# YANGAROO Inc.

Unaudited Condensed Interim Financial Statements

For the Three and Nine Months Ended September 30, 2014 and 2013

(Expressed in Canadian Dollars)

**Notice of No Auditor Review of Interim Financial Statements**

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

The management of YANGAROO Inc. is responsible for the preparation of the accompanying unaudited condensed interim financial statements. The unaudited condensed interim financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are considered by management to present fairly the financial position, operating results and cash flows of the Company.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor. These unaudited condensed interim financial statements include all adjustments, consisting of normal and recurring items, that management considers necessary for a fair presentation of the financial position, results of operations and cash flows.

| | |
|---|---|
| "Gary Moss" | "Michael Galloro" |
| Gary Moss | Michael Galloro |
| Chief Executive Officer | Chief Financial Officer |

November 20, 2014

# YANGAROO Inc.

Unaudited Condensed Interim Statements of Financial Position
As at
(Expressed in Canadian dollars)

| | September 30 2014 | December 31 2013 (audited) |
|---|---|---|
| **Assets** | | |
| **Current** | | |
| Cash and cash equivalents | **$ 941,143** | $ 764,760 |
| Accounts receivable | **897,988** | 825,210 |
| Prepaid and sundry assets | **241,469** | 144,826 |
| | **2,080,600** | 1,734,796 |
| Property and equipment | **214,783** | 127,524 |
| | **$ 2,295,383** | $ 1,862,320 |
| **Liabilities** | | |
| **Current** | | |
| Trade and other payables (note 5) | **$ 534,387** | $ 442,122 |
| Deferred revenue | **190,523** | 12,938 |
| Finance lease obligation | **59,320** | 35,666 |
| | **784,230** | 490,726 |
| Finance lease obligation | **71,819** | 47,110 |
| Accrued interest on debentures (note 6) | **-** | 75,772 |
| Debentures (note 6) | **-** | 2,021,538 |
| | **856,049** | 2,635,146 |
| **Shareholders' equity (deficiency)** | | |
| Share capital (note 7) | **31,498,041** | 27,984,047 |
| Warrant capital (note 9) | **2,246,064** | 2,177,455 |
| Contributed surplus | **3,501,982** | 3,076,340 |
| Deficit | **(35,806,753)** | (34,010,668) |
| | **1,439,334** | (772,826) |
| | **$ 2,295,383** | $ 1,862,320 |

Going concern (note 2(c))
Commitments and contingencies (note 11)

**Approved by the Board** **"Cliff Hunt"** Director **"Howard Atkinson"** Director

See accompanying notes, which are an integral part of these unaudited condensed interim financial statements

# YANGAROO Inc.

Unaudited Condensed Interim Statements of Comprehensive Income (Loss)
For the period ended September 30
(Expressed in Canadian dollars)

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| **Revenue** | **$ 2,757,633** | $ 2,435,009 | **$1,005,326** | $ 836,155 |
| **Expenses** | | | | |
| Salaries and consulting (note 8) | **3,184,814** | 2,109,653 | **1,090,674** | 698,561 |
| Marketing and promotion | **476,294** | 266,785 | **153,666** | 117,156 |
| General and administrative | **670,183** | 627,329 | **258,421** | 207,149 |
| Technology development (recovery) | **(38,791)** | (32,524) | **12,105** | (51,153) |
| Depreciation of property and equipment | **66,965** | 61,267 | **25,994** | 21,549 |
| | **4,359,465** | 3,032,510 | **1,540,860** | 993,262 |
| **Loss from operations** | **(1,601,832)** | (597,501) | **(535,534)** | (157,107) |
| **Finance income (expenses)** | | | | |
| Interest income | **3,992** | 329 | **1,978** | 11 |
| Interest expense | **(136,576)** | (628,535) | **(1,865)** | (205,163) |
| Foreign exchange gain (loss) | **37,767** | 7,036 | **37,536** | (13,340) |
| Gain (loss) on extinguishment of debt (note 6) | **(99,436)** | 1,669,880 | **-** | 1,669,880 |
| | **(194,253)** | 1,048,710 | **37,649** | 1,451,388 |
| **Net income (loss) and comprehensive income (loss)** | **$(1,796,085)** | $ 451,209 | **$(497,885)** | $1,294,281 |
| **Basic and diluted income (loss) per share** (note 10) | **$ (0.04)** | $ 0.03 | **$ (0.01)** | $ 0.08 |

See accompanying notes, which are an integral part of these unaudited condensed interim financial statements

