# Star Navigation Systems Group Ltd.
## Management's Discussion and Analysis
## For the three and six month periods ended December 31, 2013 and December 31, 2012

## 1. Date – March 3, 2014

The following management discussion and analysis ("MD&A") is a review of operations, current financial position and outlook for Star Navigation Systems Group Ltd. (the "Company" or "Star") for the three and six month periods ended December 31, 2013 and 2012 and should be read in conjunction with the consolidated audited financial statements for the years ended June 30, 2013 and June 30, 2012. Amounts are reported in Canadian dollars based upon the financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"). Information contained herein is presented as at March 3, 2014.

Certain information in this MD&A or incorporated by reference, and in other public announcements by the Company is forward–looking and is subject to important risks and uncertainties. Words such as "may", "will", "believe", "expect", "anticipate", "estimate" and similar expressions identify forward-looking statements. Forward-looking statements may be found in the Overview and Overall Performance, General Development of the Business and Overview, and Results of Operations sections of this MD&A. Forward-looking information includes information concerning the Company's future financial performance, business strategy, plans, goals and objectives. Forward–looking statements are necessarily based upon estimates and assumptions considered reasonable by management but which are subject to business, economic and competitive uncertainties. Results could differ materially from those projected in forward-looking statements. The Company continues to pursue sales and marketing efforts in the Middle East and developing countries. Therefore, the Company is potentially subject to risks involving political unrest, such as is still being experienced in Egypt, cultural differences, differing legal systems and business practices, and the significant added expense of travel and accommodation for Company personnel required to be onsite for sales, testing and installation duties. The Company endeavours to mitigate these risks as much as reasonably possible through the judicious use of secure financial instruments, experienced local sales agents and coordinated travel arrangements. Ongoing political events in the Middle East have resulted in some restriction of the Company's efforts there, although the Company recorded a sale to AlMasria Universal Airlines ("Almasria"), which is currently in the Supplemental Type Certificate ("STC") application process. As part of its internal reorganization, the Company now has the capacity to complete 100% of the design and data packages required for STC approval in-house. As stated previously with respect to the sale to Midwest (Egypt) Airlines, , the Company has been advised by MidWest that they have made changes to their fleet and the aircraft originally targeted for installation is no longer available. MidWest will advise the Company when an alternative aircraft becomes available. All other terms and conditions of the contract remain in force. In addition, other potential sales opportunities in Egypt have been impaired due to the current political unrest.
The Company's efforts continue to be primarily focused on the Middle East, North America and Europe. Now that the Company has reassumed full control of the sales and marketing function from Paradigm, it continues to refine and expand the manner in which the STAR-A.D.S.™ system is marketed and sold.

Factors which could cause actual results to differ materially from current expectations include, among other things, the ability of the Company to successfully implement its strategic, sales, research and development and financing initiatives and whether such initiatives will yield the expected benefits. In addition, the ability of the STAR-A.D.S.™ sales and marketing team to successfully promote and sell the service is critical. Competitive conditions in the business in which the Company participates, supply chain interruptions, general economic conditions and normal business uncertainty, fluctuations in foreign currency exchange rates and changes in laws, rules and regulations applicable to the Company in the jurisdictions in which the Company operates are all factors to be taken into consideration. The Company undertakes no obligation to update publicly or otherwise revise any forward-looking statements, whether as a result of new information, or future events or otherwise, except as may be required by law.

If the Company does update one or more forward-looking statements, no inference should be drawn that it will make additional updates with respect to those or other forward-looking statements, unless required by law.

Readers are cautioned that forward-looking statements are not guarantees of future performance.

Further information relating to Star is available on SEDAR at www.sedar.com.

## 2. General Development of the Business

History

Star commenced its operations in May 2000 and was listed on the TSX Venture Exchange (the "Exchange") on August 29, 2002, under the symbol 'SNA'. The Company's head office is in Toronto, Ontario. Star has successfully tested, marketed and sold technology platforms that offer operators of land, sea and air assets real-time data-solutions which allow them the opportunity to reduce costs, track assets and enhance aviation and operator safety. The Company's products have global sales potential for both new and existing aircraft as well as other transportation assets. Star has the exclusive world-wide license to the patented STAR-ISMS® technology. Patents have been granted by Canada, the United States, the United Kingdom, India, Hong Kong and Australia.

Capability of the STAR-ISMS® G2 System

The current system has been designed to provide real time, on board analyzed data over the Iridium satellite network. If the data indicates exceedance of the customer specified parameter limits for a particular system or function, and if the data suggests a significant issue, then the Iridium module is activated and a continuous stream of data is sent down for a predetermined time covering data generated both before and after the triggering event. If the exceedance is more routine, it is either reported immediately on an "Alert" basis, or is noted for further action in the post flight reporting.

