

CRS ELECTRONICS INC.

CONSOLIDATED FINANCIAL STATEMENTS

Audited, in U.S. Dollars

For the Years Ended December 31, 2013 and 2012

CRS ELECTRONICS INC.

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December 31, 2013

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Independent Auditor's Report

To the Shareholders of CRS Electronics Inc.

We have audited the accompanying consolidated financial statements of CRS Electronics Inc., which comprise the statement of financial position as at December 31, 2013, and the statements of loss and comprehensive loss, changes in equity, and cash flows for the year 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's 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 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 financial position of CRS Electronics Inc. as at December 31, 2013, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matters

Without modifying our opinion, we draw attention to Note 1 to the consolidated financial statements which highlights the existence of a material uncertainty relating to conditions that cast significant doubt on CRS Electronics Inc.'s ability to continue as a going concern.

Other Matters

The consolidated financial statements as at December 31, 2012 and for the year then ended were audited by MSCM LLP of Toronto, Canada, prior to its merger with MNP LLP. MSCM LLP expressed an unmodified opinion on those statements on April 18, 2013.

MNP LLP

**Chartered Professional Accountants
Licensed Public Accountants**

Toronto, Canada
April 23, 2014

CRS ELECTRONICS INC.
Consolidated Statements of Financial Position
Expressed in U.S. Dollars

	December 31, 2013	December 31, 2012
ASSETS		
Current Assets		
Cash and cash equivalents (Note 3)	\$ 3,081,012	\$ 4,517,911
Accounts receivable (Note 4)	221,054	514,328
Government incentives receivable (Note 14)	57,638	44,184
Inventory (Note 5)	1,110,033	725,125
Deposits and prepaid expenses	99,957	111,725
	4,569,694	5,913,273
Non-current assets		
Equipment, furniture and leaseholds (Note 6)	563,114	609,976
Patents and trademarks (Note 7)	45,208	85,165
Intangible assets (Note 8)	230,667	288,430
	\$ 5,408,683	\$ 6,896,844
LIABILITIES		
Current liabilities		
Bank indebtedness (Note 9)	\$ 414,269	\$ -
Trade and other payables	1,105,203	1,007,948
Note payable (Note 10)	-	32,420
Current portion of debt obligations (Note 11)	106,103	158,448
Current portion of finance lease obligations (Note 12)	35,946	34,584
Derivative liabilities (Note 15)	22,827	-
	1,684,348	1,233,400
Non-current liabilities		
Debt obligations (Note 11)	186,573	395,788
Finance lease obligations (Note 12)	33,128	72,747
Derivative liabilities (Note 15)	-	224,685
	1,904,049	1,926,620
Commitments and contingencies (Note 19)		
Subsequent events (Note 22)		
EQUITY		
Share capital (Note 16)	17,153,996	14,366,423
Other paid-in capital	1,750,076	1,416,338
Deficit	(15,399,438)	(10,812,537)
	3,504,634	4,970,224
	\$ 5,408,683	\$ 6,896,844

Nature of operations and going concern (Note 1)

The accompanying notes form an integral part of these consolidated financial statements.

APPROVED BY THE BOARD OF DIRECTORS:

Signed "Scott Riesebosch" Director

Signed "Rob Neill" Director

CRS ELECTRONICS INC.Consolidated Statements of Loss and Comprehensive Loss
Expressed in U.S. Dollars

For the years ended December 31

	<u>2013</u>	<u>2012</u>
SALES	\$ 2,024,300	\$ 3,070,121
Cost of sales	3,091,315	4,803,233
GROSS LOSS	(1,067,015)	(1,733,112)
EXPENSES		
Engineering, research and development	734,428	383,365
Selling and marketing	740,775	1,414,743
General and administrative	1,983,250	2,251,427
Loss on disposal of equipment, furniture and leaseholds	58,801	256,874
Impairment of patents and trademarks	24,498	21,846
Impairment of intangible assets	888	(1,448)
Change in derivative liabilities (Note 15)	(201,858)	(608,175)
SR&ED refundable tax credits	(13,454)	-
	3,327,328	3,718,632
LOSS BEFORE FINANCE REVENUE AND COSTS, FOREIGN EXCHANGE (LOSS) GAIN AND INCOME TAXES	(4,394,343)	(5,451,744)
Finance revenue – interest earned	32,956	39,508
Finance costs - debt obligations	(54,765)	(62,811)
Finance accretion costs - debt obligations	(30,395)	(41,520)
Foreign exchange (loss) gain	(140,354)	243,585
LOSS BEFORE INCOME TAXES	(4,586,901)	(5,272,982)
Income taxes (Note 13)	-	-
NET LOSS AND COMPREHENSIVE LOSS	\$ (4,586,901)	\$ (5,272,982)
Loss per share - basic and fully diluted	\$ (0.06)	\$ (0.09)
Weighted average number of common shares outstanding - basic and fully diluted	71,440,940	57,987,130

The accompanying notes form an integral part of these consolidated financial statements.

CRS ELECTRONICS INC.

Consolidated Statements of Cash Flows
Expressed in U.S. Dollars

For the years ended December 31

	2013	2012
OPERATING ACTIVITIES		
Net loss for the year	\$ (4,586,901)	\$ (5,272,982)
Items not affecting cash		
Stock-based compensation	333,738	186,945
Change in derivative liabilities	(201,858)	(608,175)
Short-term financing expense	-	58,350
Depreciation of equipment, furniture and leaseholds	182,446	294,613
Amortization of patents and trademarks	26,575	32,435
Amortization of intangible assets	106,841	114,058
Accretion expense	30,395	41,520
Loss on disposal of equipment, furniture and leaseholds	58,801	256,874
Impairment of patents and trademarks	24,498	21,846
Impairment of intangible assets	888	5,573
	(4,024,577)	(4,868,943)
Net change in non-cash working capital items relating to operating activities		
Accounts receivable	293,274	(6,912)
Government incentives receivable	(13,454)	8,699
Inventory	(384,908)	968,050
Deposits and prepaid expenses	11,768	384,387
Trade and other payables	97,255	(575,188)
Cash used in operating activities	(4,020,642)	(4,089,907)
INVESTING ACTIVITIES		
Purchase of equipment, furniture, and leaseholds	(194,385)	(143,598)
Proceeds on disposal of equipment, furniture and leaseholds	-	10,625
Additions to patent and trademark costs	(11,116)	(19,561)
Additions to intangible assets	(49,966)	(73,224)
Cash used in investing activities	(255,467)	(225,758)
FINANCING ACTIVITIES		
Repayment of note payable	(32,420)	(68,666)
Proceeds from notes payable	-	64,175
Repayment of line of credit	-	(318,513)
Proceeds from line of credit	414,269	-
Repayment of finance lease obligations	(38,256)	(25,644)
Repayment of proceeds from debt obligations	(291,956)	(175,187)
Net proceeds from issuance of common shares	2,787,573	8,422,210
Cash provided by financing activities	2,839,210	7,898,375
Net (decrease) increase in cash and cash equivalents	(1,436,899)	3,582,710
Cash and cash equivalents, beginning of year	4,517,911	935,201
Cash and cash equivalents, end of year	\$ 3,081,012	\$ 4,517,911
The following cash flows are included in operating activities:		
Interest paid	\$ 54,765	\$ 62,810
Non-cash transactions:		
Acquisition of equipment and intangibles under finance lease	\$ -	\$ 49,277

The accompanying notes form an integral part of these consolidated financial statements.

CRS ELECTRONICS INC.

