



# **Fireswirl**

## **Technologies Inc.**

**Management Discussion and Analysis of  
Financial Condition and Results of Operations**

**For the three and six months ended June 30, 2014 and 2013**

**August 26, 2014**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following Management Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with Fireswirl Technologies Inc. ("Fireswirl" or the "Company") interim consolidated financial statements and the accompanying notes for the period ended June 30, 2014 which have been prepared in accordance with International Financial Reporting Standards ("IFRS").

Additional information about the Company is available on SEDAR at ([www.sedar.com](http://www.sedar.com)) under Fireswirl Technologies Inc. and on the Company website at [www.fireswirl.com](http://www.fireswirl.com).

### **Special Note Regarding Forward Looking Statements**

This MD&A contains certain forward looking statements which reflect management's expectations regarding the Company's growth, results of operations, performance and business prospects and opportunities.

Statements about the Company's future plans and intentions, results, level of activity, performance or achievements or other future events constitute forward looking statements. Whenever possible, words such as "anticipate", "estimate", "may", "will", "could", "should", "expect", "plan", "intend", "believe", "estimate", or "potential" or similar words, have been used to identify these forward looking statements.

The Company cautions that the forward-looking statements reflect the current views and/or expectations of the Company with respect to its performance, business and future events. Investors are cautioned that all forward looking statements involve risks, uncertainties and assumptions. Including, without limitations, those relating to a limited operating history, an uncertain regulatory environment, a competitive environment, internet viability and system infrastructure and reliability, dependence on key personnel and foreign exchange fluctuations. These risks may cause the Company's actual results to differ materially from those projected in the forward looking statements. The Company does not undertake any obligations to release publicly any revisions for updating any voluntary forward looking statements.

Factors which could cause results or events to differ from current expectations include among other things: the impact of government legislation; the impact of competition; the ability of the Company to retain and attract qualified professionals; the impact of rapid technological and market change; loss of business or credit risk with current and perspective major customers; general industry and market conditions, growth rates and currency rate fluctuations. The Company disclaims any intentions or obligations to update or revise any forward looking statements, whether as a result of new information, future events or otherwise, except as required by law. No assurance can be given that actual results, performance or achievement expressed or implied by forward looking statements within this disclosure will occur; or if they do, that any benefits can be derived from them.

Past performance has been considered in drawing conclusions with respect to forward looking statements contained in this MD&A.

## **OVERVIEW**

Fireswirl Technologies Inc. (TSX Venture: FSW; "the Company") was founded in 1999 and operated as a software development and project management company specializing in payment platforms and online gaming software for the internet. In 2006, the Company became a publically listed company through a reverse takeover and a \$3.2 million equity financing accompanying its qualifying transaction.

In 2007, the Company has formed its first wholly owned subsidiary in China to explore the rapidly emerging market. The Company has since increased its business presence in the country gradually.

In 2009, the Company successfully completed its acquisition of 50% of all rights and interests of Beijing Xingchang Xinda Technology Development Co., Ltd. ("XCXD"), an e-commerce outsourcing and fulfillment solution provider in China, in consideration for 6,058,673 common shares of the Company. Fireswirl has majority voting rights and majority board control over XCXD according to the agreements related to the transaction.

## **CORPORATE SUMMARY**

Fireswirl specializes in the branded online store outsourcing market in China. Together with its subsidiary XCXD, Fireswirl is currently the operator of the branded official online stores in combination with the Tmall Flagship Store for Toys "R" Us, Hugo Boss, Bowers and Wilkins, Casio, LEGO and many other international brands in China. In order to gain access to more international brand clients and leverage from its business network, the Company also signed a partnership agreement with eBay Enterprise (formerly GSI Commerce) to expand its footprint in China. eBay Enterprise is a world leader in e-commerce solutions, serving over 1,000 retailers and brands globally and is a wholly owned subsidiary of eBay Inc.

The number of large brands outsourcing their online store operations in foreign markets to third party e-commerce partners behind the scenes has been increasing, as many brands realize that their core expertise is in designing, developing and manufacturing their products, and not in e-commerce operations.

An e-commerce business involves many aspects of operations, including continuous technology development, data infrastructure, day-to-day store operations, customer service, warehousing and logistics, payment management, return and refund handling, etc. It is generally not cost-effective and efficient to run these operations in-house for brand owners.

In the China market, it is even more compelling for international brands to use third party local partner for their online store operations in China because the landscape of the China e-commerce changes rapidly and is very different from other international markets.

Fireswirl is continuing to execute its long-term plan to becoming the largest e-commerce service platform in China for international brands, providing end-to-end operational services to these brands to break into the country's e-commerce market. With China's population exceeding 1.3 billion and being Fireswirl's predominant geographical location, the business opportunities are significant, especially when the e-commerce market is expanding at a rapid rate.

