2012

# McVicar Industries Inc.

# Annual Report

**Letter to Our Shareholders**

McVicar made solid progress during the year 2012 in both corporate development and preparing for future growth. Management began the year by proposing to privatize its public subsidiary Jite Technologies Inc. Through a two step process, McVicar successfully acquired the 43.8% remaining shares of Jite from the public market in June. Jite therefore became a wholly owned subsidiary of McVicar and was delisted from being a publically traded company. With the acquisition, McVicar was able to consolidate all the earnings from Jite, and also achieved savings for no longer having to maintain a public listing for Jite. In addition, McVicar acquired the 8% minority interest of Changlong, one of the chemical companies in McVicar, from two individual shareholders. In the later part of the year, McVicar bought a chemical company, Anhui Linghua Co. Ltd., with considerable amount of spare land in a chemical industrial park, a trend the Chinese government is pushing chemical companies to adopt. In addition to reviving Linghua's agricultural chemical business, McVicar also intends to relocate its other chemical businesses to this location to achieve its business integration purpose. McVicar accomplished all the above acquisitions with capital from its own treasury, thanks to the cash flow generated through the years. So far, McVicar still maintains a very healthy treasury, with nearly no debt in its financial book.

On the operation side, management aggressively adopted two measures, continuously controlling costs in all subsidiaries, and concentrating on products with high volume and profit margins. The company discontinued the unprofitable assembly lines in Kunshan plant and rented out the manufactory space for some additional income. As a result, despite declining revenue from the business side due to a weakening economy in China and Europe, McVicar has achieved substantial increase in gross profit margin (around 5%) and net income reached around $2.8 million, one of the best years for McVicar. Cash flow from operation also increased to approximately $6.9 million, the highest level in McVicar's history.

We entered the year 2013 with a much cleaner share structure and stronger operation base. Our subsidiaries showed clear signs of stability for their operations. Jite began its year as a wholly owned subsidiary of McVicar and will contribute substantially more to McVicar's net earnings. The chemical subsidiary Luyuan Chemical Co., is stabilizing. Management is also expecting the Chemical business to grow from a solid base. In short, Management will continue to work hard to build shareholder value.

We greatly appreciate your continuous support.

Sincerely,

Gang Chai, President & CEO

**Zhejiang Hongbo Chemical Co., Ltd**

Acquired with a 100% interest by McVicar in 2007, Zhejiang Hongbo Chemical Co., Ltd. (“Hongbo”) is the Company’s main chemical producer. Founded in 2001 with facilities situated on a 66,000 square meter parcel of land, Hongbo is a high-tech company, specializing in researching, developing, producing and marketing pharmaceutical intermediates and fine chemicals. With Hongbo’s 80% owned subsidiary Luyuan Chemical Company Ltd., McVicar’s markets include pharmaceuticals, personal care products and industrial application both in China and internationally. Hongbo has more than 100 sets of advanced facilities and test machines including six production lines, three standardized multifunctional workshops and one analytical and an R&D centre.

**Xiangshui Luyuan Chemical Company Ltd.**

Hongbo originally acquired an 80% interest in Xiangshui Luyuan Chemical Company Ltd. (“Luyuan”) in 2008 to secure chemical supply lines for the production of the main chemical for Hongbo’s key industrial customer. Established in 2003 and located in the Chemical Development Park in Xiangshui, Jiangsu, China, Luyuan’s main focus is specialized chemicals for the industrial market. The facilities are also now being used for producing some Changlong products.

**Hangzhou Changlong Chemical Co.**

Originally acquired by McVicar in 2007 with a 100% interest and a focus on the pharmaceutical industry, Hangzhou Changlong Chemical Co. (“Changlong”) was established in 1996. In 2009 the local Chinese government required Changlong to cease production activities and prepare for relocation. To date the relocation of Changlong is still pending.

It was a developer and manufacturer of organic and inorganic fine chemicals specializing in chemical intermediates for the pharmaceutical market, cationic surfactant ammonium chloride. Its main products were piperazine derivative, pyridine derivatives, ammonium chloride series, printing paste series and surfactant series. Changlong has technologies of high pressure hydrogenation, ammonification and synthesis. Changlong has moved some production to the Luyuan facilities.

## JITE Technologies Inc.

On April 5, 2012, McVicar purchased additional common shares of Jite through a public tender offer resulting in McVicar then owning 93.67%. In June, 2012 McVicar purchased the remaining outstanding shares for a 100% ownership of Jite.

Headquartered in Toronto, Canada, JITE Technologies Inc., was listed on the TSX Venture Exchange since July 2006 as JTI.V, and was made private when McVicar obtained 100% ownership. Jite is a global supplier of terminal blocks. JITE established a wide range of logistic channels and warehouses worldwide, including in China, North America and Europe.

JITE Industrial Park with R&D, manufacturing and logistics is located in Shenzhen, China, comprises over 700,000 square feet of operating space, of which 300,000 square feet is used for manufacturing, and over 500 employees.

JITE incorporated another wholly-owned subsidiary called Jite Industrial (Kunshan) Co., Ltd. at Kunshan Economic and Technological Development Zone, in Jiangsu Province, China, on October 9, 2009. The Kunshan plant has a 270,000 square foot building space with additional land to build on. The facilities are currently being used for rental income.

### Terminal Blocks

JITE follows the international and Chinese standards on connectors, terminal blocks and related application fields such as IEC, L, CSA, VDE, TUV, JIS and GB. JITE has also participated in the compiling and constituting Chinese National Standards. JITE has a WTDP lab in Shenzhen, certified by UL, and can independently carry out more than 20 kinds of product testing and experiments.

### Custom Design

JITE R&D experts custom design connection solutions for world class customers. JITE products are ROHS compliant and listed by UL, CSA and some by VDE, TUV and CQC.

### Advanced Manufacturing System

JITE has access to full capacity hardware facilities that include plastic injection, metal stamping, tooling & moulds, screw tapping, assembly and more, with ISO certifications.

JITE employs various quality assurance methods in the process of product development and manufacturing. JITE uses an advanced ERP system for production and material control. Jite’s upgraded capabilities continue to improve techniques, manufacturing process management and capital operations.

Consolidated Financial Statements
(Expressed in Canadian dollars)

# McVICAR INDUSTRIES INC.

For years ended December 31, 2012 and 2011

Collins Barrow
Chartered Accountants

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## INDEPENDENT AUDITORS' REPORT

**To the Shareholders of McVicar Industries Inc.**

We have audited the accompanying consolidated financial statements of McVicar Industries Inc. and its subsidiaries which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011 and the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the 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.

