

## Management's Discussion and Analysis

For the year ended December 31, 2013

*(in Canadian dollars unless otherwise noted)*

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*This management's discussion and analysis ("MD&A") is current to April 23, 2014 and is management's assessment of the operations and the financial results together with future prospects of Eurocontrol Technics Group Inc. ("Eurocontrol" or the "Company"). This MD&A should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2013 and 2012 and notes thereto, prepared in accordance with International Financial Reporting Standards. All figures are in Canadian dollars unless stated otherwise. Additional information relevant to Eurocontrol's activities, including Eurocontrol's press releases can be found on SEDAR at [www.sedar.com](http://www.sedar.com).*

### **FORWARD-LOOKING STATEMENTS**

*This MD&A contains forward-looking statements, which are based on certain assumptions and analyses made by the Company derived from its experience and perceptions. The forward-looking statements in this MD&A are subject to important risks, uncertainties, and assumptions, which are difficult to predict and which may affect the Company's operations. The critical risks, uncertainties, and assumptions include, without limitation: the impact of economic conditions including volatility in the price of oil, gas, and gas liquids; interest rates and foreign exchange rates; industry conditions including supply and demand fundamentals for oil and gas, and the related infrastructure and services; the ability to continue to build and improve on proven manufacturing capabilities and innovate new product lines and markets; increased competition; insufficient funds to support capital investments required to grow the business; the lack of availability of qualified personnel or management; and political unrest. As such, actual results, performance, or achievements could differ materially from those expressed in, or implied by, these forward-looking statements and accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits, including the amount of proceeds or dividends the Company and its shareholders, will derive therefrom. The forward-looking statements included in this MD&A are made as of the date of this MD&A and other than as required by law, the Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

### **BUSINESS OVERVIEW AND STRATEGY**

Eurocontrol is a Canadian listed public company with its shares traded on the TSX Venture Exchange under the symbol "EUO". The Company participates in the energy security and authentication, verification and certification markets globally. Eurocontrol has three wholly owned subsidiaries: Global Fluids International S.A. ("GFI"), Xenemetrix Ltd. ("Xenemetrix") and XwinSys Technology Development Ltd. ("XwinSys"). GFI and Xenemetrix are global pioneers in developing and implementing innovative molecular marking systems for the oil industry. Through its proprietary Petromark™ integral system and coupled with Xenemetrix's Energy-Dispersive X-ray Fluorescence ("EDXRF") technology, GFI has developed a four-part solution consisting of a molecular marker, injection, monitoring and control components to combat fuel adulteration and theft and increase fuel tax revenues. Oil industry cost realities along with GFI's 10-year research and development ("R&D") efforts is facilitating the pursuit of numerous oil marking opportunities worldwide. XwinSys is currently developing technology and intellectual property that will combine 2D and 3D image processing technology, from Brossh Inspection Systems Ltd. of Israel combined with Xenemetrix's EDXRF.

The majority of our revenues are denominated in U.S. dollars while a significant amount of our marketing and administration costs are denominated in currencies other than U.S. dollar; primarily the Canadian dollar and the Israeli shekel. To the extent that the exchange rates between of the U.S. dollar and the Canadian dollar and Israeli Shekel fluctuate, we will experience an impact on our earnings.

As our business expands internationally, we will be exposed to additional risk relating to International operations. We intend to grow our international business operations. Our international operations expose us to additional risk unique to such international markets, including but not limited to the following:

- Increased credit management risks and greater difficulties in collecting our receivables;
- Unexpected changes in regulatory requirements, exchange rates, trading policies and other barriers;
- Uncertainties of International laws and enforcement relating to the protection of intellectual property;
- Economic or political instability;
- Potential adverse tax consequences;
- Difficulty in managing a worldwide workforce in compliance with business practices and local law, that vary from country to country.

The growth of our company through the acquisitions and integration of complementary businesses is an important component of our business strategy. We continue to seek opportunities to acquire or invest in business, products and technologies to expand, complement or otherwise relate to our business.

## **LEADERSHIP TEAM**

W. Bruce Rowlands - Chairman, President and Chief Executive Officer

James Fairbairn – Director <sup>(1\*)(2)</sup>

Gadi Gonen – Director and Chief Operating Officer

Charlotte May – Corporate Secretary

General (Retired) Sir Michael Rose - Director

Andres Tinajero – Chief Financial Officer

Kenneth Wawrew – Director <sup>(1)(2\*)</sup>

Paul Wood – Director <sup>(1)(2)</sup>

Dr. Eli Zahavi - Director

Notes:

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

\* Denotes Committee Chair

Experience profiles for the board and management are available at [www.eurocontrol.ca](http://www.eurocontrol.ca).

