

# **Star Navigation Systems Group Ltd.**

**Condensed Interim Consolidated Financial  
Statements**

**(Unaudited)**

**For the three month periods ended September 30, 2013 and September  
30, 2012**

**(Expressed in Canadian dollars)**

## **NOTICE TO READER**

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The accompanying unaudited condensed interim consolidated financial statements have been prepared by the Company's management and the Company's independent auditors have not performed a review of these financial statements.

Toronto, Ontario  
November 29, 2013

**Star Navigation Systems Group Ltd.**  
**Unaudited Condensed Interim Consolidated Statements of Financial Position**  
**As at September 30, 2013**  
**(Expressed in Canadian dollars)**

|  | Sept 30,<br>2013    | June 30,<br>2013<br>(Audited) |
|--|---------------------|-------------------------------|
| <b>Assets</b>  |                     |                               |
| <b>Current</b>                                       |                     |                               |
| Cash and cash equivalents                            | \$ -                | \$ 405,603                    |
| Accounts receivable (Note 13(c))                     | 41,240              | 38,381                        |
| Inventory  | 277,149             | 277,149                       |
| Prepaid expenses and sundry receivables              | 226,958             | 206,374                       |
|  | <b>545,347</b>      | <b>927,507</b>                |
| <b>Property and equipment</b> (Note 5)               | <b>97,171</b>       | <b>110,370</b>                |
| <b>Development and Other assets</b> (Note 6)         | <b>315,632</b>      | <b>365,990</b>                |
|  | <b>\$ 958,150</b>   | <b>\$ 1,403,867</b>           |
| <b>Liabilities</b>                                   |                     |                               |
| <b>Current</b>                                       |                     |                               |
| Bank Indebtedness                                    | \$ 40,117           | \$ -                          |
| Accounts payable and accrued liabilities (Note 7)    | 288,213             | 228,705                       |
| Current portion of finance lease obligation (Note 8) | 36,429              | 36,429                        |
| Due to related parties (Note 15)                     | 1,064,572           | 1,049,392                     |
| Other payables (Note 9)                              | 196,000             | 196,000                       |
| Deferred revenue                                     | 10,000              | 10,000                        |
|  | <b>1,635,331</b>    | <b>1,520,526</b>              |
| <b>Finance lease obligation</b> (Note 8)             | <b>19,827</b>       | <b>28,738</b>                 |
|  | <b>1,655,158</b>    | <b>1,549,264</b>              |
| <b>Shareholders' Equity (Deficiency)</b>             |                     |                               |
| <b>Share capital</b> (Note 10)                       | <b>28,327,618</b>   | <b>28,327,618</b>             |
| <b>Contributed surplus</b> (Note 11)                 | <b>13,226,378</b>   | <b>13,210,102</b>             |
| <b>Deficit</b>                                       | <b>(42,251,004)</b> | <b>(41,683,117)</b>           |
|  | <b>(697,008)</b>    | <b>(145,397)</b>              |
|  | <b>\$ 958,150</b>   | <b>\$ 1,403,867</b>           |

*Nature of Operations* (Note 1)

*Commitments and Contingencies* (Note 14)

*Subsequent Event* (Note 17)

Approved by the Board

"Viraf S. Kapadia"

Director (Signed)

"Charles Wyburn"

Director (Signed)

**Star Navigation Systems Group Ltd.****Unaudited Condensed Interim Consolidated Statements of Loss and Comprehensive Loss  
Periods Ended September 30, 2013 and September 30, 2012  
(Expressed in Canadian dollars)**

|   | <b>2013</b>         | <b>2012</b>         |
|---|---------------------|---------------------|
| <b>Revenue</b>  | <b>\$ 13,855</b>    | <b>\$ 117,536</b>   |
| <b>Expenses</b>   |                     |                     |
| Cost of sales   | <b>10,437</b>       | 132,686             |
| Research and development (Note 16)                          | <b>262,942</b>      | 159,516             |
| General and administrative (Note 16)                        | <b>204,695</b>      | 305,555             |
| Marketing and promotion                                     | <b>90,316</b>       | 60,210              |
| Stock based compensation                                    | <b>16,276</b>       | 48,636              |
| Foreign exchange  | <b>(2,924)</b>      | (14)                |
|   | <b>581,742</b>      | 706,589             |
| <b>Loss from operations</b>                                 | <b>(567,887)</b>    | (589,053)           |
| <b>Other Income (expenses)</b>                              |                     |                     |
| Interest income   | -                   | 448                 |
| <b>Net Loss and Comprehensive Loss for the period</b>       | <b>\$ (567,887)</b> | <b>\$ (588,605)</b> |
| <b>Basic and diluted loss per common share</b>              | <b>\$ (0.002)</b>   | <b>\$ (0.0028)</b>  |
| <b>Weighted average number of common shares outstanding</b> | <b>249,211,966</b>  | 208,265,104         |