*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 audits to obtain reasonable assurance about 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 auditor's 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 evaluating 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 we have 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 McVicar Industries Inc. and its subsidiaries as at December 31, 2012 and December 31, 2011, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Collins Barrow Toronto LLP

Licensed Public Accountants
Chartered Accountants
April 30, 2013
Toronto, Ontario

# MCVICAR INDUSTRIES INC.

Consolidated Statements of Comprehensive Income

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

| | Note | 2012 | 2011 |
|---|---|---|---|
| | | $ | $ |
| **Sales** | | | |
| Total sales | | 28,923,058 | 30,110,407 |
| Total costs of goods sold | | (19,796,357) | (22,349,041) |
| Gross profit | | 9,126,701 | 7,761,366 |
| General and administrative expenses | 10 | (5,791,532) | (6,049,782) |
| Loss on disposal of equipment | | (5,688) | - |
| Impairment of goodwill | 15 | - | (2,701,413) |
| Other income | | 62,595 | 30,660 |
| Income (loss) on short term investments | 6 | 90,294 | (177,992) |
| Income (loss) from investment in associates | 9 | 25,350 | (60,763) |
| Income (loss) before income taxes | | 3,507,720 | (1,197,924) |
| Income taxes | 23 | (727,870) | (128,191) |
| Net income (loss) | | 2,779,850 | (1,326,115) |
| | | | |
| Other comprehensive income (loss): | | | |
| Exchange differences on translation of foreign operations | | (386,569) | 2,008,198 |
| Total comprehensive income | | 2,393,281 | 682,083 |
| | | | |
| Net income (loss) attributable to | | | |
| Non-controlling interests | | (140,897) | 469,981 |
| Shareholders of the Company | | 2,920,747 | (1,796,096) |
| | | 2,779,850 | (1,326,115) |
| | | | |
| Total comprehensive income (loss) attributable to: | | | |
| Non-controlling interests | | (140,897) | 1,102,364 |
| Shareholders of the Company | | 2,534,178 | (420,281) |
| | | 2,393,281 | 682,083 |
| | | | |
| Basic and diluted income (loss) earnings per share | | 0.082 | (0.049) |
| | | | |
| Weighted average number of shares outstanding Basic and diluted | | 35,627,320 | 36,388,620 |

See accompanying notes to consolidated financial statements.

# MCVICAR INDUSTRIES INC.

Consolidated Statements of Financial Position

as at

| (Expressed in Canadian dollars) | Note | December 31, 2012 | December 31, 2011 |
|---|---|---|---|
| **Assets** | | $ | $ |
| Current assets | | | |
| Cash and cash equivalents | | 7,555,248 | 8,856,129 |
| Short-term investments | 6 | - | 2,737,583 |
| Trade receivables | 7 | 7,636,449 | 8,404,043 |
| Inventories | 8 | 6,925,665 | 8,462,698 |
| Due from related parties | 10 | - | 56,367 |
| Other current assets | | 372,757 | 949,132 |
| Restricted cash | 11 | 1,038,050 | 2,100,800 |
| | | 23,528,169 | 31,566,752 |
| Investments in associates | 9 | 106,979 | 82,390 |
| Property, plant and equipment | 12 | 13,056,242 | 10,156,028 |
| Investment property | 13 | 3,635,744 | 1,236,194 |
| Goodwill | 15 | 3,952,298 | 3,999,321 |
| Deferred income tax assets | 23 | 1,226,486 | 971,140 |
| | | 45,505,918 | 4,8011,825 |
| **Liabilities** | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities | | 4,799,195 | 4,204,844 |
| Short-term borrowings | 14 | 1,597,000 | - |
| Bank accepted notes payable | 11 | 2,076,100 | 4,201,600 |
| Income taxes payable | | 741,804 | 196,274 |
| Deferred revenue | 13 | 109,300 | 41,662 |
| Due to related parties | 10 | 437,514 | 190,330 |
| | | 9,760,913 | 8,834,710 |
| Deferred income tax liabilities | 23 | 615,269 | 689,292 |
| | | 10,376,182 | 9,524,002 |
| **Shareholders' equity** | | | |
| Share capital | 16(a) | 26,084,508 | 26,089,267 |
| Contributed surplus | | 450,951 | 915,714 |
| Accumulated other comprehensive income | | 911,848 | 594,482 |
| Retained earnings | 17 | 7,920,090 | 1,199,996 |
| Equity attributable to shareholders | | 35,367,397 | 28,799,459 |
| Non-controlling interests | | (237,661) | 9,688,364 |
| | | 35,129,736 | 38,487,823 |
| Commitments and contingencies | 19 | | |
| Events after the reporting period | 24 | | |
| | | 45,505,918 | 48,011,825 |

Approved on behalf of the Board

Signed: "Dr. James Misener", Director

Signed: "Gang Chai", Director

See accompanying notes to consolidated financial statements.

# MCVICAR INDUSTRIES INC.

## Consolidated Statements of Changes in Equity

(Expressed in Canadian dollars, except shares)

| | | Share Capital | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Note | Shares | Amount | Contributed surplus | Accumulated other comprehensive income (loss) | Retained earnings (deficit) | Total shareholders' equity | Non-controlling Interests | Total equity |
| | | | $ | $ | $ | $ | $ | $ | $ |
| **Balance at January 1, 2011** | **23** | **37,427,320** | **27,402,375** | **943,301** | **(781,333)** | **2,185,643** | **29,749,986** | **8,850,161** | **38,600,147** |
| Adjustment for treasury stock purchased and cancelled | 16 | (1,793,500) | (1,313,108) | - | - | 419,957 | (893,151) | - | (893,151) |
| Net (loss) income | | - | - | - | - | (1,796,096) | (1,796,096) | 469,981 | (1,326,115) |
| Stock-based compensation | 16(b) | - | - | 65,428 | - | - | 65,428 | - | 65,428 |
| Options expired | 16(b) | - | - | (41,481) | - | 41,481 | - | - | - |
| Stock-based compensation of subsidiary | | - | - | 18,724 | - | - | 18,724 | 14,592 | 33,316 |
| Options expired of subsidiary | | - | - | (70,258) | - | 70,258 | - | - | - |
| Changes in interests in subsidiary | 14 | - | - | - | - | 278,753 | 278,753 | (278,753) | - |
| Other comprehensive income | | - | - | - | 1,375,815 | - | 1,375,815 | 632,383 | 2,008,198 |
| **Balance at December 31, 2011** | | **35,633,820** | **26,089,267** | **915,714** | **594,482** | **1,199,996** | **28,799,459** | **9,688,364** | **38,487,823** |
| Adjustment for treasury stock purchased and cancelled | 16 | (6,500) | (4,759) | - | - | 2,289 | (2,470) | - | (2,470) |
| Net (loss) income | | - | - | - | - | 2,920,747 | 2,920,747 | (140,897) | 2,779,850 |
| Options expired | 16(b) | - | - | (125,846) | - | 125,846 | - | - | - |
| Options expired of subsidiary | | - | - | (338,917) | - | 338,917 | - | - | - |
| Changes in interests in subsidiary | 14 | - | - | - | 703,935 | 3,332,295 | 4,036,230 | (9,785,128) | (5,748,898) |
| Other comprehensive income | | - | - | - | (386,569) | - | (386,569) | - | (386,569) |
| **Balance at December 31, 2012** | | **35,627,320** | **26,084,508** | **450,951** | **911,848** | **7,920,090** | **35,367,397** | **(237,661)** | **35,129,736** |

See accompanying notes to consolidated financial statements.