## **RECENT DEVELOPMENTS AND OUTLOOK**

The Company increased its fiscal year revenue to \$6,448,834 (\$5,008,040 as at December 31, 2012), a 29% increase. Below is a description of the recent developments and outlook for each of the Company's subsidiaries. The Company is projecting base revenue of \$7,500,000 for fiscal 2014 a 16% increase from same period in 2013. This estimate is based on existing fuel marking projects with GFI contributing approximately 70% of overall revenue and does not take into account possible new fuel marking contract wins that may occur in 2014. Additionally, the Company continues to evaluate acquisition opportunities that are synergic to the authentication, verification and certification markets.

In the first quarter of 2014, we expect year-over-year revenue and earnings growth. We expect our gross margin to decrease slightly from fourth quarter of 2013 due to a shift in product mix and we expect operating expenses to increase as a result of investment in sales and marketing capabilities. We believe that the market for our Petromark™ technology has strong long term growth prospects.

## **GFI**

GFI accounts for \$4,561,565 (\$3,543,401 as at December 31, 2012) of the revenue generated for the year ended December 31, 2013, representing 71% (2012 – 71%) of overall revenue. GFI is projecting 2014 revenue of US\$5,200,000, a 21% increase over results for the same period in 2013 based on existing on-going projects.

Over the past year, GFI has expanded its Petromark™ technology into Albania and has renewed its contracts with Uganda and Tanzania. Albania has taken the lead in the Balkan area against corruption in the fuel market and the implementation of a national fuel marking and tracing contract will improve fuel quality and the environment, and increase fuel tax collections. The Albanian contract was signed in June and commenced in September 2013. In October 2012, GFI signed a five year contract extension with the Ministry of Energy and Mineral Development, Government of the Republic of Uganda for the continued deployment of Petromark™ technology, and services were expanded to include all local logistics in country. GFI is pursuing a number of additional opportunities some of which are currently in the tender process and others that are undergoing pilot projects. GFI continues to expand its global network and presence and to source marketing and distribution partnerships with new and well established distributors in all parts of the world. GFI has numerous opportunities developing in Africa, Europe and Asia where it anticipates being the technology provider to new hydrocarbon marking programs in these regions.

GFI holds Process Patents in the countries of China, India and Russia, Israel and the US. Additional process patent applications have been submitted in other countries and GFI continues to invest in R&D to expand the marking scope of its Petromark™ technology. GFI is the only company involved in fuel marking technology that is ISO 17025 accredited.

## **Xenemetrix**

Xenemetrix accounts for \$1,887,269 (\$1,530,326 as at December 31, 2012) of the revenue generated for the year ended December 31, 2013, representing 29% (2012 – 29%) of overall revenue. Xenemetrix revenue from sales of EDXRF systems increased by 23% during the year ended December 31, 2013. Xenemetrix is projecting 2014 revenue of US\$2,300,000.

In 2013, Xenemetrix expanded the use of EDXRF to both the marine and extractive industries with the development of Petro-Marine XRF™ in February and a Geological Mapping Solution (“GMS”) in May.

Petro-Marine XRF™ is an onboard monitoring solution that facilitates regular and timely compliance of marine vessels with new and existing international regulations, and enhances the preventive maintenance process – leading to significant operational cost savings. The target market for the Petro-Marine XRF™ system is merchant ships of which there are approximately 55,000 currently in service worldwide providing the Company with an available market approximating US\$1.6 billion. In August, a pilot project commenced with one of the largest container shipping companies in the world (over 100 marine vessels) which could lead to significant sales as a successful pilot project would possibly involve the installation of the Petro-Marine XRF™ monitoring system at seven shipping hubs worldwide

GMS is a mobile EDXRF system that provides an onsite laboratory level solution to rapidly analyze almost all sample types and shapes (solids, liquids, powders and thin films) and the GMS technology utilizing EDXRF enables location based geological data to be transferred immediately to the user's server for reporting and monitoring significantly improving the user's ability to analyze data in real time from exploration locations. The target markets for GMS include geological survey companies, geological and mineral exploration companies amongst others.

Xenemetrix remains focused on the development of new applications for its EDXRF and establishing new marketing and distribution agreements in various regions.

## XwinSys

XwinSys is a research and development stage company that does not currently generate revenue. XwinSys has been focused on the development of synergistic combinations of EDXRF technology and automated 2D and 3D image processing technologies for the Semiconductor and related microelectronics industries. XwinSys continues to perform advanced demo applications for its prospective Semiconductor customers with several of the largest global companies. Demonstrations are performed on the XwinSys 100 beta system which was the major milestone accomplishment of development efforts in 2012. In November 2012, XwinSys announced that it received a grant of US\$220,000 from The Office of the Chief Science of Israel for its “Wafer bumps inspection and measurement system” and based on the milestones achieved in 2012, XwinSys was granted a second year grant of US\$250,000 in 2013. These grants have represented 50% of the R&D budget. In 2013, XwinSys continued working towards commercialization of its Wafer bumps inspection and measurement system. There exists a significant demand for this technology in the Semiconductor and related microelectronics industries.