The system sends the aircraft position at pre-determined intervals via the Data Management Centre ("DMC"). As the information is sent from the aircraft, senior management and critical ground crew are updated on their computer screens or PDA's as necessary.

This allows the ground crew and senior management to make and to optimize the decisions necessary to deal with a problem and to endeavour to eliminate any safety threats or potential costly delays on the ground.

The Company expects that the ability to access data analyzed in real time during a flight will allow the airlines to make the right decisions for safety, operational optimization and cost avoidance. In addition, the system provides for the supply of detailed follow-up reporting in a more timely fashion than any other system on the market, thus allowing the overall management of the fleet to be optimized.

In addition, utilizing data collected, Star's fuel management system allows the operator to refine operational improvements with regards to its fleet management so as to optimize fuel usage, generating direct, bottom-line savings to the airline.

**Selected Financial Information and Management's Discussion and Analysis**

**Annual Information**

The fiscal year end of the Company is June 30. The following table summarizes the Company's audited financial results for the years ended June 30, 2013, 2012 and 2011.

| | **Year ended June 30, 2013** | **Year ended June 30, 2012** | **Year ended June 30, 2011** |
|---|---|---|---|
| Total revenues | $115,717 | $72,672 | $98,591 |
| Net Loss | $(2,919,007) | $(3,059,143) | $(3,758,212) |
| Total assets | $1,403,867 | $1,189,360 | $2,734,324 |
| Total long term liabilities | $28,738 | $65,167 | $Nil |
| Cash dividends declared | $Nil | $Nil | $Nil |

The Company continues to experience losses as it moves toward full commercialization of its STAR-ISMS® product. In the fiscal year ended June 30, 2013 the Company sustained a loss of $2,919,007 compared to $3,059,143 for 2012. Losses for the last 3 years (2013, 2012 and 2011) are averaging $3,245,454 per year.

The major factor that has been contributing to these losses has been the Company's protracted transition from a research and development ("R&D") company into a company that is delivering products into the commercial market.

Anticipated sales have not been realized to date, although the Company has taken the following steps to correct this:

1. Regained full direction and control of the Sales and Marketing function.
2. Engaged a senior aviation sales and marketing professional to reorganize and manage the sales and marketing department.

Reviewed and rationalized the sales agent network.

As can be seen from the table above, total assets for the year ended 2013 have increased slightly over the 2012 levels due to an increasing cash balance.

The Company will be in a position by October 2013 where it will have to complete an equity raise to continue operations. The Company completed private placements in September 2012, May 2013 and October 2013 that raised $2,088,000, $1,003,000 and $900,000 respectively. The Company also completed a debt conversion in November 2012 which has reduced the Company's debt load by $204,037 in total.

The Company's focus and attention continues to be, very strongly directed towards commercialization of its core product, the STAR-ISMS®, the development and roll-out of the STAR-A.D.S.™, closing current sales initiatives with commercial airlines and continued development of other products currently available or in development.

The Company has minimal long-term debt as of December 31, 2013 and continues to manage its cash balance conservatively until it has completed some larger orders for its STAR-ISMS® product.

**Overview and Overall Performance**

The Company will continue to sustain losses as it pushes towards full commercialization. The Company completed a private placement in October 2013, raising $900,000. This has allowed the Company to continue to operate while it initiates the STAR-A.D.S. ™ rollout. (See Operational Milestones). The cash balance at December 31, 2013 was $345,209 compared to $405,603 at June 30, 2013. Assets are down slightly since June 30, 2013 as the Company continues to expend cash until sales can be completed.

Accounts receivable and prepaid expenses are up marginally for the six month period ended December 31, 2013.

Inventory remains the same from June 30, 2013. Star now has multiple units of its STAR-ISMS® in stock and ready for sale. Property and equipment has decreased by the depreciation recorded for the six month period ended December 31, 2013.

There were no Property and Equipment or Development and Other asset additions in this six month period.

**Overview and Overall Performance** (Cont'd)

Accounts payable and accrued liabilities are down by $30,205 from June 30, 2013.

Amounts due to related parties have increased by $205,207 from June 30, 2013 due to monthly accruals to certain of the Company directors.

The Company's share capital rose in 2013 as common shares outstanding have gone up from 249,211,966 at June 30, 2013 to 261,586,966 at December 31, 2013. The Company completed a private placement in October 2013 that raised $900,000 and added 12,375,000 common shares.

