# California Nanotechnologies Corp.

## Consolidated Financial Statements

For the years ended February 28, 2014 and 2013
(in United States Dollars)

**Contents**


| | |
|---|---|
| **Management Report** | **2** |
| **Auditors' Report** | **3** |
| **Consolidated Financial Statements** | |
| **Statements of Financial Position** | **4** |
| **Statements of Loss and Comprehensive Loss** | **5** |
| **Statements of Changes in Equity** | **6** |
| **Statements of Cash Flows** | **7** |
| **Notes to Consolidated financial statements** | **8 - 24** |

The consolidated financial statements of California Nanotechnologies Corp. and its subsidiaries (the "Company") are the responsibility of management and have been reviewed and approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. The consolidated financial statements include items that are based on best estimates and judgments of the expected effects of current events and transactions. Management has determined such items on a reasonable basis in order to ensure that the consolidated financial statements are presented fairly in all material respects.

The Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have designed disclosure controls and procedures and internal controls over financial reporting, or have caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Company has been made known to them; and information required to be disclosed in the Company's filings is recorded, processed, summarized and reported within the time periods specified in securities legislation. The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements. The Board of Directors carries out this responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board of Directors, with a majority of its members being outside directors. The Audit Committee meets periodically with management, as well as with the external auditors, to review the consolidated financial statements, external auditors' report, MD&A, auditing matters and financial reporting issues, to discuss internal controls over the financial reporting process, and to satisfy itself that each party is properly discharging its responsibilities. In addition, the Audit Committee has the duty to review the appropriateness of the accounting policies and significant estimates and judgments underlying the consolidated financial statements as presented by management, and to review and make recommendations to the Board of Directors with respect to the independence and the fees of the external auditors. The Audit Committee reports its findings to the Board of Directors for its consideration when it approves the consolidated financial statements and MD&A for issuance to shareholders.

The consolidated financial statements have been audited by MNP LLP, the external auditors, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders. The external auditors have full and free access to the Audit Committee to discuss their audit and related matters.

*signed "Christopher T. Melnyk"*
Christopher T. Melnyk
CEO

*signed "Andrew S. Bengis"*
Andrew S. Bengis
CFO

June 26, 2014

## To the Shareholders of California Nanotechnologies Corp.:

We have audited the accompanying consolidated financial statements of California Nanotechnologies Corp. and its subsidiaries, which comprise the statements of financial position as at February 28, 2014 and 2013, and the consolidated statements of loss and comprehensive loss, changes in equity, and cash flows for the years then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

Auditors' Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes assessing the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of California Nanotechnologies Corp. and its subsidiaries as at February 28, 2014 and 2013, and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards

Emphasis of Matter
Without qualifying our opinion, we draw attention to Note 2 in the financial statements which discusses the Company's ability to continue as a going concern. California Nanotechnologies Corp. has a net and comprehensive loss for the year of $302,365 accumulated losses of $3,493,599 and negative cash flows from operations of $267,923. These conditions indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern.

MNP LLP
Chartered Accountants

Calgary, Alberta
June 26, 2014

## California Nanotechnologies Corp.
### Consolidated Statements of Financial Position
### United States Dollars

| As at | Note | **February 28, 2014** | February 28, 2013 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash | | **$ 4,234** | $ 5,235 |
| Accounts receivable | **15** | **129,847** | 23,550 |
| Prepaid expenses and deposits | | **9,226** | 33,583 |
| **Total current assets** | | **143,307** | 62,368 |
| Equipment | **6** | **68,464** | 139,968 |
| Intangible assets | **7** | **92,223** | 105,339 |
| Investment | **8** | **-** | 250,000 |
| **Total assets** | | **$ 303,994** | $ 557,675 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities | | **$ 74,447** | $ 62,847 |
| Income taxes payable | | **800** | - |
| Advances from related parties | **4** | **1,167,980** | 1,145,424 |
| **Total current liabilities** | | **1,243,227** | 1,208,271 |
| Going concern | **2** | | |
| **Shareholders' equity** | | | |
| Share capital | **11** | **2,386,148** | 2,386,148 |
| Contributed surplus | **14** | **168,218** | 154,490 |
| Deficit | | **(3,493,599)** | (3,191,234) |
| **Total shareholders' equity** | | **(939,233)** | (650,596) |
| **Total liabilities and shareholders' equity** | | **$ 303,994** | $ 557,675 |

*"signed"Roger Dent*
**Director**

*"signed" Christopher Melnyk*
**Director**

*The accompanying notes are an integral part of these consolidated financial statements*

## California Nanotechnologies Corp
### Consolidated Statements of Loss and Comprehensive Loss
### United States Dollars
***For the years ended February 28,***