# YANGAROO Inc.

Unaudited Condensed Interim Statements of Changes in Equity
For the period ended September 30
(Expressed in Canadian dollars)

| | Share capital | Warrant capital | Contributed surplus | Shares and warrants to be issued | Deficit | Total |
|---|---|---|---|---|---|---|
| Balance at December 31, 2012 | $23,828,456 | $1,060,551 | $2,531,803 | $ - | $(32,380,234) | $(4,959,424) |
| Private placement (note 7) | 377,349 | - | - | 64,641 | - | 441,990 |
| Issuance of warrants (note 9) | - | 852,800 | - | - | - | 852,800 |
| Expiry of warrants (note 9) | - | (112,157) | 112,157 | - | - | - |
| Cancellation of warrants (notes 6&9) | - | (154,437) | 154,437 | - | - | - |
| Share-based payments (note 8) | - | - | 127,707 | - | - | 127,707 |
| Conversion and amendment of debenture (note 6) | - | - | - | 2,734,118 | - | 2,734,118 |
| Income for the period | - | - | - | - | 451,209 | 451,209 |
| Balance at September 30, 2013 | $24,205,805 | $1,646,757 | $2,926,104 | $2,798,759 | $(31,929,025) | $(351,600) |
| Private placement (note 7) | - | 64,641 | - | (64,641) | - | - |
| Conversion and amendment of debenture (note 6) | 3,778,242 | 466,057 | - | (2,734,118) | - | 1,510,181 |
| Share-based payments (note 8) | - | - | 150,236 | - | - | 150,236 |
| Loss for the period | - | - | - | - | (2,081,643) | (2,081,643) |
| Balance at December 31, 2013 | $27,984,047 | $2,177,455 | $3,076,340 | - | $(34,010,668) | $(772,826) |
| Private placement (note 7) | 3,437,344 | 147,767 | - | - | - | 3,585,111 |
| Exercise of warrants (notes 7&9) | 76,650 | (26,650) | - | - | - | 50,000 |
| Expiry of warrants (note 9) | - | (52,508) | 52,508 | - | - | - |
| Share-based payments (note 8) | - | - | 373,134 | - | - | 373,134 |
| Loss for the period | - | - | - | - | (1,796,085) | (1,796,085) |
| Balance at September 30, 2014 | $31,498,041 | $2,246,064 | $3,501,982 | $ - | $(35,806,753) | $1,439,334 |

See accompanying notes, which are an integral part of these unaudited condensed interim financial statements

# YANGAROO Inc.

Unaudited Condensed Interim Statements of Cash Flows
For the nine months ended September 30
(Expressed in Canadian dollars)

| | 2014 | 2013 |
|---|---|---|
| **Cash flow from operating activities** | | |
| Cash flow used in operating activities: | | |
| Net income (loss) for the period | **$ (1,796,085)** | $ 451,209 |
| Items not affecting cash: | | |
| Depreciation of property and equipment | **66,965** | 61,267 |
| Accretion interest | **13,554** | 30,517 |
| Share-based payments (note 8) | **373,134** | 127,707 |
| Accrued interest on debentures | **117,576** | 595,945 |
| Bad debt expense | **2,122** | 19,434 |
| Loss (gain) on extinguishment of debt (note 6) | **99,436** | (1,669,880) |
| Changes in non-cash operating working capital: | | |
| Accounts receivable | **(74,900)** | (19,220) |
| Prepaid and sundry assets | **(96,643)** | (41,431) |
| Trade and other payables | **92,265** | 508,879 |
| Deferred revenue | **177,585** | (12,032) |
| **Net cash used in operating activities** | **(1,024,991)** | 52,395 |
| **Cash flow from investing activities** | | |
| Acquisition of property and equipment | **(68,185)** | (2,059) |
| **Net cash used in investing activities** | **(68,185)** | (2,059) |
| **Cash flow from financing activities** | | |
| Proceeds from issuance of common shares, net of share issuance costs (note 7) | **3,585,111** | 1,294,790 |
| Redemption of debentures, including interest (note 6) | **(2,327,877)** | - |
| Payment of finance lease obligation | **(37,675)** | (13,919) |
| Debt restructuring costs | **-** | (206,189) |
| Exercise of warrants (notes 7& 9) | **50,000** | - |
| **Net cash received from financing activities** | **1,269,559** | 1,074,682 |
| **Net increase in cash and cash equivalents** | **176,383** | 1,125,018 |
| **Cash and cash equivalents at January 1** | **764,760** | 493,427 |
| **Cash and cash equivalents at September 30** | **$ 941,143** | $ 1,618,445 |
| **Cash paid for interest** | **$ 198,794** | $ 2,844 |

See accompanying notes, which are an integral part of these unaudited condensed interim financial statements

## 1. Nature of Operations

YANGAROO Inc. (“YANGAROO” or "the Company") is a technology company that is the provider of user friendly and secure business to business distribution of media via the Internet. The Company's patented Digital Media Distribution System (DMDS) is a secure B2B digital media management solution for the entertainment and advertising industries. DMDS is an end to end technology solution that provides a fully integrated work flow based digital distribution and data management solution. DMDS provides audio and video content for music, music videos, and advertising to television, radio, media, retailers, award shows and other authorized recipients with more accountable, effective, and far less costly digital distribution of broadcast quality media via the Internet.