Consolidated Statements of Changes in Equity

Expressed in U.S. Dollars

	Share capital	Other Paid-in Capital	Deficit	Total
Balance, December 31, 2012	\$ 14,366,423	\$ 1,416,338	\$ (10,812,537)	\$ 4,970,224
Net loss for the year	-	-	(4,586,901)	(4,586,901)
Issue of common shares	2,787,573	-	-	2,787,573
Stock-based compensation	-	333,738	-	333,738
Balance, December 31, 2013	\$ 17,153,996	\$ 1,750,076	\$ (15,399,438)	\$ 3,504,634

	Share capital	Other Paid-in Capital	Deficit	Total
Balance, December 31, 2011	\$ 6,403,407	\$ 711,849	\$ (5,539,555)	\$ 1,575,701
Net loss for the year	-	-	(5,272,982)	(5,272,982)
Issue of common shares	7,963,016	-	-	7,963,016
Issue of warrants	-	517,544	-	517,544
Stock-based compensation	-	186,945	-	186,945
Balance, December 31, 2012	\$ 14,366,423	\$ 1,416,338	\$ (10,812,537)	\$ 4,970,224

The accompanying notes form an integral part of these consolidated financial statements.

CRS ELECTRONICS INC.

Notes to Consolidated Financial Statements

Expressed in U.S. Dollars

For the years ended December 31, 2013 and 2012

1. NATURE OF OPERATIONS AND GOING CONCERN

CRS Electronics Inc. (the “Company” or “CRS”) was incorporated under the Canada Business Corporations Act on October 25, 1998 and continues pursuant to a Certificate of Amalgamation dated September 1, 2009. Its head office is located at 9120 Leslie Street, Suite 102, Richmond Hill, Ontario, Canada L4B 3J9 and its manufacturing warehouse is located at 129 Hagar Street, Unit 5, Welland, Ontario, Canada L3B 5V9. Its principal activities are the development, manufacture and sale, primarily in North America, of child safety systems for school buses; exterior lighting on school buses based on incandescent and light emitting diode technology (“LED”); contract manufacturing of LED light boards; and LED based space lighting products. The Company incorporated a wholly-owned subsidiary, CRS Lighting (USA) Inc., on November 9, 2012. CRS Lighting (USA) Inc. was incorporated to facilitate the Company’s overall strategy to increase market share in the North American lighting market. On November 28, 2013 the Company incorporated a wholly-owned subsidiary Chongqing Yongzhao Trading Company to manage the Chinese supply chain.

These consolidated financial statements are prepared on the assumption that the Company is a going concern, which contemplates the realization of assets and the settlement of liabilities in the normal course of operations. Due to the losses incurred by the Company in the current and previous years and negative cash flows from operating activities relating thereto, there may be significant doubt with respect to the Company’s ability to continue as a going concern. Low sales volumes and production challenges encountered during the year have contributed to negative gross profits. In fiscal 2013 the Company continued to launch its commercial LED lighting campaign. As a result, research and development expenses have increased compared to prior years without a corresponding increase in revenues.

Management recognizes that the Company must generate additional revenues and improve gross margins in order to reach profitable levels of operation. To that end, the Company continues its restructuring efforts to move production of its LED lamps and new lighting fixtures overseas and use the Canadian base as a distribution center for its LED products as well as a catalogue of synergistic products sourced through its investors. To meet its growth plan, CRS will be dependent on further financing through equity funds raised and/or loan proceeds.

These consolidated financial statements do not include adjustments related to the carrying values and classifications of assets and liabilities that would be necessary should the Company be unable to continue as a going concern.

CRS ELECTRONICS INC.

Notes to Consolidated Financial Statements

Expressed in U.S. Dollars

For the years ended December 31, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**Statement of compliance**

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiaries. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. All intercompany balances and transactions are eliminated upon consolidation.

Revenue recognition

The Company measures revenue at the fair value of the consideration received or receivable, reducing revenue for estimated customer returns, rebates and other similar allowances. It recognizes revenue from the sale of goods when it satisfies the following conditions:

- it has transferred to the buyer the significant risks and rewards of ownership of the goods;
- it retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- it can measure the amount of revenue reliably;
- it is probable that the economic benefits associated with the transaction will flow to the Company; and
- it can measure the costs incurred or to be incurred in respect of the transaction reliably.

Specifically, the Company recognizes revenue from sales of child safety systems, LED lighting products that it manufactures, and lighting products that it buys and resells, when it ships the products to the customer and collectability is reasonably assured. Ownership transfers at the point of shipment from the Company's plant.

The Company manufactures custom lighting boards based on designs from a specific customer. Customers send parts to the Company to manufacture these boards; the Company does not record the cost of these parts in its accounts. It recognizes revenues when it ships the products to the customer and collectability is reasonably assured. Ownership again transfers at the point of shipment from the Company's plant.

The Company holds a contract with a specific customer which allows for return of un-sold product 180 days from the invoice date for either credit or exchange. The Company records a sale on all goods initially shipped to the customer and provides a provision against this inventory held by the customer until the 180 day period is satisfied.

Cash and cash equivalents

Cash includes cash on hand and, when applicable, short-term, highly liquid deposits which are either cashable or with original maturities of less than three months at the date of their acquisition.

Inventory

The Company records inventory at the lower of cost and estimated net realizable value. Costs include raw materials, incoming freight, duty, brokerage and non-recoverable taxes, and are assigned to inventories on a first-in first-out basis. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

CRS ELECTRONICS INC.

Notes to Consolidated Financial Statements

Expressed in U.S. Dollars

For the years ended December 31, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Equipment, furniture and leaseholds**

The Company records equipment, furniture and leaseholds at cost (including directly applicable taxes, freight-in and installation costs) less accumulated depreciation and accumulated impairment losses. Assets held under finance leases are included in this category and are depreciated on a straight-line basis over their estimated useful lives.

It recognizes depreciation to write off the cost of assets less their residual values over their estimated useful lives, using the following methods and rates:

Office furniture and equipment	20% declining balance
Tools, moulds and dies	3 years straight-line
Computer equipment	30% declining balance
Production equipment	20% declining balance
Leasehold improvements	5 years straight-line

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

Finance lease obligations

Leases which effectively transfer substantially all of the risks and rewards of ownership to the Company are classified as finance leases and are accounted for as an acquisition of an asset and an assumption of an obligation at the inception of the lease, measured at the present value of the minimum lease payments to a maximum of the asset's fair value. The asset is depreciated in accordance with the Company's depreciation policies.

Patents and trademarks

Patents and trademarks are stated at cost, which primarily consist of legal costs in relation to their applications. Patents and trademarks are amortized using the straight-line method over the estimated useful life of five years. The amortization method and estimated useful life are reviewed at least annually.

Intangible assets

Purchased software is stated at cost less accumulated amortization and impairment losses and is amortized on a declining balance basis of 30% per annum. The amortization method and estimated useful life are reviewed at least annually.

CRS ELECTRONICS INC.

Notes to Consolidated Financial Statements

Expressed in U.S. Dollars

For the years ended December 31, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Research and development costs**

Research and development costs include materials, direct salaries and benefits, administration, contracting, consulting and professional fees.

The Company recognizes expenditure on research activities as an expense in the year incurred.

The Company recognizes an internally-generated intangible asset arising from development (or from the development phase of an internal project) if, and only if, it has demonstrated all of the following:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- the intention to complete the intangible asset and use or sell it;
- the ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount the Company initially recognizes for internally-generated intangible assets is the sum of the expenditure incurred from the date when the intangible asset first meets these recognition criteria.

Subsequent to initial recognition, it reports these assets at cost less accumulated amortization and accumulated impairment losses. The assets recognized to date are being amortized on a straight-line basis over a five year period. The amortization method and estimated useful life are reviewed at least annually.