**Star Navigation Systems Group Ltd.**  
**Unaudited Condensed Interim Consolidated Statements of Changes in Equity (Deficiency)**  
**Periods Ended September 30, 2013 and September 30, 2012**  
**(Expressed in Canadian dollars)**

|  | Number of<br>common<br>shares | Number of<br>Series I<br>preferred<br>shares | Share capital       | Contributed<br>surplus | Deficit               | Total              |
|--|-------------------------------|--|---------------------|------------------------|-----------------------|--------------------|
| <b>Balance at June 30, 2012</b>                          | <b>207,240,078</b>            | <b>615,000</b>                               | <b>\$26,280,393</b> | <b>\$11,258,453</b>    | <b>\$(38,396,973)</b> | <b>\$(858,127)</b> |
| Issued for cash on private placement                     | 26,100,000                    | -  | 2,088,000           | -                      | -                     | 2,088,000          |
| Issued as finders' fees on private placement             | 2,373,125                     | -  | 189,850             | -                      | -                     | 189,850            |
| Value allocated to warrants as part of private placement | -                             | -  | (1,095,238)         | 1,095,238              | -                     | -                  |
| Stock options exercised                                  | 48,000                        | -  | 4,800               | -                      | -                     | 4,800              |
| Share issuance costs                                     | -                             | -  | (204,281)           | -                      | -                     | (204,281)          |
| Fair Value of options exercised                          | -                             | -  | 960                 | (960)                  | -                     | -                  |
| Stock-based compensation                                 | -                             | -  | -                   | 48,636                 | -                     | 48,636             |
| Warrant modification                                     | -                             | -  | -                   | 227,855                | (227,855)             | -                  |
| Loss for the period                                      | -                             | -  | -                   | -                      | (588,605)             | (588,605)          |
| <b>Balance at Sept 30, 2012</b>                          | <b>235,761,203</b>            | <b>615,000</b>                               | <b>\$27,264,484</b> | <b>\$12,629,222</b>    | <b>\$(39,213,433)</b> | <b>\$680,273</b>   |
| <b>Balance at June 30, 2013</b>                          | <b>249,211,966</b>            | <b>615,000</b>                               | <b>\$28,327,618</b> | <b>\$13,210,102</b>    | <b>\$(41,683,117)</b> | <b>\$(145,397)</b> |
| Stock-based compensation                                 | -                             | -  | -                   | 16,276                 | -                     | 16,276             |
| Loss for the period                                      | -                             | -  | -                   | -                      | (567,887)             | (567,887)          |
| <b>Balance at Sept 30, 2013</b>                          | <b>249,211,966</b>            | <b>615,000</b>                               | <b>\$28,327,618</b> | <b>\$13,226,378</b>    | <b>\$(42,251,004)</b> | <b>\$(697,008)</b> |

**Star Navigation Systems Group Ltd.**  
**Unaudited Condensed Interim Consolidated Statements of Cash Flows**  
**For the Periods Ended September 30, 2013 and September 30, 2012**  
**(Expressed in Canadian dollars)**

|   | 2013             | 2012                |
|---|------------------|---------------------|
| <b>Cash provided by (used in)</b>                     |                  |                     |
| <b>Operations</b>                                     |                  |                     |
| Net loss  | \$(567,887)      | \$(588,605)         |
| Items not affecting cash                              |                  |                     |
| Amortization  | 63,557           | 59,835              |
| Stock-based compensation                              | 16,276           | 48,636              |
|   | <b>(488,054)</b> | <b>(480,134)</b>    |
| Net changes in non-cash working capital               |                  |                     |
| Accounts receivable                                   | (2,859)          | (106,206)           |
| Inventory   | -                | 52,500              |
| Prepaid expenses and sundry receivables               | (20,584)         | 39,456              |
| Accounts payable and accrued liabilities              | 59,508           | (207,487)           |
| Due to related parties                                | 15,180           | (83,617)            |
|   | <b>(436,809)</b> | <b>(785,488)</b>    |
| <b>Investing</b>                                      |                  |                     |
| Development and other assets additions                | -                | (6,537)             |
| <b>Financing</b>                                      |                  |                     |
| Repayment of finance lease obligation                 | (8,911)          | (8,410)             |
| Issuance of share capital net of share issuance costs | -                | 2,078,368           |
|   | <b>(8,911)</b>   | <b>2,069,958</b>    |
| <b>Net change in cash and cash equivalents</b>        | <b>(445,720)</b> | <b>1,277,933</b>    |
| <b>Cash and cash equivalents, beginning of period</b> | <b>405,603</b>   | <b>67,262</b>       |
| <b>Cash and cash equivalents, end of period</b>       | <b>(40,117)</b>  | <b>\$ 1,345,195</b> |
| <b>Supplemental Disclosure</b>                        |                  |                     |
| Interest paid   | 13,582           | -                   |
| Issuance of common shares for finder's fees           | -                | 189,850             |

**Star Navigation Systems Group Ltd.**  
**Notes to Unaudited Condensed Interim Consolidated Financial Statements**  
**September 30, 2013**  
**(Expressed in Canadian dollars)**

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**1. NATURE OF OPERATIONS**

Star Navigation Systems Group Ltd. ("the Company") is devoting substantially all of its activity to the development, marketing and promotion of an In-flight Safety Monitoring System ("STAR-ISMS®"), whereby data from an aircraft can be transmitted to ground stations for the duration of a flight. Certain technology used for this system as well as patents granted have been licensed to the Company by a director and a former director of the Company who undertook the initial research and development (Note 6). In March 2012, Transport Canada granted a STC certificate to the Company for use of the system on a Boeing 737-800.