YANGAROO Inc. is a publicly listed company incorporated on July 28, 1999 under the laws of Ontario as Musicrypt.com Inc. and changed to its present name on July 17, 2007. YANGAROO trades on the TSX Venture Exchange (TSX-V) under the symbol YOO and in the U.S. under OTCBB: YOOIF.

The address of the Company’s corporate office and principal place of business is 18 Mowat Avenue, Toronto, Ontario M6K 3E8.

## 2. Basis of Preparation

### (a) Basis of compliance

These unaudited condensed interim financial statements were prepared using the same accounting policies and methods as those used in the Company’s audited financial statements for the year ended December 31, 2013. These unaudited condensed interim financial statements are in compliance with International Accounting Standard (IAS) 34, *Interim Financial Reporting.* Accordingly, certain information and footnote disclosure normally included in annual financial statements prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), have been omitted. The preparation of these unaudited condensed interim financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies.

These statements were approved by the Board of Directors on November 20, 2014.

### (b) Basis of measurement

The condensed unaudited interim financial statements have been prepared on the historical cost basis except certain financial instruments recorded at fair value through profit and loss. Where there are assets and liabilities calculated on a different basis, this fact is disclosed in the relevant accounting policy.

## 2. Basis of Preparation (continued)

### (b) Basis of measurement (continued)

The financial statements are presented in Canadian dollars, which is also the Company's functional currency.

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment of complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in the following notes:

(i) Share-based payments

Share-based payments which include stock options granted to employees, officers and directors and warrants to the extent that they are not measured at the fair value of the services received are based on the fair value at the date of the award. These share-based payments are valued using Black-Scholes option pricing model.

(ii) Fair value of financial instruments

The Company estimated the fair value of the debentures using an estimated market interest rate derived from comparable companies.

(iii) Revenue recognition

The Company uses estimates to determine the percentage of completion of certain milestones for the awards management revenue stream.

### (c) Going concern

The Company may have to raise additional capital to fund operations until such point that revenues from their technology are able to fund operations. If the Company is not able to raise sufficient capital then there is the risk that the Company will not be able to realize the value of its assets and discharge its liabilities.

At September 30, 2014, the Company had a working capital of $1,296,370 and a deficit of $35,806,753. To date, the Company has been successful raising capital. Refer to note 7.

## 3. Significant Accounting Policies

The unaudited condensed interim financial statements are prepared in accordance with IFRS and follow the same accounting policies and methods of their application as the most recent audited financial statements for the year ended December 31, 2013. These unaudited condensed financial statements should be read in conjunction with those audited financial statements.

New standards and interpretations not yet adopted

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the IASB or IFRS Interpretations Committee (“IFRIC”) that are applicable for accounting periods beginning after December 31, 2013, as follows:

- IFRS 9 *Financial Instruments* was issued by the IASB in October 2010 and will replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Requirements relating to hedge accounting representing a new hedge accounting model have also been added to IFRS 9. The mandatory effective date for IFRS 9, which is to be applied retrospectively, would be annual periods beginning on or after January 1, 2018.
- In May 2014, the IASB issued IFRS 15 – Revenue from Contracts with Customers (“IFRS 15”) which supersedes IAS 11 – Construction Contracts, IAS 18 – Revenue, IFRIC 13 – Customer Loyalty Programmes, IFRIC 15 – Agreements for the Construction of Real Estate, IFRIC 18 – Transfers of Assets from Customers, and SIC 31 – Revenue – Barter Transactions involving Advertising Services. IFRS 15 establishes a single five-step model for determining the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. The standard is effective for annual periods beginning on or after January 1, 2017, with early adoption permitted.

The Company is currently evaluating the impact of the above mentioned standards on financial statements.

## 4. Operating Line of Credit

The Company has available an operating line of credit of $20,000. Borrowings under the operating line of credit are due on demand and bear interest at prime plus 2.5% per annum and are secured by a general security agreement. As of September 30, 2014, the Company had a balance outstanding of $Nil (December 31, 2013 - $Nil) on this line of credit.

(Expressed in Canadian dollars)

## 5. Trade and Other Payables

| | September 30 2014 | December 31 2013 (audited) |
|---|---|---|
| Trade payables | **$ 232,370** | $ 179,303 |
| Non-trade payables | **302,017** | 262,819 |
| | **$ 534,387** | $ 442,122 |

## 6. Debentures

(a) On June 23, 2011, the Company issued $2,500,000 principal amount of senior secured 18% non-convertible debentures (the “New Debenture”). As well on June 23 2011, the Company amended its previously issued $818,000 principal amount 12% convertible debentures maturing March 31, 2012 (the “March 2012 Debentures”) and $1,125,000 principal amount convertible debentures maturing July 31, 2012 to reflect the terms of the New Debentures (the “July 2012 Debentures” and together with the March 2012 Debentures, the “Amended Debentures”). $44,911 of interest that accrued on the March 2012 Debentures was added to the principal amount of the amended March 2012 Debentures.