Impairment of long-lived assets

At the end of each reporting period, the Company reviews the carrying amounts of its internally-generated intangible assets arising from development, patents and trademarks, equipment, furniture and leaseholds and assets under finance leases, to determine whether any indication exists that any of those assets have suffered an impairment loss. If any such indication exists, it estimates the asset's recoverable amount to determine the extent of the impairment loss (if any). Where it is not possible to estimate an individual asset's recoverable amount, the Company estimates the recoverable amount of the cash-generating unit ("CGU") to which the asset belongs. Where it can identify a reasonable and consistent basis of allocation, it also allocates corporate assets to individual cash-generating units, or otherwise allocates them to the smallest group of cash-generating units for which it can identify a reasonable and consistent allocation basis.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the Company discounts estimated future cash flows to their present value using a pre-tax discount rate. This rate reflects current market assessments of the time value of money and also reflects the risks specific to the asset (unless these risks are reflected in the estimates of future cash flows).

If the Company estimates an asset or cash-generating unit's recoverable amount to be less than its carrying value, it recognizes an impairment loss immediately in profit or loss. Where an impairment loss subsequently reverses, the Company increases the asset or unit's carrying amount to the revised estimate of its recoverable amount, without exceeding the carrying amount that would have existed if no impairment loss had been recognized in prior years. It recognizes a reversal of an impairment loss immediately in profit or loss.

CRS ELECTRONICS INC.

Notes to Consolidated Financial Statements

Expressed in U.S. Dollars

For the years ended December 31, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Impairment of long-lived assets (continued)**

Management evaluated whether there are any adverse qualitative factors in respect to long-lived assets indicating that they might be impaired. Potential indicators include significant negative cash flow from operations, negative gross margins relating to fixed labor and overheads and a decrease in retail sales of LED lighting products. However, management noted that the current year results related to a change in overall strategy which are not expected to be incurred in future periods as the Company transitions into the commercial LED market segment with outsourced finished goods inventory. The Company believes these potential impairment indicators are short term in nature and do not reflect impairment of the long-lived assets.

Foreign currency translation

The US dollar is the functional currency of the Company and is also the currency in which it presents these consolidated financial statements. The Company recognizes transactions in currencies other than the US dollar (foreign currencies) at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, it retranslates monetary items denominated in foreign currencies at the rates prevailing at that date. It does not retranslate non-monetary items measured in terms of historical cost in a foreign currency. It recognizes exchange differences on monetary items in profit or loss in the year in which they arise.

Loss per share

The Company calculates basic loss per share by dividing the loss for the year by the weighted average number of common shares outstanding during the year. It calculates diluted loss per share in a similar manner, except that it increases the weighted average number of common shares outstanding, using the treasury stock method, to include common shares potentially issuable from the assumed exercise of stock options and other instruments, if dilutive. In the Company's case, these potential issuances are "anti-dilutive" as they would decrease the loss per share; consequently, the amounts calculated for basic and diluted loss per share are the same.

Stock-based compensation

The Company measures equity-settled share-based payments to employees and others who provide similar services, issued under the stock option plan described in Note 16, at the fair value of the equity instruments at the grant date. For options granted to consultants, the same method of valuation is used unless the value of services provided is more readily determinable. It calculates the fair value using the Black-Scholes option valuation model and expenses this amount on a straight-line basis over the vesting period, based on the Company's estimate of equity instruments that will eventually vest, crediting the amounts to other paid-in capital. It revises its estimate of the number of equity instruments expected to vest at the end of each reporting period, recognizing the impact of revising the original estimates, if any, in net loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to other paid-in capital. When options are exercised, the Company credits the proceeds, together with the amount originally credited to other paid-in capital, to share capital.

CRS ELECTRONICS INC.

Notes to Consolidated Financial Statements

Expressed in U.S. Dollars

For the years ended December 31, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Income taxes**

Income tax expense consists of current and deferred tax expense. Current and deferred tax are recognized in profit or 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 difference 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 net earnings and comprehensive 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 each reporting period end, 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.

Government assistance

The Company makes periodic applications for financial assistance under available government incentive programs including grants, low interest loans and tax credits, related to purchasing equipment and to other expenditures. The Company recognizes government assistance on an accrual basis when it has completed all requirements to earn the assistance and receipt is reasonably assured. It reflects government grants relating to capital expenditures as a reduction of the cost of such assets, and reflects government grants relating to operating expenses as a reduction of the expense. Non-interest bearing loans are discounted at market lending rates and accretion expense is recorded as a financing cost in the period incurred.

Provisions

The Company recognizes a provision when it has a present obligation (legal or constructive) as a result of a past event, it is probable it will be required to settle the obligation, and it can make a reliable estimate of its amount. The amount it recognizes as a provision is its best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the surrounding risks and uncertainties. Where it measures a provision using the cash flows estimated to settle the present obligation, the carrying amount is the present value of those cash flows, calculated using a pre-tax discount rate reflecting the risks specific to the liability. The Company adjusts the liability at the end of each reporting period for the unwinding of the discount rate and for changes to the discount rate or to the amount or timing of the estimated cash flows underlying the obligation.

Financial instruments

The Company recognizes a financial asset or financial liability when it becomes a party to the instrument's contractual provisions. It initially measures financial assets and financial liabilities at their fair value, adding or deducting directly attributable transaction costs (except for transaction costs directly attributable to acquiring financial assets or financial liabilities at fair value through profit or loss, which it recognizes immediately in profit or loss).

CRS ELECTRONICS INC.

Notes to Consolidated Financial Statements

Expressed in U.S. Dollars

For the years ended December 31, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Financial instruments (continued)**

The Company's financial instruments and their classifications, described further below, are as follows:

Financial assets:	Classification:
Cash and cash equivalents	Loans and receivables
Accounts receivable	Loans and receivables
Government incentives receivable	Loans and receivables

Financial liabilities:	Classification:
Bank indebtedness, trade and other payables, note payable, debt and finance lease obligations	Other financial liabilities
Derivative liabilities	Fair value through profit or loss

Financial assets

The Company recognizes and derecognizes all financial assets on the trade date. It derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of its ownership to another entity. It classifies financial assets into the following specified categories: financial assets 'at fair value through profit or loss' (FVTPL), 'held-to-maturity' investments, 'available-for-sale' financial assets and 'loans and receivables'. It determines the classification at the time of initial recognition, depending on the nature and purpose of the financial assets. The Company does not currently have any financial assets in the FVTPL held-to-maturity or available-for-sale categories.

The Company measures financial assets at FVTPL at fair value, recognizing any gains or losses arising from this measurement in profit or loss. It measures loans and receivables at amortized cost using the effective interest method, less any impairment, except for short-term receivables for which recognizing interest would be immaterial. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all transaction costs and other premiums or discounts) through the instrument's expected life (or, where appropriate, a shorter period) to the net carrying amount on initial recognition. The Company assesses financial assets, other than those at FVTPL, for indicators of impairment at the end of each reporting period. For financial assets carried at amortized cost, the amount of any impairment loss is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. Trade receivables are discounted by an allowance for doubtful accounts which reflects the net realizable value.

Financial liabilities

The Company classifies financial liabilities as either financial liabilities 'at FVTPL' or 'other financial liabilities'.

Financial liabilities classified as other financial liabilities are initially recognized at fair value less directly attributable transaction costs. After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method.

CRS ELECTRONICS INC.