These unaudited condensed interim consolidated financial statements have been prepared on a going concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. The Company incurred a net loss of \$567,887 for the three month period ended September 30, 2013 (2012 - \$588,605), has an accumulated deficit of \$42,251,004 (2012 - \$39,213,433) and has negative working capital of \$1,089,984 (2012 - \$593,119). The Company's ability to continue operations, meet its obligations and realize its investment in development costs is dependent on the continued support from investors and related parties to finance sales to customers, continue the project development, obtain the necessary certifications from regulatory agencies as well as successfully marketing the STAR-ISMS® for gain.

The Company has completed the development of their STAR-ISMS®. The Company's registered office is located at 203-2970 Lakeshore Blvd W., Toronto, Ontario M8V 1J7.

**2. BASIS OF PRESENTATION**

(a) Statement of Compliance

These unaudited condensed interim consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The unaudited condensed interim consolidated financial statements were authorized for issue by the Board of Directors on November 29, 2013.

(b) Basis of Measurement

The unaudited condensed interim consolidated financial statements have been prepared under the historical cost convention, except for certain financial assets which are measured at fair value through profit or loss ("FVTPL").

(c) Functional and presentation currency

These unaudited condensed interim consolidated financial statements are presented in Canadian dollars, which is also the Company's functional currency.

**Star Navigation Systems Group Ltd.**  
**Notes to Unaudited Condensed Interim Consolidated Financial Statements**  
**September 30, 2013**  
**(Expressed in Canadian dollars)**

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**3. SIGNIFICANT ACCOUNTING POLICIES**

Principles of Consolidation

These unaudited condensed interim consolidated financial statements include the accounts of the Company and its wholly-owned operating subsidiaries, Star Navigation Systems Inc. ("Star"), Star Navigation Systems (Quebec) Inc. and Star Navigation Systems (U.K) Ltd. Star Navigation Systems (Quebec) Inc. and Star Navigation Systems (U.K) Ltd. are inactive. All significant inter-company transactions and balances have been eliminated on consolidation. All references to the Company should be treated as references to the Company and its subsidiaries.

Cash and Cash Equivalents

Cash and cash equivalents include bank deposits such as guaranteed investment certificates, with maturities of less than three months.

Impairment

(a) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset and that event has an impact on the estimated future cash flows of the financial asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in the statement of comprehensive loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in the statement of comprehensive loss.



**3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

Impairment (Cont'd)

(b) Non-financial assets

Impairment tests on intangible assets with indefinite useful economic lives and intangible assets with definite useful lives that have not been put into use yet are undertaken annually at the financial year-end. Other non-financial assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of its value in use and fair value less costs to sell, the asset is written down to its recoverable amount.

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets. The Company has one cash-generating unit for which impairment testing is performed.

An impairment loss in respect of other assets is assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Revenue Recognition

The Company recognizes revenue at the time persuasive evidence of an arrangement exists, price is fixed and determinable, the delivery has occurred and collectability is reasonably assured. Revenues from the sale of the Company's STAR-ISMS® are recognized when the installation of the system is complete, defined to be when the related equipment has been installed in a customer's aircraft or transportation vehicle, tested and accepted by the customer, and has received the necessary regulatory approvals. Installations are generally conducted by customers under the Company's management and supervision. In the event the customer chooses to manage the installation without the Company's supervision, revenues are recognized when the product is delivered to the customer.

Revenues from airtime services are recognized as the services are performed based on air time used by the customer. The customer is billed at the end of each month.

**3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

In the event that the Company's STAR-ISMS® and airtime are sold as a bundled package, the Company enters into transactions that represent multiple-element arrangements. These multiple-element arrangements are assessed to determine whether they can be sold separately in order to determine if they can be treated as more than one unit of accounting or element for the purpose of revenue recognition. When there are multiple elements or units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting or elements on a relative fair value basis, as determined by reliable objective evidence of fair value. Objective evidence of fair value is based on the price charged when the elements are sold separately, which is in accordance with the Company's standard price list. If elements cannot be sold separately, revenue recognition is deferred until all elements have been delivered.

**Foreign Exchange**

Monetary assets and liabilities denominated in foreign currencies are translated at the period end exchange rate. Non-monetary assets and liabilities as well as revenue and expense transactions denominated in foreign currencies are translated at the rate prevailing at the time of the transaction. Translation gain or loss adjustments are recognized in the period in which they occur.

**Loss Per Share**

Basic loss per share is calculated by dividing the net loss available to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the net loss attributable to common shareholders and the weighted average number of common shares outstanding, for the effects of all dilutive potential common shares, which comprise share options and warrants issued by the Company. The outstanding share options and warrants are not included in the diluted net loss per common share as they are anti-dilutive for all periods presented.

