

**CRS ELECTRONICS INC.**

**CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**As at June 30, 2014**

**Unaudited, in U.S. dollars**

## **MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING**

These unaudited condensed consolidated interim financial statements for the six months ended June 30, 2014 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including IAS 34, 'Interim financial reporting'. The unaudited condensed consolidated interim financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2013, which have been prepared in accordance with IFRS as issued by the IASB.

Management has established processes, which are in place to provide them sufficient knowledge to support management representations that they have exercised reasonable diligence that (i) the unaudited condensed consolidated interim financial statements do not contain any untrue statement of material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it is made, as of the date of and for the periods presented by the unaudited condensed consolidated interim financial statements and (ii) the unaudited condensed consolidated interim financial statements fairly present in all material respects the financial condition, results of operations and cash flows of the Company, as of the date of and for the periods presented by the unaudited condensed consolidated interim financial statements.

The Board of Directors is responsible for reviewing and approving the unaudited condensed consolidated interim 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 unaudited condensed consolidated interim 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 unaudited condensed consolidated interim financial statements together with other financial information of the Company for issuance to the shareholders.

Management recognizes its responsibility for conducting the Company's affairs in compliance with established financial standards, and applicable laws and regulations, and for maintaining proper standards of conduct for its activities.

## **NOTICE TO READER**

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

The accompanying unaudited condensed consolidated interim financial statements of the Company have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these unaudited condensed consolidated interim financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of condensed consolidated interim financial statements by an entity's auditor.

**CRS ELECTRONICS INC.**  
Condensed Consolidated Interim  
Statements of Financial Position  
Unaudited, in U.S. dollars

	June 30, 2014	December 31, 2013
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents (Note 3)	\$ 618,154	\$ 3,081,012
Accounts receivable (Note 4)	571,652	221,054
Government incentives receivable (Note 12)	-	57,638
Inventory (Note 5)	1,051,892	1,110,033
Deposits and prepaid expenses	75,210	99,957
	<b>2,316,908</b>	<b>4,569,694</b>
<b>Non-current assets</b>		
<b>Equipment, furniture and leaseholds</b> (Note 6)	<b>621,740</b>	<b>563,114</b>
<b>Patents and trademarks</b> (Note 7)	<b>39,881</b>	<b>45,208</b>
<b>Intangible assets</b> (Note 8)	<b>180,478</b>	<b>230,667</b>
	<b>\$ 3,159,007</b>	<b>\$ 5,408,683</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Bank indebtedness (Note 9)	\$ 151,955	\$ 414,269
Trade and other payables	1,209,014	1,105,203
Current portion of debt obligations (Note 10)	110,299	106,103
Current portion of finance lease obligations (Note 11)	29,850	35,946
Derivative liabilities (Note 13)	-	22,827
	<b>1,501,118</b>	<b>1,684,348</b>
<b>Non-current liabilities</b>		
<b>Debt obligations</b> (Note 10)	<b>129,694</b>	<b>186,573</b>
<b>Finance lease obligations</b> (Note 11)	<b>26,499</b>	<b>33,128</b>
	<b>1,657,311</b>	<b>1,904,049</b>
<b>Commitments and contingencies</b> (Note 15)		
<b>Subsequent events</b> (Note 17)		
<b>EQUITY</b>		
Share capital (Note 14)	17,153,996	17,153,996
Other paid-in capital	1,969,494	1,750,076
Deficit	(17,621,794)	(15,399,438)
	<b>1,501,696</b>	<b>3,504,634</b>
	<b>\$ 3,159,007</b>	<b>\$ 5,408,683</b>

**Nature of operations and going concern** (Note 1)

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

APPROVED BY THE BOARD OF DIRECTORS:

Signed "Scott Riesebosch" Director

Signed "Rob Neill" Director

**CRS ELECTRONICS INC.**

Condensed Consolidated Interim Statements of Loss  
and Comprehensive Loss  
Unaudited, in U.S. dollars