| | Note | 2014 | 2013 |
|---|---|---|---|
| **Revenue** | | **$ 373,481** | $ 261,302 |
| **Cost of goods sold** | | **48,636** | 34,966 |
| **Gross margin** | | **324,845** | 226,336 |
| **Expenses** | | | |
| Advertising and promotion | | **19,655** | 10,624 |
| Amortization and depreciation - equipment and intangible assets | **6, 7** | **90,254** | 142,523 |
| Impairment | **5, 7** | **-** | 4,350 |
| Bad debt | **15** | **-** | 15,253 |
| Consulting | | **24,235** | - |
| Office | | **38,281** | 28,478 |
| Professional fees | | **49,707** | 62,308 |
| Repairs and maintenance | | **21,254** | 4,909 |
| Research | | **66,795** | 93,473 |
| Salaries, wages and benefits | | **213,256** | 206,496 |
| Supplies | | **73,397** | 88,763 |
| Travel and entertainment | | **8,599** | 5,141 |
| Share-based compensation | **11(c), 14** | **13,728** | 42,054 |
| | | **619,161** | 704,372 |
| **Loss from operations** | | **(294,316)** | (478,036) |
| Foreign exchange loss | | **(150)** | (799) |
| Interest expense | | **(9,699)** | (52,087) |
| Interest income | | **2,600** | - |
| **Loss before income taxes** | | **(301,565)** | (530,922) |
| **Provision for income taxes** | **9** | **800** | 889 |
| **Net loss and comprehensive loss** | | **$ (302,365)** | $ (531,811) |
| **Loss per share - basic** | **13** | **$ (0.01)** | $ (0.02) |
| **- diluted** | **13** | **(0.01)** | (0.02) |
| **Weighted average shares outstanding - basic** | **13** | **25,820,000** | 25,820,000 |
| **- diluted** | **13** | **25,820,000** | 25,820,000 |

*The accompanying notes are an integral part of these consolidated financial statements*

## California Nanotechnologies Corp.
### Consolidated Statements of Changes in Equity
### United States Dollars
*For the years ended February 28*

| | Note | Share capital | Contributed surplus | Deficit | Total |
|---|---|---|---|---|---|
| Balance at February 29, 2012 | | $ 2,386,148 | $ 112,436 | $ (2,659,423) | $ (160,839) |
| Share-based compensation | 14 | - | 42,054 | - | 42,054 |
| Net loss and comprehensive loss | | - | - | (531,811) | (531,811) |
| **Balance at February 28, 2013** | | **$ 2,386,148** | **$ 154,490** | **$ (3,191,234)** | **$ (650,596)** |
| **Share-based compensation** | **14** | **-** | **13,728** | **-** | **13,728** |
| **Net loss and comprehensive loss** | | **-** | **-** | **(302,365)** | **(302,365)** |
| **Balance at February 28, 2014** | | **$ 2,386,148** | **$ 168,218** | **$ (3,493,599)** | **$ (939,233)** |

*The accompanying notes are an integral part of these consolidated financial statements*

## California Nanotechnologies Corp.
### Consolidated Statements of Cash Flows
### United States Dollars
***For the years ended February 28,***

| | Note | **2014** | 2013 |
|---|---|---|---|
| **Cash provided by (used for) the following activities** | | | |
| **Operating activities** | | | |
| Net loss | | **$ (302,365)** | $ (531,811) |
| Amortization and depreciation - equipment and intangible assets | **7,8** | **90,254** | 142,523 |
| Bad debt | **15** | **-** | 15,253 |
| Impairment | **5, 7** | **-** | 4,350 |
| Share-based compensation | **14** | **13,728** | 42,054 |
| | | **(198,383)** | (327,631) |
| Changes in working capital accounts | | | |
| Accounts receivable | | **(106,297)** | (26,541) |
| Prepaid expenses and deposits | | **24,357** | (29,769) |
| Income taxes payable | | **800** | (800) |
| Accounts payable and accrued liabilities | | **11,600** | (5,045) |
| **Net cash used for operating activities** | | **(267,923)** | (389,786) |
| **Financing activities** | | | |
| Payments to related parties | | **(268,868)** | (75,080) |
| Advances from related parties | **4** | **291,424** | 456,004 |
| **Net cash provided by financing activities** | | **22,556** | 380,924 |
| **Investing activities** | | | |
| Purchases of equipment | **6** | **(5,634)** | (8,520) |
| Purchases of intangibles | **7** | **-** | (4,350) |
| Proceeds from disposal of Investment | **8** | **250,000** | - |
| **Net cash provided by (used for) investing activities** | | **244,366** | (12,870) |
| **Decrease in cash resources** | | **(1,001)** | (21,732) |
| **Cash, beginning of year** | | **5,235** | 26,967 |
| **Cash, end of year** | | **$ 4,234** | $ 5,235 |

*The accompanying notes are an integral part of these consolidated financial statements*

## 1. Incorporation and operations

Veritek Technologies Inc. was incorporated under the laws of the Province of Alberta on May 19, 2002. On February 1, 2007, the Company changed its name to California Nanotechnologies Corp. (the "Company") in connection with the reverse takeover with California Nanotechnologies Inc. The consolidated financial statements of the Company for the year ended February 28, 2014 include the accounts of the Company and its wholly-owned subsidiaries. The consolidated financial statements were authorized for issue by the Board of Directors on June 26, 2014. Its head office, research and development, and production operations are located at 17220 Edwards Road, Cerritos, California, U.S.A, 90703. A corporate, registered office is located at #1600, 205 - 5th Avenue S.W., Calgary, Alberta T2P 2V7. Since the date of the reverse takeover, the Company has been devoted to the development of nanocrystalline materials through grain size reduction. The advantages of these materials include improved strength and stability. The Company's target markets are Aerospace, Defense, Automotive, Medical and Sports and Recreation. Since the most significant portion of the Company's operations is located in the United States and its functional currency is denominated in United States dollars, these consolidated financial statements are presented in United States dollars.

## 2. Going concern

These consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due.

The Company has a net loss for the year of $302,365 (2013 - $531,811) and negative cash flows from operating activities of $267,923 (2013 – $389,786). In addition, the Company has an accumulated deficit of $3,493,599 (2013 - $3,191,234). These conditions indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern.