**Stock-Based Compensation and Other Stock-Based Payments**

The Company applies a fair value based method of accounting to all stock-based payments. Accordingly, stock-based payments for employees are measured at the fair value of the equity instruments issued and stock-based payments for non-employees are measured at the fair value of the consideration received or provided, unless the fair value cannot be estimated reliably. In cases where the fair value cannot be estimated reliably, the Company measures these transactions by reference to the fair value of the equity instruments granted. Each tranche is considered a separate award with its own vesting period and fair value. Stock-based compensation is charged to the statement of comprehensive loss over the tranche's vesting period and the offset is credited to contributed surplus. Consideration received upon the exercise of stock options is credited to share capital and the related contributed surplus is transferred to share capital.

**Warrants**

For transactions involving the issuance of warrants, the Company measures these transactions at the fair value of the goods or services received, unless the fair value cannot be estimated reliably. In cases where the fair value cannot be estimated reliably, the Company measures these transactions by reference to the fair value of the equity instruments granted. In the case of unit placements, the proceeds from the issuance of units is allocated between common shares and warrants on a pro-rata basis based on relative fair values.

**3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

Warrants (Cont'd)

Share issuance costs incurred in connection with the issuance of share capital are netted against the proceeds received. Any incremental fair value resulting upon modification of warrants previously issued as part of unit placements is recognized in deficit.

Accounting Estimates and Judgements

The preparation of consolidated financial statements in compliance with IFRS requires the Company's management to make certain estimates and assumptions that they consider reasonable and realistic. Despite regular reviews of these estimates and assumptions, based in particular on past achievements or anticipations, facts and circumstances may lead to changes in these estimates and assumptions which could impact the reported amount of the Company's assets, liabilities, equity or earnings. These estimates and assumptions notably relate to the amortization of and measurement of impairment of property and equipment and development and other assets, stock-based compensation, warrants, and deferred income taxes. The judgements notably relate to the provisions and contingencies, assessment of going concern uncertainties, application of the deferral criteria and determination of when development was completed on the STAR-ISMS®.

**4. RECENT ACCOUNTING PRONOUNCEMENTS ISSUED AND NOT YET APPLIED**

Future IFRS changes

Certain pronouncements were issued by the IASB or the IFRIC that are mandatory for accounting periods after June 30, 2013 or later periods. Many are not applicable or do not have a significant impact to the Company. The following have not yet been adopted and are being evaluated to determine the resultant impact on the Company.

- (i) 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. IFRS 9 is effective for annual periods beginning on or after January 1, 2015.

**Star Navigation Systems Group Ltd.**  
**Notes to Unaudited Condensed Interim Consolidated Financial Statements**  
**September 30, 2013**  
**(Expressed in Canadian dollars)**

**5. PROPERTY AND EQUIPMENT**

|                                 | Leasehold<br>Improvement | Aircraft        | Furniture<br>and<br>Equipment | Computer<br>Equipment<br>and<br>Software | Computer<br>Equipment<br>under<br>Finance<br>Lease | Vehicles       | Total            |
|---------------------------------|--------------------------|-----------------|-------------------------------|--|--|----------------|------------------|
| <b>Cost</b>                     |                          |                 |                               |  |  |                |                  |
| Balance at June 30, 2013        | \$84,626                 | \$50,951        | \$69,180                      | \$148,922                                | \$116,101  | \$6,690        | <b>\$476,470</b> |
| Additions                       | -                        | -               | -                             | -  | -  | -              | -                |
| <b>Balance at Sept 30, 2013</b> | <b>\$84,626</b>          | <b>\$50,951</b> | <b>\$69,180</b>               | <b>\$148,922</b>                         | <b>\$116,101</b>                                   | <b>\$6,690</b> | <b>\$476,470</b> |
| <b>Accumulated amortization</b> |                          |                 |                               |  |  |                |                  |
| Balance at June 30, 2013        | \$62,688                 | \$25,873        | \$62,993                      | \$133,557                                | \$75,395   | \$5,594        | <b>\$366,100</b> |
| Amortization for period         | 4,231                    | 1,567           | 309                           | 1,921                                    | 5,088  | 83             | <b>13,199</b>    |
| <b>Balance at Sept 30, 2013</b> | <b>\$66,919</b>          | <b>\$27,440</b> | <b>\$63,302</b>               | <b>\$135,478</b>                         | <b>\$80,483</b>                                    | <b>\$5,677</b> | <b>\$379,299</b> |
| <b>Carrying Amounts</b>         |                          |                 |                               |  |  |                |                  |
| As at June 30, 2013             | \$21,938                 | \$25,078        | \$6,187                       | \$15,365                                 | \$40,706   | \$1,097        | <b>\$110,370</b> |
| <b>As at Sept 30, 2013</b>      | <b>\$17,707</b>          | <b>\$23,511</b> | <b>\$5,878</b>                | <b>\$13,444</b>                          | <b>\$35,618</b>                                    | <b>\$1,013</b> | <b>97,171</b>    |