### SUMMARIZED FINANCIAL RESULTS

	Three Months Ended		Year Ended	
	December 31,		December 31,	
	2013	2012	2013	2012
	\$	\$	\$	\$
Revenue	1,755,631	1,625,040	6,448,834	5,008,040
Cost of sales	(1,022,546)	(965,871)	(3,694,337)	(2,870,843)
Gross profit	<u>733,085</u>	<u>659,169</u>	<u>2,754,497</u>	<u>2,137,197</u>
Expenses	617,447	625,039	3,223,950	3,206,259
Other expense (income)	(50,144)	405,974	(48,086)	274,033
Income tax expense	6,931	7,736	20,854	24,637
Net income (loss)	<u>158,851</u>	<u>(379,580)</u>	<u>(442,221)</u>	<u>(1,367,732)</u>
Basic and fully diluted loss per share	<u>0.00</u>	<u>(0.00)</u>	<u>(0.00)</u>	<u>(0.02)</u>
EBITDA	<u>464,689</u>	<u>(7,160)</u>	<u>844,533</u>	<u>74,309</u>
EBIT	<u>190,202</u>	<u>(348,618)</u>	<u>(323,996)</u>	<u>(1,246,303)</u>

Record revenues for the three months and year ended December 31, 2013 amounted to \$1,755,631 and \$6,448,834 respectively, compared to \$1,625,040 and \$5,008,040 for the three months and year ended December 31, 2012. These figures represent an increase of 8% from the prior three months in 2012 and an increase of 29% from the year ending December 2012.

Gross margin remains strong at 43%. Product mix and average selling price remains constant as compared with 2012.

EBITDA improved by \$770,224 to \$844,533 in 2013 compared to \$74,309 in 2012.

The Company recorded a net income of \$158,851 and net loss of \$442,221 for the three months and year ended December 31, 2013 respectively, compared to a net loss of \$379,580 and \$1,367,732 for the comparable three months and year ended December 31, 2012.

Expenses of \$617,447 for the fourth quarter of 2013 remained consistent in comparison with the expenses of \$625,039 for the fourth quarter of 2012. Expenses for the year ended December 31, 2013 of \$3,223,950 remained consistent in comparison with expenses of \$3,206,259 for the year ended December 31, 2012. The small increase for the year is primarily due to share-based compensation expense in the amount of \$151,000 recognized on the granting of 5,112,500 stock options during the first quarter of 2013 (no stock options granted during the year ended 2012) and increases in sales and marketing related expenses and R&D which all increased due to an overall increase in activity in the Company and higher sales which increased to \$6,448,834 from \$5,008,040 for the year ended December 31, 2013 compared to 2012 offset by a decrease in consulting and management expenses and office and general expenses. The expenses for the three month period remained consistent as sales and marketing related expenses and research and development in the current period remained consistent as did sales which were comparable at \$1,755,631 from \$1,625,040 for the three months ended December 31, 2013 compared to 2012.

The Company also incurred a foreign exchange translation gain of \$75,124 and \$146,018 for the three months and year ended December 31, 2013 respectively, compared to a loss of \$82,814 and a gain of \$122,692 respectively for the three months and year ended December 31, 2012. The Company has shareholder loans denominated in US dollars and Euros. The Company's revenue is earned in US dollars. The Company is therefore subject to gains and losses due to fluctuations in these currencies relative to the Canadian dollar.

Interest expense amounted to \$24,987 and \$97,371 for the three months and year ended December 31, 2013, compared to \$23,168 and \$96,792 for the three months and year ended December 31, 2012, mainly related to GFI's shareholder loans, payable to the former shareholders of GFI. As the balance of these loans decreases, the amount of interest expense is expected to decrease.

#### **SELECTED ANNUAL INFORMATION**

The information below should be read in conjunction with the management's discussion and analysis, the consolidated financial statements and related notes and other financial information. The following is for the periods ended:

	<b>Year Ended December 31, 2013</b>	<b>Year Ended December 31, 2012</b>	<b>Year Ended December 31, 2011</b>
	\$	\$	\$
Total revenue	6,448,834	5,008,040	5,399,601
Loss	442,221	1,367,732	2,409,670
Loss per share	0.00	0.02	0.03
Total assets	7,230,829	8,247,321	8,948,077

**SUMMARY OF QUARTERLY RESULTS**

The following tables set forth selected financial information for each of the Company's eight most recently completed quarters:

	<b>Q4 2013</b>	<b>Q3 2013</b>	<b>Q2 2013</b>	<b>Q1 2013</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Revenue	1,755,631	1,530,889	1,816,035	1,346,279
Cost of sales*	(1,022,546)	(397,700)	(427,182)	(312,198)
Gross profit	733,085	1,133,189	1,388,853	1,034,081
Expenses	617,447	1,317,563	1,349,610	1,474,041
Other expense (income)	(7)	918	1,298	(1,648)
Interest expense	24,987	25,191	23,915	23,278
Foreign exchange loss (gain)	(75,124)	69,591	(102,152)	(38,333)
Income taxes expense (recovery)	6,931	5,145	8,339	439
	574,234	1,418,408	1,281,010	1,457,777
Net income (loss)	158,851	(285,219)	107,843	(423,696)
Basic and fully diluted loss per share	\$ 0.00	\$ (0.00)	\$ 0.00	\$ (0.00)
Total assets	7,230,829	7,328,927	9,184,103	7,910,139