# MCVICAR INDUSTRIES INC.

Consolidated Statements of Cash Flows

For the years ended December 31, 2012 and 2011

(Expressed in Canadian dollars)

| | Note | 2012 | 2011 |
|---|---|---|---|
| | | $ | $ |
| **Operating activities** | | | |
| Net income (loss) | | 2,779,850 | (1,326,115) |
| Adjustments for: | | | |
| Depreciation expense | | 1,072,157 | 975,270 |
| Income taxes | | 727,870 | 128,191 |
| Interest (income) expenses, net | | (51,077) | 771 |
| Provision for doubtful accounts | | 8,232 | 204,013 |
| Inventory provision | | 393,696 | 218,508 |
| Loss on disposal of property, plant and equipment | | 5,688 | 89,846 |
| Impairment of property, plant and equipment | | 161,107 | - |
| Impairment of goodwill | | - | 2,701,413 |
| Stock-based compensation expense | | - | 98,744 |
| (Income) loss on short term investments | | (90,294) | 177,992 |
| (Income) loss from investment in associates | | (195,094) | 60,763 |
| Due to and from related parties | | (256,568) | (66,498) |
| Income taxes paid | | (643,072) | (467,976) |
| Interest received | | 51,077 | (771) |
| Changes in non-cash working capital | 18 | 2,952,991 | 503,122 |
| **Net cash generated from operating activities** | | 7,147,781 | 3,297,273 |
| | | | |
| **Investing activities** | | | |
| Acquisitions of non-controlling interests in subsidiaries | 14 | (5,322,635) | (1,412,107) |
| Cash from sale short-term investments | | 2,773,669 | 167,847 |
| Cash acquired in business combination | | - | 14,085 |
| Proceeds on disposal of property, plant and equipment | | 7,096 | 42,148 |
| Additions of property, plant and equipment | | (4,561,539) | (1,350,051) |
| **Net cash used in investing activities** | | (7,103,409) | (2,538,078) |
| | | | |
| **Financing activities** | | | |
| Increase (Decrease) in restricted cash | | 1,029,600 | (918,600) |
| Increase (Decrease) in bank accepted notes payable | | (2,234,509) | 1,998,800 |
| Loan from CEO | | 1,400,000 | - |
| Repayment of loan from CEO | | (1,400,000) | |
| Government compensation | | - | 111,797 |
| **Net cash generated from financing activities** | | (1,204,909) | 1,191,997 |
| | | | |
| (Decrease) increase in cash | | (1,160,537) | 1,951,192 |
| Cash and cash equivalents, beginning of year | | 8,856,129 | 6,571,900 |
| Effect of exchange rate changes on cash and cash equivalents | | (140,344) | 333,037 |
| **Cash and cash equivalents, end of year** | | 7,555,248 | 8,856,129 |

See accompanying notes to consolidated financial statements.

## 1. Corporate information:

McVicar Industries Inc. (the "Company" or "McVicar") was incorporated under the Business Corporations Act (Ontario) on February 19, 2003. The Company holds a 100% (2011 – 100%) interest in its Hong Kong subsidiary, McVicar (Hong Kong) Advanced Materials Co. Ltd. ("MAM") and a 100% (December 31, 2011 - 56.2%) interest in a Canadian company JITE Technologies Inc. ("JITE"). Through its subsidiaries, the Company is operating in two different segments; the chemical industry and the technology industry. The registered office of the Company is located at 55 University Avenue, Suite 605, Toronto, Ontario, M5C 3A1, and the principal operations of its business are in China.

## 2. Basis of presentation:

(a) Statement of compliance:

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (''IFRS'') as issued by the International Accounting Standards Board (the ''IASB''). The significant accounting policies set out below were consistently applied to all periods presented.

The consolidated financial statements were approved and authorized by the Board of Directors on April 30, 2013.

The consolidated financial statements have been prepared on a historical cost basis for all its recognized assets and liabilities, except for certain financial instruments measured at fair value.

The consolidated financial statements are presented in Canadian dollars unless indicated with "RMB" to represent the Chinese Renminbi or "US$" to represent the United States dollar.

## 3. Significant accounting policies:

(a) Basis of consolidation:

The consolidated financial statements of the Company include the accounts of the Company and its subsidiaries. The subsidiaries of the Company are:

(i) JITE is a private company, but was a publicly listed company on the TSX-V (as “JTI”) in 2011. JITE has a wholly owned subsidiary, Jite (Hong Kong) Limited ("Jite Hong Kong"), which owns 100% of Jite Industrial (Shenzhen) Co. Ltd. ("Jite Shenzhen"), 100% of Jite Industrial (Kunshan) Co., Ltd. ("Jite Kunshan") and 100% of Shenzhen Relisen Electronic Co., Ltd. (“Relisen”). The core business of JITE is the development, manufacture and sales primarily in North America and China of terminal blocks used in security, elevator, railway and automation systems.

**3. Significant accounting policies (continued):**

(a) Basis of consolidation (continued):

(ii) MAM, whose major operating subsidiary companies are a 100% owned Zhejiang Hongbo Chemical Co. Ltd. ("Hongbo"), a 100% (2011 - 92%) owned Hangzhou Changlong Chemical Co. Ltd. ("Changlong"), a 100% owned McVicar (Hang Zhou) Management Co. Ltd., ("McVicar (HZ)"), an indirect 80% interest in Luyuan Chemical Co. Ltd. ("Luyuan") which is held by Hongbo, 70% in McVicar (Kunshan) New Materials Co., Ltd.("McVicar (Kunshan)"), and its newly acquired 100% interest in Anhui Linghua Co. Ltd. ("Anhui"). The principal activities of all these chemical subsidiaries are the development, manufacture and sales of specialized refined chemical products used in pharmaceutical and cosmetic industries both in China and international markets.

(b) Cash and cash equivalents:

Cash and cash equivalents consist of cash and investments in Guaranteed Investment Certificates ("GIC") at a major Canadian chartered bank with original maturities of three months or less.

(c) Investments:

Short-term investments consist primarily of investments in GICs with original maturities of greater than three months but less than one year and in shares of publicly traded companies both in Canada and China.

Investments in associates are long-term investments that the Company has significant influence and are recorded using the equity method.

(d) Business combinations, goodwill and non-controlling interests:

The acquisition method of accounting is used to account for the acquisition of subsidiaries and businesses as follows:

- Cost is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange;
- Identifiable assets acquired and liabilities assumed are measured at their fair values at the acquisition date;
- The excess of acquisition cost over the fair value of the identifiable net assets acquired is recorded as goodwill; and
- If the acquisition cost is less than the fair value of the net assets acquired, the difference is recognized as gain directly in the income statement.
- Transaction costs are expensed as incurred.