**6. DEVELOPMENT AND OTHER ASSETS**

|                                      | Licenses         | Website<br>Costs | STAR-ISMS®<br>and Peripherals | Total            |
|--------------------------------------|------------------|------------------|-------------------------------|------------------|
| <b>Cost</b>                          |                  |                  |                               |                  |
| Balance at June 30, 2013             | \$136,146        | \$25,037         | \$566,998                     | <b>\$728,181</b> |
| Additions                            | -                | -                | -                             | -                |
| <b>Balance at September 30, 2013</b> | <b>\$136,146</b> | <b>\$25,037</b>  | <b>\$569,998</b>              | <b>\$728,181</b> |
| <b>Accumulated Amortization</b>      |                  |                  |                               |                  |
| Balance at June 30, 2013             | \$130,284        | \$16,054         | \$215,853                     | <b>\$362,191</b> |
| Amortization for period              | 250              | 2,858            | 47,250                        | <b>50,358</b>    |
| <b>Balance at September 30, 2013</b> | <b>\$130,534</b> | <b>\$18,912</b>  | <b>\$263,103</b>              | <b>\$412,549</b> |
| <b>Carrying Amounts</b>              |                  |                  |                               |                  |
| As at June 30, 2012                  | \$5,862          | \$8,983          | \$354,145                     | <b>\$365,990</b> |
| <b>As at September 30, 2013</b>      | <b>\$5,612</b>   | <b>\$6,125</b>   | <b>\$303,895</b>              | <b>315,632</b>   |

In 2002, the Company acquired the license rights to the STAR-ISMS® from a director and a former director of the Company. The underlying patents are now owned by one director of the Company (see Note 15). The Company owns the exclusive, worldwide license for the lifetime of the patents.

**Star Navigation Systems Group Ltd.**  
**Notes to Unaudited Condensed Interim Consolidated Financial Statements**  
**September 30, 2013**  
**(Expressed in Canadian dollars)**

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**7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

|                               | <b>Sept 30,<br/>2013</b> | June 30,<br>2013<br>(Audited) |
|-------------------------------|--------------------------|-------------------------------|
| Trade payables                | <b>\$ 150,461</b>        | \$83,897                      |
| Accrued liabilities and other | <b>137,751</b>           | 144,808                       |
|                               | <b>\$288,212</b>         | \$228,705                     |

**8. FINANCE LEASE OBLIGATION**

During the year ended June 30, 2012, the Company entered into a finance lease for computer equipment. The gross amount of the minimum lease payments related to assets under the finance lease was \$117,745. The lease bears interest at 5.80%. The term of the lease is for 36 monthly payments, expiring on March 1, 2015. The following is a schedule of the future minimum lease payments under this finance lease expiring by 2015 together with the balance of the obligation under the finance lease.

|   | <b>Sept 30,<br/>2013</b> |
|---|--------------------------|
| 2014  | <b>\$ 29,436</b>         |
| 2015  | <b>29,437</b>            |
| Total minimum payments                      | <b>58,873</b>            |
| Less: interest at the implicit rate of 5.8% | <b>(2,617)</b>           |
| Balance of the obligation                   | <b>56,256</b>            |
| Less: current portion                       | <b>(36,429)</b>          |
|   | <b>\$ 19,827</b>         |

**9. OTHER PAYABLES**

Other payables are amounts due to a former employee of the Company with respect to compensation, and are unsecured, non-interest bearing with no fixed terms of repayment.

**Star Navigation Systems Group Ltd.**  
**Notes to Unaudited Condensed Interim Consolidated Financial Statements**  
**September 30, 2013**  
**(Expressed in Canadian dollars)**

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**10. SHARE CAPITAL**

Authorized

- 615,000 Series I First Preferred Shares, non-voting, entitled to non-cumulative dividends at a rate of 7% in priority to common shares, redeemable at \$1.00 at the option of the Company.
- 350,000 Series II First Preferred Shares, non-voting, entitled to cumulative dividends at 9% per annum in priority to common shares and exchangeable for common shares at the rates of 5 common shares, 3.33 common shares and 2.5 common shares for each Series II Preferred Share in each of the first, second and third years after issue respectively. Redeemable at \$1.00 per share at the option of the Company.
- Unlimited common shares

**11. CONTRIBUTED SURPLUS, STOCK-BASED COMPENSATION AND WARRANTS**

Stock-Based Compensation

The Company has a Stock Option Plan (the "Plan") for employees, officers, directors and consultants performing special technical or other services of the Company ("Optionees"). During 2010, the Company amended the Plan whereby the number of common shares to be issued under the Plan is not to exceed 30,000,000 common shares. The designation of Optionees, amount and vesting provisions of awards under the Plan are determined by the Board of Directors.