	<b>Q4 2012</b>	<b>Q3 2012</b>	<b>Q2 2012</b>	<b>Q1 2012</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Revenue	1,625,040	1,142,059	1,146,960	1,093,981
Cost of sales*	(965,871)	(127,155)	(487,857)	(382,699)
Gross profit	659,169	1,014,904	679,103	711,282
Expenses	625,039	1,215,099	1,169,193	1,124,189
Other expense (income)	(8)	(6)	(14)	(39)
Provision for HST recoverable	300,000	-	-	-
Interest expense	23,168	23,694	24,492	25,438
Foreign exchange loss (gain)	82,814	(127,258)	(103,476)	25,228
Income taxes expense (recovery)	7,736	10,732	4,153	2,016
	1,891,459	1,122,261	1,094,348	1,176,832
Net income (loss)	(379,580)	(107,357)	(415,245)	(465,550)
Basic and fully diluted loss per share	\$ (0.01)	\$ (0.00)	\$ (0.00)	\$ (0.01)
Total assets	8,247,321	8,050,359	8,263,751	8,279,038

\*Cost of sales: Q4, 2013 and 2012 cost of sales amounts have been reclassified to conform with change in presentation of costs of operations.

**Disclosure of Outstanding Share Data as of April 23, 2014**

	<b>Authorized</b>	<b>Outstanding</b>
Voting or equity securities issued and outstanding	Unlimited Common Shares	89,160,738 Common Shares
Securities convertible or exercisable into voting or equity shares		a) Options to acquire up to 6,812,500 common shares b) Nil Warrants exercisable to acquire common shares of the Company

See note 15, 16 and 17 to the audited consolidated financial statements for the year ended December 31, 2013 and 2012 for more detailed disclosure of outstanding shares data.

**Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements.

**Financial Instruments and Other Instruments**

The Company's financial instruments consist of cash, amounts receivables, loan receivable, accounts payable and accrued liabilities, shareholder loans and loan payable. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments and that the fair values of these financial instruments approximate their carrying values.

**Dividends**

The Company has neither declared nor paid any dividends on its Common Shares. The Company intends to retain its earnings, if any, to finance growth and expand its operation and does not anticipate paying any dividends on its Common Shares in the foreseeable future.

**Assessment of Recoverability of Deferred Income Tax Assets**

In preparing the consolidated financial statements, the Company is required to estimate its income tax obligations. This process involves estimating the actual tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. The Company assesses, based on all available evidence, the likelihood that the deferred income tax assets will be recovered from future taxable income and, to the extent that recovery cannot be considered "more likely than not," a valuation allowance is established. If the valuation allowance is changed in a period, an expense or benefit must be included within the tax provision on the consolidated income statement.

**Estimate of Stock Based Compensation and Associated Assumptions**

The Company recorded stock-based compensation based on an estimate of the fair value on the grant date of stock options issued. This valuation required estimates of interest rate, life of options, stock price volatility and the application of the Black-Scholes option pricing model. See note 17 of the audited consolidated financial statements for the year ended December 31, 2013 and 2012 for a full disclosure.

**Assessment of Recoverability of Receivables**

The carrying amount of amounts receivable, are considered representative of their respective values. The Company assesses the likelihood that these receivables will be recovered and, to the extent that recovery is considered doubtful a provision for doubtful accounts is recorded.

## **CARRYING VALUE OF BALANCE SHEET ITEMS**

Deferred development costs of \$337,388 as at December 31, 2013 (December 31, 2012 - \$521,578) represent fuel marker and analyzing equipment technology development costs that have been deferred and are being amortized over 10 years (life of the technology rights) and three years (life of the equipment), respectively. As of December 31, 2013, the equipment has been fully amortized.

Technology rights that were purchased in connection with the acquisitions of GFI and Xenometrix have attributed values of \$7,844,267 and \$892,184, respectively. Technology rights assets relating to markers and detectors and XRF Systems are being amortized over their estimated useful lives on a straight-line basis of 10 years (ending in fiscal 2016) and seven years (ending in fiscal 2018), respectively. As at December 31, 2013, the carrying value of the technology rights is \$2,654,718 (December 31, 2012 - \$3,578,868).

Intellectual property that was purchased as part of the 100% acquisition of XwinSys has an attributed value of \$349,568. As at December 31, 2013, the carrying value of the intellectual property is \$349,568 (December 31, 2012 - \$349,568).