Fireswirl's core business is to operate the "official online store" in China for its international brand partners with contractual agreements, thus it is not in direct competition with most other online retailers who do not represent any particular brand and sell products from a variety of brand names.

The Company generates its revenues mainly from reselling branded products on the respective official branded online stores it operates. As the Company's business model evolves, it also generates revenue from sales-based service fee and other service fees for operating some of these official branded online stores without being the product reseller. Regardless of being a reseller or a service provider, management views this as a major competitive advantage over other online retailers in China. As China

e-commerce is becoming a priority for many international brands, the partnerships between these brands and Fireswirl is an important part of the company's sustainable growth strategy.

Fireswirl also operates the Tmall Flagship Store for a number of international brands. Tmall is an online marketplace owned by the world's largest e-commerce company, Taobao, where many domestic and local brands sell their products under its own branded flagship store within the marketplace. Tmall is the most popular online shopping destination in China. XCXD is an official Taobao Partner licensed to help international brands launch and operate their stores within Tmall.

For each new brand to launch a branded online store, the usual time frame for it to gain market acceptance before showing meaningful growth in sales would range from nine to twelve months. Fireswirl's strategy is to sacrifice short term gains and invest in increasing its brand portfolio and serving these brands and their online customers well. In the long run, Fireswirl targets to achieve economy-of-scale in its operations and eventually share the financial success of its brand clients in their e-commerce business growth.

To achieve profitability and high growth, the Company is focused in two directions:

- (I) Achieve economies-of-scale by increasing the number of brand partners it signs up to grow overall recurring revenues. All branded official online stores the Company operates are running on the same technology platform, and will leverage off the Company's existing resources including data infrastructure, warehouse management and administrative support structure. Economies of scale are achieved as the cost per transaction can be substantially reduced as transaction volume increases.
- (II) Nurture key brands for rapid online sales growth to increase the company's long-term sales-based revenue. Many brand clients have experienced rapid e-commerce growth in North America and other markets, and it is to the mutual benefit for Fireswirl and these brands to repeat such success in China. The company believes key clients such as these will be successful in China as well and generate comparable revenue growth to their US online stores in the long term. Fireswirl strives to nurture the stores of these key brands to achieve significant revenue growth in the future.

Despite the recent high growth in both the e-commerce market and Fireswirl's overall revenue, management believes e-commerce is still in its infancy in China. As its citizens' income continues to rise and their appetite for goods and services continue to increase, the Company shall benefit from its business model.

## **SUMMARY OF FINANCIAL RESULTS**

### **Key Financial Events**

- Total operating revenue increased to \$12,430,965 and \$22,568,228 for the three and six months ended June 30, 2014 compared to \$9,557,955 and \$19,143,749 during the same periods in 2013, representing an increase of 30.1% and 17.9%. Merchandise revenue increased by 26.2% and 15.5% during the three and six months ended June 30, 2014 respectively compared to the same periods in 2013. Service revenue increased by 61% and 41% respectively during the three and six months ended June 30, 2014 compared to the same period in 2013.
- Total operating expense was \$12,684,537 and \$22,963,724 for the three and six months ended June 30, 2014 compared to \$9,670,370 and \$19,313,223 for the same periods of 2013, representing an increase of 31.2% and 18.9% respectively. The increase was mainly due to the increase in cost of sales related expenses corresponding to increase in revenue and an increase in General administration expense and Salaries and Benefits.

- The Company reported a net loss on common shares of \$324,145 and \$594,972 for the three and six month periods ended June 30, 2014 compared to a net loss on common share of \$222,590 and \$297,967 for the same periods of 2013, representing an increase in loss of 45.6% and 99.7% respectively.
- Fully diluted loss per share was \$0.01 and \$0.01 for the three and six month period ended June 30, 2014 compared to fully diluted losses of \$0.00 and \$0.01 for the same periods of 2013.
- As at June 30, 2014, the Company had cash and cash equivalents (including restricted cash) of \$740,398 compared to \$1,182,387 as at December 31, 2013, representing a decrease of 37.4%. As at June 30, 2014, the Company had working capital of \$1,841,486 compared to \$1,011,257 as at December 31, 2013, representing an increase of 82.1%.

## SELECTED QUARTERLY FINANCIAL DATA

The following table sets out selected unaudited financial information of the Company on a consolidated basis for the last eight quarters.