Results of operations continue to show losses. However, the Company has now moved from a "development stage" company to a "commercial" company with a fully viable product that it expects will be able to turn the tide on the quarterly losses. The Company will continue to invest money in the development of its STAR-ISMS® unit and the STAR-A.D.S.™ service.

Other complimentary products such as "STAR-ISMS® Lite" (flight tracking and monitoring system incorporating two-way voice and data), STAR-ISMS® Ultra Lite (an airborne asset tracking and monitoring system), as well as Terrestrial Monitoring and Marine Monitoring (which serve the same purpose for land and marine applications), are available and continue to be marketed. See the Company's website at www.star-navigation.com for more information.

The Company continues its efforts to conclude existing sales initiatives with customers in Pakistan, India, Europe and North America.

To-date there has been little progress in discussions with appropriate authorities in India concerning the granting of the Indian Aeromobile license required to use the STAR-ISMS® in Indian airspace. As the Company's system cannot be utilized in the absence of such approval. negotiations which were underway with several airlines in India have been suspended.

**Operational Milestones**

During the year ended June 30, 2013 and for the six month period ended December 31, 2013, the Company has made the following progress towards achieving its objectives:

- The Company announced a sale of the STAR-A.D.S.™ system to Almasria Universal Airlines of Egypt.

- The Company amended its agreement with Paradigm Services Limited in October 2013. This allows Star to assume full control of the sales and marketing functions of the business, in addition to its other responsibilities. Paradigm continues to supply communications services. The service was rebranded as "STAR-A.D.S.™" in order to reflect these changes.

- The Company continued its drive to forge alliances with manufacturers of complimentary products with a view to leveraging the synergies available, add to its product line and develop end to end solutions for the airline industry. Testing in various areas continues and the results are encouraging. The Company has augmented its research and development, engineering and software capabilities by increasing its complement of Professional Engineers (P.Eng.) on staff.

- Star continues discussions with other entities in China regarding collaboration and strategic alliances due to continuing delays in the COMAC 919 project.

- The Company commenced the reorganization of its Sales & Marketing department, further streamlined its management reporting organization and added additional research depth.

**Outlook**

Star's Management looks towards achieving the following objectives over the balance of calendar 2014:

- To execute the commercialization of the STAR-A.D.S.™ and develop new business opportunities in the field of aircraft critical data collection, analysis and transmission.

- To further develop the capability of its ground station and data management services.

- To continue to further develop and refine the military version of the STAR-ISMS® system.

- In conjunction with one of Stars strategic partners, further develop and refine the medical monitoring aspects of the STAR-ISMS®.

- Expand the Sales & Marketing presence of the Company at Airshows and Industry Conferences in a professional, efficient and rewarding manner.

- Continue R&D efforts to add functionality with respect to complete data download at the end of a flight. Continuing to update the functionality and utility of the STAR-ISMS® system in order to compete in a wider range of markets and to service more sophisticated requirements.

- Continue to closely monitor and defend our Intellectual Property and to challenge any infringement and take appropriate action.

- To take a leading position in the market through innovation and fast response to the changing requirements of our customer base.

- Expansion of the revenue stream from existing STAR-A.D.S.™,STAR-ISMS®, STAR-ISMS® Lite, STAR-ISMS® Ultra Lite and Terrestrial Monitoring products through effective sales, installation and world-wide marketing. Expand the product line through internal research and development as well as through targeted alliances with manufacturers of complimentary aerospace products. For more information see the Company's website at www.star-navigation.com.

**Summary of Quarterly Results**

The following table sets out selected unaudited financial information, presented in Canadian dollars and prepared in accordance with IFRS. The information contained herein is drawn from interim financial statements of the Company for each of the aforementioned eight quarters.

(Expressed in $)

| **Three months** | **2013** | **2013** | **2013** | **2012** |
|---|---|---|---|---|
| **Period Ending** | **December 31** | **September 30** | **June 30** | **March 31** |
| Revenue | 9,912 | 13,855 | (28,764) | 10,498 |
| Working Capital/(Deficit) | (784,092) | (1,089,984) | (593,019) | (891,820) |
| Expenses | 680,465 | 581,742 | 918,234 | 655,440 |
| Net Loss | (695,510) | (567,887) | (946,998) | (644,942) |
| Net Loss (per Share) | (0.02) | (0.02) | (0.01) | (0.003) |

| | **2012** | **2012** | **2012** | **2011** |
|---|---|---|---|---|
| **Period Ending** | **December 31** | **September 30** | **June 30** | **March 31** |
| Revenue | 16,447 | 117,536 | 15,940 | 18,841 |
| Working Capital/(Deficit) | (319,144) | 179,639 | (1,403,649) | (586,787) |
| Expenses | 754,910 | 706,589 | 707,642 | 789,475 |
| Net Loss | (738,463) | (588,604) | (691,702) | (752,206) |
| Net Loss (per Share) | (0.003) | (0.0028) | (0.004) | (0.003) |

Quarter-over-quarter fluctuations for the eight periods ended and prior to December 31, 2013 are primarily as follows:

- Continued low revenue generation throughout these periods.