## 3. Significant accounting policies (continued):

(e) Business combinations, goodwill and non-controlling interests (continued):

For each business combination, the acquirer measures the non-controlling interest in the acquiree at the proportionate share of the acquiree's identifiable net assets. Transaction costs incurred are expensed and included in administrative expenses.

When the Company acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to its fair value as at the acquisition date through profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Transactions with non-controlling interests are treated as transactions with equity owners of the Company. For purchases from non-controlling interests that do not involve loss of control, the difference between the fair value of the consideration paid and the share of the carrying value of net assets acquired is recorded in equity. Similarly, gains or losses on disposals to non-controlling interests, that do not involve loss of control, are computed and also recorded in equity.

(f) Property, plant and equipment:

Property and equipment is carried at cost, less accumulated depreciation and accumulated impairment losses. Costs comprise the fair value of consideration given to acquire or construct an asset and include the direct charges associated with bringing the asset to the location and condition necessary for putting it into use along with the future cost of dismantling and removing the asset. When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment. Depreciation of property, plant and equipment commences when the assets are ready for their intended use. Depreciation on property, plant and equipment is calculated using the straight-line method to allocate their costs, less residual value, over their estimated useful lives, as follows:

| | |
|---|---|
| Buildings – power system component | 20 years |
| Buildings – elevator system | 20 years |
| Buildings – other | 44.5 years |
| Land use rights | 44.5 years |
| Furniture and equipment | 5 years |
| Leasehold improvements | 5 years |
| Manufacturing equipment | 10 years |
| Transportation equipment | 5 years |
| Other equipment | 5 years |
| Metal and plastic moulds | 5 years |

**3. Significant accounting policies (continued):**

(g) Property, plant and equipment (continued):

Construction in progress represents plant and machinery under construction and is stated at cost. Cost comprises directly attributable costs of acquisition or construction, net of any income received towards the construction in progress. Interest expense incurred for qualifying assets are capitalized.

Assets under construction are not depreciated. Completed items are transferred from construction in progress to proper categories of plant and equipment when they are ready for their intended use.

The estimated useful lives, residual values and depreciation method are reviewed at each period end, with the effect of any changes in estimate accounted for on a prospective basis.

(h) Stock-based payments:

The Company has a stock-based compensation plan that is described in note 16(b). Share-based payments to employees and others providing similar services are measured at the fair value of the instruments issued at the grant date and amortized over the vesting periods. Share-based payments to non-employees are measured at the fair value of the goods or services received, or the fair value of the equity instrument issued if it is determined that the fair value of the goods or services received cannot be reliably measured, and are recorded at the date the goods or services are received.

Non-market vesting conditions are considered in making assumptions about the number of awards that are expected to vest. The expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are satisfied. For awards with graded vesting, the fair value of each tranche is recognized over its respective vesting period. The offset to the recorded cost is to contributed surplus. Considerations received on the exercise of warrants and stock options are recorded as share capital and the related value of warrants or options is transferred to share capital.

At each balance sheet date, the Company reassesses its estimates of the number of awards that are expected to vest and recognizes the impact of any revision in the statement of comprehensive income with a corresponding adjustment to equity as appropriate.

(i) Share issue costs:

Costs incurred for the issue of common shares are deducted from share capital.

(j) Impairment of non-financial assets:

Non-financial assets with finite lives are tested for impairment when events or changes in circumstances indicate that their carrying amounts may not be recoverable. In addition, non-financial assets that are not amortized including goodwill, are subject to an annual impairment assessment. Any impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount within earnings of continuing or discontinued operations, as appropriate. The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use.

## 3. Significant accounting policies (continued):

(j) Impairment of non-financial assets (continued):

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows ("cash-generating units" or "CGUs"). The Company evaluates impairment losses for potential reversals, when events or changes in circumstances warrant such consideration.

(k) Earnings per share:

Basic earnings per share is computed by dividing income for the year attributable to shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated by dividing the income attributable to shareholders for the year by the weighted average number of common shares and potential common shares outstanding during the year. Potential common shares, which are the incremental common shares issuable upon the exercise of share options, are included in the computation of diluted earnings per share to the extent such shares are dilutive. In 2012 and 2011, stock options had no dilutive effect.

(l) Income taxes:

The tax expense for the period comprises current and deferred tax. Tax expense is recognized in the consolidated statement of comprehensive income, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the corresponding tax expense is also recognized in other comprehensive income or directly in equity respectively.

(i) Current income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted on the balance sheet date in the countries where the Company's subsidiaries and associates operate and generate taxable income.

(ii) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from 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 profit or loss.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

**3. Significant accounting policies (continued):**

(l) Income taxes (continued):

(ii) Deferred income tax (continued):

The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised. Unrecognised deferred income tax assets are reassessed at the end of each reporting period and are recognised to the extent that it has become probable that future taxable profit will be available to allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

(m) Foreign currency translation:

The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. The financial statements of each of the Company's subsidiaries are measured using the currency of the primary economic environment in which the subsidiary operates (the "functional currency"). The functional currency of the Company and Jite are Canadian dollar. The functional currency of Jite Hong Kong is Hong Kong dollars. The functional currency of McVicar (Hong Kong) Advanced Materials Co. Ltd. ("MAM") is Canadian dollar. The functional currency of the Company’s subsidiaries in China is the RMB. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions as well as monetary assets and liabilities not denominated in the functional currency of the subsidiary which are translated at the year-end exchange rate are recognized in the income statement. Non-monetary items in a foreign currency are measured based on historical cost and translated using the exchange rate at the date of the transaction.

Assets and liabilities of entities (“foreign operations”) with functional currencies other than Canadian dollars are translated to Canadian dollars at the period end rates of exchange, and the results of their operations are translated at average rates of exchange for the period. The resulting translation adjustments are included in accumulated other comprehensive income in shareholders' equity.

Additionally, foreign exchange gains and losses related to certain intercompany loans that are part of a net investment in foreign operations are included in accumulated other comprehensive income.

**3. Significant accounting policies (continued):**

(n) Revenue recognition:

(i) Sale of products

Revenue is measured at the fair value of the consideration received or receivable. Revenue from the sale of product is recognized upon shipment, when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods; the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; the amount of revenue can be measured reliably; it is probable that the economic benefits associated with the transaction will flow to the Company; and the costs incurred or to be incurred in respect of the transaction can be measured reliably. The transfer of risks and rewards occurs based on the terms of the sales contract. The Company sells its products at agreed upon prices to its customers, which reflect prevailing market prices.

(ii) Rental income

Rental income under operating leases is recognized on a straight line basis over the terms of the respective leases, except where an alternative basis is more representative of the pattern of benefits to be derived from the use of the leased asset. Lease incentives granted are recognized in profit or loss as an integral part of the aggregate net lease payment receivable. Contingent rentals are recognized as income in the accounting period in which they are earned. Rental deposit is recognized as deferred revenue on the statements of financial position and transferred to income when incurred.