	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013	Q4 2012	Q3 2012
<b>Operating revenues</b>								
Sales revenue	10,710,765	9,277,366	10,723,830	13,294,351	8,489,168	8,824,527	10,993,101	5,815,967
Service revenue	1,720,197	859,896	1,217,548	1,323,288	1,068,656	761,267	820,464	603,806
<b>Total operating revenues</b>	<b>12,430,962</b>	<b>10,137,262</b>	<b>11,941,378</b>	<b>14,617,639</b>	<b>9,557,824</b>	<b>9,585,794</b>	<b>11,813,565</b>	<b>6,419,773</b>
Other operating revenue	3				131			
<b>Total operating revenues</b>	<b>12,430,965</b>	<b>10,137,262</b>	<b>11,941,378</b>	<b>14,617,639</b>	<b>9,557,955</b>	<b>9,585,794</b>	<b>11,813,565</b>	<b>6,419,773</b>
<b>Operating expenses</b>								
Purchases	10,698,497	8,372,131	9,886,366	12,833,831	8,127,740	8,146,566	10,553,200	5,344,922
Delivery charges	181,110	107,297	146,754	146,037	136,827	120,691	101,598	90,557
Technical service charge	512,321	534,174	941,390	551,860	473,309	287,209	273,336	147,714
Other related expense	70,012	32,056	27,508	29,734	18,859	188,875	75,783	40,687
Foreign exchange (gain)/loss	1,337	4,829	876	580	(5,387)	10,004	1,701	1,493
Amortization	16,897	21,507	43,459	41,413	39,177	38,929	36,254	38,149
Sales and marketing	33,525	47,643	40,187	13,537	26,375	39,225	37,658	53,582
General administration	279,668	283,997	266,594	240,700	184,965	213,347	274,501	227,696
Salaries and benefits	891,170	875,552	723,334	783,573	662,672	598,007	486,488	464,901
Share-based payment expense	-	-	-	-	-	-	11,807	20,324
Impairment	-	-	452	-	-	-	-	-
Bad debt expense	-	-	-	-	5,833	-	-	-
<b>Total operating expense</b>	<b>12,684,537</b>	<b>10,279,186</b>	<b>12,076,919</b>	<b>14,641,265</b>	<b>9,670,370</b>	<b>9,642,853</b>	<b>11,852,325</b>	<b>6,430,026</b>
<b>Operating Income/(Loss)</b>	<b>(253,572)</b>	<b>(141,923)</b>	<b>(135,541)</b>	<b>(23,626)</b>	<b>(112,415)</b>	<b>(57,059)</b>	<b>(38,760)</b>	<b>(10,253)</b>
Finance income	2,796	4,310	3,013	2,940	3,703	2,832	2,550	2,642
Finance costs	(76,888)	(140,461)	(19,794)	(106,768)	(73,494)	(17,158)	(87,627)	(129,851)
<b>Income/(loss) before income tax</b>	<b>(327,664)</b>	<b>(278,074)</b>	<b>(152,322)</b>	<b>(127,454)</b>	<b>(182,206)</b>	<b>(71,385)</b>	<b>(123,837)</b>	<b>(137,462)</b>
Income tax recovery (expenses)	(8,934)	(2,569)	(11,254)	(9,190)	(9,078)	(2,762)	(14,367)	(7,021)
<b>Net income/(loss)</b>	<b>(336,598)</b>	<b>(280,643)</b>	<b>(163,576)</b>	<b>(136,644)</b>	<b>(191,284)</b>	<b>(74,147)</b>	<b>(138,205)</b>	<b>(144,483)</b>
Other comprehensive income/(loss)								
Foreign exchange currency adjustment	(91,463)	(7,638)	89,099	(38,536)	81,146	39,530	36,437	(35,894)
<b>Comprehensive income/(loss)</b>	<b>(428,061)</b>	<b>(288,281)</b>	<b>(74,477)</b>	<b>(175,180)</b>	<b>(110,138)</b>	<b>(34,617)</b>	<b>(101,768)</b>	<b>(180,377)</b>
Net income/(loss) attributable to:								
Common shares	(324,145)	(270,827)	(128,964)	(155,258)	(222,590)	(75,378)	(146,395)	(157,965)
Non-controlling interest	(12,453)	(9,816)	(34,612)	18,614	31,306	1,231	8,191	13,482
	<b>(336,598)</b>	<b>(280,643)</b>	<b>(163,576)</b>	<b>(136,644)</b>	<b>(191,284)</b>	<b>(74,147)</b>	<b>(138,205)</b>	<b>(144,483)</b>
Comprehensive income/(loss) attributable to:								
Common shares	(393,902)	(268,532)	(56,194)	(186,464)	(156,667)	(42,498)	(116,180)	(191,228)
Non-controlling interest	(34,159)	(19,749)	(18,283)	11,284	46,529	7,881	14,412	10,851
	<b>(428,061)</b>	<b>(288,281)</b>	<b>(74,477)</b>	<b>(175,180)</b>	<b>(110,138)</b>	<b>(34,617)</b>	<b>(101,768)</b>	<b>(180,377)</b>
<b>Basic/Diluted income/(loss) per share</b>	<b>\$ (0.01)</b>	<b>\$ (0.01)</b>	<b>\$ (0.00)</b>	<b>\$ (0.00)</b>	<b>\$ (0.00)</b>	<b>\$ (0.00)</b>	<b>\$ (0.00)</b>	<b>\$ (0.00)</b>