- Working capital has been in a deficit position for all eight quarters as the Company continues to spend money to get its product to market in the absence of any significant sales.

**Summary of Quarterly Results** (Cont'd)

- Working capital fluctuations are primarily due to the completion of equity private placements that the Company has completed throughout these periods.

- Expenses per quarter for the last eight quarters have remained consistent averaging $727,432 per quarter.

- Net losses are averaging $703,289 per quarter for the last eight quarters due to research and development costs and no revenue generation.

**RESULTS OF OPERATIONS**

**Comparison of the three and six month periods ended December 31, 2013 and December 31, 2012.**

The following commentary compares the unaudited condensed interim consolidated financial results for the three and six months ended December 31, 2013 and 2012.

**<u>Overview</u>:**

The Company sustained a loss of $695,510 for the three month period ended December 31, 2013 vs. $738,462 for the three month period ended December 31, 2012. For the six month period ended December 31, 2013 the loss amounts to $1,263,397 vs. $1,327,067 for the corresponding period of 2012. The decrease in loss in both the three and six month periods is due to many variances including, but not limited to, increases/decreases in R&D costs, general and administration ("G&A") costs, marketing and promotional costs ("M&P"), foreign exchange costs and stock-based compensation.

The Company is continuing to build on increased market awareness as a result of its STAR-A.D.S.™ marketing initiatives through targeted airshows and industry conferences and is confident that further sales will occur at an increased rate in the future.

The Company also continues to expand its visibility in the overseas markets. It hopes that the increased exposure will lead to increased sales figures as the world-wide economy stabilizes and airline companies increase their capital spending. Both Boeing and Airbus have increased their forecasts for aircraft production through to 2030.

**<u>Revenues</u>:**

Revenues for the three month period ended December 31, 2013 have decreased by $6,535 over the same period in 2012 (2013 - $9,912 vs. 2012 - $16,447). For the six month period sales are $23,767 vs. $133,983 for 2012.

The decrease in the three month period is a result of a lower number of STAR-ISMS® Lite customers and some existing customers flying less thereby resulting in lower fees being charged.

For the six month period ending December 31, 2013 the large decrease from 2012 is a result of a sale of 3 STAR-ISMS® units to Paradigm that occurred in September 2012.

The Company continues to generate airtime revenue from customers who use the STAR-ISMS® Lite product. These revenues fluctuate from period to period depending on the usage of the STAR-ISMS® Lite devices in the aircraft and land vehicles. The decrease in air time from fielded units is a result of the rundown of North Atlantic Treaty Organization ("NATO") activity in Afghanistan and the termination of work at one of our land vehicle customers.

The Company did not sell any of its STAR-ISMS® Lite units during the six month period ended December 31, 2013. The inconsistency in sales highlights the Company's push to market of its STAR-ISMS® and STAR-A.D.S™ products.

**Cost of Sales:**

Cost of Sales for the three and six month periods ended December 31, 2013 decreased for the same reasons as the decline in sales revenue. The Company did not sell any of its STAR-ISMS® units in the current period. Cost of sales in the 2012 period contained the Air North pilot project costs which were higher than expected.

Sales of new aviation products can have a fairly long sales cycle and acceptance by several customers rather than just one is often a prerequisite to further sales. As a result the Company's margins have been kept low.

**Research and Development:**

| Three Month Periods Ended December 31, | | | | | |
|---|---|---|---|---|---|
| | 2013 | | 2012 | | Variance |
| | | | | | |
| Total R&D expenses | 224,467 | | 253,377 | | 28,910 |
| | | | | | |
| Amortization expense | 63,557 | | 61,244 | | 2,313 |
| R&D Wages | 155,784 | | 118,481 | | 37,303 |
| Material costs | 984 | | 8,297 | | (7,313) |
| Research & development costs | 3,692 | | 45,106 | | (41,414) |
| STC costs | - | | 17,660 | | (17,660) |
| Travel costs | 450 | | 2,589 | | (2,139) |

R&D expenses have increased by $28,910 for the three month period ended December 31, 2013 over the same period of 2012. This increase is due to increases in amortization, wage costs and decreases in project costs.