(iii) Interest income

Interest income is recorded on an accrual basis.

(o) Inventories:

Inventories include raw materials, parts and work in progress, and finished goods. Inventories are stated at the lower of cost and net realizable value. Cost is determined on a weighted average basis for raw materials and finished goods are valued at standard costs and include material, labour and production overhead. Net realizable value is the anticipated selling price over costs to sell and replacement cost for raw materials. Reversal of previous write-downs is required when there is a subsequent increase in the value of inventories.

(p) Provisions:

Provisions represent liabilities to the Company for which the amount or timing is uncertain. Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognized for future operating losses. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. Provisions are re-measured at each balance sheet date using the current discount rate. The increase in the provision due to passage of time is recognized as interest expense.

**3. Significant accounting policies (continued):**

(q) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the respective assets. All other borrowing costs are expensed in the period they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

(r) Investment property

Investment property, which is property held to earn rentals and for capital appreciation (including property under construction for such purposes), is measured initially at cost, including transaction costs. Subsequent to initial recognition, investment property is measured at cost less accumulated depreciation and accumulated impairment losses. When parts of an item of investment property have different useful lives, they are accounted for as separate items (major components) of investment property. Depreciation of investment property commences when the assets are ready for their intended use. Depreciation is provided to the costs of the assets less their residual values over their estimated useful lives. The estimated useful lives, residual values and depreciation method are reviewed at each period end, with the effect of any changes in estimate accounted for on a prospective basis.

(s) Government grant and compensation:

Government grant in assistance for the purchase of plant asset is recorded as a reduction to the plant asset costs.

Government compensation for impairment loss related to plant assets expropriated is recorded as income when the compensation becomes receivable.

Government assistance for general purposes is recognized into income statement when the assistance is received or receivable and the Company has reasonable assurance that the Company will comply with the conditions attaching to it.

(t) Financial instruments:

<u>Financial assets</u>

Purchases and sales of financial assets are recognized on the settlement date, which is the date on which the asset is delivered to or by the Company. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or were transferred and the Company has transferred substantially all risks and rewards of ownership. Financial assets are classified in the following categories at the time of initial recognition based on the purpose for which the financial assets were acquired:

**3. Significant accounting policies (continued):**

(t) Financial instruments (continued):

Financial assets (continued):

*Financial assets at fair value through profit and loss ("FVTPL")*

- Classification

  Financial assets are classified as fair value through profit or loss if acquired principally for the purpose of selling in the short-term, such as financial assets held for trading, or if so designated by management.

- Recognition and measurement

  Financial assets carried at fair value through profit or loss are initially recognized, and subsequently carried, at fair value, with changes recognized in the income statement. Transaction costs are expensed. Assets in this category include short-term investments.

*Loans and receivables*

- Classification

  Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the end of the reporting period, which are classified as non-current assets. Assets in this category include "trade receivables", and "due from related parties" and "cash and cash equivalents" and "restricted cash".

- Recognition and measurement

  Loans and receivables are initially recognized at fair value plus transaction costs and subsequently carried at amortized cost using the effective interest method.

*Available-for-sale financial assets*

- Classification

  Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in other non-current financial assets unless management intends to dispose of the assets within 12 months of the end of the reporting period.

- Recognition and measurement

  Available-for-sale financial assets are initially recognized at fair value plus transaction costs and are subsequently carried at fair value with changes recognized in other comprehensive income. Upon sale or impairment, the accumulated fair value adjustments recognized in other comprehensive income are included in the statement of comprehensive income.

**3. Significant accounting policies (continued):**

(t) Financial instruments (continued):

Financial assets (continued):

*Impairment of financial assets*

At the end of each reporting period, the Company assesses whether there is objective evidence that a financial asset is impaired. Impairments are measured as the excess of the carrying amount over the fair value and are recognized in the statement of comprehensive income.

Financial liabilities

*Initial recognition and measurement*

Financial liabilities within the scope of IAS 39 – Financial Instruments: Recognition and Measurement are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Company determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognised initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The Company's financial liabilities include accounts payables and accrued liabilities, short term borrowings, bank accepted notes payable and due to related parties.

*Fair value measurement*

The Company categorizes its financial assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs used in the measurement.

Level 1: This level includes assets and liabilities measured at fair value based on unadjusted quoted prices for identical assets and liabilities in active markets that are accessible at the measurement date.

Level 2: This level includes valuations determined using directly or indirectly observable inputs other than quoted prices included within Level 1. Derivative instruments in this category are valued using models or other standard valuation techniques derived from observable market inputs.

Level 3: This level includes valuations based on inputs which are less observable, unavailable or where the observable data does not support a significant portion of the instruments' fair value.

Short-term investments are measured as level 1.

**3. Significant accounting policies (continued):**

(u) Financial instruments (continued):

*Subsequent measurement*

The measurement of financial liabilities depends on their classification as follows:

- Financial liabilities at fair value through profit or loss

  Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

  Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. Gains or losses on liabilities held for trading are recognised in income statement.

  The Company has not designated any financial liabilities upon initial recognition as at fair value through profit or loss.

- Interest-bearing loans and borrowings

  After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate (EIR) method. Gains and losses are recognised in profit or loss when the liabilities are derecognised, as well as through the EIR amortization process.

  Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortization is included in finance costs in profit or loss.

  The Company's financial liabilities comprising short-term borrowings, due to related parties, bank accepted notes payable and accounts payable and accrued liabilities are subsequently measured at amortized cost.

*Derecognition*

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or extinguishment is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

<u>Offsetting of financial instruments</u>

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

**4. Accounting standards issued but not yet effective:**

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are not yet effective for the year ended December 31, 2012, and have not been applied in preparing these consolidated financial statements.

(i) Financial instruments - recognition and measurement:

In October 2010, the IASB published amendments to IFRS 9, Financial Instruments ("IFRS 9 (2010)"), which provide added guidance on the classification and measurement of financial liabilities. IFRS 9 (2010) supersedes IFRS 9 (2009) and is effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. For annual periods beginning before January 1, 2015, either IFRS 9 (2009) or IFRS 9 (2010) may be applied. The Company intends to adopt IFRS 9 (2010) in its financial statements for the annual period beginning on January 1, 2015. The extent of the impact of adoption of IFRS 9 (2010) has not yet been determined.

(ii) Financial assets and liabilities:

In December 2011, the IASB amended IFRS 7-Financial Instruments: Disclosures and IAS 32 – Financial Instruments: Presentation (“IAS 32”) to clarify the requirements for offsetting financial instruments and to require new disclosures on the effect of offsetting arrangements on an entity’s financial position. The IFRS 7 amendments will be applied retrospectively for annual periods beginning on or after January 1, 2013. The IAS 32 amendments will be applied retrospectively for annual periods beginning on or after January 1, 2014. The IFRS 7 amendments will result in additional financial statement note disclosures. The Company is assessing the potential impact of the IAS 32 amendments.