The Company's ability to continue as a going concern is dependent upon its ability to attain profitable operations and generate funds therefrom, and to continue to obtain equity investment and borrowings sufficient to meet current and future obligations and/or restructure the existing debt and payables. These consolidated financial statements do not reflect the adjustments or reclassification of assets and liabilities which would be necessary if the Company were unable to continue its operations.

## 3. Significant accounting policies

These consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC") in effect at February 28, 2014. The principal accounting policies are set out below.

Any standards and interpretations that have been issued but are not yet effective, and that are available for early application, have not been applied to the Company in these consolidated financial statements. Application of the majority of these standards and interpretations is not expected to have a material effect on the consolidated financial statements in the future.

The preparation of consolidated financial statements requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

## 3. Significant accounting policies – continued

(a) Consolidation

The Company has consolidated the assets, liabilities, revenues and expenses of the subsidiaries after the elimination of intercompany transactions and balances. These consolidated financial statements include the accounts of the Company, and its wholly owned subsidiaries, California Nanotechnologies Inc. and White Roof Solutions, Inc.

(b) Basis of measurement

These consolidated financial statements have been prepared on a going concern basis, using the historical cost convention except for share-based payments and financial assets classified as fair value through profit or loss or available for sale which are measured at fair value. In addition, they have been prepared on an accrual basis of accounting except for cash flow information.

(c) Revenue recognition

Revenue is recognized when goods are shipped or services provided to the customer, significant contractual obligations have been satisfied, and collection of the resulting receivable is reasonably assured. The Company recognizes revenue and profits from contracts on the percentage of completion basis, and accordingly costs are expensed as incurred and revenue is recognized only to the extent of contract costs incurred that will be recoverable. Expected losses are recognized immediately when it is probable that total contract costs will exceed total contract revenue. Revenue on investments is recognized on an accrual basis.

(d) Cash

Cash includes balances with banks. Bank borrowings are considered to be financing activities. Any bank indebtedness is covered with the Company's overdraft protection in the amount of $30,000.

(e) Business combinations

The Company uses the acquisition method of accounting to account for business combinations. The consideration transferred is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Company. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

(f) Equipment

Equipment is carried at historical cost less accumulated depreciation. Depreciation is provided using the straight line method and is calculated over the estimated useful life of the assets, which has been estimated as seven years for nanotechnology equipment and three years for roof coating equipment. Borrowing costs are capitalized that are directly attributable to the acquisition of equipment. The Company reviews the criteria for capitalization and the useful life of its equipment on an on-going basis considering changes in circumstances.

When the cost of a part of an item of equipment is significant in relation to the total cost of an item and the items have different useful lives, they are accounted for as separate items (significant components) of equipment. The costs of day-to-day servicing of equipment are recognized in direct operating expenses. Gains and losses on disposal of an item of equipment is determined by comparing the proceeds from disposal with the carrying amount of equipment, and are recognized net within other (income) expense in the consolidated statements of loss and comprehensive loss. Depreciation methods, useful lives and residual values are reviewed at the end of each reporting period and adjusted if appropriate.

**3. Significant accounting policies – continued**

(g) Intangible assets
Intangible assets are comprised of intellectual property, customer relationships, trade secrets, use of operating rights and contract intangibles. Intangible assets are recorded at cost less any accumulated amortization and/or impairment losses. Intangible assets are amortized on a straight-line basis over their estimated useful life of 15 years and are assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization method and amortization period of an intangible asset is reviewed at least annually.

(h) Impairment of non-financial assets excluding goodwill
The Company assesses, at the end of each reporting period, whether there is an indication that an asset group may be impaired. If any indication of impairment exists, the Company estimates the recoverable amount of the asset group. External triggering events include, for example, changes in customer or industry dynamics, other technologies and economic declines. Internal triggering events for impairment include lower profitability or planned restructuring. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets, cash generating units (“CGU”).

If the carrying amount of the asset, or its respective CGU, exceeds its estimated recoverable amount, the difference is recognized as an impairment charge. The Company’s corporate assets, which do not generate separate cash inflows, are allocated to the CGUs on a reasonable basis for impairment testing purposes.

The Company’s impairment tests compare the carrying amount of the asset or CGU to its recoverable amount. The recoverable amount is the higher of fair value less costs to sell (“FVLCS”) and value in use (“VIU”). FVLCS is the amount obtainable from the sale of an asset or CGU in an arm’s length transaction of similar assets or observable market prices, less the costs of disposal. The determination of VIU requires the estimation and discounting of cash flows which involves key assumptions that consider all information available on the respective testing date. Management uses its judgment, considering past and actual performance as well as expected developments in the respective markets and in the overall macro-economic environment and economic trends to model and discount future cash flows.

(i) Goodwill
Goodwill represents the excess of the purchase price over the fair value of net assets acquired and liabilities assumed in a business combination. Goodwill is not amortized but is reviewed for impairment at least annually. For the purpose of impairment testing, goodwill is allocated to each of the Company’s CGU’s expected to benefit from the synergies of the combination. CGU’s to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the CGU may be impaired. If the recoverable amount of the CGU is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the CGU. An impairment loss recognized for goodwill is not reversed in a subsequent period.

(j) Provisions
Provisions cover risks resulting from legal disputes and proceedings. In order to determine the amount of the provisions, the facts related to each case, the size of the claim, awards in similar cases, the expected timing of such possible awards, insurance coverage and deductibles and independent expert advice are considered along with assumptions regarding the probability of a successful claim and the range of possible awards. The actual costs can deviate from these estimates.