	Three Month Period Ended June 30		Six Month Period Ended June 30	
	2014	2013	2014	2013
<b>SALES</b>	<b>\$ 714,079</b>	<b>\$ 565,326</b>	<b>\$ 1,304,165</b>	<b>\$ 1,303,811</b>
Cost of sales	<b>770,211</b>	674,466	<b>1,501,852</b>	1,675,213
<b>GROSS LOSS</b>	<b>(56,132)</b>	(109,140)	<b>(197,687)</b>	(371,402)
<b>EXPENSES</b>				
Engineering, research and development	<b>216,033</b>	236,543	<b>424,965</b>	368,833
Selling and marketing	<b>349,119</b>	118,773	<b>644,802</b>	248,321
General and administrative	<b>402,392</b>	571,496	<b>856,293</b>	957,967
Loss on disposal of equipment, furniture and fixtures	-	-	<b>11,588</b>	-
Change in warrant liability (Note 13)	<b>(1,825)</b>	54,718	<b>(22,827)</b>	16,722
	<b>965,719</b>	981,530	<b>1,914,821</b>	1,591,843
<b>LOSS BEFORE FINANCE COSTS, FOREIGN EXCHANGE GAIN (LOSS) AND INCOME TAXES</b>	<b>1,021,851</b>	1,090,670	<b>2,112,508</b>	1,963,245
Finance revenue – interest earned	<b>3,869</b>	11,392	<b>9,602</b>	24,534
Finance costs - debt obligations	<b>(6,104)</b>	(15,975)	<b>(18,083)</b>	(27,870)
Finance accretion costs - debt obligations	<b>(4,936)</b>	(7,903)	<b>(10,482)</b>	(16,414)
Foreign exchange gain (loss)	<b>2,532</b>	(108,151)	<b>(90,885)</b>	(185,385)
LOSS BEFORE INCOME TAXES	<b>(1,026,490)</b>	(1,211,307)	<b>(2,222,356)</b>	(2,168,380)
Income Taxes	-	-	-	-
<b>NET LOSS AND COMPREHENSIVE LOSS</b>	<b>\$ (1,026,490)</b>	<b>\$ (1,211,307)</b>	<b>\$ (2,222,356)</b>	<b>\$ (2,168,380)</b>
Loss per share - basic and fully diluted	(0.01)	(0.02)	(0.03)	(0.03)
Weighted average number of common shares outstanding				
- basic and fully diluted	<b>86,399,844</b>	71,399,844	<b>86,399,844</b>	71,399,844

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

**CRS ELECTRONICS INC.**

## Condensed Consolidated Interim Statements of Cash Flows

Unaudited, in U.S. dollars

For the six months ended June 30

	2014	2013
<b>OPERATING ACTIVITIES</b>		
Net loss for the period	\$ (2,222,356)	\$ (2,168,380)
Items not affecting cash		
Stock-based compensation	219,418	112,924
Change in warrant liability	(22,827)	16,722
Amortization of intangible assets	50,415	51,468
Depreciation of equipment, furniture and leaseholds	89,213	90,609
Amortization of patents and trademarks	9,766	13,620
Accretion expense	10,482	16,414
Loss on disposal of equipment, furniture and leaseholds	11,588	-
Net change in non-cash working capital items relating to operating activities	(1,854,301)	(1,866,623)
Accounts receivable	(350,598)	(117,882)
Government incentives receivable	57,638	
Inventory	58,141	89,476
Deposits and prepaid expenses	24,747	24,773
Trade and other payables	103,810	89,705
Cash used in operating activities	(1,960,563)	(1,780,551)
<b>INVESTING ACTIVITIES</b>		
Purchase of equipment, furniture, and leaseholds	(159,427)	(109,971)
Proceeds on disposal of equipment, furniture and leaseholds	-	-
Additions to intangible assets	(226)	(34,966)
Additions to patent and trademark costs	(4,439)	(4,535)
Cash used in investing activities	(164,092)	(149,472)
<b>FINANCING ACTIVITIES</b>		
Receipt of notes payable	-	989,275
Repayment of notes payable	-	(32,420)
Repayment of line of credit	(262,314)	-
Repayment of finance lease obligations	(12,725)	(21,739)
Repayment of debt obligations	(63,164)	(224,475)
Net proceeds from issuance of common share units	-	-
Issue of common shares	-	-
Cash provided by financing activities	(338,203)	710,641
Net (decrease) increase in cash and cash equivalents	(2,462,858)	(1,219,382)
Cash and cash equivalents, beginning of period	3,081,012	4,517,911
Cash and cash equivalents, end of period	\$ 618,154	\$ 3,298,529
The following cash flows are included in operating activities:		
Interest paid	\$ 18,083	(23,959)
Non-cash transactions:		
Acquisition of equipment and intangibles under finance lease	\$ 19,665	-

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

**CRS ELECTRONICS INC.**

Condensed Consolidated Interim  
Statements of Change in Equity  
Unaudited, in U.S. dollars