Notes to Consolidated Financial Statements

Expressed in U.S. Dollars

For the years ended December 31, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Financial instruments (continued)**

Financial liabilities classified as FVTPL include financial liabilities held-for-trading and financial liabilities designated upon initial recognition as FVTPL. Derivatives, including separated embedded derivatives, are also classified as held-for-trading unless they are designated as effective hedging instruments. Transaction costs on financial liabilities classified as FVTPL are expensed as incurred. Fair value changes on financial liabilities classified as FVTPL are recognized in profit or loss.

At the end of each reporting period subsequent to initial recognition, financial liabilities at FVTPL are measured at fair value, with changes in fair value recognized directly in profit or loss. The net gain or loss recognized in net loss excludes any interest paid on the financial liabilities.

The Company classifies its financial instruments according to a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. The three levels of fair value hierarchy are as follows:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for assets and liabilities, either directly or indirectly; and
- Level 3 – Inputs for assets or liabilities that are not based on observable market data.

As described in Note 15, the Company has two derivative liabilities: forward contracts and warrants outstanding. The forward contracts are classified as level 2 financial instruments and the derivative liabilities as level 3.

Derecognition of financial assets and liabilities

Financial assets are derecognized when the rights to receive cash flows from the assets expire or the financial assets are transferred and the Company has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable is recognized in profit or loss. Financial liabilities are derecognized when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

Measurement uncertainty

Preparing financial statements in conformity with IFRS requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the end of the reporting period and the reported amounts of revenues and expenses during the reporting period. Items affected by significant estimates include, but are not limited to, the allowance for doubtful accounts receivable, the allowance for obsolete inventory, the useful lives of tangible and intangible assets, and the assumptions used in the assessment of impairment of long term assets. In all these cases, actual results could differ from the estimates that the Company used.

Accounting standards recently adopted and issued but not yet effective

Certain pronouncements were issued by the IASB that are mandatory for accounting periods beginning after January 1, 2014 or later periods.

The following new standard which has not been early-adopted in these consolidated financial statements, may have an effect on the Company's future results and financial position:

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Accounting standards issued but not yet effective, continued****IFRS 9, Financial Instruments (“IFRS 9”):**

In October 2010, the IASB issued IFRS 9. IFRS 9, which replaces IAS 39, Financial Instruments: Recognition and Measurement, establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity’s future cash flows. This new standard is effective for the Company’s financial statements commencing January 1, 2018. The Company is assessing the impact of this new standard on its consolidated financial statements.

The following standards were adopted in these consolidated financial statements.

IFRS 10, Consolidated Financial Statements (“IFRS 10”):

In May 2011, the IASB issued IFRS 10. IFRS 10, Consolidated Financial Statements, which replaces the consolidated requirements of SIC-12 Consolidation – Special Purpose Entities and IAS 27 Consolidated and Separate Financial Statements, establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. This new standard was adopted in the current year and is effective for the Company’s financial statements commencing January 1, 2013. There are no material changes to the consolidated financial statements as a result of the adoption of this new standard.

IFRS 12, Disclosure of Interests in Other Entities (“IFRS 12”):

In May 2011, the IASB issued IFRS 12. IFRS 12, Disclosure of Interests in Other Entities, establishes new and comprehensive disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. This new standard was adopted in the current year and is effective for the Company’s financial statements commencing January 1, 2013. There are no material changes to the consolidated financial statements as a result of the adoption of this new standard.

IFRS 13, Fair Value Measurement (“IFRS 13”):

In May 2011, the IASB issued IFRS 13. IFRS 13, Fair Value Measurement, replaces the fair value guidance contained in individual IFRSs with a single source of fair value measurement guidance. This new standard was adopted in the current year and is effective for the Company’s financial statements commencing January 1, 2013. There are no material changes to the consolidated financial statements as a result of the adoption of this new standard.

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3. CASH AND CASH EQUIVALENTS

	December 31 2013	December 31 2012
Cash	\$ 1,858,752	\$ 325,182
One year term deposit 1.3% per annum	-	1,177,429
One year term deposit 1.536% per annum	-	3,015,300
Ninety day term deposit 1.4% per annum	1,222,260	-
	\$ 3,081,012	\$ 4,517,911

As at December 31, 2013, the Company held two ninety day term deposits which matured on January 20, 2014, earning compound interest of 1.4% per annum and another ninety day term deposit earning compound interest of 1.4% per annum maturing on March 3, 2014. As at December 31, 2012, the Company held a one year term deposit which matured on June 22, 2013, earning compound interest of 1.3% per annum and another one year term deposit which matured on July 20, 2013, earning compound interest of 1.536% per annum. All term deposits are redeemable at any time before maturity.

4. ACCOUNTS RECEIVABLE

	December 31 2013	December 31 2012
Trade accounts receivable	\$ 194,756	\$ 485,908
Other receivables	32,683	37,214
Allowance for doubtful accounts	(6,385)	(8,794)
	\$ 221,054	\$ 514,328

The three largest accounts receivable balances relate to a bus manufacturer based in the United States, an LED lighting manufacturer based in Canada, and an international LED manufacturer which make up 66%, 6% and 4% of the trade accounts receivable on December 31, 2013, respectively (29%, 20% and 10% on December 31, 2012).

The movement in the allowance for doubtful accounts is as follows:

	December 31 2013	December 31 2012
Opening balance	\$ 8,794	\$ 4,326
Provision for impairment of accounts receivable	-	4,468
Write-off of accounts previously allowed for	(2,409)	-
Closing balance	\$ 6,385	\$ 8,794

5. INVENTORY

	December 31 2013	December 31 2012
Finished goods	\$ 712,060	\$ 297,567
Raw materials	313,120	414,124
Inventory in transit	84,853	13,434
	\$ 1,110,033	\$ 725,125

During the year ended December 31, 2013, the Company recorded inventory write-downs of \$91,007 (\$399,007 for December 31, 2012) and made no reversals of previous inventory write-downs.

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6. EQUIPMENT, FURNITURE AND LEASEHOLDS

Cost and accumulated depreciation and movements during the year, are as follows:

At December 31, 2013:

	Office Furniture and Equipment	Tools, moulds and dies	Computer equipment	Production Equipment	Leasehold improvements	Assets under finance lease	Total
Cost							
At January 1, 2013	\$ 100,912	\$ 89,440	\$ 73,426	\$ 712,556	\$ 175,173	\$ 87,741	\$ 1,239,248
Additions	-	104,163	55,461	34,761	-	-	194,385
Disposals	(12,907)	(47,741)	(7,594)	(43,797)	(40,526)	-	(152,565)
	88,005	145,862	121,293	703,520	134,647	87,741	1,281,068
Accumulated depreciation							
At January 1, 2013	53,712	9,720	42,260	390,314	108,232	25,034	629,272
Depreciation for the year	9,627	30,757	20,848	75,333	26,833	19,048	182,446
Eliminated on disposals	(9,418)	(15,510)	(5,765)	(22,545)	(40,526)	-	(93,764)
	53,921	24,967	57,343	443,102	94,539	44,082	717,954
Net carrying value at December 31, 2013	\$ 34,084	\$ 120,895	\$ 63,950	\$ 260,418	\$ 40,108	\$ 43,659	\$ 563,114

At December 31, 2012:

	Office Furniture and Equipment	Tools, moulds and dies	Computer equipment	Production Equipment	Leasehold improvements	Assets under finance lease	Total
Cost							
At January 1, 2012	\$83,795	\$427,730	\$62,630	\$762,363	\$255,995	\$38,464	\$1,630,977
Additions	17,117	90,109	11,139	25,233	-	49,277	192,875
Disposals	-	(428,399)	(343)	(75,040)	(80,822)	-	(584,604)
	100,912	89,440	73,426	712,556	175,173	87,741	1,239,248
Accumulated depreciation							
At January 1, 2012	41,660	142,834	29,018	344,606	82,198	11,448	651,764
Depreciation for the year	12,052	121,427	13,242	90,992	43,314	13,586	294,613
Eliminated on disposals	-	(254,541)	-	(45,284)	(17,280)	-	(317,105)
	53,712	9,720	42,260	390,314	108,232	25,034	629,272
Net carrying value at December 31, 2012	\$47,200	\$ 79,720	\$31,166	\$322,242	\$ 66,941	\$62,707	\$ 609,976

For the year ended December 31, 2013, \$112,706 of depreciation was included in cost of sales, \$20,677 was included in research and development, and \$49,063 within general and administrative (December 31, 2012: \$238,810, \$17,319 and \$38,484 respectively).