Total accounts payable, accrued liabilities, and shareholder loans amounted to \$2,327,309 as at December 31, 2013 (December 31, 2012 - \$3,041,202). The shareholder loans amounted to \$1,491,322 (December 31, 2012 - \$1,552,189) and are due to the former shareholders of GFI who advanced funds to GFI prior to its acquisition by the Company. The shareholder loans consist of two amounts:

- Principal of €500,000 (\$731,420) (December 31, 2012 - €500,000 (\$655,900)) and accrued interest of €380,567 (\$556,708) (December 31, 2012 - €320,059 (\$419,853)) loaned by the former shareholders of GFI in order to post the bid bond in a tender, managed by EMRA (Energy Market Regulatory Authority, a statutory regulatory entity of the Turkish Government). This portion of the shareholder loans is reimbursed by first priority from the earlier of (i) the results of the legal proceedings with EMRA, and/or (ii) the first income generated by GFI. This portion of the loans payable bears an annual interest rate of 7.2%.
- Principal of US\$850,000 (\$904,060) (December 31, 2012 - US\$850,000 (\$845,665)) and accrued interest of US\$376,607 (\$400,559) (December 31, 2012 - US\$364,118 (\$362,261)).

As at December 31, 2013, the Company repaid US\$1,035,563 (\$1,101,425) (December 31, 2012 - US\$735,239 (\$731,490)). This portion of the loans payable bears an annual interest rate of 5.0%.

## **LIQUIDITY AND CASH FLOWS**

The Company ended fiscal 2013 with cash of \$2,185,662, compared to \$1,582,030 as at December 31, 2012. The Company had working capital of \$1,015,751 as at December 31, 2013 compared to working capital of \$567,091 as at December 31, 2012.

Cash provided from operating activities was \$896,624 during the year ended December 31, 2013 compared to cash provided of \$206,591 during the year ended December 31, 2012. Changes to cash flows from operating activities primarily relate to higher sales revenues during the period.

Cash used in investing activities was \$94,463 during the year ended December 31, 2013 compared to the use of \$322,427 during the year ended December 31, 2012. Investing activities mainly relate to equipment and intangible asset acquisitions and disposals and loans.

Cash used in financing activities was \$309,275 during the year ended December 31, 2013 compared to cash used in financing activities of \$220,967 during the year ended December 31, 2012. Financing activities mainly relate to the repayment of the shareholder loans and financings through private placements. The decrease is due to repayments of shareholder loans made during the year ended



December 31, 2013 of \$309,275 compared to repayments made during the year ended December 31, 2012 of \$201,053.

Due to continuing operating losses, the Company's continuance as a going concern is dependent upon its ability to obtain profitable levels of operation. It is not possible to predict if the Company will attain profitable levels of operations.

In the financial periods ended December 31, 2013 and for several annual financial periods, the Company has posted net losses. Management of the Company expects that the Company's revenue from operations, together with its existing cash and other current assets, will be adequate to meet its short-term working capital requirements during the next twelve months

## TRANSACTIONS WITH RELATED PARTIES

### Shareholder loans

For the year ended December 31, 2013 \$97,371 (2012 - \$96,792) in interest was charged on the shareholder loans as described in note 14 of the audited consolidated financial statements for the years ended December 31, 2013 and 2012.

### Compensation of key management personnel of the Company

The remuneration of directors and other members of key management personnel during the year were as follows:

<b>For the years ended December 31,</b>	2013	2012
Short-term compensation and benefits	\$ 669,830	\$ 623,310
Share-based payments	126,000	-
	<b>\$ 795,830</b>	<b>\$ 623,310</b>

As at December 31, 2013, an amount of \$101,762 (December 31, 2012 - \$nil) due to members of key management personnel, was included in accounts payable and accrued liabilities. This amount is unsecured, non-interest bearing and without fixed terms of repayment.

In accordance with IAS 24, key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company directly or indirectly, including any directors (executive and non-executive) of the Company.

The remuneration of directors and key executives is determined by the compensation committee.

## ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of consolidated financial statements in conformity with IFRS requires the Company's management to make judgments, estimates and assumptions about future events that affect the amounts reported in the consolidated financial statements and related notes to the financial statements. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may differ from those estimates. The areas which require management to make significant judgments, estimates and assumptions in determining carrying values include, but are not limited to:

- **Assets' carrying values and impairment charges** - In the determination of carrying values and impairment charges, management looks at the higher of the recoverable amount or fair value less costs to sell in the case of assets and at objective evidence, significant or prolonged decline of fair value on financial assets indicating impairment. These determinations and their individual assumptions require that management make a decision based on the best available information at each reporting period.