	<b>Share capital</b>	<b>Other Paid-in Capital</b>	<b>Deficit</b>	<b>Total</b>
<b>Balance, December 31, 2013</b>	\$ 17,153,996	\$ 1,750,076	\$ (15,399,438)	\$ 3,504,634
Net loss for the year	-	-	(2,222,356)	(2,222,356)
Issue of common shares	-	-	-	-
Stock-based compensation	-	219,418	-	219,418
<b>Balance, June 30, 2014</b>	\$ 17,153,996	\$ 1,969,494	\$ (17,621,794)	\$ 1,501,696

	<b>Share capital</b>	<b>Other Paid-in Capital</b>	<b>Deficit</b>	<b>Total</b>
<b>Balance, December 31, 2012</b>	\$ 14,366,423	\$ 1,416,338	\$ (10,812,537)	\$ 4,970,224
Net loss for the year	-	-	(2,168,380)	(2,168,380)
Issue of common shares	-	-	-	-
Stock-based compensation	-	112,924	-	112,924
<b>Balance, June 30, 2013</b>	\$ 14,366,423	\$ 1,529,262	\$ (12,980,917)	\$ 2,914,768

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

## **CRS ELECTRONICS INC.**

Notes to Condensed Consolidated Interim Financial Statements

As at June 30, 2014

Unaudited, in U.S. Dollars

### **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 condensed consolidated interim 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 period have contributed to negative gross profits. In the current period, the Company launched its commercial LED lighting campaign. As a result, fixed expenses have continued to be incurred 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 condensed consolidated interim 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.

### **2. BASIS OF PREPARATION**

#### **Statement of compliance**

These condensed consolidated interim financial statements for the six months ended June 30, 2014 have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) applicable to the preparation of interim financial statements, including IAS 34, ‘Interim financial reporting’. The condensed consolidated interim financial statements should be read in conjunction with the annual financial statements for the year ended December 31, 2013, which have been prepared in accordance with IFRS as issued by the IASB.

The Company uses the same accounting policies and methods of computation as in the annual financial statements for the year ended December 31, 2013.

**CRS ELECTRONICS INC.**

Notes to Condensed Consolidated Interim Financial Statements

As at June 30, 2014

Unaudited, in U.S. Dollars

**2. BASIS OF PREPARATION (continued)****Accounting standards 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 standards which have not been early-adopted in these condensed consolidated interim financial statements, may have an effect on the Company's future results and financial position:

**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 prior 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 prior 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 prior 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.



**CRS ELECTRONICS INC.**

Notes to Condensed Consolidated Interim Financial Statements

As at June 30, 2014

Unaudited, in U.S. Dollars

**3. CASH AND CASH EQUIVALENTS**

	<b>June 30 2014</b>	December 31 2013
Cash	\$ 141,694	\$ 1,858,752
Ninety day term deposit 1.4% per annum	<u>476,460</u>	<u>1,222,260</u>
	<u><b>\$ 618,154</b></u>	<u><b>\$ 3,081,012</b></u>

As at June 30, 2014, the Company held one ninety day term deposits earning compound interest of 1.4% per annum maturing on July 20, 2014. 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. All term deposits are redeemable at any time before maturity.

**4. ACCOUNTS RECEIVABLE**

	<b>June 30, 2014</b>	December 31 2013
Trade accounts receivable	\$ 576,462	\$ 194,756
Other receivables	1,575	32,683
Allowance for doubtful accounts	<u>(6,385)</u>	<u>(6,385)</u>
	<u><b>\$ 571,652</b></u>	<u><b>\$ 221,054</b></u>

The three largest accounts receivable balances relate to a bus manufacturer based in the United States, a LED lighting manufacturer based in China, and a LED manufacturer based in the Canada which make up 41%, 25% and 9% of the trade accounts receivable on June 30, 2014, respectively (66%, 0% and 6% on December 31, 2013).

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

	<b>June 30 2014</b>	December 31 2013
Opening balance	\$ 6,385	\$ 8,794
Write-off of accounts previously allowed for	-	(2,409)
Closing balance	<u><b>\$ 6,385</b></u>	<u><b>\$ 6,385</b></u>

**5. INVENTORY**

	<b>June 30 2014</b>	December 31 2013
Finished goods	724,486	\$ 712,060
Raw materials	268,345	313,120
Inventory in transit	<u>59,061</u>	<u>84,853</u>
	<u><b>\$ 1,051,892</b></u>	<u><b>\$ 1,110,033</b></u>

During the period ended June 30, 2014, the Company recorded inventory write-downs of \$7,898 (\$91,007 for December 31, 2013) and made no reversals of previous inventory write-downs.

