1,900,000 | 165,131 |
| Private placement (2) | 625,000 | 405,679 |
| Investment | 275,000 | 189,200 |
| Balance June 30, 2018 (3) | 20,173,696 | **$ 23,215,877** |

(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.

(2) The Company completed a private placement transaction whereby it issued 625,000 working capital units for gross proceeds of $531,250. Each unit consisted 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. The Company paid finders' fees of $37,188, incurred other costs of $16,140, attributed a value of $57,615 to the common share purchase warrants, and issued 43,750 broker warrants valued at $14,665. Each broker warrant entitles the holder to acquire 1 common share of the Company for $0.85 until January 30, 2019.

(3) Subsequent to the financial reporting date 50,000 stock options were exercised for gross proceeds of $5,000.

(Stated in Canadian Dollars)

## 9. Share Capital - continued

**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 June 30, 2017 | 4,900,000 | | 105,376 |
| Warrants issued via private placement | 312,500 | | 57,615 |
| Broker warrants issued via private placement | 43,750 | | 14,665 |
| Warrants exercised | (1,900,000) | | (39,131) |
| Warrants expired | (100,000) | | (1,055) |
| Balance June 30, 2018 | 3,256,250 | **$** | **137,470** |

| | Number of Warrants | | Exercise Price | Expiry Date |
|---|---|---|---|---|
| Issued Dec. 15, 2016 | 2,900,000 | $ | 0.06 | Dec. 15, 2021 |
| Issued Jan. 30, 2018 | 43,750 | $ | 0.85 | Jan. 30, 2019 |
| Issued Jan. 30, 2018 | 312,500 | $ | 1.10 | Jan. 31, 2019 |

| | Number of Warrants | | Weighted Average Price per Warrant | Weighted Average Expiry Date |
|---|---|---|---|---|
| Beginning of the year | 4,900,000 | $ | 0.06 | Aug. 14, 2021 |
| Issued during the year | 356,250 | $ | 1.07 | Jan. 30, 2019 |
| Exercised during the year | (1,900,000) | $ | 0.07 | Apr. 21, 2021 |
| Expired during the year | (100,000) | $ | 0.10 | Oct. 31, 2017 |
| End of year | 3,256,250 | $ | 0.17 | Aug. 22, 2021 |

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

| | **2018** | 2017 |
|---|---|---|
| Dividend yield | **Nil** | Nil |
| Risk free interest rate (%) | **1.61** | 1.20 |
| Expected stock volatility (%) | **70.49** | 130.19 |
| Expected life (years) | **1** | 5 |

**Details of options outstanding:**

| | Common Shares Under Option | Number of Options Vested | | Exercise Price | Expiry Date |
|---|---|---|---|---|---|
| Granted December 31, 2013 | 300,000 [1,2] | 300,000 | $ | 0.10 | Dec. 31, 2018 |
| Granted Mar. 3, 2016 | 400,000 [1] | 400,000 | $ | 0.05 | Mar. 3, 2021 |
| Granted December 21, 2016 | 150,000 [1] | 150,000 | $ | 0.15 | Dec. 21, 2021 |
| Granted December 21, 2016 | 50,000 | 50,000 | $ | 0.15 | Dec. 21, 2021 |
| Granted January 12, 2018 | 600,000 [1] | 600,000 | $ | 0.95 | Jan. 12, 2023 |

(1) Directors and/or Officers of the Company hold these options.
(2) Subsequent to the financial reporting date 50,000 options were exercised.

(Stated in Canadian Dollars)

## 9. Share Capital - continued

**Details of options outstanding - continued:**

| | Common Shares Under Option | | Weighted Average Price/Option | Weighted Average Expiry Date |
|---|---|---|---|---|
| Beginning of the year | 1,230,000 | $ | 0.09 | June 20, 2020 |
| Granted during the year | 1,040,000 | $ | 0.95 | Aug. 27, 2021 |
| Exercised during the year | (200,000) | $ | 0.10 | Jul. 27, 2021 |
| Expired during the year | (570,000) | $ | 0.76 | Sept. 14, 2017 |
| End of year | 1,500,000 | $ | 0.43 | Aug. 2, 2021 |

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

| | **2018** | 2017 |
|---|---|---|
| Dividend yield | **Nil** | Nil |
| Risk free interest rate (%) | **1.62 – 1.98** | 1.19 |
| Expected stock volatility (%) | **99.36 – 154.07** | 135.35 |
| Expected life (years) | **1 - 5** | 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:

| | | **2018** | | 2017 |
|---|---|---|---|---|
| Contributed surplus, beginning of year | **$** | **955,168** | $ | 952,327 |
| Stock options granted | | **591,996** | | 39,312 |
| Stock options exercised | | **(17,085)** | | (36,471) |
| Warrants expired | | **1,055** | | - |
| Contributed surplus, end of year | **$** | **1,531,134** | $ | 955,168 |

## 10. Related Party Transactions and Balances

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 year with key management personnel:

| Description | | **2018** | | 2017 |
|---|---|---|---|---|
| Employee and consultant compensation | **$** | **399,698** | $ | 361,492 |
| Professional fees | | **69,052** | | 31,074 |
| Professional fees classified as cost of investment | | **4,750** | | 15,000 |
| Professional fees classified as share issuance costs | | **16,250** | | 7,500 |
| | **$** | **489,750** | $ | 415,066 |
| Stock-based compensation | **$** | **493,017** | $ | 26,208 |

As at June 30, 2018 $169,370 (2017 - $154,136) was payable to key management personnel and included in accounts payable and accrued liabilities.