- **Impairment of technology rights, deferred development and intellectual property assets** - While assessing whether any indications of impairment exist for technology rights, deferred development costs and intellectual property asset, consideration is given to both external and internal sources of information. Information the Company considers include changes in the market, economic and legal environment in which the Company operates that are not within its control and affect the recoverable of such assets. Internal sources of information include the manner in which technology rights and deferred development assets are being used or are expected to be used and indications of expected economic performance of the assets. Estimates include but are not limited to estimates of the discounted future after-tax cash flows expected to be derived from the Company's technology rights, deferred development and intellectual property assets, costs to sell the assets and the appropriate discount rate.
- **Share-Based Payments** – The Company determines costs for share-based payments using market-based valuation techniques. The fair value of the market-based and performance-based non-vested share awards are determined at the date of grant using generally accepted valuation techniques. Assumptions are made and judgment used in applying valuation techniques. These assumptions and judgments include estimating the future volatility of the stock price, expected dividend yield, future employee turnover rates and future employee stock option exercise behaviors and corporate performance. Such judgments and assumptions are inherently uncertain. Changes in these assumptions affect the fair value estimates.
- **Income taxes** - The Company must make significant estimates in respect of the provision for income taxes and the composition of its deferred income tax assets and deferred income tax liabilities. The Company's operations are, in part, subject to foreign tax laws where interpretations, regulations and legislation are complex and continually changing. As a result, there are usually some tax matters in question which may, on resolution in the future, result in adjustments to the amount of deferred income tax assets and deferred income tax liabilities, and those adjustments may be material to the Company's financial position and results of operations.
- **Functional currency determination** - The functional currency for the Company and its subsidiaries is the currency of the primary economic environment in which the entity operates. Determination of functional currency is conducted through an analysis of the consideration factors identified in IAS 21 The Effects of Changes in Foreign Exchange Rates and may involve certain judgments to determine the primary economic environment. The Corporation reconsiders the functional currency of its entities if there is a change in events and conditions which determine the primary economic environment. Significant changes to those underlying factors could cause a change to the functional currency.

## **RISKS AND UNCERTAINTIES**

The Company's Board of Directors has overall responsibility for the oversight of the Company's risk management policies. In carrying on its business, the Company is exposed to a variety of risks, including the risks described elsewhere in this MD&A. The Company can neither predict nor identify all such risks nor can it accurately predict the impact, if any, of such risks on its business, operations or the extent to which one or more risks or events may materially change future results of financial position from those reported or projected in any forward looking statements. Accordingly the Company cautions the reader not to rely on reported financial information and forward looking statements to predict actual future results. This MD&A and the accompanying financial information should be read in conjunction with this statement concerning risks and uncertainties. Some of the risks, uncertainties and events that may affect the Company, its business, operations, and results, are given in this section. However, the factors and uncertainties are not limited to those stated. The Company has policies and practices mandated by the

Board of Directors to manage the Company's risks which include the risks described elsewhere in this MD&A and below.

The Company's ability to continue to generate revenue and achieve positive cash flow in the future is dependent upon various factors, including the level of market acceptance of its products, the degree of competition encountered by the Company, technology risks, general economic conditions, and the stability of foreign governments and regulatory requirements. Moreover, it is also possible that new competitors will enter the marketplace. The Company's future performance depends in part upon attracting and retaining key technical, sales and management personnel. There can be no assurance that the Company can retain these personnel. As such, these new competitors and the loss of the services of the Company's key employees could potentially have a material adverse effect on the Company's business, operating results and financial condition.

### **COMMITMENTS AND CONTINGENCIES**

In January 2012, a lawsuit for approximately US\$100,000 was filed against the Company by a supplier for services it alleges were received by the Company but not paid for. In the opinion of management, this lawsuit has no merit and the ultimate disposition of this lawsuit will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows. As a result, this amount has not been reflected in the consolidated financial statements.

The Company is party to certain management contracts. These contracts require that payments of up to approximately \$162,000 be made upon the occurrence of certain events such as a change of control. As a triggering event has not taken place, the contingent payments have not been reflected in these consolidated financial statements. Additional minimum management contractual commitments remaining under these contracts approximate \$253,000 due within one year.

### **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

The Company's financial instruments consist of cash, amounts receivables, loan receivable, accounts payable and accrued liabilities, shareholder loans and loan payable. In the opinion of management of the Company, the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments and the fair values of these financial instruments approximate their carrying values. As at December 31, 2013, there were no significant concentrations of credit risk for loans as the Company currently transacts with highly rated counterparties. The carrying amount reflected above represents the Company's exposure to credit risk for such loans and receivables. In the opinion of management of the Company, as at December 31, 2013, the Company did not hold financial instruments recorded at fair value that would require classification within the fair value hierarchy.

The carrying value of cash, amounts receivable, loan receivable, accounts payable, accrued liabilities and loans classified as long term approximate fair value because of the limited terms of these instruments. It is not possible to determine if the shareholder loans are at fair value as there is no comparable market value for such loans.

The Company's risk exposure and the impact on the Company's financial instruments are summarized below. There have been no changes in the risks, objectives, policies and procedures from the previous reporting period.

#### **Credit risk**

The Company's credit risk is primarily attributable to cash and amounts receivable. Financial instruments included in amounts receivable consist primarily of receivables due from customers. The Company currently transacts with highly rated counterparties for the sale of its marking systems. Management believes that the credit risk concentration with respect to these financial instruments is minimal.