**CRS ELECTRONICS INC.**

Notes to Condensed Consolidated Interim Financial Statements

As at June 30, 2014

Unaudited, in U.S. Dollars

**6. EQUIPMENT, FURNITURE AND LEASEHOLDS**

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

**At June 30, 2014:**

	Office Furniture and Equipment	Tools, moulds and dies	Computer equipment	Production Equipment	Leasehold improvements	Assets under finance lease	Total
<b>Cost</b>							
At January 1, 2014	\$88,005	\$145,862	\$121,293	\$703,520	\$134,647	\$87,741	\$1,281,068
Additions	-	\$139,762	-	-	-	\$19,665	\$159,427
Disposals	-	-	-	-	-	(\$28,676)	(\$28,676)
	\$88,005	\$285,624	\$121,293	\$703,520	\$134,647	\$78,730	\$1,411,819
<b>Accumulated depreciation</b>							
At January 1, 2014	\$53,921	\$24,967	\$57,343	\$443,102	\$94,539	\$44,082	\$717,954
Depreciation for the year	\$3,407	\$30,947	\$9,625	\$26,598	\$12,591	\$6,045	\$89,213
Eliminated on disposals	-	-	-	-	-	(\$17,088)	(\$17,088)
	\$57,328	\$55,914	\$66,968	\$469,700	\$107,130	\$33,039	\$790,079
<b>Net carrying value at March 31, 2014</b>	<b>\$30,677</b>	<b>\$229,710</b>	<b>\$54,325</b>	<b>\$233,820</b>	<b>\$27,517</b>	<b>\$45,691</b>	<b>\$621,740</b>

**At December 31, 2013:**

	Office Furniture and Equipment	Tools, moulds and dies	Computer equipment	Production Equipment	Leasehold improvements	Assets under finance lease	Total
<b>Cost</b>							
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
<b>Accumulated depreciation</b>							
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
<b>Net carrying value at December 31, 2013</b>	<b>\$ 34,084</b>	<b>\$ 120,895</b>	<b>\$ 63,950</b>	<b>\$ 260,418</b>	<b>\$ 40,108</b>	<b>\$ 43,659</b>	<b>\$ 563,114</b>

For the period ended June 30, 2014, \$62,314 of depreciation was included in cost of sales, \$8,111 was included in research and development, and \$18,788 within general and administrative (December 31, 2013: \$112,706, \$20,677 and \$49,063 respectively).

**CRS ELECTRONICS INC.**

Notes to Condensed Consolidated Interim Financial Statements

As at June 30, 2014

Unaudited, in U.S. Dollars

**7. PATENTS AND TRADEMARKS**

Patents and trademarks at June 30, 2014 and December 31, 2013 consist of the following:

Cost		Cost	
At January 1, 2014	\$ 94,067	At January 1, 2013	\$ 134,816
Additions	4,439	Additions	11,116
Impairments	-	Impairments	(51,865)
	<u>98,506</u>		<u>94,067</u>
Accumulated Amortization		Accumulated Amortization	
At January 1, 2014	48,859	At January 1, 2013	49,651
Amortization for the year	9,766	Amortization for the year	26,575
Decrease due to impairment	-	Decrease due to impairment	(27,367)
	<u>58,625</u>		<u>48,859</u>
<b>Net Carrying value at June 30, 2014</b>	<b>\$ 39,881</b>	<b>Net Carrying value at December 31, 2013</b>	<b>\$ 45,208</b>

The amortization expense was charged to general and administration expense for 2014 and 2013.

**CRS ELECTRONICS INC.**

## Notes to Condensed Consolidated Interim Financial Statements

As at June 30, 2014

Unaudited, in U.S. Dollars

**8. INTANGIBLE ASSETS**

	Deferred Development Costs	Computer Software	Total
Cost			
At January 1, 2014	\$ 331,102	\$ 229,779	\$ 560,881
Additions	-	226	226
Disposals	-	-	-
	331,102	230,005	561,107
Accumulated Amortization			
At January 1, 2014	217,499	112,715	330,214
Amortization for the year	33,110	17,305	50,415
Eliminated on disposals	-	-	-
	250,609	130,020	380,629
Net carrying value at June 30, 2014	<b>\$ 80,493</b>	<b>\$ 99,985</b>	<b>\$ 180,478</b>
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	<b>\$ 113,603</b>	<b>\$ 117,064</b>	<b>\$ 230,667</b>

For the period ended June 30, 2014 \$16,211 of amortization was included in general and administrative, \$1,094 was included in research and development and \$33,110 within cost of sales (December 31, 2013: \$37,416, \$3,205 and \$66,220 respectively).