## QUARTERLY RESULTS

### Comparison of the three and six month period ended June 30, 2014 and June 30, 2013

#### Revenue

The Company reported total operating revenue of \$12,430,965 and \$22,568,228 for the three and six months ended June 30, 2014 compared to \$9,557,955 and \$19,143,749 for the same periods in 2013, representing an increase of 30.1% and 17.9% due to an increase in merchandise revenue by 26.2% and of 15.5% and an increase in service revenue by 61% and of 41% respectively. The increase in merchandise revenue for the six months period is mainly due to an increase in digital product sales. The increase in service revenue is mainly due to the increase in setup, customization and software development and deployment fee for new brands joining our platform to launch their branded online store.

The breakdown of the Company's revenues by category for the three and six months ended June 30, 2014 and 2013 are as follow:

	Three months ended		Six months ended	
	30-Jun-14	30-Jun-13	30-Jun-14	30-Jun-13
Merchandise resale and trading	\$ 10,710,765	\$ 8,489,168	\$ 19,988,132	\$ 17,313,695
Service and software fees	1,720,197	1,068,656	2,580,093	1,829,923
<b>Total Revenue</b>	<b>12,430,962</b>	<b>9,557,824</b>	<b>22,568,225</b>	<b>19,143,618</b>
Purchases	10,698,497	8,127,740	19,070,628	16,274,306
Technical service fee	512,321	473,309	1,046,495	760,519
Delivery charges	181,110	136,827	288,407	257,518
Other related expense	70,012	18,859	102,069	207,734
<b>Total Cost of Goods Sold</b>	<b>11,461,940</b>	<b>8,756,735</b>	<b>20,507,599</b>	<b>17,500,077</b>
<b>Gross profit</b>	<b>\$ 969,022</b>	<b>\$ 801,089</b>	<b>\$ 2,060,626</b>	<b>\$ 1,643,541</b>

During the three and six months period ended June 30, 2014, the Company recognized \$10,710,765 and \$19,988,132 respectively (same period 2013: \$8,489,168 and \$17,313,695) of revenue from the online merchandise sales in China. The Company also recognized \$1,720,197 and \$2,580,093 (same periods 2013: \$1,068,656 and \$1,829,923) of revenue from service and maintenance fees during the three and six month periods ended June 30, 2014. These sales incurred a cost of goods sold of \$11,461,940 and \$20,507,599 for the three and six month periods ended June 30, 2014 (same periods 2013: \$8,756,735 and \$17,500,077), resulting in the gross profit margin of 7.8% and 9.1% (same periods 2013: 8.4% and 8.6%).

### Operating Expenses

Total operating expenses increased to \$12,684,537 and \$22,963,724 for the three and six month periods ended June 30, 2014 compared to \$9,670,370 and \$19,313,223 for the same periods of 2013, representing a increase of 31.2% and 18.9%.

### Cost of Good Sold

Previously, cost of goods sold was presented as a separate line item under GAAP which includes the cost of purchasing the merchandise, sales tax, delivery, technical service, collection and advertising expenses related to the sales. As we have chosen to present expense using the nature approach under IFRS, cost of goods sold is presented as change in inventory, delivery charges and other related expenses under operating expenses.

The overall cost of good sold increased to \$11,461,940 and \$20,507,599 for the three and six month periods ended June 30, 2014 compared to \$8,756,735 and \$17,500,077 for the same periods of 2013, representing an increase of 30.9% and 17.2% respectively. The increase was mainly due to the increase in purchases and technical service expenses corresponding to increase in revenue.

### Foreign Exchange Gain

The Company recognized foreign exchange gain of \$1,337 and gain of \$6,167 for the three and six month periods ended June 30, 2014 (same period 2013: loss of \$5,387 and gain of \$4,616). The Company does not utilize any hedges or forward contract arrangements.

### Amortization

The Company reported depreciation and amortization expense of \$16,897 and \$38,404 for the three and six months period ended June 30, 2014 compared to \$39,177 and \$78,107 for the same periods of 2013,

representing a decrease of 56.9% and 50.8% respectively. This decrease is due to a leasehold improvement expense has been amortized by XCXD in 2013.

### **Sales and Marketing**

Sales and marketing expense increased to \$33,525 and \$81,168 for the three and six month periods ended June 30, 2014 compare to \$26,375 and \$65,599 for the same periods of 2013, representing an increase of 27.1% and 23.7%. During the three and six months period ended June 30, 2014, XCXD represented \$6,774 and \$19,343 (same period in 2013: \$11,135 and \$29,827) or 20.2% and 23.8% (same period in 2012: 42.2% and 45.5%) of the sales and marketing expenses. The overall increase is due to increase in traveling expenses of management in expanding the Asia market.