Pursuant to their terms, the New Debentures and the Amended Debentures (collectively, the “Debentures”) are, among other things, non-convertible and repayable upon demand, after the first anniversary of their issuance, subject to the requisite determination of the holders of the outstanding Debentures to make demand for repayment. In addition, in the event of an asset sale in excess of $3,000,000, the Company would be required to offer to repurchase a minimum of 50% of the outstanding Debentures, plus all accrued and unpaid interest due. Debenture holders would also have a right of first refusal to participate in future offerings by the Company, subject to the satisfaction of certain conditions. In turn, the Company may redeem the Debentures in the event that it has first raised a minimum of $4 million of “net new cash”, which would include the proceeds raised from the issuance of the New Debentures but would exclude, among other things, the proceeds from the repayment of any debentures that, in turn, are used to fund the purchase of new securities of the Company. The non-convertible debentures are secured by all tangible and intangible assets of the Company.

The Company incurred cash financing costs of $374,969, “Bonus” common shares of $946,505 and 2,066,000 warrants with a fair value of $78,281 in connection with the June 23, 2011 transaction. These costs were allocated between the New Debentures and the previously issued convertible debentures on a pro rata basis resulting in $606,011 of these costs being included in the loss on extinguishment of debentures and $793,744 recorded against the carrying value of the New Debentures.

**6. Debentures (continued)**

The New Debentures were being accreted to their face value at a weighted average effective interest rate of 39.72%. The amendment to the debentures was accounted for as an extinguishment of the previously issued convertible debentures as they had yet to mature when the terms were modified on June 23, 2011. Also, the terms between current debentures and the previously issued convertible debentures were considered to be substantially different.

(b) As a result of closing the Private Placement on October 3, 2012 and achieving the minimum threshold of $1,250,000 in financing, the existing debenture holders of the Company have consented to the amendment of their existing debenture agreements. The key amendments include lowering the interest rate from 18% to 14% and extending the repayment date of the existing debentures for an additional three years, all as of the closing date of the Private Placement. Accrued interest recorded up to the date of the amendment of $687,301 was added to the principle of the Amended Debentures. The remaining interest will accrue at 14% throughout the amended term and is payable with the redemption of the principal portion of the debenture.

As part of the amended debenture agreement, the Company was required to issue bonus warrants to the debenture holders as soon as practicable following the execution of the agreement and receipt of approval from the TSX Venture Exchange. The amended agreement also outlined that there was to be approximately 8,900,000 bonus warrants issued to the debenture holders. However, only 3,600,000 warrants were actually approved for issuance. The Company issued 3,600,000 bonus warrants to the holders of the debentures as of December 31, 2012. These warrants were cancelled as of December 31, 2013 (note 9).

The amendment to the debentures is accounted for as an extinguishment since the amendments to the debt terms has resulted in a change in value of more than 10%. The difference between the fair value of the debentures and its face amount was $154,437 which was ascribed to the bonus warrants. The debentures are being accreted to its face amount of $5,598,692 using an effective interest rate of 15%.

The amended debenture agreement includes a cash sweep whereby the Company is to repay the debenture holders if the cash balance in any fiscal quarter end exceeds certain thresholds. In the event that the cash balance of the Company exceeds $1,000,000, the Company is required to repay 25% of the amount over $1,000,000 up to $250,000. If the cash balance at any quarter end exceeds $2,000,000, then in addition to the $250,000 payable above, the Company is also required to pay to the debenture holders 50% of the amount over $2,000,000.

As outlined in the amended debenture agreement, because the TSX Venture Exchange did not approve the bonus warrants, the Company was required to increase the percentage used to estimate the cash sweep over $1,000,000 to be 35% up to a maximum of $350,000.

**6. Debentures (continued)**

(c) On September 12, 2013, the Company issued amended debenture agreements to two of three classes of debenture holders who provided the requisite consent. Upon approval of the TSX Venture Exchange, the Company would offer a one-half of one warrant for every $1.00 of current indebtedness to the debenture holders as consideration for amending the debenture agreements to reflect more favourable terms, as described below. Each whole warrant will be exercisable for a period of 36 months from the date of issuance at a price equal to $0.25. 2,382,726 warrants were issued on October 7, 2013 and included in shares and warrants to be issued as of September 30, 2013 (note 9).

The amended debentures provide for the reduction of the interest rate from 14% to 10%, an extension of the term by an additional 12 months to October 3, 2016, and the waiver of the cash sweeps, as defined above. The cash sweeps have been eliminated in connection with the private placement and all future debt, equity, and equity-like financings pursuant to the amended debentures.