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7. PATENTS AND TRADEMARKS

Patents and trademarks at December 31, 2013 and December 31, 2012 consist of the following:

Cost		Cost	
At January 1, 2013	\$ 134,816	At January 1, 2012	\$ 150,028
Additions	11,116	Additions	19,561
Impairments	(51,865)	Impairments	(34,773)
	<u>94,067</u>		<u>134,816</u>
Accumulated Amortization		Accumulated Amortization	
At January 1, 2013	49,651	At January 1, 2012	30,143
Amortization for the year	26,575	Amortization for the year	32,435
Decrease due to impairment	(27,367)	Decrease due to impairment	(12,927)
	<u>48,859</u>		<u>49,651</u>
Net Carrying value at December 31, 2013	\$ 45,208	Net Carrying value at December 31, 2012	\$ 85,165

The amortization expense was charged to general and administration expense for 2013 and 2012.

Management has reviewed the carrying value of each patent and identified patents that it will not be using in future products of the Company. The related net costs of \$24,498 has been recognized as a loss during the year (2012 - \$21,846).

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8. INTANGIBLE ASSETS

	Deferred Development Costs	Computer Software	Total
Cost			
At January 1, 2013	\$ 331,102	\$ 197,261	\$ 528,363
Additions	-	49,966	49,966
Disposals	-	(17,448)	(17,448)
	331,102	229,779	560,881
Accumulated Amortization			
At January 1, 2013	151,279	88,654	239,933
Amortization for the year	66,220	40,621	106,841
Eliminated on disposals	-	(16,560)	(16,560)
	217,499	112,715	330,214
Net carrying value at December 31, 2013	<u><u>\$ 113,603</u></u>	<u><u>\$ 117,064</u></u>	<u><u>\$ 230,667</u></u>
Cost			
At January 1, 2012	\$ 331,102	\$ 131,058	\$ 462,160
Additions	-	73,224	73,224
Disposals	-	(7,021)	(7,021)
	331,102	197,261	528,363
Accumulated Amortization			
At January 1, 2012	85,059	42,264	127,323
Amortization for the year	66,220	47,838	114,058
Eliminated on disposals	-	(1,448)	(1,448)
	151,279	88,654	239,933
Net carrying value at December 31, 2012	<u><u>\$ 179,823</u></u>	<u><u>\$ 108,607</u></u>	<u><u>\$ 288,430</u></u>

For the year ended December 31, 2013 \$37,416 of amortization was included in general and administrative, \$3,205 was included in research and development and \$66,220 within cost of sales (December 31, 2012: \$43,172, \$4,666 and \$66,220 respectively).

Management has reviewed the carrying value of the intangible assets and identified items that it will not be using in future products of the Company. The related net costs of \$888 has been recognized as a loss during the year (2012 - \$5,573).

9. BANK INDEBTEDNESS

Bank indebtedness consists of the following:

	December 31 2013	December 31 2012
TD Canada Trust – revolving demand line of credit.	<u><u>\$ 414,269</u></u>	<u><u>\$ -</u></u>
	<u><u>\$ 414,269</u></u>	<u><u>\$ -</u></u>

The Company has an operating line of credit in the amount of \$900,000 which is allocated CAD \$500,000 and USD \$400,000. The operating line may be cancelled at any time. The line of credit is renewable annually and is secured against the Company's property. Interest is charged monthly at a rate of prime plus 0.50% which was 3.5% at December 31, 2013.

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10. NOTE PAYABLE

Note payable consists of the following:

	December 31 2013	December 31 2012
Extended payments on insurance – bearing interest at 4.989% per annum with 10 monthly payments of CAD \$6,532, commencing July 20, 2012 and maturing May 20, 2013.	\$ -	\$ 32,420
	<u>\$ -</u>	<u>\$ 32,420</u>

11. DEBT OBLIGATIONS

Debt obligations consist of the following:

	December 31 2013	December 31 2012
PenFinancial Credit Union - 8% interest, payable in blended monthly installments of CAD \$1,440, maturing December 20, 2014.	\$ -	\$ 32,036
PenFinancial Credit Union - 9% interest, payable in blended monthly installments of CAD \$3,921, maturing June 14, 2015.	-	105,622
Advances received under the Southern Ontario Development Plan (SODP) as described in detail below.	<u>292,676</u>	<u>416,578</u>
	292,676	554,236
Less: principal due within one year	<u>(106,103)</u>	<u>(158,448)</u>
	<u>\$ 186,573</u>	<u>\$ 395,788</u>

The PenFinancial loans were collateralized by a registered general security agreement, representing a first fixed and floating charge over the assets and undertakings of the Company. There was also a personal guarantee for CAD \$200,000 executed by two shareholders and officers of the Company. The loans were repaid prior to their maturity.

Contribution Agreement (“CA”) with the Southern Ontario Development Program (“SODP”)

In June 2011, the Company signed a revised Contribution Agreement with the SODP, a program administered by the Government of Canada for a maximum contribution amount of CAD \$667,036. The contribution amount is based on 50% of eligible capital costs and 75% of eligible non-capital costs for projects to develop indoor and outdoor lighting and to increase the production capacity of the Company’s facility in Welland, Ontario. The interest-free contribution amount is repayable over five years. No payments were required until August 1, 2011. The contribution amount is repayable in 60 monthly payments equal to \$11,118 from August 1, 2011 to July 1, 2016. No assets of the Company currently owned or to be acquired under the CA will be pledged as security. As at December 31, 2011, the maximum contribution amount of \$667,036 had been received under the CA. The Company has discounted the SODP loan using an annual interest rate of 7.5% over the term of the loan.

The discounted principal amounts of debt obligations, due in each of the next three years, are presented in US Dollars as follows:

2014	\$ 106,103
2015	115,202
2016	<u>71,371</u>
	<u>\$ 292,676</u>

12. FINANCE LEASE OBLIGATIONS

The following is a schedule of minimum lease payments under the finance leases expiring in 2016:

	December 31 2013	December 31 2012
USD Value of undernoted leases ⁽¹⁾	\$ 74,594	\$ 117,688
Less: amount representing interest at 7.4%	5,520	10,357
	69,074	107,331
Less: current portion	(35,946)	(34,584)
	\$ 33,128	\$ 72,747

⁽¹⁾ Comprised of four leases: i) 66 month lease for a printer copier at 10.9% per annum commenced July 2011 with quarterly repayments of CAD \$1,777, ii) 39 month lease for computer software at 12.6% per annum commenced December 2011 with monthly repayments of CAD \$1,878, iii) 39 month lease for a vehicle at 2.9% per annum commenced July 2012 with monthly repayments of CAD \$536, and iv) 48 month lease for a vehicle at 2.9% per annum commenced October 2012 with monthly repayments of CAD \$582.