### **General and Administrative**

General and administrative expense increased to \$279,668 and \$563,665 for the three and six month periods ended June 30, 2014 compared to \$184,965 and \$398,312 for the same periods of 2013, representing an increase of 51.2% and 41.5% respectively. The increase is mainly due increase in audit and accounting fees accrual, legal fees, rent and bank charges. During the three and six month periods ended June 30, 2014, XCXD represented \$163,184 and \$349,186 (same period in 2013: \$129,183 and \$269,417) or 58.3% and 61.9% (same period in 2013: 69.8% and 67.6%) of the general and administrative expenses. The increase in XCXD General and Administrative expense is mainly due to expanding to have a branch office in Shanghai and increase in rent of the current office.

### **Salaries and Benefits**

Salaries and benefits expense increased to \$891,170 and \$1,766,721 for the three and six month periods ended June 30, 2014 compared to \$662,672 and \$1,260,679 for the same periods of 2013, representing an increases of 34.5% and 40.1%. During the three and six months period ended June 30, 2014, XCXD represented \$652,507 and \$1,328,704 (same period in 2013: \$505,056 and \$950,117) or 73.2% and 75.2% (same period in 2013: 76.2% and 75.4%) of the salaries and benefits expenses. The increase is mainly attributable to business expansion in XCXD and salary adjustment.

### **Bad Debt Expense**

The Company recorded Nil bad debt expense for the three and six month periods ended June 30, 2014 compared to \$5,833 and \$5,833 for the same periods of 2013. The bad debt expense in 2013 is due to the winding down of the Fireswirl Beijing office and wrote off its miscellaneous accounts receivables.

### **Finance Income**

The Company recorded \$2,796 and \$7,106 of interest income for the three and six month periods ended June 30, 2014 (same periods in 2013: \$3,703 and \$6,535). This interest income is mainly earned by XCXD restricted cash deposit for the three and six month periods ended June 30, 2014 and 2013.

### **Finance Expense**

The Company recorded \$76,888 and \$217,348 of interest expense for the three and six month periods ended June 30, 2014 (same periods in 2013: \$73,494 and \$90,653). This interest expense was incurred by the short term loans and long term loan drawn down by XCXD in 2014 and XCXD and Fireswirl Technologies (SZ) Co. Ltd. in 2013 for the six month periods ended June 30, 2014 and 2013. During the first quarter of 2013, XCXD has received \$71,775 (RMB450,000) from government as a subsidy for business on interest expense for the year 2012.



## **Net Comprehensive Loss**

The Company reported net comprehensive loss attributable to the common shares of \$393,902 and \$662,434 for the three and six month periods ended June 30, 2014 compared to net comprehensive loss attributable to the common shares of \$156,667 and \$199,165 for the same periods of 2013, representing an increase in loss of 151.4% and 232.6%.

Diluted loss per share on net comprehensive loss was \$0.01 and \$0.02 for the three and six month period ended June 30, 2014 compared to a diluted loss per share on net comprehensive loss of \$0.00 and \$0.00 in the same period of 2013.

## **Non Controlling Interest**

The Company's foreign subsidiary, XCXD realized the net loss of \$24,906 and \$44,538 for the three and six month periods ended June 30, 2014 compared to the same periods in 2013 with net income of \$62,611 and \$65,073, a decrease of 140% and 168.4% respectively. Based on the Company's ownership of 50%, only 50% of the net income/loss is being taken out/added to in the interim consolidated income statement.

## **CASH FLOW STATEMENT**

### **Operating Activities**

Cash by operating activities was an outflow of \$2,631,301 and \$2,575,313 for the three and six month periods ended June 30, 2014 compared to cash inflow to operation of \$276,857 and \$250,129 for the same periods of 2013. The increase in cash outflow for the six month periods is mainly due to increase in prepaid & deposit and decrease in accounts payable and loan from shareholders.

### **Investing Activities**

Cash used by investing activities was \$16,162 and \$30,825 for the three and six month periods ended June 30, 2014 compared to \$28,604 and \$42,815 for the same periods of 2013 representing a decrease of 43.5% and 28%. The company's investing activities in the six months of 2013 consisted mainly of computer equipment purchase.

### **Financing Activities**

Cash inflow from financing activities was \$2,604,028 and \$2,643,902 for the three and six month periods ended June 30, 2014 compared to \$164,908 cash inflow and \$39,087 cash outflow for the same periods of 2013. The cash inflow is mainly from cash contribution from XCXD shareholders, proceeds from private placement and cash released from restricted cash during the six month period. The cash outflow from the comparative period is mainly due to cash being pulled to restricted cash.