The amendment to the debentures is accounted for as an extinguishment since the amendments to the debt terms has resulted in a change in value of more than 10%.

(d) On September 19, 2013, the Company announced that it had entered into shares for debt agreements with a majority of its current debenture holders whereby, of the current outstanding indebtedness of the Company equal to $6,379,656.84, a total of $4,245,128 will be converted into post-consolidation common shares of the Company at a fair value of $0.25 per common share. 16,980,514 shares were issued on October 7, 2013 and included in shares and warrants to be issued as of September 30, 2013 (note 7).

(e) The Company entered into an advisory agreement with Fraser Mackenzie Merchant Capital Partnership ("FMMC") with respect to the services provided by FMMC in connection with the shares for debt transaction and the debenture amendment and, under such agreement, FMMC was entitled to receive 384,281 common shares and 336,364 non-transferable warrants for a period of 36 months. Each warrant entitles the holder to purchase one common share at a price of $0.25 per unit within the first year of the warrant exercise period, and at a price of $0.35 per unit within the second and third years of the warrant exercise period. Both common shares and warrants were issued on October 7, 2013 and included in shares and warrants to be issued as of September 30, 2013 (notes 7 & 9).

As a result of the transactions described above in (c), (d), and (e), the Company recorded a charge of $202,371 relating to the debenture amendments, conversions and related costs during the year ended December 31, 2013.

(f) On June 11, 2014, the Company announced that it had redeemed all of its outstanding debentures early, without penalty and in full for the aggregate amount of $2,327,876.62 in principal and interest, entering into debenture redemption agreements with the debenture holders. The difference between the redeemed amount and the carrying value of the debentures, which included accrued interest, was recorded in loss from extinguishment of debt.

(Expressed in Canadian dollars)

## 7. Share Capital

The Company is authorized to issue an unlimited number of common shares.

The following is a summary of changes in common share capital from January 1, 2013 to September 30, 2014:

| | Number of shares | Value |
|---|---|---|
| Balance at December 31, 2012 | 163,244,771 | $ 23,828,456 |
| Effect of share consolidation [(a)] | (146,920,287) | - |
| Balance at September 19, 2013, date of share consolidation[(a)] | 16,324,484 | $ 23,828,456 |
| Issued for cash on September 30, 2013[(b)] | 6,400,000 | 377,349 |
| Balance at September 30, 2013 | 22,724,484 | $ 24,205,805 |
| Issued in connection with conversion of debentures [(c)] | 16,980,514 | 3,693,700 |
| Issued in connection with conversion of debentures and amendment of debt[(d)] | 384,281 | 84,542 |
| Balance at December 31, 2013 | 40,089,279 | $ 27,984,047 |
| Issued for cash on May 30, 2014[(e)] | 8,236,669 | 2,140,154 |
| Issued for cash on June 11, 2014[(f)] | 4,053,334 | 1,043,027 |
| Issued for cash on August 25, 2014[(g)] | 1,000,000 | 254,163 |
| Exercise of warrants[(h)] | 200,000 | 76,650 |
| **Balance at September 30, 2014** | **53,579,282** | **$ 31,498,041** |

(a) On September 19, 2013, the Company completed the consolidation of its issued and outstanding common shares. Effective on this date, the Company's common shares were consolidated on a basis of ten pre-consolidation shares for each one post-consolidation share. After the consolidation, the Company’s common shares were reduced by 146,920,287, resulting in 16,324,484 common shares outstanding, prior to the issuance of the common shares underlying the subscription receipts. The shareholders of the Company approved the share consolidation at its Annual and Special Meeting of the Shareholders held on August 15, 2013.

## 7. Share Capital (continued)

(b) The Company issued 6,400,000 units at a price of $0.25 per unit for gross proceeds of $1,600,000 by way of a private placement. Each unit consists of one post-consolidation common share and one warrant entitling the holder to purchase one additional common share within 36 months of closing, at a price of $0.25 per share within the first year of the warrant exercise period, and at a price of $0.35 per share within the second and third years of the warrant exercise period. The majority of the proceeds were deposited into escrow with Equity Financial Trust Company, an escrow agent to be held until their release upon the satisfaction by the Company of the release conditions. The escrow release conditions were satisfied on September 30, 2013 and 6,400,000 shares and 6,400,000 warrants were issued on this date (note 9). Share issuance costs of $369,851 have been netted against share capital and $852,800 has been allocated to warrants (note 9). Included in share issuance costs is $64,641, which represents the value of 443,200 warrants to be issued to Fraser Mackenzie Limited, who acted as agents in connection with the private placement. Each warrant will be exercisable at a price of $0.25 per common share for a period of 36 months. These warrants were issued on October 7, 2013 and included in shares and warrants to be issued as of September 30, 2013 (note 9). Fraser Mackenzie Limited also received in consideration for its services a cash commission of $110,800.