The principal amounts of lease obligations, due in each of the next three years, are presented in US Dollars as follows:

2014	\$ 35,946
2015	22,020
2016	11,108
	\$ 69,074

13. DEFERRED INCOME TAXES

The reconciliation of the combined Canadian federal and provincial statutory income tax rate of 26.5% to the effective tax rates is as follows:

	2013	2012
Net loss before recovery of income taxes	\$ (4,586,901)	\$ (5,272,982)
	26.5%	26.5%
Expected income tax recovery	\$ (1,202,280)	\$ (1,397,300)
Difference in foreign tax rates	(102,320)	-
Tax rate changes and other adjustments	20,920	(29,100)
Changes in unrecognized deductible temporary differences	-	(164,800)
Non-deductible expenses	102,760	-
Change in tax benefits not recognized	1,180,920	1,591,200
	\$ -	\$ -

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13. DEFERRED INCOME TAXES (Continued)**Unrecognized deferred tax assets**

Deferred income 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 income tax assets have not been recognized in respect of the following deductible temporary differences:

	2013	2012
Non-capital losses carried forward - Canadian	12,592,500	10,099,900
Non-capital losses carried forward – US	1,199,370	-
Property, plant and equipment	1,236,260	988,740
Share issuance costs	391,180	576,900
Deferred development costs	372,540	462,150
Patents and trademarks	133,770	272,010
Other deductible temporary differences	438,910	119,100

The US non-capital loss carry forwards expire in 2033. Share issue and financings costs will be fully amortized in 2017. The remaining deductible temporary differences 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 Company can utilize the benefits therefrom.

The Company's Canadian non-capital income tax losses expire as follows:

2025	\$ 265,800
2026	233,700
2027	86,200
2028	84,600
2029	240,900
2030	719,200
2031	3,302,600
2032	4,690,000
2033	2,969,500
	<u>\$ 12,592,500</u>

14. GOVERNMENT INCENTIVES RECEIVABLE

The Scientific Research and Experimental Development Tax Credits ("SR&ED"), offered by the Government of Canada and the Ontario Innovation Tax Credit ("OITC") and Ontario Research and Development Tax Credit ("ORDTC") offered by the Ontario Provincial Government are awarded for expenditures on research and development. The tax credits relating to deferred development costs are recorded in the consolidated statements of financial position as a reduction of deferred development costs. The tax credits relating to research are recorded as a reduction of expenses on the consolidated statements of loss and comprehensive loss. When CRS was a privately held company all SR&ED, OITC and ORDTC were refundable tax credits and were normally paid to the Company in the year following the year the tax credits were claimed. As a result of becoming a publicly traded company in May 2009, the SR&ED tax credit rate decreased to 20% from 35% of expenditures and the SR&ED, and the ORDTC are no longer refundable tax credits payable in cash to the Company but can only be applied against income taxes payable in future years. The Company continues to file for SR&ED, OITC and ORDTC. The Company provides a valuation allowance for the SR&ED and ORDTC tax credits receivable until it is reasonably certain it will realize the benefit of these tax credits.

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14. GOVERNMENT INCENTIVES RECEIVABLE (Continued)

Government incentives receivable consist of the following:

	December 31 2013	December 31 2012
OITC and ORDTC	\$ 95,621	\$ 60,592
SR&ED	211,290	220,719
Valuation allowance – SR&ED	(211,290)	(220,719)
Valuation allowance – ORDTC	(37,983)	(16,408)
	<u>\$ 57,638</u>	<u>\$ 44,184</u>

The SR&ED, OITC and ORDTC tax credits are based on the Company having incurred expenses which in management's opinion qualify as research and development costs under the Income Tax Act of Canada. These expenses are subject to review and approval by the Canada Revenue Agency and accordingly, the actual credits received may differ from the recorded amounts. Any such adjustments will be made in the year in which the refunds are received or applied against future income taxes due.

15. DERIVATIVE LIABILITIES

The Company has the following financial instruments classified at the following levels as at December 31, 2013:

	Level 1	Level 2	Level 3
Derivative liabilities – forward contracts	-	1,110	-
Derivative liabilities - warrants	-	-	21,717

Warrants

On April 28, 2011 the Company issued 9,379,156 common share units as part of a private placement of units. The units were comprised of one common share and one half-warrant. These warrants (Series D) are considered to be derivative liabilities due to the warrants being exercisable in a currency (Canadian dollars) other than the functional currency of the Company (U.S. dollars). The derivative is measured at fair value with changes in fair value included in net and comprehensive loss.

Each whole warrant entitles the holder to acquire one common share upon payment of CAD \$0.65 per common share on (a) the earlier of the accelerated expiry date specified by the Company (that is not less than 10 days after written notice is deemed to have been received by the Warrant holders for the Common Shares) where the Volume Weighted Average price of the Common Shares on the Exchange for a period of 20 consecutive trading days has been greater than \$1.00 or (b) the expiry date of April 28, 2014. The warrants are not registered for trading and all common shares issued through the exercise of warrants before August 29, 2011 were restricted from trading until that date. As at December 31, 2013 9,379,156 half-warrants, entitling the warrant holders to purchase 4,689,578 common shares, are outstanding (December 31, 2012: 9,379,156 half-warrants to purchase 4,689,578 were outstanding).

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15. DERIVATIVE LIABILITIES (Continued)

The value of the warrants at the date of issuance, net of an allocation of the closing costs, was determined to be CAD \$1,854,136 (USD \$1,949,624) using the Black-Scholes option pricing model based on the following assumptions: expected dividend yield of 0%, expected volatility of 109%, risk-free interest rate of 1.57% and an expected life of 2.8 years.

The Company recorded a gain related to the change in the fair value of the warrants as follows:

	December 31 2013	December 31 2012
Gain on warrant liability	\$ 201,858	\$ 608,175

The Company determined the fair value of these warrants to be:

	December 31 2013	December 31 2012
Series D	\$ 21,717	\$ 224,685

The Company determined the fair value of these warrants at December 31, 2013 and 2012 using the Black-Scholes option pricing model with assumptions as follows:

	December 31 2013	December 31 2012
Exercise price (CAD \$)	\$0.65	\$0.65
Share price (CAD \$)	\$0.30	\$0.24
Risk-free interest rate	1.13%	1.13%
Expected life	0.32 years	1.3 years
Expected volatility	85%	103%
Dividend rate	0%	0%

Forward Contracts

The Company had two forward contracts outstanding at December 31, 2013 (December 31, 2012 – Nil). These contracts totaled \$450,000 and settled on January 2, 2014 and January 3, 2014. The Company recorded a loss related to the change in the fair value of the forward contracts as follows:

	December 31 2013	December 31 2012
Loss on forward contracts	\$ 1,110	\$ -

The loss on forward contracts is also equal to its fair value as at December 31, 2013 and 2012.

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16. SHARE CAPITAL

Shares

Authorized

Unlimited number of common shares

Issued and outstanding

86,399,844 common shares

The common share transactions over the year are as follows:

	Number of shares	Amount
Balance January 1, 2012	40,723,434	\$ 6,403,407
Issuance of common shares for cash – June 8, 2012	30,400,548	7,904,666
Issuance of common shares in connection with short-term financing during the year	275,862	58,350
Balance December 31, 2012	71,399,844	14,366,423
Issuance of common shares for cash – December 31, 2013	15,000,000	2,787,573
Balance December 31, 2013	86,399,844	\$ 17,153,996

[a] Common stock

Issuance of common shares for cash:

The Company completed a private placement on June 8, 2012 and issued 30,400,548 shares at a price of CAD \$0.2921 per unit for gross proceeds of CAD \$8,880,000 (USD \$8,622,982). The Company also issued 2,389,167 common share purchase warrants as compensation for Parklea Capital Inc. acting as a special advisor to the Chief Executive Officer and the Board of Directors of the Company. Each warrant entitles the holder to acquire one common share upon payment of CAD \$0.2921 per common share no later than June 8, 2017. The warrants are not registered for trading and all common shares issued through the exercise of warrants before October 9, 2012 were restricted from trading until that date. Other closing costs for legal expenses and filings fees were CAD \$204,693 (USD \$200,772).