Amortization has increased marginally in this three month period of 2013 over 2012. There have been no new asset additions in this period.

## Research and Development (Cont'd)

Project costs for 2012 were reduced to a negative position after application of SRED grant refund was applied to those costs.

Wages have increased by $37,303 due to both wage increases to staff and the addition of two senior level staff members that occurred in March of 2013.

Research & development costs were higher in 2012 due to costs absorbed by the Company for increased testing on its STAR-ISMS® Unit. As well, STC costs occurred in 2012 as a result of the Air North project. No such costs have been incurred in this three month period.

| Six Month Periods Ended December 31, | | | | | |
|---|---|---|---|---|---|
| | 2013 | | 2012 | | Variance |
| | | | | | |
| **Total R&D expenses** | **487,409** | | **412,893** | | **74,516** |
| | | | | | |
| **Amortization expense** | **127,114** | | **121,079** | | **6,035** |
| **R&D Wages** | **336,981** | | **227,602** | | **109,379** |
| **Material costs** | **9,047** | | **13,577** | | **(4,530)** |
| **Research & development costs** | **3,692** | | **26,844** | | **(23,152)** |
| **STC costs** | **-** | | **17,660** | | **(17,660)** |
| **Travel costs** | **10,575** | | **6,131** | | **4,444** |

R&D expenses have increased by $74,516 for the six month period ended December 31, 2013 over the same period of 2012. This change was due to increases in amortization and wage costs.

Amortization has increased marginally in this six month period of 2013 over 2012. There have been no new asset additions in this period.

Research & development costs were higher in 2012 due STC costs and increased testing on its STAR-ISMS® Unit. No such costs have been incurred in this six month period.

Wages have increased due to both wage increases to staff and the addition of two senior level staff members.

**General and Administrative**:

| Three Month Periods Ended December 31, | | | | | |
|---|---|---|---|---|---|
| | **2013** | | **2012** | | **Variance** |
| | | | | | |
| **Total G&A expenses** | **262,889** | | **394,744** | | **(131,855)** |
| | | | | | |
| **Board and Committee fees** | 35,945 | | 47,299 | | (11,354) |
| **Consultant cost** | 9,000 | | 13,000 | | (4,000) |
| **Insurance** | 19,671 | | 20,526 | | (855) |
| **Professional fees** | 44,409 | | 75,684 | | (31,275) |
| **Wages** | 50,477 | | 129,277 | | (78,800) |
| **Bank charges & interest** | 14,971 | | 728 | | 14,243 |
| **Other** | 88,416 | | 108,230 | | (19,814) |

G&A expenses have decreased by $131,855 for the three month period ended December 31, 2013 over the same period of 2012.

Board and Committee fees have decreased due to the resignation of one of the Company directors who was also a committee chairperson as well. The Company now has 4 directors, three of which are non-executive board members for the three months ended December 31, 2013. The Company will fill the current vacancy on the Board as soon as a qualified and experienced candidate can be selected.

G&A consulting costs relate to services provided by an executive familiar with the Company to aid it in facilitating talks with the CMC project as well as gaining additional footholds in airlines across Europe.

Professional fees have decreased over 2012 due to a decrease in audit fees. Legal fees and accounting fees were similar to those of 2012.

Wages have decreased significantly for this three month period over the same in 2012. A decrease of $78,800 has been due to the CEO reducing his salary from $22,500 per month down to Nil for this period in order to assist the Company in managing its cash flow. Also, the position of COO has been vacant since July 2013.

Interest charges have risen in 2013 as the Company has now entered into an agreement with the CEO of the Company to accrue interest monthly at the rate of Business Prime Rate + 2% on an annual basis on the outstanding balance of monies owed to the CEO.

Other expenses have decreased by a combined $19,814 over 2012. The increases were minimal in amount.

**General and Administrative (Cont'd)**

The Company is committed to monitoring all expenditures and has implemented a series of procedures that ensures that future expenditures are fully sourced out with more than one vendor and that discounts are sought at all times. This allows the Company to continue to monitor its cash balance effectively.

| Six Month Periods Ended December 31, | | | | | |
|---|---|---|---|---|---|
| | 2013 | | 2012 | | Variance |
| | | | | | |
| **Total G&A expenses** | **467,584** | | **700,299** | | **(232,715)** |
| | | | | | |
| **Board and Committee fees** | 75,230 | | 83,989 | | (8,759) |
| **Consultant cost** | 18,000 | | 19,000 | | (1,000) |
| **Insurance** | 36,530 | | 41,052 | | (4,522) |
| **Professional fees** | 74,284 | | 116,651 | | (42,367) |
| **Wages** | 64,521 | | 255,910 | | (191,389) |
| **Bank charges & interest** | 29,673 | | 2,915 | | 26,758 |
| **Other** | 169,346 | | 180,782 | | (11,436) |

G&A expenses have decreased by $232,715 for the six month period ended December 31, 2013 over the same period of 2012.