**3. Significant accounting policies – continued**

(j) Provisions - continued

A provision is recognized in the consolidated financial statements when the Company has a material obligation, whether existing or potential, as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the obligation is determined to be material, then the estimated amount of the provision is determined by discounting the expected future cash outflows. At February 28, 2014 and February 28, 2013 there were no provisions recognized in the consolidated financial statements.

(k) Income taxes

Income tax expense for the year consists of current and deferred tax. Deferred tax is recognized in the consolidated statement of loss and comprehensive loss, except to the extent that it relates to a business combination or items recognized in other comprehensive loss ("OCL") or directly in equity.

Taxable income differs from income as reported in the consolidated statements of loss and comprehensive loss. As a result, current tax is the expected tax due on taxable income less adjustments to prior periods using tax rates enacted, or substantively enacted as at the reporting date in jurisdictions where the Company operates.

In general, deferred taxes are recognized based on temporary differences arising between the tax value of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax liabilities are not recognized and are not accounted for if they arise from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable income. Deferred taxes are calculated on the basis of the tax laws enacted or substantively enacted as at the reporting date and apply to when the related deferred tax asset is realized or the deferred tax liability is settled.

Current and deferred tax assets and liabilities are offset when there is a legally enforceable right to settle on a net basis and when such assets and liabilities relate to income taxes imposed by the same taxation authority.

(l) Foreign exchange

These consolidated financial statements have been presented in United States (U.S.) dollars, the functional currency of the Company's operations. Monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the foreign exchange rate in effect at the statement of financial position date. Revenue and expense transactions in foreign currencies are translated to the appropriate functional currency at the foreign exchange rate on the date of the transaction with all consequential exchange differences recognized in net loss.

Non-monetary assets that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transactions. All resulting exchange differences from translation of the functional currency into a different reporting currency are recognized as a separate component of other comprehensive loss.

(m) Significant accounting estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and judgments that affect the reported amounts of revenues, expenses, assets and liabilities and the disclosure of contingent assets and liabilities at the reporting date. On an ongoing basis, management evaluates its judgments and estimates in relation to revenue, expenses, assets and liabilities. Management uses historical experience and various other factors it believes to be reasonable under the given circumstances as the basis for its judgments and estimates. Actual outcomes may differ from these estimates under different assumptions and conditions.

## 3. Significant accounting policies – continued

(m) Significant accounting estimates and judgments- continued

The following are the most significant accounting judgments and estimates made by the Company in applying accounting policies:

**Judgments**

Determining cash generating units ("CGU's")

For the purpose of assessing impairment of tangible and intangible assets, assets are grouped at the lowest level of separately identified cash flows which make up the CGU. Determination of what constitutes a CGU is subject to management judgment. The asset composition of a CGU can directly impact the recoverability of assets included within the CGU. In assessing the recoverability of tangible and intangible assets, each CGU's carrying value is compared to the greater of its fair value less costs to sell and value in use.

Deferred taxes

Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable earnings will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable earnings together with future tax planning strategies.

**Estimates**

Valuation of accounts receivables

Accounts receivable are reviewed on a regular basis to estimate recoverability of balances. Accounts receivable are stated after evaluation as to their collectability and an appropriate allowance for doubtful accounts is provided where considered necessary.

Business combinations

Business combinations have been accounted for using the acquisition method of accounting. Under the acquisition method, the acquiring company adds to its statement of financial position the estimated fair values of the acquired assets and liabilities. There are various assumptions made when determining the fair values of the assets and liabilities acquired. The most significant assumptions and those requiring the most judgment involve the estimated fair value of intangible assets.

Share-based payments

The Corporation uses an option pricing model to determine the fair value of share-based payments. Inputs to the model are subject to various estimates about volatility, interest rates, dividend yields, forfeiture rates and expected life of the units issued. Fair value inputs are subject to market factors as well as internal estimates. The Company considers historic trends together with any new information to determine the best estimate of fair value at the date of grant.

Depreciation and amortization

The consolidated financial statements include estimates of the useful economic life of equipment and intangibles. Due to varying assumptions required to be made with regards to future recoverability of these assets, the depreciation and amortization recorded by management is based on their best estimate in this regard and may be significantly different from those determined based on future operational results.

**3. Significant accounting policies – continued**

(n) Share-based compensation plan

The Company provides equity-settled share-based payments in the form of a share option plan to its employees, officers, directors and consultants. The Company accounts for these share options using the fair value method of accounting for share-based compensation expense. Under this method, the associated compensation expense is charged to net loss with a corresponding increase to contributed surplus less an estimated forfeiture rate over each vesting period (tranches) of the options granted. The forfeiture rate is based on past experience of actual forfeitures. Each tranche is treated as a separate share option grant, and subsequently valued at the start of each tranche's vesting period.

Share-based compensation transactions with non-employees are measured at the fair value of the goods or services recovered. However, if the fair value cannot be estimated reliably, the share-based compensation transaction is measured at the fair value of the equity instruments granted at the date the non-employee provides the goods or services.

(o) Per share amounts

Basic loss per share is calculated using the weighted average number of shares outstanding during the period. The Company follows the treasury stock method for the computation of diluted per share amounts. This method assumes the proceeds from the exercise of dilutive options and warrants are used to purchase common shares at the weighted average market price during the period.

(p) Research and development expenses

Expenses related to research and development activities that do not meet generally accepted criteria for deferral are expensed as incurred, net of related tax credits and government grants. Development expenses that meet generally accepted criteria for deferral, in accordance with the IAS 38, "Intangible Assets", are capitalized, net of related tax credits and government grants, and are amortized against earnings over the estimated benefit period and are tested annually for impairment. Research and development expenses are mainly comprised of salaries and related expenses, material costs as well as fees paid to third party consultants.