(c) The Company issued 16,980,514 shares in connection with the shares for debt agreements entered into on September 19, 2013. A total of $4,245,128 indebtedness was converted into post-consolidated common shares of the Company at the fair value of $0.25 per common share (note 6). The issuance costs totaled $551,428.

(d) The Company issued 384,281 common shares in connection with the advisory agreement entered into with FMMC with respect to the services provided by FMMC in connection with the shares for debt transaction and debenture amendment (note 6).

(e) The Company issued 8,236,669 shares at a price of $0.30 per share for gross proceeds of $2,471,000 by way of a private placement. The proceeds were used primarily to repay existing indebtedness in the form of debentures (note 6). Share issuance costs of $243,915 have been netted against share capital and $86,931 has been allocated to 534,567 warrants issued to agents in connection with the private placement (note 9).

(f) The Company issued 4,053,334 shares at a price of $0.30 per share for gross proceeds of $1,216,000 by way of a private placement. Share issuance costs of $120,692 have been netted against share capital and $52,281 has been allocated to 283,734 warrants issued to agents in connection with the private placement (note 9).

(g) The Company issued 1,000,000 shares at a price of $0.30 per share for gross proceeds of $300,000 by way of a private placement. Share issuance costs of $37,282 have been netted against share capital and $8,555 has been allocated to 70,000 warrants issued to agents in connection with the private placement (note 9).

(Expressed in Canadian dollars)

## 7. Share Capital (continued)

(h) On September 26, 2014, 200,000 warrants were exercised for cash proceeds of $50,000. The fair value of $26,650 related to the warrant exercise was reclassified from warrants to share capital (note 9).

## 8. Share-Based Payments

On October 1, 2013, the Company announced that it had amended its "fixed" stock option plan (the "Old Plan") to a 10% "rolling" plan (the "Amended Plan").

Under the Old Plan, the Company had reserved a fixed number of 11,804,761 (pre-consolidation) common shares for the grant of stock options. Under the Amended Plan, the Company is entitled to grant stock options to purchase up to 10% of the issued capital of the Company at the time of an applicable option grant.

The Amended Plan was approved by the TSX Venture Exchange on September 25, 2013 as well as the Company's shareholders at the Annual and Special Meeting of the Shareholders held on August 15th, 2013.

The Company had issued stock options to acquire common shares as follows:

| | | Weighted average exercise price | Outstanding options | Vested options | Weighted average remaining life (years) |
|---|---|---|---|---|---|
| Balance at December 31, 2012 | $ | 0.10 | 9,553,000 | 3,885,513 | 3.58 |
| Expired | | 0.20 | (350,000) | | |
| Cancelled | | 0.10 | (666,667) | | |
| Effect of share consolidation (note 7) | | - | (7,682,700) | | |
| Balance at September 30, 2013 | $ | 1.01 | 853,633 | 768,633 | 3.04 |
| Granted | | 0.26 | 2,244,998 | | |
| Expired | | 1.00 | (36,000) | | |
| Forfeited | | 1.00 | (38,333) | | |
| Cancelled | | 0.25 | (9,000) | | |
| Balance at December 31, 2013 | $ | 0.46 | 3,015,298 | 893,548 | 4.08 |
| Granted | | 0.33 | 1,024,500 | | |
| Expired | | 1.00 | (2,500) | | |
| Forfeited | | 0.97 | (8,000) | | |
| Cancelled | | 0.25 | (3,000) | | |
| **Balance at September 30, 2014** | **$** | **0.42** | **4,026,298** | **2,077,798** | **3.63** |

For the nine months ended September 30, 2014, the fair value of the options granted was $275,879 (September 30, 2013 – $Nil).

(Expressed in Canadian dollars)

**8. Share-Based Payments (continued)**

The Company had the following stock options outstanding at September 30, 2014:

| Number of options | Number of non-vested options | Number of vested options | Exercise price | Expiry date |
|---:|---:|---:|:---:|---|
| 40,000 | - | 40,000 | $1.10 | November 18, 2014 |
| 40,000 | - | 40,000 | $1.00 | April 20, 2015 |
| 146,000 | 85,000 | 61,000 | $1.00 | February 11, 2016 |
| 186,026 | - | 186,026 | $1.00 | August 18, 2016 |
| 60,000 | - | 60,000 | $1.00 | December 13, 2017 |
| 276,828 | - | 276,828 | $1.00 | December 20, 2017 |
| 20,946 | - | 20,946 | $1.00 | December 21, 2017 |
| 1,897,000 | 1,137,000 | 760,000 | $0.25 | October 1, 2018 |
| 320,000 | 80,000 | 240,000 | $0.35 | October 15, 2016 |
| 7,500 | 4,500 | 3,000 | $0.25 | November 1, 2018 |
| 7,498 | - | 7,498 | $0.25 | November 18, 2016 |
| 852,500 | 511,500 | 341,000 | $0.34 | March 3, 2019 |
| 30,000 | 27,000 | 3,000 | $0.30 | May 28, 2019 |
| 27,000 | - | 27,000 | $0.35 | June 20, 2019 |
| 115,000 | 103,500 | 11,500 | $0.28 | September 2, 2019 |
| **4,026,298** | **1,948,500** | **2,077,798** | **$0.42** | |