Board and Committee fees have decreased due to the resignation of one of the Company directors who was also a committee chairperson as well. The Company now has 4 directors, three of which are non-executive board members for the three months ended December 31, 2013.

G&A consulting costs relate mainly to services provided by an executive who is familiar with the Company to aid it in facilitating talks with the CMC project as well as gaining additional footholds in airlines across Europe.

Professional fees have decreased over 2012 due to a decrease in the firm's legal fees. Fees related to mediation costs for a former employee were incurred in 2012. Also audit costs went down in 2013.

Interest charges have risen in 2013 as the Company has now entered into an agreement with the CEO of the Company to accrue interest monthly at the rate of Business Prime Rate + 2% on an annual basis of the outstanding balance of monies owed to the CEO.

Wages have decreased significantly for this six month period over the same in 2012 due to same reasons as the decrease for three months. Also, the Company has not filled the vacant COO position since July 2013.

## General and Administrative (Cont'd)

Other expenses have decreased by a combined $11,436 over 2012. The increases were minimal in amount.

## Marketing and Promotion:

| Three Month Periods Ended December 31, | | | | | |
|---|---|---|---|---|---|
| | 2013 | | 2012 | | Variance |
| | | | | | |
| **Total Marketing expenses** | **125,106** | | **47,601** | | **77,505** |
| | | | | | |
| **Investor relations** | **24,000** | | **-** | | **24,000** |
| **Travel costs** | **38,087** | | **2,601** | | **35,486** |
| **Consultant costs** | **51,520** | | **45,000** | | **6,520** |
| **Other costs** | **11,499** | | **-** | | **11,499** |

For the three month period ended December 31, 2013, Marketing and Promotion ("M&P") costs have increased by $77,505 over the same period of 2012.

Consulting costs are slightly higher than 2012, the Company has not engaged any new consultants as it tries to manage its cash flows.

Investor relations ("IR") costs are up as the Company did not have an IR firm until January of 2013 so therefore no costs in the 2012 period.

Travel costs increased in this period as the Company was actively engaged in setting up the distributorship agreement with ICG in Virginia, USA. The Company has focused mostly on getting the STAR-A.D.S.™ project up and running, funneling more resources to that. It has also had to increase travel expenditures as the Company has increased the number of presentations to airlines of its STAR-A.D.S ™ system. Travel costs will continue to occur as the Company continues to push its message out to the industry at large and to prospective customers around the world.

## Marketing and Promotion (Cont'd)

| Six Month Periods Ended December 31, | | | | | |
|---|---|---|---|---|---|
| | 2013 | | 2012 | | Variance |
| | | | | | |
| **Total Marketing expenses** | **215,422** | | **107,811** | | **107,611** |
| | | | | | |
| **Investor relations** | **29,000** | | **-** | | **29,000** |
| **Travel costs** | **56,403** | | **6,066** | | **50,337** |
| **Consultant costs** | **112,519** | | **101,145** | | **11,374** |
| **Other costs** | **17,500** | | **600** | | **16,900** |

For the six month period ended December 31, 2013, Marketing and Promotion ("M&P") costs have increased by $107,611 over the same period of 2012.

Consulting costs are slightly higher than 2012, the Company has not engaged any new consultants as it works to manage its cash flows.

Investor relations ("IR") costs are up by $29,000 as the Company did not have an IR firm until January of 2013. (See Subsequent Events)

Travel costs are up for the six months ended December 31, 2013 for the same reasons mentioned above in the three month summary.

## Stock based compensation:

The Company has a stock option plan (the "Plan") for employees, officers, directors and consultants performing special technical or other services for 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 (2009 - 19,589,684) common shares. In 2011, the shareholders approved an increase in the number of shares that could be issued under the Plan to 35,000,000. To date, application for regulatory approval for that increase has not been made but is expected within the current quarter.

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 liabilities incurred, whichever is more reliably measurable.

Each tranche is considered a separate award with its own vesting period and fair value.

Stock-based compensation is charged to operations 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.

During the period ended December 31, 2013 stock-based compensation amounted to $69,602 vs. $50,170 in 2012.

**<u>Foreign Exchange Gain/Loss:</u>**

Monetary assets and liabilities denominated in foreign currencies are translated at the yearend 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. The Company transacts its sales and equipment purchases in US dollars. At the period ended December 31, 2013, the Company held $6,028 (June 30, 2013 - $84,047) of cash and cash equivalents in US dollars.