| <b>Stock Option Transactions</b>    | <b>Number</b>     | <b>Exercise Price</b> | <b>Weighted-Average Exercise price</b> |
|-------------------------------------|-------------------|-----------------------|--|
| <b>Balance at June 30, 2012</b>     | <b>15,060,728</b> |                       | <b>\$ 0.19</b>                         |
| Issued                              | 6,342,900         | \$0.10-\$0.20         | \$ 0.14                                |
| Exercised                           | (48,000)          | \$0.11-\$0.21         | \$ 0.16                                |
| Expired                             | (6,535,400)       | \$0.15-\$0.21         | \$ 0.18                                |
| Forfeited                           | (250,328)         | \$0.15-\$0.20         | \$ 0.17                                |
| <b>Balance at June 30, 2013</b>     | <b>14,569,900</b> |                       | <b>\$ 0.19</b>                         |
| Expired                             | (440,000)         | \$0.15-\$0.21         | \$ 0.18                                |
| <b>Balance at Sept 30, 2013</b>     | <b>14,129,900</b> |                       | <b>\$ 0.19</b>                         |
| <b>Exercisable at Sept 30, 2013</b> | <b>13,817,400</b> |                       | <b>\$ 0.20</b>                         |

The weighted average share price at the date of exercise was \$Nil for options exercised during the three-month period ended September 30, 2013 (2012 - \$0.16).

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**11. CONTRIBUTED SURPLUS, STOCK-BASED COMPENSATION AND WARRANTS (Cont'd)**

As at September 30, 2013 the Company had stock options issued to directors, officers, employees and key consultants of the Company outstanding as follows:

| <b>Date of Grant</b> | <b>Options Granted</b> | <b>Options Exercisable</b> | <b>Exercise Price</b> | <b>Expiry Date</b> |
|----------------------|------------------------|----------------------------|-----------------------|--------------------|
| March 31, 2008       | 300,000                | 300,000                    | \$0.15                | March 30, 2015     |
| November 6, 2008     | 90,000                 | 90,000                     | \$0.15                | November 5, 2013   |
| June 30, 2009        | 627,000                | 627,000                    | \$0.10                | June 14, 2014      |
| January 8, 2010      | 315,000                | 315,000                    | \$0.15-\$0.21         | January 1, 2015    |
| February 26, 2010    | 500,000                | 500,000                    | \$0.26                | January 1, 2015    |
| March 30, 2010       | 2,025,000              | 2,025,000                  | \$0.15-\$0.32         | March 31, 2015     |
| June 3, 2010         | 450,000                | 450,000                    | \$0.15-\$0.22         | March 31, 2015     |
| February 4, 2011     | 500,000                | 500,000                    | \$0.21                | January 1, 2015    |
| February 10, 2011    | 100,000                | 100,000                    | \$0.20                | January 1, 2015    |
| February 25, 2011    | 500,000                | 500,000                    | \$0.29                | February 24, 2016  |
| May 31, 2011         | 350,000                | 350,000                    | \$0.15-\$0.21         | May 31, 2014       |
| February 17, 2012    | 200,000                | 175,000                    | \$0.12-\$0.20         | February 18, 2015  |
| June 6, 2012         | 1,930,000              | 1,930,000                  | \$0.10-\$0.20         | April 15, 2015     |
| August 31, 2012      | 120,000                | 120,000                    | \$0.20                | August 31, 2014    |
| January 15, 2013     | 1,382,900              | 1,382,900                  | \$0.15                | January 15, 2018   |
| February 15, 2013    | 4,740,000              | 4,453,400                  | \$0.12-\$0.15         | February 14, 2018  |
|                      | <b>14,129,900</b>      | <b>13,817,400</b>          |                       |                    |

The weighted average remaining contractual life of the outstanding options is 2.85 years.

The fair value of the options is recognized over the vesting period as compensation expense and contributed surplus. Stock options granted to non-employees were measured at the fair value of the equity instruments granted as the fair value of services was not reliably measurable. The fair value of the stock options granted is determined using the Black-Scholes model for pricing options under the following weighted average assumptions:

|                         | <b>Sept 30,<br/>2013</b> | <b>June 30,<br/>2013<br/>(Audited)</b> |
|-------------------------|--------------------------|--|
| Expected dividend yield | -                        | Nil                                    |
| Risk free interest rate | -                        | 1.39%                                  |
| Expected Volatility     | -                        | 82%                                    |
| Expected Life           | -                        | 4.28 years                             |
| Share price             | -                        | \$ 0.08                                |

Expected volatility is based on historical data.

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**11. CONTRIBUTED SURPLUS, STOCK-BASED COMPENSATION AND WARRANTS (Cont'd)**

Warrants

|                                 | Number of<br>Warrants | Weighted-average<br>Exercise Price | Expiry<br>Date     |
|---------------------------------|-----------------------|------------------------------------|--------------------|
| <b>Balance at June 30, 2012</b> | 69,368,880            | \$0.27                             |                    |
| Issued                          | 28,473,125            | \$0.20                             | September 17, 2017 |
| Issued                          | 10,903,000            | \$0.20                             | May 6, 2016        |
| <b>Balance at June 30, 2013</b> | 108,745,005           | \$0.24                             |                    |
| Issued                          | -                     | -                                  |                    |
| <b>Balance at Sept 30, 2013</b> | 108,745,005           | \$0.24                             |                    |

The fair value of the warrants modified during 2013 is determined using the Black-Scholes model for pricing warrants under the following weighted average assumptions:

|                         | Sept 30,<br>2013 | June 30,<br>2013<br>(Audited) |
|-------------------------|------------------|-------------------------------|
| Expected dividend yield | -                | Nil                           |
| Risk free interest rate | -                | 1.16%                         |
| Expected volatility     | -                | 79%                           |
| Expected life           | -                | 2.14 years                    |
| Share price             | -                | \$ 0.09                       |

Expected volatility is based on historical data.