(iii) Consolidated financial statements:

In May 2011, the IASB issued IFRS 10 – Consolidated Financial Statements (“IFRS 10”), which replaces portions of IAS 27 – Consolidated and Separate Financial Statements (“IAS 27”) and all of Standing Interpretation Committee – Consolidation – Special Purpose Entities (“SIC-12”). IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an investor controls one or more investees. The standard requires an investor to consolidate an investee when it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. As a consequence, IAS 27 has been amended but retains the existing guidance for separate financial statements.

**4. Accounting standards issued but not yet effective (continued):**

(iv) Joint arrangements:

In May 2011, the IASB issued IFRS 11 – Joint Arrangements ("IFRS 11"), which replaces IAS 31 – Interests in Joint Ventures and SIC-13 – Jointly Controlled Entities – Non-Monetary Contributions by Venturers. IFRS 11 requires a venturer to classify its interest in a joint arrangement as either a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting. The existing option to account for joint ventures using proportionate consolidation has been removed. For a joint operation, the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation.

As a result of the issuance of IFRS 10 and IFRS 11, IAS 28, Investment in Associates, has been amended to correspond to the guidance provided in IFRS 10 and IFRS 11.

(v) Disclosure of interests in other entities:

In May 2011, the IASB issued IFRS 12, Disclosure of Interests in Other Entities ("IFRS 12"), which contains disclosure requirements for companies that have interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities.

IFRS 10, IFRS 11 and IFRS 12, and the amendments to IAS 27 and IAS 28 are all effective for annual periods beginning on or after January 1, 2013. Early adoption is permitted, so long as IFRS 10, IFRS 11 and IFRS 12, and the amendments to IAS 27 and IAS 28 are adopted at the same time. The Company does not expect IFRS 10, IFRS 11, IAS 27 and IAS 28 to have any significant impact on its financial statement. The implementation of IFRS 12 will result in additional financial statement note disclosures.

(vi) Fair value measurement:

In May 2011, the IASB issued IFRS 13 – Fair Value Measurement ("IFRS 13"), which is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard 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. It also establishes disclosure requirements about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures. IFRS 13 is effective for annual periods beginning on or after January 1, 2013. The Company does not expect IFRS 13 to have any significant impact on its financial statements.

## 4. Accounting standards issued but not yet effective (continued):

(vii) Presentation of financial statements:

In June 2011, the IASB amended IAS 1 – Presentation of Financial Statements ("IAS 1") to require companies to group together items within OCI that may be reclassified to net income. The amendments reaffirm the existing requirements that items in OCI and net income should be presented as either a single statement or two consecutive statements. The amendments are effective for annual periods beginning on or after July 1, 2012. The Company does not expect the IAS 1 amendments to have any significant impact on its financial statements.

## 5. Critical accounting estimates and judgements:

The preparation of financial statements requires management to make estimates and judgments about the future. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Accounting estimates will, by definition, seldom equal the actual results. The following discussion sets forth management's most critical estimates and assumptions in determining the value of assets and liabilities and most critical judgments in applying accounting policies.

### Allowance for doubtful accounts

The Company must make an assessment of whether accounts receivable are collectible from customers. Accordingly, management establishes an allowance for estimated losses arising from non-payment and other sales adjustments, taking into consideration customer creditworthiness, current economic trends and past experience. Amounts past due is based on balances exceeding the agreed upon credit period. If future collections differ from estimates, future earnings would be affected.

### Inventory

In determining the net realizable amount of inventory, the Company needs to estimate the saleability of the inventory, the price of sales, and the costs to sell. Changes in assumptions about these factors could affect the reported fair value of inventory. Costing of inventory also needs estimate relating to overhead allocation and labour allocation.

### Residual value and useful lives of property and equipment, and investment property

The Company estimates the residual value and useful lives of property and equipment, and investment property, at the end of each reporting period. The results will impact the depreciation costs recorded in the period and future periods.

## 5. Critical accounting estimates and judgments (continued):

### Impairment of assets

An assessment is carried out at each reporting date to determine whether there is objective evidence that a financial or non-financial asset, is impaired. If any such indication exists, any impairment loss is determined and recognized as follows:

For current receivables carried at amortized cost, the impairment loss is recognized when there is objective evidence of impairment and measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective rate where the effect of discounting is material. Objective evidence of impairment includes observable data that comes to the attention of the Company about events that have an impact on the asset's estimated future cash flows such as significant financial difficulty of the debtor. If in a subsequent period the amount of impairment loss decreases, the impairment loss is reversed through profit or loss. A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognized in prior years.

### Impairment of goodwill

Goodwill is tested for impairment annually as at December 31 and when circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of each CGU (or group of CGUs) to which the goodwill relates to. For the purpose of testing this goodwill for impairment, any of the related deferred tax liabilities recognised on acquisition that remain at the balance sheet date reduce the goodwill amount and any residual goodwill is treated as part of the relevant CGU or group of CGUs. Where the recoverable amount of the CGU is less than its carrying amount including goodwill, an impairment loss is recognised. Impairment losses relating to goodwill cannot be reversed in future periods.

Management judgment is applied in determining the relevant CGUs that the goodwill relates to. In connection with the Company's goodwill, management has determined that the goodwill balance relates to MAM (Note 15). Estimates and assumptions are required to determine the recoverable amount of the CGU.

### Income taxes

The Company computes an income tax provision in each of the jurisdictions in which it operates. However, actual amounts of income tax expense only become final upon filing and acceptance of the tax return by the relevant authorities, which occur subsequent to the issuance of the financial statements. Additionally, estimation of income taxes includes evaluating the recoverability of deferred tax assets based on an assessment of the ability to use the underlying future tax deductions before they expire against future taxable income. The assessment is based upon existing tax laws and estimates of future taxable income. To the extent estimates differ from the final tax return, earnings would be affected in a subsequent period. To the extent that forecasts differ from actual results, adjustments are recorded in subsequent periods.

**5. Critical accounting estimates and judgments (continued):**

**Uncertain tax positions**

The Company is subject to taxation in numerous jurisdictions. There are many transactions and calculations during the course of business for which the ultimate tax determination is uncertain. The Company maintains provisions for uncertain tax positions that it believes appropriately reflect its risk. These provisions are made using the best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors. The Company reviews the adequacy of these provisions at the end of the reporting period. However, it is possible that at some future date, liabilities in excess of the Company's provisions could result from audits by, or litigation with relevant tax authorities. Where the final outcome of these tax-related matters is different from the amounts that were initially recorded, such differences will affect the tax provisions in the period in which such determination is made.

**Functional currency**

Selection of functional currency is open to judgment. The conclusion will affect the translation method and the disposition of resulting gains or losses for each foreign subsidiary. In many cases the functional currency may not be clearly identifiable if a foreign operation conducts significant amounts of business in two or more countries. When the indicators are mixed and the functional currency is not obvious, management uses its judgment to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and condition. Consequently, how the Company applies IAS 21 – The effects of changes in foreign exchange rates, for the purpose of determining its functional currency - whether it is an investment holding company or any other type of entity - requires the exercise of judgment.