## **LIQUIDITY AND CAPITAL RESOURCES**

As at June 30, 2014, the Company has \$367,721 in cash and short term investments and working capital (defined as current assets less current liabilities) of \$1,841,846 compared to \$364,988 in cash and short term investments and working capital of \$1,011,257 as at December 31, 2013. Recent dramatic change in the global economic environment has resulted in increased uncertainty regarding future revenue and customer commitments, both in terms of timing and magnitude for such future sales. Contractual commitments are summarized in "Contractual Obligations" section of this MD&A. To the extent the Company is unable to cover its ongoing cash requirements through operations, the Company expects to

raise additional equity financing to cover any shortfall. There can be no assurance that such financing and profitability will occur in the amounts and with terms expected. These condensed consolidated interim financial statements do not give effect to adjustments that would be necessary to the carrying value and classification of assets and liabilities should the Company be unable to continue as a going concern.

The Company does not have commitments for capital expenditures as of June 30, 2014. The Company's capital resources consist of common share issuances.

### **Contractual Obligations**

The Company signed a three year lease agreement for an office space in Vancouver on May 1, 2012, which will expire on April 30, 2015. The foreign subsidiary XCXD has a lease obligation of \$18,156 (RMB103,333) per month until December 1, 2017 where rent will increase by 5% until lease expired on November 30, 2018. XCXD has a lease obligation for its Shanghai office of approx \$7,665 (RMB43,628) per month until August 15, 2016 when the lease expires. XCXD has a lease obligation for its Beijing warehouse facility of approx \$61,495 (RMB350,000) per year until September 15, 2016 where rent will increase to \$70,280 (RMB400,000) until September 14, 2019 when the lease expires.

The Company's future minimum annual payments under operating leases are the following:

2014	\$231,898
2015	\$387,034
2016	\$339,970
2017	\$282,243
2018	\$264,460
2019	\$ 54,498

### **Related Party Transactions**

In the six month period of 2014, the Company paid \$121,800 (same period 2013: \$121,800) in salaries to its management. The Company paid \$8,000 (same period 2012: \$8,000) to directors as director fees. As of June 30, 2014, the accounts payable balance includes \$62,685 (same period 2013: \$140,736) that is incurred from regular operational expenses outstanding to an officer of the company and the Company also had a balance of \$711,500 (same period 2013: \$1,045,749) due to the shareholders of Fireswirl Technologies Inc. and XCXD.

All of the above transactions were in the normal course of operations and are measured and recorded at the exchange amount of consideration established and agreed to by the related parties.

### **SIGNIFICANT ACCOUNTING POLICIES**

Significant accounting policies and methods used in preparation of the Company's financial statements are described in Note 2 of unaudited condensed interim consolidated financial statements of the Company for the three and six month period ended June 30, 2014.

### **CHANGES IN ACCOUNTING POLICIES**

The accounting policies applied in the preparation of these unaudited condensed interim consolidated financial statements are consistent with those applied and disclosed in the Company's audited consolidated financial statements for the year ended December 31, 2013, except for the application of the following new interpretation and amendments to existing IFRSs, which were effective January 1, 2014:

- IFRIC 21 – *Levies* (“IFRIC 21”), an interpretation of IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* (“IAS 37”), clarifies that the obligating event, as defined by IAS 37, that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. The Company has applied IFRIC 21 on a retrospective basis in compliance with the transitional requirements of IFRIC 21. The application of IFRIC 21 did not result in an adjustment to the Company’s unaudited condensed interim consolidated financial statements.
- Certain amendments to IFRSs as issued by the IASB. These amendments did not have a significant impact on the Company’s unaudited condensed interim consolidated financial statements.

The Company’s interim results are not necessarily indicative of its results for a full year.

### **Standards issued but not yet effective**

The Company has not yet applied the following new standards, interpretations or amendments to standards that have been issued as at March 31, 2014 but are not yet effective. Unless otherwise stated, the Company does not plan to early adopt any of these new or amended standards and interpretations and intends to adopt those standards when they become effective. The Company does not expect the impact of such changes on the financial statements to be material, unless otherwise stated.

#### *IFRS 2 Share-based payment*

The amendments to IFRS 2, issued in December 2013 clarify the definition of “vesting conditions”, and separately define a “performance condition” and a “service condition”. A performance condition requires the counterparty to complete a specified period of service and to meet a specified performance target during the service period. A service condition solely requires the counterparty to complete a specified period of service. The amendments are effective for share-based payment transactions for which the grant date is on or after July 1, 2014.

#### *IFRS 3 Business combinations*

The amendments to IFRS 3, issued in December 2013, clarify the accounting for contingent consideration in a business combination. At each reporting period, an entity measures contingent consideration classified as an asset or a financial liability at fair value, with changes in fair value recognized in profit or loss. The amendments are effective for business combinations for which the acquisition date is on or after July 1, 2014.