The Black-Scholes value attributed to these modifications was \$Nil (2013 - \$367,137) and has been recorded in deficit.

The fair value of the warrants issued is determined using the Black-Scholes model for pricing warrants under the following weighted average assumptions:

|                         | Sept 30,<br>2013 | June 30,<br>2013<br>(Audited) |
|-------------------------|------------------|-------------------------------|
| Expected dividend yield | -                | Nil                           |
| Risk free interest rate | -                | 1.37%                         |
| Expected Volatility     | -                | 125%                          |
| Expected Life           | -                | 4.45 years                    |
| Share price             | -                | \$ 0.05                       |

Expected volatility is based on historical data.



## **12. CAPITAL RISK MANAGEMENT**

The Company includes equity, comprised of issued share 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 develop, market and promote its STAR-ISMS® technology 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 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 period ended September 30, 2013.

## **13. FINANCIAL RISK MANAGEMENT**

The Company is exposed to a variety of financial risks by virtue of its activities: market risk (including currency risk and interest rate risk), fair value risk, credit risk and liquidity risk. The overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on financial performance.

Risk management is carried out by management under policies approved by the Board of Directors. Management is charged with the responsibility of establishing controls and procedures to ensure that financial risks are mitigated in accordance with the approved policies.

### **(a) Market Risk**

#### **(i) Currency risk:**

The Company is exposed to foreign exchange risk from various currencies, primarily US dollars. Foreign exchange risk arises from significant sales and purchase transactions as well as recognized financial assets and liabilities denominated in foreign currencies.

The Company's main objective in managing its foreign exchange is to maintain US cash on hand to support US forecasted cash flows over a 12 month horizon. To achieve this objective the Company monitors forecasted cash flows in foreign currencies and attempts to mitigate the risk by modifying the currency of cash held. A 1% change in the foreign exchange rate would have a \$1,000 impact on foreign exchange gain.

As at September 30, 2013 the Company held \$6,081 (2013 - \$84,047) of cash and cash equivalents in US dollars.

#### **(ii) Interest rate risk:**

Interest rate risk is the risk that the future cash flows or the fair value of a financial instrument will fluctuate because of changes in market interest rates. The majority of the Company's debt is at fixed rates and due in the short term. Accordingly, there is limited exposure to cash flow or price interest rate risk.

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**13. FINANCIAL RISK MANAGEMENT (Cont'd)**

(b) Fair Value Risk

The carrying amount of cash and cash equivalents, accounts receivables, accounts payable and accrued liabilities, due to related parties and other payables (Notes 9 and 15) approximate their fair values due to the short-term maturities of these instruments. The long-term portion of finance lease obligation has been discounted at a rate that approximates current market rates and therefore, approximates fair value.

(c) Credit Risk

The Company does not believe it is exposed to any significant concentration of credit risk. However, the Company earns a significant amount of revenue from one customer. As at September 30, 2013, approximately \$24,461 (2013 - \$16,588) of the Company's receivables were past due the average credit period of 90 days.

(d) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due.

The Company manages its liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities. Senior management is also actively involved in the review and approval of planned expenditures.

As at September 30, 2013, the Company has current liabilities of \$1,595,213 due within 12 months and has cash of \$(40,117) to meet its current obligations. As at September 30, 2013 the Company has working capital deficiency of \$1,089,984 and accordingly, the Company is subject to liquidity risk. Management will continue to raise capital to develop, market and promote its STAR-ISMS® technology and to maintain its ongoing operations.

**14. COMMITMENTS AND CONTINGENCIES**

- (a) The Company is committed to leases of its premises and equipment. Minimum lease payments for successive years are as follows:

| <b>Year</b> | <b>Premises</b> | <b>Equipment</b> | <b>Total</b>      |
|-------------|-----------------|------------------|-------------------|
| 2014        | 144,000         | 9,444            | \$ 153,444        |
| 2015        | 144,000         | 9,444            | 153,444           |
| 2016        | 144,000         | 9,444            | 153,444           |
| 2017        | 144,000         | 7,140            | 151,140           |
| 2018        | 144,000         | -                | 144,000           |
|             | <b>720,000</b>  | <b>35,472</b>    | <b>\$ 755,472</b> |

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**14. COMMITMENTS AND CONTINGENCIES (Cont'd)**

- (b) The Company has filed a notice of dismissal of its patent infringement lawsuit against Aeromechanical Services Ltd. (TSX-V: AMS). There was still a pending counterclaim in Ontario as at June 30, 2011. AMS had filed a counterclaim against the Company claiming, among other things, \$5,000,000 for lost revenue and investment capital, \$10,000,000 for loss of reputation and \$5,000,000 for loss of goodwill. No amounts had been accrued in the financial statements. During the year ended June 30, 2012, the Company settled the matter with AMS without payments or costs to either party.
- (c) An agreement was entered into between 2283188 Ontario Limited (the "Licensor"), a Company controlled by a shareholder, director and officer of the Company, and the Company, which requires royalties to be payable by the Company to the Licensor in the amount of:
  - a. 3% of gross revenues from all sales of airborne ISMS units;
  - b. 10% of all service fees; and
  - c. 10% of all usage.
- (d) In the ordinary course of business activities, the Company may be contingently liable for litigation and claims with customers, vendors and former employees. Management believes that adequate provisions have been recorded in the accounts where required.