**9. BANK INDEBTEDNESS**

Bank indebtedness consists of the following:

	June 30 2014	December 31 2013
TD Canada Trust – revolving demand line of credit.	\$ 151,955	\$ 414,269

The Company has an operating line of credit in the amount of \$500,000 which is allocated CAD \$250,000 and USD \$250,000. 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 June 30, 2014.

**CRS ELECTRONICS INC.**

Notes to Condensed Consolidated Interim Financial Statements

As at June 30, 2014

Unaudited, in U.S. Dollars

**10. DEBT OBLIGATIONS**

Debt obligations consist of the following:

	<u>June 30</u> <u>2014</u>	<u>December 31</u> <u>2013</u>
Advances received under the Southern Ontario Development Plan (SODP) as described in detail below.	239,993	292,676
Less: principal due within one year	<u>(110,299)</u>	<u>(106,103)</u>
	<u>\$ 129,694</u>	<u>\$ 186,573</u>

**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	\$ 54,016
2015	114,834
2016	<u>71,143</u>
	<u>\$ 239,993</u>

**CRS ELECTRONICS INC.**

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**11. FINANCE LEASE OBLIGATIONS**

The following is a schedule of minimum lease payments under the finance leases expiring in 2019:

	June 30 2014	December 31 2013
USD Value of undernoted leases <sup>(1)</sup>	\$ 60,852	\$ 74,594
Less: amount representing interest at 7.4%	4,503	5,520
	<u>56,349</u>	69,074
Less: current portion	(29,850)	(35,946)
	<u>\$ 26,499</u>	<u>\$ 33,128</u>

- <sup>(1)</sup> Comprised of four leases: i) 66 month lease for a printer copier at 10.9% per annum commenced March 2014 with quarterly repayments of CAD \$1,414 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 six years, are presented in US Dollars as follows:

2014	\$ 17,159
2015	19,432
2016	8,413
2017	4,121
2018	4,677
2019	<u>2,547</u>
	<u>\$ 56,349</u>

**12. 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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**12. GOVERNMENT INCENTIVES RECEIVABLE (Continued)**

Government incentives receivable consist of the following:

	June 30 2014	December 31 2013
OITC and ORDTC	\$ 37,983	\$ 95,621
SR&ED	211,290	211,290
Valuation allowance – SR&ED	(211,290)	(211,290)
Valuation allowance – ORDTC	(37,983)	(37,983)
	<u>\$ -</u>	<u>\$ 57,638</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.

**13. DERIVATIVE LIABILITIES**

The Company has the following financial instruments classified at the following levels as at June 30, 2014:

	Level 1	Level 2	Level 3
Derivative liabilities – forward contracts	-	-	-
Derivative liabilities - warrants	-	-	-

**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 June 30, 2014 9,379,156 half-warrants, entitling the warrant holders to purchase 4,689,578 common shares, had expired unexercised (December 31, 2013: 9,379,156 half-warrants to purchase 4,689,578 were outstanding).

**CRS ELECTRONICS INC.**

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**13. 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:

	<b>June 30 2014</b>	December 31 2013
Gain on warrant liability	<b>\$ 21,717</b>	<b>\$ 201,858</b>

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

	<b>June 30 2014</b>	December 31 2013
Series D	-	<b>\$ 21,717</b>

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

	December 31 2013
Exercise price (CAD \$)	<b>\$0.65</b>
Share price (CAD \$)	<b>\$0.30</b>
Risk-free interest rate	<b>1.13%</b>
Expected life	<b>0.32 years</b>
Expected volatility	<b>85%</b>
Dividend rate	<b>0%</b>

**Forward Contracts**

The Company had zero forward contracts outstanding at June 30, 2014 (December 31, 2013 – Two forward contracts which 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:

	<b>June 30 2014</b>	December 31 2013
Loss on forward contracts	<b>\$ 1,825</b>	<b>\$ 1,110</b>

The loss on forward contracts is also equal to its fair value as at June 30, 2014 and December 31, 2013.