#### *IFRS 8 Operating segments*

The amendments to IFRS 8, issued in December 2013, require an entity to disclose the judgments made by management in applying the aggregation criteria for reportable segments. The amendments will only affect disclosure and are effective for annual periods beginning on or after July 1, 2014.

#### *IFRS 9 Financial instruments*

IFRS 9 was issued in November 2009 and subsequently amended as part of an ongoing project to replace IAS 39 Financial instruments: Recognition and measurement. The standard requires the classification of financial assets into two measurement categories based on the entity’s business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. The two categories are those measured at fair value and those measured at amortized cost. The classification and measurement of financial liabilities is primarily unchanged from IAS 39. However, for financial liabilities measured at fair value, changes in the fair value attributable to changes in an entity’s “own credit risk” is now recognized in other comprehensive income instead of in profit or loss. This new standard will also impact disclosures provided under IFRS 7 Financial instruments: disclosures.

In November 2013, the IASB amended IFRS 9 for the significant changes to hedge accounting. In addition, an entity can now apply the “own credit requirement” in isolation without the need to change any other accounting for financial instruments. The mandatory effective date of January 1, 2018 has been removed to provide sufficient time for preparers of financial statements to make the transition to the new requirements.

#### *IAS 14 Regulatory Deferral Accounts*

IFRS 14 is intended to enhance the comparability of financial reporting by entities engaged in rate-regulated activities and is effective for annual periods beginning on or after January 1, 2016. IFRS14 is not expected to be applicable to the Company.

#### *IAS 16 Property, plant and equipment and IAS 38 Intangible assets*

The amendments to IAS 16 and IAS 38, issued in December 2013, clarify how an entity calculates the gross carrying amount and accumulated depreciation when a revaluation is performed. The amendments are effective for annual periods beginning on or after July 1, 2014.

#### *IAS 24 Related party disclosures*

The amendments to IAS 24, issued in December 2013, clarify that a management entity, or any member of a group of which it is a part, that provides key management services to a reporting entity, or its parent, is a related party of the reporting entity. The amendments also require an entity to disclose amounts incurred for key management personnel services provided by a separate management entity. This replaces the more detailed disclosure by category required for other key management personnel compensation. The amendments will only affect disclosure and are effective for annual periods beginning on or after July 1, 2014.

### **CRITICAL ACCOUNTING ESTIMATES**

The preparation of the condensed interim consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In the application of the Company's accounting policies, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from those estimates.

#### *Critical estimates in applying accounting policies*

##### *Sales allowances and returns*

Sales allowances for customer promotions, discounts and returns are recorded as a reduction of revenue when the related revenue is recognized. Revenue from product sales is recognized upon passing of title to the customer, generally at the time of shipment. Revenue from product sales, less related sales allowances, is reflected as net sales in the consolidated income statements. The Company routinely commits to promotional sales allowance programs with customers. These allowances primarily relate to fixed programs, which the customer earns based on purchases of the Company's products during the year. Discounts and allowances are recorded as a reduction of related revenue at the time of sale. While many of the allowances are based on fixed amounts, certain of the allowances, such as the returns allowance, are based on market data, historical trends and information from customers, and are therefore subject to estimation.

For its allowance programs that are not fixed, such as returns, the Company estimates these amounts using a combination of historical experience and current market conditions. These estimates are reviewed periodically against actual results and any adjustments are recorded at that time as an increase or decrease to net sales. During the three month period ended March 31, 2014, there have been no material adjustments to the Company's estimates made in prior years.

### *Allowance for doubtful accounts*

The Company's allowance for doubtful accounts is based on management's assessment of the business environment, customers' financial condition, historical collection experience, accounts receivable aging, customer disputes and the collectability of specific customer accounts. If there were a deterioration of a major customer's creditworthiness, or actual defaults were higher than the Company's historical experience, estimates of the recoverability of amounts due could be overstated, which could have an adverse impact on operating results. The allowance for doubtful accounts is also affected by the time at which uncollectible accounts receivable balances are actually written off.

Major customers' accounts are monitored on an ongoing basis; more in depth reviews are performed based on changes in customer's financial condition and/or the level of credit being extended. When a significant event occurs, such as a bankruptcy filing by a specific customer, and on a quarterly basis, the allowance is reviewed for adequacy and the balance or accrual rate is adjusted to reflect current risk prospects.

### *Reserve for inventory obsolescence*

The Company's values inventory at the lower of cost or net realizable value. Based upon a consideration of quantities on hand, actual and projected sales volume, anticipated product selling prices and product lines planned to be discontinued, slow-moving and obsolete inventory is written down to its net realizable value. Failure to accurately predict and respond to consumer demand could result in the Company under producing popular items or overproducing less popular items. Furthermore, significant changes in demand for the Company's products would impact management's estimates in establishing its inventory provision.