(q) Financial instruments

All financial instruments are required to be measured at fair value on initial recognition of the instrument. Measurements in subsequent periods depends on whether the financial instrument has been classified as "at fair value through profit or loss", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the standard.

Financial assets and financial liabilities "at fair value through profit or loss" are measured at fair value with changes in those fair values recognized in net loss. Financial assets "available-for-sale" are measured at fair value, with changes in those fair values recognized in OCL. Financial assets "held-to-maturity", "loans and receivables" and "other financial liabilities" are measured at amortized cost using the effective interest method of amortization.

Cash is designated as "fair value through profit or loss" and is measured at fair value. Accounts receivable are designated as "loans and receivables". Accounts payable and accrued liabilities, and advances from related parties are designated as "other liabilities". Long-term investments are financial instruments classified as "available-for-sale". They are initially recorded at their fair value unless fair value is not readily determinable. Subsequent changes to the market value of the investments are recorded as changes to other comprehensive income. Realized gains and losses are recognized in net loss when the investments are actually disposed of.

**3. Significant accounting policies – continued**

(q) Financial instruments - continued

Financial instruments measured at fair value on the consolidated statement of financial position require classification into one of the following levels of the fair value hierarchy:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices listed in Level 1 that are observable for the asset or liability either directly or indirectly;
- Level 3 - Inputs that are not based on observable market data.

The fair value hierarchy level at which a fair value measurement is categorized is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. Cash is measured at Level 1 and the investment is recorded at Level 2.

A financial asset is assessed at each reporting date to determine whether it is impaired based on objective evidence indicating that one or more events have had a negative effect on the estimated future cash flows of that asset. An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the net present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value and any amounts in OCL are transferred to net loss. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics. All impairment losses are recognized in net loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized.

(r) Capital Disclosures

The Company discloses its objective, policies and processes for managing capital.

(s) New accounting policies

On March 1, 2013, the Company adopted the following new standards and amendments that became effective for annual periods on or after March 1, 2013:

i. IFRS 10, “Consolidated Financial Statements,” supersedes IAS 27 “Consolidated and Separate Financial Statements” and SIC-12 “Consolidation – Special Purpose Entities”. This standard provides a single model to be applied in control analysis for all investees including special purpose entities. The adoption of this standard had no impact on the amounts recorded in the Company’s consolidated financial statements.

ii. IFRS 11, “Joint Arrangements,” whereby joint arrangements are classified as either joint operations or joint ventures, each with their own accounting treatment. All joint arrangements are required to be reassessed on transition to IFRS 11 to determine their type to apply the appropriate accounting. The adoption of this standard had no impact on the amounts recorded in the Company’s consolidated financial statements.

iii. IFRS 12, “Disclosure of Interest in Other Entities,” combines the disclosure requirements for entities that have interest in subsidiaries, joint arrangements, and associates as well as unconsolidated structured entities. The adoption of this standard had no impact on the Company’s consolidated financial statements.

## 3. Significant accounting policies – continued

(s) New accounting policies - continued

iv. IFRS 13, "Fair Value Measurement," establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. This standard defines fair value as 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. The adoption of this standard had no material impact on the Company's consolidated financial statements.

v. IFRS 7, "Financial Instruments: Disclosures" was amended to develop common disclosure requirements for financial assets and financial liabilities that are offset in the financial statements, or that are subject to enforceable master netting arrangements or similar agreements. The adoption of this amendment had no material impact on the Company's consolidated financial statements.

vi. IAS 1, "Presentation of Financial Statements" was amended to introduce new terminology for the consolidated statement of loss and comprehensive loss. The amendments required the Company to group other comprehensive income (loss) items by those that will be reclassified subsequently to profit or loss and those that will not be reclassified. These changes did not result in any adjustments to comprehensive loss or other comprehensive loss.

(t) Future accounting policies

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and assessed that the following pronouncements are applicable to the Company:

As of March 1, 2014, the Company will be required to adopt amendments to IAS 36, "Impairment of Assets". The amendments reduce the circumstances in which the recoverable amount of CGUs is required to be disclosed and clarifies the disclosures required when an impairment loss has been recognized or reversed in the period.

As of March 1, 2014, the Company will be required to adopt IFRS Interpretations Committee ("IFRIC") 21 "Levies". IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified in the relevant legislation, occurs.

As of March 1, 2018, IFRS 9 will replace the guidance of IAS 39, "Financial Instruments: Recognition and Measurement." This standard eliminates the existing IAS 39 categories of held to maturity, available-for-sale and loans receivable. Financial assets will be classified into one of two categories: amortized cost or fair value.