Private placement June 8, 2012 allocation of proceeds is as follows:

	Amount CAD	Amount USD
Common Shares (issued 30,400,548)	\$ 8,880,000	\$ 8,622,982
Less: Issuance costs - warrants (issued 2,389,167)	(531,523)	(517,544)
Less: Other issuance costs	(204,693)	(200,772)
Net Proceeds of Private Placement	\$ 8,143,784	\$ 7,904,666

The Company completed a private placement on December 31, 2013 and issued 15,000,000 shares at a price of CAD \$0.20 per unit for gross proceeds of CAD \$3,000,000 (USD \$2,815,335).

Private placement December 31, 2013 allocation of proceeds is as follows:

	Amount CAD	Amount USD
Common Shares (issued 15,000,000)	\$ 3,000,000	\$ 2,815,335
Less: Other issuance costs	(23,700)	(27,762)
Net Proceeds of Private Placement	\$ 2,976,300	\$ 2,787,573

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16. SHARE CAPITAL (Continued)**[a] Common stock (continued)****Issuance of common shares in connection with short term-financing**

The Company obtained short-term financing from Diocles Capital on May 4, 2012 and issued 275,862 units at a price of CAD \$0.2175 per unit as a payment in kind of CAD \$60,000 (USD \$58,350). In return, the Company obtained a CAD \$300,000 (USD \$303,521) bridge loan prior to the receipt of the June 8, 2012 private placement proceeds.

[b] Stock options**Employee stock option plan**

In 2008, CRS established a stock option plan under which directors, officers, employees and consultants, subject to certain conditions, may be granted options to purchase common shares of the Company.

Under the plan, the Company may grant stock options to directors, senior officers, employees and advisors and is authorized to issue options to acquire up to 10% of the issued and outstanding shares of the Company. The Board of Directors administers the plan and determines the vesting and other terms of each award.

Value of stock options granted:

Stock-based compensation expense recognized for the year ended December 31, 2013 was \$339,485 (December 31, 2012 – \$186,945), of which \$16,981 is included within cost of sales, \$278,450 is included within general and administrative expense, \$276 is included within selling and marketing expenses, and \$43,778 in R&D expenses (December 31, 2012 - \$15,106 was included within cost of sales, \$116,901 was included within general and administrative, and \$54,938 was included within selling expense).

For the year ended December 31, 2013, stock-based compensation expense related to the termination of 16,666 unvested options issued during fiscal 2011 which were reversed upon an employee leaving the Company. The related stock-based compensation included in selling and marketing expense is \$(5,747).

For the year ended December 31, 2012, stock-based compensation expense related to the termination of 88,333 options, issued during fiscal 2011 which were reversed upon employees and officers leaving the Company. The related stock-based compensation of (\$23,132) of which (\$3,210) is included within cost of sales, (\$2,120) is included in selling and marketing expense, and (\$17,802) is included within general and administrative expense. Additionally, stock-based compensation expense related to the forfeiture of 450,000 options, issued during fiscal 2011 which was accelerated in fiscal 2012 upon forfeit. The related stock-based compensation of \$41,902 was included within general and administrative expenses in fiscal 2012.

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16. SHARE CAPITAL (Continued)

[b] Stock options (continued)

The Company's stock option activity during the year is as follows:

	December 31, 2013		December 31, 2012	
	No. of shares	Weighted average exercise price (\$)	No. of shares	Weighted average exercise price (\$)
Outstanding, beginning of year	1,384,169	0.44	2,226,624	0.48
Granted ⁽¹⁾	4,370,000	0.24	450,000	0.28
Expired	(706,669)	0.39	(454,122)	0.42
Forfeited voluntarily	-	-	(450,000)	0.58
Forfeited	(16,666)	0.48	(388,333)	0.33
Outstanding, end of year	5,030,834	0.27	1,384,169	0.44

⁽¹⁾ The Company determined the fair value of these options using the Black-Scholes option pricing model with assumptions as follows:

	April 22 2013	April 9 2013	June 30 2012	August 29 2011	May 5 2011
Exercise price (CAD \$)	\$0.24	\$0.24	\$0.28	\$0.48	\$0.58
Options granted	1,870,000	2,500,000	450,000	202,500	905,000
Share price (CAD \$)	\$0.25	\$0.28	\$0.28	\$0.50	\$0.58
Risk-free interest rate	1.185%	1.215%	1.223%	1.073%	1.625%
Expected life	5 years	5 years	5 years	5 years	5 years
Expected volatility	100%	99%	105%	111%	111%
Dividend rate	0%	0%	0%	0%	0%

Under the Plan the total number of stock options that may be outstanding at any time is equal to 10% of the common shares outstanding. The remaining number of options available to be granted under the plan as at December 31, 2013 is 3,609,150.

The following table summarizes information about options outstanding as at December 31, 2013:

Range of exercise prices	Number outstanding	Weighted average remaining contractual life (months)	Weighted-average exercise price
\$0.24 - \$0.48	4,672,500	51	\$0.25
\$0.58 - \$0.59	358,334	15	\$0.58
Total	5,030,834	48	\$0.27

660,834 options are exercisable as at December 31, 2013. The weighted average exercise price of these options is \$0.48.

CRS ELECTRONICS INC.

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16. SHARE CAPITAL (Continued)**[b] Stock options (continued)****Charitable options:**

In March 27, 2008, charitable options to purchase 66,486 common shares were granted to an eligible charitable organization. These options are exercisable at CAD \$0.30 per share with an expiry date as of March 27, 2018.

[c] Warrants

On June 8, 2012 the Company issued 2,389,167 common share purchase compensation warrants. Each warrant entitles the holder to acquire one common share upon payment of CAD \$0.2921 per common share no later than June 8, 2017. The warrants are not registered for trading and all common shares issued through the exercise of warrants before October 9, 2012 were restricted from trading until that date. As at December 31, 2013 and 2012, 2,389,167 warrants, entitling the warrant holders to purchase 2,389,167 common shares, are outstanding.

The value of the warrants at date of issuance, net of an allocation of the closing costs, was determined to be CAD \$531,523 (USD \$517,544) using the Black-Scholes option pricing model based on the following assumptions: expected dividend yield of 0%, expected volatility of 105%, risk-free interest rate of 1.29% and an expected life of 5 years.

17. CAPITAL MANAGEMENT

Management defines capital as the Company's equity. The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. In order to achieve this objective, the Company recognizes the need to increase its capital base by issuing common shares or other equity based financial instruments and the Company's need to become profitable to finance the future capital expenditures and working capital necessary to sustain a growth in operations.

Continuing a consistent objective year over year, the Board of Directors does not establish quantitative "return on capital" criteria for management; but instead promotes year over year sustainable profitable growth.

18. FINANCIAL INSTRUMENTS

[a] Fair value

The carrying values of cash and cash equivalents, accounts receivable, trade and other payables and note payable do not materially differ from their fair values given their short-term period to maturity. The fair values of bank indebtedness, finance lease obligations and debt obligations approximate carrying value as the instruments bear interest or are discounted at market rates.