**Liquidity and Capital Resources**

The Company had a cash and cash equivalents of $345,209 at December 31, 2013, 2013 compared to a cash balance of $405,603 at June 30, 2013.
The Company completed a private placement in October 2013 for proceeds totaling $900,000. The Company now has a working capital deficiency of $784,092 at December 31, 2013 compared to a working capital deficiency of $593,019 at June 30, 2013.
The Company's cash balance for the period ended June 30, 2013 was supplemented by the completion in September 2012 and May 2013 of two non-brokered private placements for gross proceeds totaling $3,091,000. The Company also completed a debt for shares conversion in December 2012 which further reduced its debt-load by $204,037.

Due to the uncertain nature of its ability to close sales with major airlines, the Company cannot project with certainty what level of cash commitment it may face in the future. That being said, the Company may seek additional financing through the equity markets.

The Company continues to keep its accounts payable current and does not suffer from any defaults on its lease commitments.

The Company is subject to the risks generally associated with high-technology development stage companies, which include fluctuations in operating expenses and revenues, and its ability to secure further equity or debt financing/funding which is subject to prevailing market conditions at that time.

There can be no assurance that management will be successful in raising the necessary capital required to continue the project but it has taken the necessary steps to address this concern.

**Off Balance Sheet Arrangements**

As at December 31, 2013 the Company had no off balance sheet arrangements such as guaranteed contracts, contingent interests in assets transferred to an entity, derivative instrument obligations or any instruments that could trigger financing, market or credit risk to the Company.

**Outstanding Share Data**

| | |
|---|---|
| Series I First Preferred Shares | 615,000 |
| Common Shares (i) | 261,586,966 |
| Share Purchase Warrants (ii) | 121,120,005 (exercise prices ranging from $0.20 cents to $0.50) |
| Stock Options | 17,314,900 (exercise prices ranging from $0.10 to $0.32 with expiry dates up to February 14, 2018 and various graded vesting provisions). |

**Significant Accounting Policies**

The unaudited condensed interim consolidated financial statements are prepared in accordance with IFRS and follow the same accounting policies and methods of their application as the most recent audited consolidated financial statements for the year ended June 30, 2013.

These unaudited condensed interim consolidated financial statements should be read in conjunction with those audited consolidated financial statements.

**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.

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. The effective date for IFRS 9, which is to be applied retrospectively, has not yet been determined.

## 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 judgments 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®.

## 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 December 31, 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.

The following balances are due to related parties as of December 31, 2013:

Due to Directors - $62,323 (2013 - $16,000), Due to Committee Chairpersons - $32,323 (2013 - $16,000), and Due to Chief Executive Officer and Chairman of the Board of Directors - $1,159,953 (2013 – $1,017,392).

**Related Party Transactions** (Cont'd)

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 six month period ended December 31, 2013, in general and administrative expenses is $93,911 (2012 - $277,489) in fees paid and accrued to directors and officers of the Company. An amount of $Nil in respect of salary (2012 - $135,000) was paid to the Company CEO. As well, a total of $26,005 (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 $93,911 (2012 - $277,489) were Board of Directors fees of $46,323 (2012 - $48,000) which were accrued. Chairperson fees of $28,907 (2012 - $30,989) were accrued and paid. Payments to the Chief Operating Officer $Nil (2012 - $75,000) were paid. Professional fees of $39,000 (2012 – $36,000) 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).

**Subsequent Events**

The Company's AS9100 Rev C: ISO 9001:2008 recertification audit by the BSI Group Canada Inc. ("BSI') (the certifying organization) in January 2014 was successfully completed and the Company was recommended for continued certification. AS9100 Rev. "C" is the international quality management system standard for Aircraft, Space and Defense ("AS&D") industry

On Feb. 20, 2014, Star Navigation Systems Group Ltd. (TSX-V:SNA) ("Star" or the "Company") announced that it has entered an agreement of purchase and sale whereby Star will acquire the assets, client list and IP (including numerous patents) of an aerospace products company in Canada. The assets to be acquired will expand Star's ability to secure and improve the efficiency of its supply chain, enhance its product offering in commercial and military equipment, generate additional revenue and integrate its manufacturing and research and development areas more effectively.

The transaction is subject to a due diligence period, the negotiation and preparation of supporting documentation and to the filing of required TSX Venture Exchange material.

## Subsequent Events (Cont'd)

The Company severed its relationship with its Investor Relations provider, Renmark Financial Communications Inc.