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**14. 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, 2013	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	<b>86,399,844</b>	<b>\$ 17,153,996</b>
	-	-
Balance June 30, 2014	<b>86,399,844</b>	<b>17,153,996</b>

**[a] Common stock****Issuance of common shares for cash:**

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	<b>\$ 2,976,300</b>	<b>\$ 2,787,573</b>

**CRS ELECTRONICS INC.**

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**14. SHARE CAPITAL (Continued)****[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 period ended June 30, 2014 was \$219,418 (June 30, 2013 – \$118,671), of which \$7,331 is included within cost of sales, \$140,764 is included within general and administrative expense, \$33,902 is included within selling and marketing expenses, and \$37,421 in R&D expenses (June 30, 2013 - \$7,635 is included within cost of sales, \$95,729 is included within general and administrative expense, \$276 is included within selling expenses, and \$15,031 in R&D expenses).

For the period ended June 30, 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).

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**14. SHARE CAPITAL (Continued)****[b] Stock options (continued)**

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

	June 30, 2014		December 31, 2013	
	No. of shares	Weighted average exercise price (\$)	No. of shares	Weighted average exercise price (\$)
Outstanding, beginning of year	5,030,834	0.27	1,384,169	0.44
Granted <sup>(1)</sup>	1,050,000	0.27	4,370,000	0.24
Expired	(385,834)	0.51	(706,669)	0.39
Forfeited	-	-	(16,666)	0.48
Outstanding, end of year	<b>5,695,000</b>	<b>0.26</b>	<b>5,030,834</b>	<b>0.27</b>

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

	May 16 2014	April 23 2014	January 20 2014	April 22 2013	April 9 2013	June 30 2012	August 29 2011	May 5 2011
Exercise price (CAD \$)	\$0.225	\$0.26	\$0.31	\$0.24	\$0.24	\$0.28	\$0.48	\$0.58
Options granted	100,000	100,000	850,000	1,870,000	2,500,000	450,000	202,500	905,000
Share price (CAD \$)	\$0.225	\$0.26	\$0.29	\$0.25	\$0.28	\$0.28	\$0.50	\$0.58
Risk-free interest rate	1.533%	1.683%	1.637%	1.185%	1.215%	1.223%	1.073%	1.625%
Expected life	5 years	5 years	5 years	5 years	5 years	5 years	5 years	5 years
Expected volatility	111%	112%	114%	100%	99%	105%	111%	111%
Dividend rate	0%	0%	0%	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 June 30, 2014 is 2,944,984.

The following table summarizes information about options outstanding as at June 30, 2014:

Range of exercise prices	Number outstanding	Weighted average remaining contractual life (months)	Weighted-average exercise price
\$0.24 - \$0.48	5,690,000	47	\$0.26
\$0.58 - \$0.59	5,000	14	\$0.59
<b>Total</b>	<b>5,695,000</b>	<b>47</b>	<b>\$0.26</b>

1,367,500 options are exercisable as at June 30, 2014. The weighted average exercise price of these options is \$0.27.

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**14. 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 June 30, 2014, 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.

**15. 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	\$ 4,392
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	\$ 1,127
2015	2,255
2016	1,128

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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	\$	21,449
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	\$	5,020
2015		10,040
2016		1,673

5. The Company signed a lease agreement for the use of a vehicle. The term of the agreement is from March 11, 2014 to March 10, 2019. 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	\$	4,984
2015		8,971
2016		8,971
2017		8,971
2018		8,971
2019		1,495

**16. AUTHORIZATION**

The Board of Directors is responsible for reviewing and approving the condensed consolidated interim 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 condensed consolidated interim financial statements together with other financial information of the Company for issuance to the shareholders.

These unaudited condensed consolidated interim financial statements as at June 30, 2014 were approved by the Board of Directors on August 28, 2014.

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**17. SUBSEQUENT EVENTS**

On August 11, 2014, the Company announced that it has closed its non-brokered private placement of 11,200,000 units of the Company at an offering price of \$0.18 per Unit for gross proceeds to the Company of \$2,016,000 (Canadian Dollars). Canaccord Genuity Corp. assisted with the Offering and received a cash commission of \$120,960 (Canadian Dollars) and 672,000 compensation options. Each compensation option entitles Canaccord to purchase one common share of the Company at a price of \$0.18 until August 11, 2016.

Each Unit is comprised of one common share of the Company and one common share purchase warrant. Each warrant entitles the holder thereof to purchase one common share of the Company at a price of \$0.18 until August 11, 2016. If the closing price of the common shares of the Company on the TSX Venture Exchange is \$0.30 or above for 20 consecutive trading days, the Company has the right to accelerate the expiry date of the warrants upon notice to the holders.

All securities issued pursuant to this Offering are subject to a four month hold period expiring on December 12, 2014.