	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 3,081,012	\$ -	\$ -
Accounts receivable	221,054	-	-
Government incentives receivable	57,638	-	-
Bank indebtedness	414,269	-	-
Trade and other payables	1,105,203	-	-
Derivative liabilities – forward contracts	-	1,110	-
Derivative liabilities - warrants	-	-	21,717
Debt obligations	292,676	-	-
Finance lease obligations	69,074	-	-

[b] Credit risk

The Company is exposed to credit risk in the event of non-performance by customers in paying outstanding trade accounts receivable. The Company's three main customers represent 66%, 6% and 4% respectively of accounts receivable at December 31, 2013 (29%, 20% and 10% at December 31, 2012). The Company has purchased insurance from the Export Development Corporation to compensate for this risk in addition to monitoring the status of accounts on a regular basis. The Company purchases credit reports from an industry leading credit analysis firm to further mitigate this credit risk.

Trade accounts receivable are past due when a customer fails to make a payment when contractually due, which is generally 30 days from invoice date. The Company specifically identifies customers with past due balances (over normal credit term) and provides for these accounts where appropriate. The following is an aging of trade accounts receivable:

	Current	30-60 days	60-90 days	Over 90 days	Total
December 31, 2013	\$69,305	\$65,485	\$56,832	\$3,134	\$194,756

[c] Interest rate risk

The Company is exposed to interest rate risk on its short-term credit facilities and on a portion of its long-term debt, since the interest rate charged on these facilities fluctuates with the general level of interest rates. However, in management's opinion, this risk is not significant as the short term credit facilities do not represent a significant amount of financing.

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18. FINANCIAL INSTRUMENTS (Continued)**[d] Liquidity risk**

The Company incurs obligations to deliver cash or other financial assets on future dates. Liquidity risk inherently arises from these obligations, which include requirements to repay debt and make operating lease payments.

The Company manages liquidity risk by maintaining adequate cash and cash equivalent balances and by appropriately utilizing its line of credit. Company management continuously monitors and reviews both actual and forecasted cash flows and matches the maturity profile of financial assets and financial liabilities. Accounts payable are generally due within 30 days.

The following table outlines the Company's contractual undiscounted obligations. The Company analyzes contractual obligations for financial liabilities in conjunction with other commitments in managing liquidity risk. Contractual obligations include debt obligations, operating leases and commitments on short-term forward foreign exchange contracts used to mitigate the currency risk on U.S. dollar purchases as at December 31, 2013.

	Total	< 1 year	2 – 3 years	4 – 5 years	> 5 years
Debt obligations	324,010	125,435	198,575	-	-
Lease obligations	192,016	105,132	86,884	-	-
Foreign exchange forwards	450,000	450,000	-	-	-
Total contractual obligations	<u>966,026</u>	<u>680,567</u>	<u>285,459</u>	<u>-</u>	<u>-</u>

The Company's obligation under its foreign exchange forwards are stated above on a gross basis rather than net of the corresponding contractual benefits.

[e] Foreign currency risk

The Company is exposed to currency risk because it makes purchases and sales transacted in Canadian currency. The following accounts were denominated in Canadian dollars:

	December 31 2013	December 31 2012
Cash and cash equivalents	\$ 3,168,631	\$ 4,392,331
Accounts receivable	47,349	236,628
Trade and other payables	(29,806)	(60,481)
Debt obligations	(372,708)	(702,088)

At December 31, 2013 a 10% change in the average exchange rate between U.S. dollars and Canadian dollars would have resulted in a \$281,347 change on reported net loss and comprehensive loss for the year.

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19. COMMITMENTS AND CONTINGENCIES

Due to the nature of the business, the Company may have unspecified contingent liabilities that are not known to the Company at the end of the year. The Company will recognize contingent liabilities in a future year when they become known to the Company.

The Company has the following commitments outstanding:

1. The Company signed a service agreement with Niagara Regional Broadband Network Limited, for high-speed fiber optic network bandwidth and related management services for the Welland plant. The term of the agreement is from April 1, 2011 to March 31, 2016.

In accordance with the agreement, the service cost to be paid by the Company over the remaining term thereof is as follows:

<u>Year</u>	<u>IT Hosting Fees</u>
2014	\$ 8,744
2015	\$ 8,744
2016	\$ 2,186

2. The Company signed a service agreement with Activo Inc., for high-speed fiber optic network bandwidth and related management services for the Richmond Hill office. The term of the agreement is from August 1, 2012 to June 30, 2016.

In accordance with the agreement, the service cost to be paid by the Company over the remaining term thereof is as follows:

<u>Year</u>	<u>IT Hosting Fees</u>
2014	\$ 2,255
2015	\$ 2,255
2016	\$ 1,128

3. The Company signed a tenant lease agreement for the use of office space located at 9120 Leslie Street, Suite 102, Richmond Hill, Ontario. The tenant agreement covers general rent of office space, operating costs, utilities and realty taxes. The term of the agreement is from August 1, 2012 to July 31, 2015.

In accordance with the agreement, the service cost to be paid by the Company over the remaining term thereof is as follows:

<u>Year</u>	<u>Rent</u>
2014	\$ 43,617
2015	\$ 25,673

4. The Company signed a lease agreement for the use of a vehicle. The term of the agreement is from March 20, 2013 to March 20, 2016. In accordance with the agreement, the service cost to be paid by the Company over the remaining term thereof is as follows:

<u>Year</u>	<u>Rent</u>
2014	\$ 10,040
2015	\$ 10,040
2016	\$ 1,673

5. The Company signed a royalty agreement with GE Lighting Solutions, LLC ("GE") subsequent to December 31, 2013. The amount payable each year is based on the Company's annual sales and therefore is not determinable for years following December 31, 2013.

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20. RELATED PARTY TRANSACTIONS

Key management includes the Chief Executive Officer, Chief Administrative Officer, Chief Financial Officer, and the Chief Technology Officer. The compensation paid or payable to key management for services is as follows:

	December 31 2013	December 31 2012
Wages and benefits	\$ 732,330	\$ 483,100
Stock-based compensation	313,312	84,363
	\$ 1,045,642	\$ 567,463

21. AUTHORIZATION

The Board of Directors is responsible for reviewing and approving the consolidated financial statements together with other financial information of the Company and for ensuring that management fulfills its financial reporting responsibilities. An Audit Committee assists the Board of Directors in fulfilling this responsibility. The Audit Committee meets with management to review the financial reporting process and the financial statements together with other financial information of the Company. The Audit Committee reports its findings to the Board of Directors for its consideration in approving the consolidated financial statements together with other financial information of the Company for issuance to the shareholders.

These audited annual consolidated financial statements as at December 31, 2013 were approved by the Board of Directors on April 23, 2014.

22. SUBSEQUENT EVENTS

- a) On December 28, 2012, GE filed a lawsuit against the Company claiming CRS has infringed upon two GE patents and asked for an Order to have CRS destroy all infringing products and related moulds, machine, tooling or other equipment used in their manufacture, to prevent CRS from importing, manufacturing, using, selling and/or offering all infringing products and to have CRS pay damages to GE, together with costs and prejudgment and post-judgment interest. The amount of the claim for damages and costs was not stipulated in the lawsuit. On January 31, 2014 CRS and GE reached a settlement and patent license agreement whereby CRS is licensed under the two GE patents. All amounts applicable to the agreement have been accrued as at December 31, 2013.
- b) On January 20, 2014, the Company announced the grant of new incentive stock options to acquire up to 870,000 common shares of the Company to an officer and several employees of the Company. All of the options have a term of five years, are exercisable at a price of \$0.31 per share and vest one fourth at the end of each of the four anniversary dates following the individually agreed upon grant dates and subject to the terms of the Company's stock option plan. A total of 150,000 options were granted to the Chief Financial Officer of the Company.