## 4. Related party transactions

Advances from related parties are from a related entity. The advances bear interest at 5% through December 31, 2012 and 2% thereafter per annum and are due upon demand. There are no set terms for repayment and the loan is secured by all the assets of the Company. No interest was paid on the advances with accrued interest in the amount of $111,814 (February 28, 2013 – $102,115). The related party engaged with the Company for revenue of $79,823 (February 28, 2013 – $17,817) and incurred expenses of $13,182 (February 28, 2013 – $2,039). The transactions are considered to be in the normal course of operations and are initially recognized at their fair value.

| | **February 28, 2014** | February 28, 2013 |
|---|---|---|
| Advances from related parties | **$ 1,167,980** | $ 1,145,424 |

Significant subsidiaries:

The table below provides information relative to California Nanotechnologies Corp.'s significant subsidiaries, including the entity's name, its jurisdiction of incorporation/formation, the percentage of securities directly or indirectly owned by California Nanotechnologies Corp., and the market areas served, if applicable.

| **Company (Jurisdiction of Incorporation/ Formation** | **Percentage of ownership by California Nanotechnologies Corp.** | **Overview** | **Market Area** |
|---|---|---|---|
| California Nanotechnologies Inc. (California, USA) | 100% | Wholly-owned subsidiary of California Nanotechnologies Corp. which was formed and incorporated on February 4, 2005. It is the head office which conducts research and development, and materials processing. | USA |
| White Roof Solutions Inc. (California, USA) | 100% | Wholly-owned subsidiary of California Nanotechnologies Inc. which was formed and incorporated on May 21, 2012. It conducts sales of the application of white solar reflective roof coatings. | USA |

## 5. Business Combination

On May 17, 2012, the Company closed an asset purchase agreement to acquire all the assets of White Roof Systems, Inc. of Culver City, California. White Roof Systems Inc. developed the protocol necessary for the application of a patented new white roof coating system. The Company will be undertaking these activities through a wholly owned subsidiary called White Roof Solutions, Inc.

The acquisition has been accounted for using the acquisition method of accounting with an effective date of May 17, 2012, whereby the assets acquired are recorded at their fair values.

| | |
|---|---|
| **Consideration paid:** | |
| Cash | $ 13,535 |
| **Assets acquired:** | |
| Equipment | 5,770 |
| Inventory | 3,415 |
| | 9,185 |
| **Goodwill** | $ 4,350 |

At February 28, 2013 management performed an impairment assessment of goodwill and determined that the total value of goodwill was impaired.

## 6. Equipment

| | Nanotechnology equipment | Roof coating equipment | Totals |
|---|---|---|---|
| **Cost** | | | |
| At February 29, 2012 | 902,499 | - | 902,499 |
| Additions from business combination (Note 5) | - | 5,770 | 5,770 |
| Additions | - | 2,750 | 2,750 |
| At February 28, 2013 | 902,499 | 8,520 | 911,019 |
| Additions | 5,634 | - | 5,634 |
| At February 28, 2014 | 908,133 | 8,520 | 916,653 |
| **Accumulated depreciation** | | | |
| At February 29, 2012 | 642,079 | - | 642,079 |
| Depreciation | 127,109 | 1,863 | 128,972 |
| At February 28, 2013 | 769,188 | 1,863 | 771,051 |
| Depreciation | **74,298** | **2,840** | **77,138** |
| At February 28, 2014 | **843,486** | **4,703** | **848,189** |
| **Net book value** | | | |
| At February 28, 2013 | 133,311 | 6,657 | 139,968 |
| At February 28, 2014 | **64,647** | **3,817** | **68,464** |

## 7. Intangible assets

| | Trade secrets | Use of operating rights | Customer list | Customer contract | Goodwill | Totals |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At February 29, 2012 | 100,000 | 50,000 | 27,000 | 23,000 | - | 200,000 |
| Additions from business combination (Note 5) | - | - | - | - | 4,350 | 4,350 |
| Impairment (Note 5) | - | - | - | - | (4,350) | (4,350) |
| At February 28, 2013 | 100,000 | 50,000 | 27,000 | 23,000 | - | 200,000 |
| At February 28, 2014 | **100,000** | **50,000** | **27,000** | **23,000** | **-** | **200,000** |
| **Accumulated amortization** | | | | | | |
| At February 29, 2012 | 40,557 | 20,277 | 10,950 | 9,326 | - | 81,110 |
| Amortization | 6,667 | 3,333 | 1,800 | 1,751 | - | 13,551 |
| At February 28, 2013 | 47,224 | 23,610 | 12,750 | 11,077 | - | 94,661 |
| Amortization | **6,666** | **3,334** | **1,800** | **1,316** | **-** | **13,116** |
| At February 28, 2014 | **53,890** | **26,944** | **14,550** | **12,393** | **-** | **107,777** |
| **Net book value** | | | | | | |
| At February 28, 2013 | 52,776 | 26,390 | 14,250 | 11,923 | - | 105,339 |
| At February 28, 2014 | **46,110** | **23,056** | **12,450** | **10,607** | **-** | **92,223** |

## 8. Investment

At February 28, 2013, the long-term investment consists of an available-for-sale investment in approximately 2.7% of the common shares, at $0.10 per share, of SRL Nano Corporation ("SRL Nano"), a privately held California company specializing in the use of new patented materials that exhibit high strength at elevated temperatures. As there is no quoted market price for the shares, they have been measured at cost.

At June 18, 2012, a complaint was filed by the Company with the Superior Court of the State of California seeking compensation for damages from SRL Nano. At January 31, 2013, the parties entered into a settlement agreement and mutual release to have the investment sold to a third party for $250,000 with a down payment of $9,000. On August 9, 2013, the investment was sold in the amount of $250,000.

| | Carrying Amount |
|---|---|
| Investment at February 28, 2013 | $ 250,000 |
| Proceeds from sale of investment | **250,000** |
| Investment at February 28, 2014 | **$ -** |

## 9. Income Taxes

| | **February 28, 2014** | February 28, 2013 |
|---|---|---|
| Statutory tax rate | **25.00%** | 25.00% |
| | | |
| Income taxes recovery at the statutory rate | **$ (75,592)** | $ (132,731) |
| Share-based compensation | **3,432** | 10,514 |
| Other | **(11,850)** | 4,938 |
| Tax rate differences | **(32,988)** | (61,238) |
| Change in deferred tax asset not recognized | **117,798** | 179,406 |
| | **$ 800** | $ 889 |