### Liquidity risk

Liquidity risk is the risk that the Company will not have sufficient cash resources to meet its financial obligations as they come due. The Company's liquidity and operating results may be adversely affected if the Company's access to the capital market is hindered, whether as a result of a downturn in stock market conditions generally or related to matters specific to the Company. The Company generates cash flow primarily from its operating activities. As at December 31, 2013, the Company had current assets of \$3,343,060 (December 31, 2012 - \$3,294,199) to settle current liabilities of \$2,327,309 (December 31, 2012 - \$3,041,202). This amount includes \$1,491,322 (December 31, 2012 - \$1,552,189) in shareholder loans (note 14 of the audited consolidated financial statements for the years ended December 31, 2013 and 2012).

All of the Company's financial liabilities have contractual maturities of less than 365 days and are subject to normal trade terms. The Company currently has sufficient cash flow to meet its operating obligations however current cash levels would require the Company to seek alternative capital in the event the shareholder loans become due.

### Market risk

#### (a) Interest rate risk

The Company carries shareholder loans with interest and repayment terms as described in note 14 of the audited consolidated financial statements for the years ended December 31, 2013 and 2012. Management believes that interest rate risk is remote as the Company currently does not carry interest-bearing debt at floating rates.

#### (b) Foreign currency risk

The functional and reporting currency of the Company is the Canadian dollar. The Company undertakes transactions denominated in foreign currencies, including US dollars and Euros, and as such is exposed to price risk due to fluctuations in foreign exchange rates against the Canadian dollar. The Company does not use derivative instruments to reduce exposure to foreign exchange risk.

The exposure of the Company's financial assets and liabilities to foreign currency risk as at December 31, 2013 is as follows:

	CDN Dollar	US Dollar	Euro	Total (in CDN dollars)
<b>Financial assets</b>				
Cash	\$ 17,637	\$ 2,168,025	\$ -	\$ 2,185,662
Amounts receivable	-	\$ 583,698	-	583,698
Loan receivable	-	\$ 322,807	-	322,807
	<b>\$ 17,637</b>	<b>\$ 3,074,530</b>	<b>\$ -</b>	<b>\$ 3,092,167</b>
<b>Financial liabilities</b>				
Accounts payable and accrued liabilities	\$ 75,607	\$ 760,380	\$ -	\$ 835,987
Shareholder loans	-	186,703	1,304,619	1,491,322
Loan	-	22,749	-	22,749
	<b>\$ 75,607</b>	<b>\$ 969,832</b>	<b>\$ 1,304,619</b>	<b>\$ 2,350,058</b>

A 10% change in foreign exchange rates between the Canadian dollar and these foreign currencies over the next year would affect net loss by approximately \$119,000 (December 31, 2012 - \$51,000) based on the foreign currency balances at December 31, 2013.

#### (c) Price risk

The Company is engaged in the development and implementation of marking systems for various types of oil. As a result, the Company is exposed to price risk with respect to commodity prices, specifically oil. The Company closely monitors commodity prices to determine the appropriate course of action to be taken by the Company. The Company's future operations would be negatively affected by a significant

decrease in the market prices for oil. Oil prices fluctuate on a daily basis and are affected by numerous factors beyond the Company's control. The supply and demand for oil, the level of interest rates, the rate of inflation, investment decisions by large holders of oil, and stability of exchange rates can all cause significant fluctuations in oil prices. Such external economic factors are in turn influenced by changes in international investment patterns, and monetary systems and political developments.

*(d) Political risk*

The Company operates mainly in Israel and Africa, and such operations are exposed to various levels of political, economic, and other risk and uncertainties. These risks and uncertainties include, but are not limited to: terrorism, hostage taking, fluctuation in currency exchange rates, high rates of inflation, labour unrest, the risks of civil unrest, renegotiation or nullification of existing agreements, licenses, permits and contracts, restrictions on foreign exchange and repatriation, and changing political conditions, currency controls, and government regulations that favour or require the awarding of contracts to local contractors or require foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction.

**Fair value**

The Company has designated cash and amounts receivable classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and shareholder loans are classified as other financial liabilities, which are measured at amortized cost.

The carrying value of cash, amounts receivable, and accounts payable and accrued liabilities approximates fair value because of the limited term of these instruments.

It is not possible to determine if the shareholder loans are at fair value as there is no comparable market value for such loans.

**CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION**

The Company has adopted the following new standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

IFRS 7 — Financial Instruments: Disclosures (“IFRS 7”) was amended by the IASB in December 2011 to amend the disclosure requirements in IFRS 7 to require information about all recognised financial instruments that are offset in accordance with paragraph 42 of IAS 32 Financial Instruments: Presentation. The amendments also require disclosure of information about recognised financial instruments subject to enforceable master netting arrangements and similar agreements even if they are not set off under IAS 32. The adoption of this standard did not result in any changes to the Company's disclosure of its financial instruments.