**15. RELATED PARTY TRANSACTIONS**

The Company has accrued and carries a significant balance on its consolidated financial statements of amounts due to related parties. The amounts represent compensation accrued with respect to salary compensation for its officers, monthly compensation accrued for its directors and committee chairpersons that have accumulated over the past several years. The Company's Board of Directors are compensated at the rate of \$2,000 per month for performing duties such as providing guidance to management in areas such as budgeting, new sales contracts or joint ventures anticipated and any other issues that management deems necessary.

Committee Chairpersons are selected from amongst the Directors of the Company to lead the Audit, Compensation and Corporate Governance committees. Chairpersons are remunerated at the following rates; Audit Chairman - \$2,000 per month accrued, Corporate Governance Chairman - \$1,000 per month paid, Human Resources Chairman - \$1,000 per month accrued. All of the above amounts are recognized in the consolidated financial statements of the Company. The terms for repayment of the amounts owing to the various Board and Committee members are restricted. These amounts can only be settled when individuals wish to exercise options that have been granted to them by the Company or to participate in a private placement being done by the Company. Such amounts are non-interest bearing and unsecured.

At September 30, 2013, management estimates that there is the potential for the amounts due to be paid in the next fiscal year, and accordingly they have been classified as current liabilities. The only fixed contractual obligations the Company has with related parties are the compensation contracts it has with the CEO and CFO.

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**15. RELATED PARTY TRANSACTIONS (Cont'd)**

The following balances are due to related parties as of September 30, 2013:

Due to Directors - \$40,000 (2013 - \$16,000), Due to Committee Chairpersons - \$25,000 (2013 - \$16,000), and Due to Chief Executive Officer and Chairman of the Board of Directors - \$999,573 (2013 - \$1,017,392).

The amount due to the Chief Executive Officer and Chairman of the Board of Directors resulted from salary accrual in prior years including certain years where as CEO, no salary was taken due to the economic limitations the Company was experiencing at the time. The CEO also financed the Company at various times when the Company was experiencing funding shortfalls and deferred repayment until the Company attained financial stability.

Included in the unaudited condensed interim statement of comprehensive loss for the three month period ended September 30, 2013, in general and administrative expenses is \$58,785 (2012 - \$92,189) in fees paid and accrued to directors and officers of the Company. An amount of \$Nil in respect of salary (2012 - \$45,000) was paid to the Company CEO. As well, a total of \$12,681 (2012 - Nil) was paid to the Chief Executive Officer regarding interest on the outstanding loan owed to him. The rate of interest paid was Bank of Canada prime + 2%.

Also included in the general and administrative total of \$58,785 (2012 - \$92,189) were Board of Directors fees of \$24,000 (2012 - \$24,000) which were accrued. Chairperson fees of \$15,285 (2012 - \$12,689) were accrued and paid. Payments to the Chief Operating Officer \$Nil (2012 - \$37,500) were paid. Professional fees of \$19,500 (2012 - \$18,000) were paid to the Chief Financial Officer of the Company.

The amounts owing to related parties are unsecured, bear interest at prime + 2.0% and have no fixed terms for repayment.

See also Notes 6, 9 and 14(c).

**16. EXPENSE DISCLOSURES**

Employee benefits totaling \$195,242 (2012 - \$235,753) are included in research and development and general and administrative in the amounts of \$181,197 (2012 - \$109,121) and \$14,045 (2012 - \$126,632), respectively. Amortization of \$63,557 (2012 - \$59,835) is included in research and development.

**17. SUBSEQUENT EVENT**

On October 18, 2013, the Company announced that it has completed a non-brokered private placement of 11,250,000 units of the Company at a price per Unit of \$0.08 (the "Units"), for gross proceeds totaling \$900,000. The price was reserved with the TSX-V.

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**17. SUBSEQUENT EVENT (Cont'd)**

Each Unit consists of one common share and one common share purchase warrant (a "Warrant"). Each Warrant entitles the holder to purchase one common share of the Company (a "Warrant Share") at a price of \$0.20 per Warrant Share for a term of 24 months from the closing date. Finder's fees on portions of the placement in the amount of \$90,000 will be paid in Units. All securities issued in the Offering and any shares issued upon exercise of Warrants are subject to a four month statutory hold period from the date of issuance. The net proceeds of the placement will be used for research and development, marketing and general working capital purposes.