On February 10, 2014, the Company hired a senior aerospace Sales & Marketing professional to reorganize and manage its Sales & Marketing department, and to review and rationalize its existing network of sales agents.

## Contingency

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.

## Risk Factors and Risk Management

Although management is working diligently towards generating revenue, improving cost containment and achieving profitable operations, the Company is subject to the risks generally associated with high-technology development stage companies. These risks include fluctuations in operating expenses, lengthy sales cycles, the pace of technological change, human resource costs of necessary additional research and development, competition, regulatory approvals and permitting, and the need to secure further equity or debt financing and/or funding.

The Company is also subject to the risk of competition in a fast moving high technology industry. Protection of the Company's intellectual property carries the risk of expensive litigation. Retention of highly skilled key personnel, fluctuation of input costs, travel costs and general economic conditions may impact the Company's performance.

The Company's revenues depend mainly upon two factors: hardware sales and ongoing monthly monitoring charges and airtime. Revenues from hardware are normally a one-time event and are dependent upon sales. Therefore, these revenues will vary from period to period. Revenue from a customer from ongoing monthly monitoring is relatively stable, but can vary depending upon usage and, in rare cases, upon the financial health of the customer. The Company is working diligently to increase the level of sales across its product suite, carefully monitors the payment records of its customers, and sets its pricing models to reflect risk and return realities.

Operating expenses are generally stable but will vary depending on required staffing levels, equipment update and replacement, sales activity and required R&D activities. These expense items are pre-revenue in nature. As the Company is now in a position to offer a fully developed STAR-A.D.S. system to the commercial aviation world, the demands upon its R&D department are increasing, resulting in the need to hire additional staff in this area.

**Risk Factors and Risk Management (Cont'd)**

Also, as the Company is determined to protect its Intellectual Property, cases of potential infringement of patent are not predictable and the legal costs involved can be substantial. While all eventualities cannot be predicted, the Company maintains a sufficient level of funds to cover most contingencies.

The Company's target clients for the flagship STAR-ISMS® and STAR-A.D.S ™ system are mainly commercial airlines. As is the case with high technology sales to any large commercial operation operating on slim margins in a competitive environment, the sales cycle is generally a lengthy one, involving multiple varied sales presentations to several different departments and stakeholders, including engineering, finance, operations or the executive.

A large percentage of the Company's sales initiatives prior to STAR-A.D.S.™ involved non-North American customers, with the attendant travel and time requirements. Amongst other initiatives such as the STAR-A.D.S.™ service, the Company is reviewing and reorganizing its sales process, and making greater use of video conferencing.

In order to maintain and enhance its current competitive advantage, the research and development department of the Company is continually working to upgrade the existing functionality, size, weight and price point of the STAR-ISMS® system and development of the next generation G3 systems has commenced.

Although the Company's exclusive world wide license to the patented technology underlying the STAR-ISMS® system provides a large measure of security, advances in technology are possible.

As has been demonstrated by duration of the Company's discussions with the Government of India with respect to the ability of Indian customers to utilize the STAR-ISMS® system in Indian airspace, and the current political unrest in Egypt, regulatory matters can delay the sales process to varying degrees. The Company relies upon entities such as Transport Canada ("TC") to issue approvals such as STC's, required whenever the Company is installing equipment aboard an aircraft. While TC works hard to provide excellent service, this is not always the case around the world.

Until revenues exceed expenses, the Company raises the necessary capital through private placements. There can be no assurance that management will be successful in raising the necessary capital required to fund pre-revenue activities.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING AND DISCLOSURE CONTROLS AND PROCEDURES

In accordance with National Instrument 52-109, Certification of Disclosure in Issuer's Annual and Interim Filings ("NI 52-109"), the CEO and CFO file a Venture Issuer Basic Certificate with respect to the financial information contained in the financial statements and accompanying Management's Discussion and Analysis. The Venture Issuer Basic Certification includes a "Note to Reader" stating that the CEO and CFO do not make any representations relating to the establishment and maintenance of disclosure controls and procedures ("DC&P") and internal controls over financial reporting ("ICFR"), as defined in NI 52-109.

As part of our corporate governance practices, ICFR and DC&P have been designed. There has been no formal evaluation of the operation of these controls. The Company has designed its ICFR to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance IFRS.

Management works to mitigate the risk of a material misstatement in financial reporting; however, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

The Company's DC&P have been designed to ensure that information required to be disclosed by Star is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure.

It should be noted that while the Company's CEO and CFO believe that the Company's DC&P provide a reasonable level of assurance that they are effective, they do not expect that the DC&P or ICFR will prevent all errors or fraud. There have been no material changes to the internal controls of the Company for the period ended December 31, 2013.