Principal components of deferred tax are:

| Deferred tax asset (liability): | **February 28, 2014** | February 28, 2013 |
|---|---|---|
| Unused tax losses carry forward - US (1) | **$ 1,195,220** | $ 1,097,857 |
| Unused tax losses carry forward – Canada (1) | **161,031** | 165,221 |
| Disallowed interest - US | **41,005** | 41,005 |
| | | |
| Deferred tax liability: | | |
| Equipment - US | **(22,321)** | (46,947) |
| | **1,374,935** | 1,257,137 |
| Deferred tax asset not recognized | **(1,374,935)** | (1,257,137) |
| | **$ -** | $ - |

(1) Consists of US Federal and State tax losses and States in the approximate amount of $3,064,666 expiring at various dates commencing 2025. Canadian tax losses in the approximate amount of $644,124 expiring at varying dates commencing 2015.

## 10. Compensation of Key Management Personnel

The remuneration of key management personnel during the year was as follows:

| | **February 28, 2014** | February 28, 2013 |
|---|---|---|
| Remuneration | **$ 78,402** | $ 83,464 |

Key management personnel of the Company include the CEO, CFO, and Vice-president.

## 11. Share capital

(a) Authorized:

Unlimited number of Class "A" Common shares, without nominal or par value.

(b) Issued:

| | Number | Amount |
|---|---|---|
| Total issued and outstanding, February 29, 2012 | 25,820,000 | $ 2,386,148 |
| Total issued and outstanding, February 28, 2013 | 25,820,000 | 2,386,148 |
| Total issued and outstanding, February 28, 2014 | **25,820,000** | **2,386,148** |

(c) Options - Directors, Officers, Employees and Consultants

The Company has a stock option plan for directors, officers, employees and consultants. Stock options can be issued up to a maximum number of common shares equal to 10% of the issued and outstanding common shares of the Company. The exercise price of options granted is not less than the market price of the common shares traded and along with the vesting period, is determined by the Board of Directors. Options granted have a term of up to 5 years.

| | Number of Options | Weighted Average price *(CAD)* |
|---|---|---|
| Balance, February 29, 2012 | 1,390,000 | $ 0.25 |
| Granted | 400,000 | 0.10 |
| Forfeited | (375,000) | 0.10 |
| Expired | (195,000) | 0.24 |
| Balance, February 28, 2013 | 1,220,000 | $ 0.10 |
| Granted | **1,150,000** | **0.05** |
| Forfeited | **(20,000)** | **0.10** |
| Expired | **(50,000)** | **0.20** |
| Balance, February 28, 2014 | **2,300,000** | **$ 0.08** |

During the year ended February 28, 2014, the Company recorded $13,728 in share-based compensation expense (February 28, 2013 - $42,054). The fair value of the options granted in the current year was estimated using the Black Scholes option-pricing model with the following assumptions:

| | |
|---|---|
| Risk free interest rate (%) | 1.6 |
| Expected term (years) | 5.0 |
| Expected volatility (%) | 156.3 |
| Dividend per share | - |
| Forfeiture rate (%) | 6.1 |

## 11. Share capital - continued

The following tables summarize information about stock options outstanding at February 28, 2014:

| | **Options Outstanding** | | | **Options Exercisable** | |
|---|---|---|---|---|---|
| **Exercise Price** | **Number of options** | **Weighted Average of Remaining Contractual Life (years)** | **Weighted Average Exercise Price *(CAD)*** | **Number of Options** | **Weighted Average Exercise Price *(CAD)*** |
| **$ 0.05 - 0.20** | **2,300,000** | **3.7** | **$ 0.08** | **724,995** | **$ 0.10** |

The following tables summarize information about stock options outstanding at February 28, 2013:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Exercise Price | Number of options | Weighted Average of Remaining Contractual Life (years) | Weighted Average Exercise Price *(CAD)* | Number of Options | Weighted Average Exercise Price *(CAD)* |
| $ 0.10 - 0.20 | 1,220,000 | 3.5 | $ 0.10 | 414,992 | $ 0.11 |

## 12. Segmented information

Management has segmented the Company's business based on differences in products and services and management responsibility. The Company's business is conducted predominantly through two major business segments - Nanocrystalline materials and Solar coatings.

Nanocrystalline materials include the development, processing, marketing and sale of nanocrystalline materials for coatings and bulk material applications. Solar coatings conduct sales of the application of white solar reflective roof coatings. Both segments' operations are located in Southern California.

The Company has utilized and reported results based on each segment since the inception of solar coatings at May 17, 2012 as follows:

| **February 28, 2014** | **Nanocrystalline materials** | **Solar coatings** | **Inter-corporate elimination** | **Totals** |
|---|---|---|---|---|
| **Revenue** | **$ 373,481** | **$ -** | **$ -** | **$ 373,481** |
| **Net loss** | **(294,770)** | **(7,595)** | **-** | **(302,365)** |
| **Assets** | **323,083** | **10,596** | **(29,685)** | **303,994** |
| **Liabilities** | **1,243,227** | **29,685** | **(29,685)** | **1,243,227** |

## 12. Segmented information - continued

| February 28, 2013 | Nanocrystalline materials | Solar coatings | Inter-corporate elimination | Totals |
|---|---|---|---|---|
| Revenue | $ 174,281 | $ 87,021 | $ - | $ 261,302 |
| Goodwill impairment | - | (4,350) | - | (4,350) |
| Net loss | (520,317) | (11,494) | - | (531,811) |
| Assets | 555,635 | 37,091 | (35,051) | 557,675 |
| Liabilities | 1,194,737 | 48,585 | (35,051) | 1,208,271 |

## 13. Loss per share

The basic loss per common share is calculated using net loss divided by the weighted-average number of common shares outstanding. The diluted loss per common share is calculated using net loss divided by the weighted-average number of diluted common shares outstanding.