(Stated in Canadian Dollars)

## 11. Selling, general and administrative expenses

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

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Employee and consultant compensation *(note 10)* | **$** | **896,089** | $ | 852,682 |
| Insurance | | **30,945** | | 29,643 |
| Occupancy costs | | **263,446** | | 262,472 |
| Professional fees *(note 10)* | | **99,998** | | 56,074 |
| Shareholder services | | **26,121** | | 22,117 |
| Other | | **59,352** | | 55,224 |
| | **$** | **1,375,951** | $ | 1,278,212 |

## 12. Income Taxes

**Current Income Taxes**

A reconciliation of combined federal and provincial corporate income taxes at the Company's effective tax rate of 26.50% (2017 – 26.50%) is as follows:

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Net loss before income taxes | **$** | **(856,305)** | $ | (497,880) |
| Expected income tax recovery | $ | **(226,921)** | $ | (131,939) |
| Expenses not deductible for income tax purposes | | **157,537** | | 10,649 |
| Change in tax benefits not recognized | | **69,384** | | 121,290 |
| Income tax expense | **$** | **-** | $ | - |

**Deferred Tax**

The following table summarizes the components of deferred tax:

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Deferred tax assets: | | | | |
| Non-capital losses carried forward | $ | **7,643** | $ | 5,675 |
| Deferred tax liabilities: | | | | |
| Temporary timing differences | | **(7,643)** | | (5,675) |
| Net deferred tax liabilities | **$** | **-** | $ | - |

**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:

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Inventory | $ | **10,935** | **$** | 11,236 |
| Share issuance costs | | **47,162** | | 6,000 |
| Intangible assets | | **30,110** | | 32,376 |
| Property, plant and equipment | | **25,394** | | 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 | | **1,790,025** | | 1,503,716 |
| Net capital loss carry-forwards | | **15,592,989** | | 15,592,989 |

(Stated in Canadian Dollars)

## 12. Income Taxes - continued

**Unrecognized Deferred Tax Assets - continued**
Share issue costs expire in 2022 and non-capital loss carry-forwards expire as disclosed below. The remaining deductible temporary differences may be carried forward indefinitely but net capital loss carry-forwards can only be used to reduce capital gains. 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.

**Tax Loss Carry-Forwards**
The potential income tax benefits resulting from the application of income tax losses have not been recognized in these consolidated financial statements. The following losses, which may be subject to verification by Canada Revenue Agency, will expire at the end of the taxation years as follows:

| 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 |
| 2038 | 294,158 |
| | $ 1,906,232 |

## 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.

| | **2018** | 2017 |
|---|---|---|
| Long-term debt | **$ 42,774** | $ 82,277 |
| Share capital | **23,215,877** | 22,418,782 |
| Warrants | **137,470** | 105,376 |
| Contributed surplus | **1,531,134** | 955,168 |
| Deficit | **(23,414,807)** | (22,558,502) |
| Net capital under management | **$ 1,512,448** | $ 1,003,101 |

## 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. The Company incurred bad debts of $Nil (2017 - $1,286) during the year ended June 30, 2018.

## 14. Financial risk factors - continued

**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 financial reporting period. During the current year the Company had three major customers which represented 12%, 12% and 10% of total revenues. In the prior year one major customer accounted for 14% of revenues. Amounts due from major customers represented 27% of accounts receivable at June 30, 2018 (2017 - 11%). 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.

**Liquidity risk**

Liquidity risk arises through the excess of financial obligations over available financial assets due at any point in time. At June 30, 2018 the Company had current financial assets of $479,621 (2017 - $830,960) available to settle current financial liabilities of $780,607 (2017 - $819,904). The Company manages its liquidity risk through the management of its capital *(note 13)* which incorporates the continuous monitoring of actual and projected cash flows to ensure that it has sufficient liquidity to meet its operating commitments without incurring unacceptable losses or risking damage to the Company's reputation.

**Market risks**

The Company is exposed to interest rate risk due to two 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 year the Company has reported a foreign exchange gain of $1,982 (2017 – gain of $7,705).

**Sensitivity to market risks**

At June 30, 2018 the Company had $42,784 (2017 – $82,277) in long term debt and a bank operating loan in the amount of $110,000 (2017 – $Nil) each of which bears interest predicated upon the TD Bank prime lending rate. The bank operating loan is revolving in nature, meaning it may increase or decrease in accordance with daily cash requirements. In the event the amount due on the operating loan remains at current levels, a 1% increase in the TD Bank prime lending rate, as at the financial reporting date, would result in additional interest expense – long-term debt of $255 and interest expense – other of $1,100 over the next 12 month period.

At June 30, 2018 the Company had an overdraft of US$16,417 (2017 – US $46,339 cash) included in bank indebtedness or cash. A 5% increase in the value of the Canadian dollar relative to the US dollar would result in a reduction of $265 in carrying value.

At June 30, 2018 the Company had US$4,634 (2017 – 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 a recognition of $75 in additional future expenses.

At June 30, 2018 the Company had US$63,433 (2017 –US $56,360) 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 $1,026 in future cash inflow.

At June 30, 2018 the Company had US$27,879 (2017 – 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 $451 in future revenue.

At June 30, 2018 the Company had US$119,219 (2017 – 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 $1,928 in future cash outflow.

Based upon observations of recent market trends management believes that each of these outcomes is possible.