**Fair value**

Where the fair value of financial assets and financial liabilities and the fair value of stock based payments recorded in the statement of financial position cannot be derived from active markets, their fair value is determined using valuation techniques including the discounted cash flow model and stock options and warrants valuation model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments on the discounted cash flow model include considerations of inputs such as liquidity risk, credit risk and volatility. The estimates on the measurement of stock options and warrants valuation include dividends, life of the instruments, volatility and vesting of options. Changes in assumptions about these factors could affect the reported fair value of financial instruments and the equity instruments.

Fair values related to assets acquired and liabilities assumed in a business combination are determined using external appraisal or where appropriate, they are based on valuation technique. Additionally, fair value estimate disclosures relating to investment properties are based on a discounted cash flow method taking into consideration annual rental cash flows.

(Expressed in Canadian dollars, unless otherwise indicated)

## 5. Critical accounting estimates and judgments (continued):

### Business combination versus asset acquisition

The determination of whether an acquisition constitutes a business is a matter of judgment based on an assessment of the specific facts and circumstances. The Company bases its assessment on historical experience, current trends and various other assumptions that are believed to be reasonable under certain situations, especially for an acquisition of a development stage entity that has yet to commence planned principal operations. The conclusion as to whether an acquired set of activities and assets is a business can lead to significantly different accounting results. The assessment will affect the accounting as of the acquisition date, but will also affect future amortization, depreciation and possible impairment. Accordingly, the conclusion as to whether a business has been acquired can have a significant effect on the Company's reported financial position and financial performance.

## 6. Short-term investments:

The Company engaged a consulting company that was controlled by the Chief Executive Officer of the Company to manage certain investment in shares of publicly traded companies under the Company's name. Pursuant to the terms of the agreement, the consulting company guaranteed the value of the initial amount of the portfolio investment of $775,680 (RMB4,800,000) and would be compensated 20% of any net gains in the portfolio when realized. In December 2011, the agreement was terminated by both parties after the consulting company had offset the loss of $161,600 incurred at the date of termination against the Company's short-term borrowing from the consulting company in the same amount. See note 10(e). The Company sold all the short-term investments in 2012, and accordingly recorded a net investment income of $90,294 (2011-$(177,992)).

## 7. Trade receivables:

(a) Components of trade receivables are as follows:

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | $ | $ |
| Trade receivables | 8,127,896 | 8,893,403 |
| Allowance for doubtful debts | (491,447) | (489,360) |
| | 7,636,469 | 8,404,043 |

The Company performs periodic credit reviews of its customers and customer credit is extended following an evaluation of creditworthiness. The credit terms granted to different customers range from 30 days to 150 days. The Company performs ongoing credit evaluations of its customers, but does not require collateral to support customer accounts receivable. No interest is charged on trade receivables outstanding. The Company establishes an allowance for doubtful accounts based on the credit risk applicable to particular customers, historical experience and other information. Trade receivables disclosed above include amounts that are past due at the end of the reporting period but against which the Company has not recognized an allowance for doubtful receivables because there has not been a significant change in credit quality and the amounts are still considered recoverable.

(Expressed in Canadian dollars, unless otherwise indicated)

## 7. Trade receivables (continued):

As at December 31, 2012, trade receivables from one customer was 12% (2011 – 18%) of total trade and other receivables. As at December 31, 2012 around 91% (2011 - 77%) of trade and other receivables are outstanding for less than 90 days. Allowance for doubtful debts is as follows:

| Allowance for doubtful debts | 2012 | 2011 |
|---|---|---|
| | $ | $ |
| Balance at beginning of the period | 489,360 | 322,428 |
| Additional bad debt provision | 117,608 | 264,354 |
| Bad debt recovery | (109,211) | (60,341) |
| Foreign exchange gain (loss) | (6,310) | (37,081) |
| | 491,447 | 489,360 |

## 8. Inventories:

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Raw materials | $ 1,480,160 | 1,099,568 |
| Parts and work in process | 2,228,257 | 2,662,086 |
| Finished goods | 3,217,248 | 4,701,044 |
| | $ 6,925,665 | 8,462,698 |

The amount of inventory recognized as expense during the year ended December 31, 2012 was $19,796,357 (2011: $22,349,041). The Company recorded a provision of $1,392,036 (2011: $1,007,846) for slow moving inventory and reversed an impairment of $nil (2011: $7,356) related to finished goods inventory written off and subsequently sold.

## 9. Investments in associates:

(a) At December 31, 2012, the Company has an associate of Shenzhen Delicheng Technologies Co., Ltd. ("Delicheng") carrying on business in China which affects the profits and assets of the Company. The Company owns a 30% interest in Delicheng which was acquired in 2010. The Company has determined that it has significant influence and has accounted for its investment in Delicheng using the equity method. The Company's share of income during the year was $25,350 (2011-$14,142)

(b) In 2011, the Company disposed of the 20% equity interest in Shenzhen Jietexing Electronics Co., Ltd. ("Jietexing") to the controlling shareholder for RMB 100,000 with no material gain or loss. Jietexing was incorporated in 2010 as a sales agent to serve some small customers of Jite Shenzhen.

## 10. Related party transactions:

(a) Included in general and administration expenses was $50,000 (2011: $50,000) charged in 2012 by a company controlled by the Chief Executive Officer ("CEO") of the Company for consulting fees related to management and strategic planning services.

(b) Included in the due to related parties as at December 31, 2012 was an amount due to Delicheng of $72,005 (RMB 450,874) (December 31, 2011 - $44,510; RMB275,434) for the purchase of screws. During 2012 Jite Shenzhen purchased product from Delicheng equal to $289,810 (RMB 1,830,771); 2011 - $310,086; RMB 2,082,510). In 2011, Jite Shenzhen had a loan receivable of $56,367 (RMB 348,808) from Delicheng. The loan bears annual interest of 5.76%.

(c) Included in due to/from related parties as at December 31, 2012 was a loan of $319,000 (RMB 2,000,000)(2011: nil) payable to the CEO of McVicar for a consulting fee in connection with the acquisition of Anhui (note 14(b)(ii))paid by the CEO on behalf of the Company to unrelated third party. The loan is interest free and is payable on demand. In January 2013, the loan was repaid.

(d) During 2012, the Company received a bridge financing facility from the CEO of McVicar to assist in the purchase of the non-controlling interest of Jite. The principal amount was up to $1.4 million and the interest rate was based on the prime rate of interest charged by the Bank of Montreal in Toronto on Canadian dollar loans to its most creditworthy customers plus one percent (1%) payable monthly in arrears on the balance outstanding. If the loan is not repaid by June 29, 2012, additional interest at the rate of 2% per month, calculated daily will be payable. The bridge financing facility was secured by a promissory note having a principal amount of $1.4 million and maturing on June 29, 2012.