## 14. Contributed surplus

| | **February 28, 2014** | February 28, 2013 |
|---|---|---|
| Balance, beginning of year | **$ 154,490** | $ 112,436 |
| Share-based compensation (11(c)) | **13,728** | 42,054 |
| Balance, end of year | **$ 168,218** | $ 154,490 |

## 15. Financial instruments

Financial instruments of the Company consist of cash, accounts receivable, investment, accounts payable and accrued liabilities and advances from related parties.

| | **February 28, 2014** | | February 28, 2013 | |
|---|---|---|---|---|
| | **Carrying Value** | **Fair Value** | Carrying Value | Fair Value |
| **At fair value through profit or loss** | | | | |
| Cash | **$ 4,234** | **$ 4,234** | $ 5,235 | $ 5,235 |
| **Loans and receivables** | | | | |
| Accounts receivable | **129,847** | **129,847** | 23,550 | 23,550 |
| **Available for sale** | | | | |
| Investment | **-** | **-** | 250,000 | 250,000 |
| **Other liabilities** | | | | |
| Accounts payable and accrued liabilities | **74,447** | **74,447** | 62,847 | 62,847 |
| Advances from related parties | **1,167,980** | **1,167,980** | 1,145,424 | 1,145,424 |

## 15. Financial instruments - continued

The table below sets out fair value measurements using fair value hierarchy.

| | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash | $ 5,235 | $ 5,235 | - | - |

There have been no transfers during the year between Levels 1, 2 and 3.

The carrying values of cash, accounts receivable, investment, accounts payable and accrued liabilities approximate their fair value due to their short-term nature.

The fair value of the Company's advances from related parties approximate their fair values due to the interest rates applied to these instruments, which approximate market interest rates.

As disclosed above, the Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to various risks. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical. The Company does not use off statement of financial position contracts to manage these risks.

Liquidity Risk
The Company defines liquidity risk as the financial risk that the Company will encounter difficulties meeting its obligations associated with financial liabilities. The Company's objective for managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. This risk is mitigated by managing the cash flow by controlling receivables and payables to vendors and related parties. At February 28, 2014, the Company had a working capital deficiency of $1,099,920 (February 28, 2012 – $1,145,903).

Foreign currency risk
A portion of the Company's operations are located outside of the United States and, accordingly, the related financial assets and liabilities are subject to fluctuations in exchange rates.

The Company manages its exposure to foreign currency fluctuations by maintaining foreign currency bank accounts and receivables to offset foreign currency payables and planned expenditures. At February 28, 2014, the Company had the following balances denominated in Canadian dollars. The balances have been translated into United States currency in accordance with the Company's foreign exchange accounting policy.

| | **USD February 28, 2014** | USD February 28, 2013 |
|---|---|---|
| Cash | **$ 410** | $ 602 |
| Accounts Payable | **31,053** | 33,691 |

## 15. Financial instruments - continued

The Company operates with a U.S. dollar functional currency which gives rise to currency exchange rate risk on the Company's Canadian dollar denominated monetary assets and liabilities, such as Canadian dollar bank accounts and accounts payable, as follows:

| | Impact on Net Loss |
|---|---|
| U.S. Dollar Exchange Rate – 10% increase | **$ 3,064** |
| U.S. Dollar Exchange Rate – 10% decrease | **(3,064)** |

Credit risk

The Company manages credit risk by dealing with financially sound customers, based on an evaluation of the customer's financial condition. For the year ended February 28, 2014, the Company was engaged in contracts for products with three (February 28, 2013 – two) customers in excess of 10% of revenue, which accounted for $286,560 (February 28, 2013 - $122,713) or 77% (February 28, 2013 – 47%) of the Company's total revenue. The maximum exposure to credit risk is the carrying value of accounts receivable. No allowance for doubtful accounts was recorded (2013 – $15,253). The table below provides an analysis of our current financial assets and the age of our past due but not impaired accounts receivables by type of credit risk.

| Total | Current | ≤ 30 days | > 30 days ≤ 60 days | > 60 days ≤ 90 days | > 90 days |
|---|---|---|---|---|---|
| $ 129,847 | $ 129,847 | $ - | $ - | $ - | $ - |

## 16. Capital Disclosures

The Company manages its capital to maintain its ability to continue as a going concern and to provide returns to shareholders and benefits to other stakeholders. The capital structure of the Company consists of cash, and equity comprised of issued capital, contributed surplus and deficit.

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share issues or by undertaking other activities as deemed appropriate under the specific circumstances.

The Company is not subject to externally imposed capital requirements and the Company's overall strategy with respect to capital risk management remains unchanged from the year ended February 28, 2013.

## 17. Subsequent event

On April 9, 2014, the Company completed a private placement of 5,290,296 units, with each unit consisting of one common share and one-half of one common share purchase warrant, at a price of $0.135 CAD. The purchase warrants have a one year term with an exercise price of $ 0.225 CAD. The private placement resulted in the Company receiving total gross proceeds of $714,190 CAD.