IFRS 10 – Consolidated Financial Statements (“IFRS 10”) was issued by the IASB in May 2011 and will replace IAS 27 Consolidated and Separate Financial Statements and SIC 12 Consolidation – Special Purpose Entities. IFRS 10 is a new standard which identifies the concept of control as the determining factor in assessing whether an entity should be included in the consolidated financial statements of the parent company. Control is comprised of three elements: power over an investee; exposure, or rights, to variable returns from involvement with the investee; and the ability to use power over the investee to affect returns. The adoption of this standard did not result in any changes in the consolidation status of the Company's subsidiaries.

IFRS 11 – Joint Arrangements (“IFRS 11”) was issued by the IASB in May 2011 and will replace IAS 31 Interest in Joint Ventures and SIC 13 Jointly Controlled Entities – Non-Monetary Contributions by Venturers. IFRS 11 is a new standard which focuses on classifying joint arrangements by their rights and obligations rather than their legal form. Entities are classified into two groups: joint operations and joint ventures. A joint operation exists when the parties have rights to the assets and obligations for the

liabilities of a joint arrangement. A joint venture exists when the parties have rights to the net assets of a joint arrangement. Assets, liabilities, revenues and expenses in a joint operation are accounted for in accordance with the arrangement. Joint ventures are accounted for using the equity method. The adoption of this standard did not result in any changes to the Company's investments in joint ventures.

IFRS 12 – Disclosure of Interests in Other Entities (“IFRS 12”) was issued by the IASB in May 2011. IFRS 12 is a new standard which provides disclosure requirements for entities reporting interests in other entities, including joint arrangements, special purpose vehicles and off balance sheet vehicles. The adoption of this standard did not result in any changes to the Company's disclosure requirements for interests in other entities.

IFRS 13 – Fair Value Measurement (“IFRS 13”) was issued by the IASB in May 2011. IFRS 13 is a new standard which provides a precise definition of fair value and a single source of fair value measurement considerations for use across IFRS. IFRS 13 clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. It also establishes disclosures about fair value measurement. The adoption of this standard did not result in any significant changes to the Company's disclosures of its financial instruments.

IAS 1 – Presentation of Financial Statements (“IAS 1”) was amended by the IASB in June 2011. As a result of the amendment, items in other comprehensive income will be required to be presented in two categories: items that will be reclassified into profit or loss and those that will not be reclassified. The flexibility to present a statement of comprehensive income as one statement or two separate statements of profit and loss and other comprehensive income remains unchanged. The adoption of this standard has not resulted in any disclosure requirements as the Company's net loss is equal to the Company's comprehensive loss.

#### *Accounting Standards issued but not yet applied*

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the IASB or IFRIC that are mandatory for accounting periods beginning after January 1, 2013 or later periods. The standards impacted that are applicable to the Company are as follows:

IFRS 9 – Financial Instruments (“IFRS 9”) was issued by the IASB in November 2009 with additions in October 2010 and May 2013 and will replace IAS 39 Financial Instruments: Recognition and Measurement (“IAS 39”). 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, except that an entity choosing to measure a financial liability at fair value will present the portion of any change in its fair value due to changes in the entity's own credit risk in other comprehensive income, rather than within profit or loss. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2018.

IAS 32, *Financial Instruments, Presentation* – In December 2011, effective for annual periods beginning on or after January 1, 2014, IAS 32 was amended to clarify the requirements for offsetting financial assets and liabilities. The amendments clarify that the right of offset must be available on the current date and cannot be contingent on a future date.

IAS 36 – Impairments of Assets (“IAS 36”) was amended by the IASB in May 2013 to clarify the requirements to disclose the recoverable amounts of impaired assets and require additional disclosures about the measurement of impaired assets when the recoverable amount is based on fair value less costs of disposal, including the discount rate when a present value technique is used to measure the

recoverable amount. The amendments to IAS 36 are effective for annual periods beginning on or after January 1, 2014.

IAS 39 – Financial Instruments: Recognition and Measurement (“IAS 39”) was amended by the IASB in June 2013 to clarify that novation of a hedging derivative to a clearing counterparty as a consequence of laws or regulations or the introduction of laws or regulations does not terminate hedge accounting. The amendments to IAS 39 are effective for annual periods beginning on or after January 1, 2014. Earlier adoption is permitted.

IFRIC 21 – Levies (“IFRIC 21”) was issued in May 2013. IFRIC 21 provides guidance on the accounting for levies within the scope of IAS 37 – Provisions, Contingent Liabilities and Contingent Assets (“IAS 37”). IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (“obligating event”). IFRIC 21 clarifies that the obligating event 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. IFRIC 21 is effective for annual periods commencing on or after January 1, 2014. Earlier adoption is permitted.

### **Management’s responsibility**

Management is responsible for all information contained in this report. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and include amounts based on management’s informed judgments and estimates. The financial and operating information included in this report is consistent with that contained in the consolidated financial statements in all material aspects.

Management maintains internal controls to provide reasonable assurance that financial information is reliable and accurate and assets are safeguarded.

The Audit Committee has reviewed the consolidated financial statements with management. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.

April 23, 2013

W. Bruce Rowlands  
Chairman, President and Chief Executive Officer