The estimated fair value of the options is expensed over the vesting period. The fair value of the compensation and contributed surplus relating to the stock options for the nine months ended September 30, 2014 was $373,134 (September 30, 2013 - $127,707) The fair value of all the Company's stock options was estimated using the Black-Scholes option pricing model.

Stock options granted during the period ended September 30, 2014 used the following assumptions:

| | **September 30 2014** | September 30 2013 |
|---|---:|---:|
| Volatility (based on historical share prices) | **117%** | Nil% |
| Risk-free interest rate | **1.62%** | Nil% |
| Expected life (years) | **5** | Nil |
| Dividend yield | **Nil** | Nil |
| Forfeiture rate | **10%** | Nil% |
| Underlying share price | **$0.33** | $Nil |

(Expressed in Canadian dollars)

## 9. Warrants

The Company had issued warrants to acquire common shares as follows:

| | Number of warrants | Amount | Weighted average exercise price |
|---|---|---|---|
| Balance at December 31, 2012 | 39,613,652 | $ 1,060,551 | $ 0.10 |
| Warrants expired | (2,666,000) | (112,157) | 0.10 |
| Bonus warrants cancelled (note 6) | (3,600,000) | (154,437) | 0.10 |
| Effect of share consolidation (note 7) | (30,012,887) | - | - |
| Balance at September 19, 2013, date of share consolidation | 3,334,765 | $ 793,957 | $ 1.00 |
| Warrants issued (note 7) | 6,400,000 | 852,800 | 0.25 |
| Balance at September 30, 2013 | 9,734,765 | $ 1,646,757 | $ 0.51 |
| Warrants issued (note 7) | 443,200 | 64,641 | 0.25 |
| Warrants issued (note 6) | 2,382,726 | 429,057 | 0.25 |
| Warrants issued (note 6) | 336,364 | 37,000 | 0.25 |
| Balance at December 31, 2013 | 12,897,055 | $ 2,177,455 | $ 0.44 |
| Warrants issued (note 7) | 534,567 | 86,931 | 0.30 |
| Warrants issued (note 7) | 283,734 | 52,281 | 0.30 |
| Warrants issued (note 7) | 70,000 | 8,555 | 0.30 |
| Warrants expired | (75,000) | (52,508) | 1.00 |
| Warrants exercised (note 7) | (200,000) | (26,650) | 0.25 |
| **Balance at September 30, 2014** | **13,510,356** | **$ 2,246,064** | **$ 0.48** |

(Expressed in Canadian dollars)

**9. Warrants (continued)**

The Company had the following warrants outstanding and exercisable at September 30, 2014, as adjusted for the share consolidation:

| Number of warrants | | Exercise price | Expiry date |
|---:|---|:---:|---|
| 687,565 | (i) | $1.00 | September 7, 2015 |
| 1,850,000 | (ii) | $1.00 | October 3, 2015 |
| 73,800 | (iii) | $1.00 | October 3, 2014 |
| 630,000 | (iv) | $1.00 | December 13, 2015 |
| 18,400 | (v) | $1.00 | December 13, 2014 |
| 6,200,000 | (vi) | $0.25 in Year 1 & $0.35 in Years 2 & 3 | September 30, 2016 |
| 443,200 | (vii) | $0.25 | October 7, 2016 |
| 2,382,726 | (viii) | $0.25 | October 7, 2016 |
| 336,364 | (ix) | $0.25 in Year 1 & $0.35 in Years 2 & 3 | October 7, 2016 |
| 534,567 | (x) | $0.30 | May 30, 2016 |
| 283,734 | (xi) | $0.30 | June 11, 2016 |
| 70,000 | (xii) | $0.30 | August 25, 2016 |
| **13,510,356** | | | |

(i) These warrants were issued as part of the private placement of units. The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 119%; (III) a risk free rate of 1.25%; and (IV) an expected life of 3 years.

(ii) These warrants were issued as part of the private placement of units. The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 116%; (III) a risk free rate of 1.14%; and (IV) an expected life of 3 years.

(iii) These warrants were issued to agents in connection with the issuance of the private placement. The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 115%; (III) a risk free interest rate of 1.08% and (IV) an expected life of 2 years.

(iv) These warrants were issued as part of the private placement of units. The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 114%; (III) a risk free rate of 1.19%; and (IV) an expected life of 3 years.