Management estimates are monitored on a quarterly basis and a further adjustment to reduce inventory to its net realizable value is recorded, as an increase to cost of sales, when deemed necessary under the lower of cost or net realizable value.

### *Depreciation*

The amounts recorded for depreciation are based on estimates including economic life of the asset and residual values of the asset at the end of its economic life. The actual lives of the assets and residual values are assessed annually taking into account factors such as technological innovation and maintenance programs.

### *Share-based compensation*

The Company uses the fair value method of valuing compensation expense associated with the Company's share-based compensation plan whereby notional shares are granted to employees, board of directors and key consultants. Estimating fair value requires determining the most appropriate valuation model for a grant of equity instruments, which is dependent on the terms and conditions of the grant.

### *Critical judgments in applying accounting policies*

The following are the critical judgments that the management has made in the process of applying the Company's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

### *Income taxes*

The Company is subject to income taxes in Canada and in China. Management has estimated the income tax provision and deferred tax balances in accordance with its interpretation of the various income tax laws and regulations, and has estimated the recoverability of deferred tax balances. It is possible,

due to complexity inherent in estimating income taxes that the tax provision and deferred tax balances could change.

#### *Key assumptions used in discounted cash flow projections*

Key assumptions used in the calculation of impairment tests and valuation of goodwill are forecast growth rates for revenue, estimated margins, discount rates, and other assumptions.

#### *Going concern*

The assessment of the Company's ability to execute its strategy by funding future working capital requirements involves judgment. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

### **RISKS AND UNCERTAINTIES**

Important risks factors that could cause actual results, performance or achievements to be materially different than past performance or those implied by forward looking statements include:

- Foreign currency exchange risk
- Uncertainty as to the degree of new and continuing market acceptance of our products;
- Our products could contain defects that lead to costs, damage of reputation or litigation;
- Our dependence on brand partners' performance;
- Uncertainty regarding future profitability;
- Uncertainty regarding the pricing, reporting and collection of accounts;
- Risks associated with sales in foreign countries and their government policy and regulations therein
- Our ability to attract and retain key personnel

#### **Subsequent Events**

There is no subsequent event.

#### **Off Balance Sheet Arrangement**

As at June 30, 2014 and the date of this report the Company has not entered into any off balance sheet arrangements.

#### **Financial Instruments and Other Instruments**

The Company's financial instruments consists of cash, short term investments, accounts receivable, accounts payable and accrued liabilities, income taxes recovery and capital lease obligations. The fair values of these financial instruments approximate their carrying values, except as noted below. It is management's opinion that the Company is not exposed to significant interest risks. The Company's short term investments consist of investments in low risk bank certificates. A substantial portion of the Company's revenue is earned in foreign currencies and is exposed to currency fluctuations. The Company does not use financial derivatives or "other financial instruments".

### **INTERNAL CONTROL OVER FINANCIAL REPORTING AND DISCLOSURE CONTROLS**

The Company evaluated the effectiveness and design of its disclosure controls and procedures for the three month period ended June 30, 2014 and based on this evaluation (which included testing of the key

controls by examining evidence demonstrating their existence on a test basis) have determined these controls to be effective.

The Corporation's financial reporting procedures and practices have enabled the certification of Fireswirl Technologies Inc. annual filing in compliance with Multilateral Instrument 52-109 "Certification of Disclosure in Issuers Annual and Interim Filings". Management has designed such internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements and other annual filings in accordance with Canadian Generally Accepted Accounting Principles, except as noted below.

Given the size of the Company, the evaluation of the design of internal controls over financial reporting for the Company resulted in the identification of the following weaknesses:

Management is aware that due to its relatively small scale of operation there is a lack of segregation of duties to a limited number of employees dealing with accounting and financial matters. However, management has concluded that considering the employees involved and the control procedures in place, including management and Audit Committee oversight, risks associated with such lack of segregation of duties are not significant enough to justify the expense associated with adding employees to segregate duties.

Management is aware that in-house expertise to deal with complex taxation, accounting and reporting issues may not be sufficient. The Company requires outside assistance and advice on new accounting pronouncements and complex accounting and reporting issues, which is common with companies of similar size.

There have been no significant changes to the Company's internal control over financial reporting that occurred during the most recent period that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting. The Company internal control systems continue to evolve as the Company grows. We believe these systems are sufficient to execute the business plan and provide meaningful information upon which to manage the business. Management believes the disclosure, controls and procedures currently in place are effective.

The Company has 53,571,285 common shares and 1,450,000 options and 1,700,000 warrants outstanding and exercisable at June 30, 2014 and as at the date of report. If all of the Company's exercisable options and warrants were exercised, the Company would have 56,721,285 common shares outstanding at the date of report.