**9. Warrants (continued)**

(v) These warrants were issued to agents in connection with the issuance of the private placement. The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 118%; (III) a risk free interest rate of 1.12% and (IV) an expected life of 2 years.

(vi) These warrants were issued as part of the private placement of units (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 114%; (III) a risk free rate of 1.4%; and (IV) an expected life of 3 years.

(vii) These warrants were issued to agents as part of the private placement of units (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 114%; (III) a risk free interest rate of 1.40% and (IV) an expected life of 3 years.

(viii) These warrants were issued as part of the amended debenture agreements (note 6). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 115%; (III) a risk free interest rate of 1.39% and (IV) an expected life of 3 years.

(ix) These warrants were issued to advisors in connection with the shares for debt transaction and debenture amendment (note 6). The fair value of the warrants issued was based on the advisory agreement with FMMC.

(x) These warrants were issued to agents as part of the private placement (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 98%; (III) a risk free interest rate of 1.05% and (IV) an expected life of 2 years.

(xi) These warrants were issued to agents as part of the private placement (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 97%; (III) a risk free interest rate of 1.07% and (IV) an expected life of 2 years.

(xii) These warrants were issued to agents as part of the private placement (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 95%; (III) a risk free interest rate of 1.09% and (IV) an expected life of 2 years.

Except where noted above, warrants issued to agents and related to financings were not measured at the fair value of the services received as the fair value of such services was not reliably measurable.

(Expressed in Canadian dollars)

## 10. Income (Loss) per Share

| | Nine Months Ended | | Three Months Ended | |
|---|---|---|---|---|
| | **September 30, 2014** | September 30, 2013 | **September 30, 2014** | September 30, 2013 |
| Numerator: | | | | |
| Net income (comprehensive loss) for the period | **$(1,796,085)** | $ 451,209 | **$(497,885)** | $ 1,294,281 |
| Denominator: | | | | |
| Weighted average number of common shares | **45,632,577** | 16,347,920 | **52,792,325** | 16,394,042 |
| Basic and diluted income (loss) per share | **$ (0.04)** | $ 0.03 | **$ (0.01)** | $ 0.08 |

For the above-mentioned periods, the Company had securities outstanding which could potentially dilute basic earnings per share in the future, but were excluded from the computation of dilutive net loss per share in the periods presented, as their effect would have been anti-dilutive. Such outstanding securities consist of the following:

| | **September 30 2014** | September 30 2013 |
|---|---|---|
| Options | **4,026,298** | 853,633 |
| Warrants | **13,510,356** | 9,734,765 |

## 11. Commitments and Contingencies

### (a) Litigation

In the ordinary course of business activities, the Company may be contingently liable for litigation and claims with customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required.

(Expressed in Canadian dollars)

## 11. Commitments and Contingencies (continued)

### (b) Leases

Total future annual lease payments for the premises are as follows:

| | |
|---|---|
| 2014 | $ 21,709 |
| 2015 | 86,836 |
| 2016 | 86,836 |
| 2017 | 65,127 |
| | $ 260,508 |

## 12. Capital Risk Management

The Company includes equity; comprised of share capital, warrant capital, contributed surplus, and deficit, in the definition of capital.

The Company's primary objective with respect to its capital management is to ensure that it has sufficient cash resources to further develop and market its digital media distribution systems, and to maintain its ongoing operations. To secure the additional capital necessary to pursue these plans, the Company may attempt to raise additional funds through the issuance of equity and warrants, debt or by securing strategic partners.

The Company is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital risk management strategy during the three and nine months ended September 30, 2014.

(Expressed in Canadian dollars)

## 13. Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, excluding HST, trade and other payables, finance lease obligation and debentures with related accrued interest. The fair values of financial instruments approximate their carrying values because of their current nature.

| | **September 30 2014** | December 31 2013 (audited) |
|---|---|---|
| Fair value through profit or loss (i) | **$ 941,143** | $ 764,760 |
| Loans and receivables (ii) | **$ 897,988** | $ 825,210 |
| Other financial liabilities (iii) | **$ 665,526** | $ 2,622,208 |

The following table summarizes the carrying values of the Company's financial instruments:

(i) Cash and cash equivalents
(ii) Accounts receivable excluding HST
(iii) Trade and other payables, finance lease obligation, debentures and accrued interest

The Company classifies its fair value measurements in accordance with the three levels fair value hierarchy 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 the asset or liabilities either directly or indirectly, and
- Level 3 – Inputs that are not based on observable market data.

The Company's financial instruments measured at fair value on a recurring basis are as follows:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| As at September 30, 2014 | | | | |
| Cash and cash equivalents | $ 941,143 | $ - | $ - | $ 941,143 |
| As at December 31, 2013 | | | | |
| Cash and cash equivalents | $ 764,760 | $ - | $ - | $ 764,760 |