Upon execution of the agreement, a total amount of $1.4 million loan was borrowed on April 4, 2012, and was repaid on June 15, 2012, together with borrowing interest of $11,046.

(Expressed in Canadian dollars, unless otherwise indicated)

**10. Related party transactions (continued):**

(e) In October 2011, Jite Shenzhen borrowed $161,600 (RMB 1,000,000) from the company controlled by the CEO of the Company for short-term working capital purposes. In December 2011, the loan payable was offset against the Company's receivable from the company for the guaranteed cost value of short-term investment.

The Company engaged the consulting company that was controlled by the Chief Executive Officer of the Company and to manage certain investment in shares of publicly traded companies under the Company's name. Pursuant to the terms of the agreement, the consulting company guaranteed the value of the initial amount of the portfolio investment of $775,680 (RMB4,800,000) and would be compensated 20% of any net gains in the portfolio when realized. In December 2011, the agreement was terminated by both parties after the consulting company had offset the amount owing to the Company to cover the loss of $161,600 incurred at the date of termination against the Company's short-term borrowing from the consulting company in the same amount.

(f) As at December 31, 2012, the Company owed certain officers and directors unpaid salaries and director's fees of $22,428 (2011: $12,500).

(g) Transactions with key management personnel:

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company and/or its subsidiaries, directly or indirectly, including any external director of the Company and/or its subsidiaries. Key management personnel include: the Chief Executive Officer, the Chief Financial Officer, the Vice President and the Company's directors.

Remuneration of key management of the Company comprised the following expenses:

| | 2012 | 2011 |
|---|---|---|
| Salaries, consulting fees and other benefits | $ 299,184 | $ 307,371 |
| Directors' fees | 22,443 | 22,900 |
| Stock-based compensation expense | - | 96,728 |
| | $ 321,617 | $ 426,999 |

## 11. Bank accepted notes payable:

Hongbo, a subsidiary of the Company, maintains a credit facility with a Chinese Bank for a total amount of $3,194,000 (RMB 20,000,000) (2011 - $3,232,000 (RMB 20,000,000), of which $1,836,550 (RMB11,500,000), is secured by the land use rights and facilities of Hongbo, and the remaining amount of $1,357,450 (RMB8,500,000) is guaranteed by Jite Shenzhen. The credit facility is to be used for the issuance of notes payable up to a maximum amount of $6,388,000 (RMB40,000,000). Under the terms of the facility, on issuance of notes half of the value must be deposited as cash in the bank by Hongbo and held until maturity of the notes. As at December 31, 2012, Hongbo utilized $1,038,050 (RMB6,500,000) (December 31, 2011 - $2,100,800 (RMB13,000,000)) of the facility by issuing $2,076,100 (RMB13,000,000) (2011-$4,201,600 (RMB26,000,000)) notes payable due within six months from the dates of issuance. Included in restricted cash as at December 31, 2012 is a deposit of $1,038,050 (RMB6,500,000) (2011-$2,100,800 (RMB13,000,000)) or half the amount of these notes payable.

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(Expressed in Canadian dollars, unless otherwise indicated)

## 12. Property, plant and equipment

| Cost | Buildings | Metal and plastic moulds | Land use rights | Transportation equipment | Furniture and equipment | Leasehold improvements | Manufacturing equipment | Construction in progress | Total |
|---|---|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ | $ | $ |
| Balance, January, 2011 | 5,030,770 | 2,111,255 | 1,462,106 | 427,555 | 787,987 | 696,470 | 3,035,415 | 559,165 | 14,110,723 |
| Additions | - | 537,292 | - | - | 82,038 | 19,496 | 2,136,931 | 208,236 | 2,983,993 |
| Disposal/transfer | (1,020,783) | (86,708) | (280,836) | (62,162) | (40,508) | - | (112,312) | - | (1,603,309) |
| Foreign currency translation | 322,553 | 149,704 | 103,674 | 30,317 | 55,874 | 49,385 | 215,235 | 39,649 | 966,391 |
| Balance, December 31, 2011 | 4,332,540 | 2,711,543 | 1,284,944 | 395,710 | 885,391 | 765,351 | 5,275,269 | 807,050 | 16,457,798 |
| Additions | 52,110 | 253,276 | 1,574,325 | - | 27,654 | - | 59,284 | 4,736,306 | 6,702,955 |
| Disposal/transfer | (1,510,302) | - | (1,119,152) | - | (12,349) | - | (413,456) | (84,067) | (3,139,326) |
| Foreign currency translation | (50,939) | (31,881) | 128,622 | (4,653) | (9,885) | (4,048) | (65,135) | (9,489) | (47,408) |
| Balance, December 31, 2012 | 2,823,409 | 2,932,938 | 1,868,739 | 391,057 | 890,811 | 761,303 | 4,855,962 | 5,449,800 | 19,974,019 |

| Accumulated amortization | Buildings | Metal and plastic moulds | Land use rights | Transportation equipment | Furniture and equipment | Leasehold improvements | Manufacturing equipment | Construction in progress | Total |
|---|---|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ | $ | $ |
| Balance, January 1, 2011 | 719,791 | 1,585,057 | 38,855 | 188,471 | 557,026 | 564,910 | 1,247,881 | - | 4,901,991 |
| Additions | 103,240 | 190,589 | 5,501 | 40,503 | 74,655 | 68,360 | 492,422 | - | 975,270 |
| Disposal/transfer | (52,659) | (38,400) | (12,766) | (56,461) | (33,461) | - | (76,842) | - | (270,589) |
| Foreign currency translation | 102,078 | 224,786 | 5,427 | 26,728 | 78,996 | 80,114 | 176,969 | - | 695,098 |
| Balance, December 31, 2011 | 872,450 | 1,962,032 | 37,017 | 199,241 | 677,216 | 713,384 | 1,840,430 | - | 6,301,770 |
| Additions | 213,617 | 255,544 | 2,259 | 27,955 | 70,332 | 35,802 | 372,571 | - | 978,080 |
| Disposal/transfer | (72,557) | - | (50,871) | - | (6,897) | - | (101,128) | - | (231,454) |
| Impairment | - | - | - | - | - | - | (161,107) | - | (161,107) |
| Foreign currency translation | 64,588 | (23,068) | 27,565 | (2,343) | (5,005) | (8,388) | (22,861) | - | 30,488 |
| Balance, December 31, 2012 | 1,078,098 | $ ,194,508 | 15,970 | 224,853 | 735,646 | 740,798 | 1,927,905 | - | 6,917,777 |

| Net book values | Buildings | Metal and plastic moulds | Land use rights | Transportation equipment | Furniture and equipment | Leasehold improvements | Manufacturing equipment | Construction in progress | Total |
|---|---|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ | $ | $ |
| December 31, 2011 | 3,460,090 | 749,511 | 1,247,928 | 196,469 | 208,175 | 51,967 | 3,434,839 | 807,050 | 10,156,028 |
| December 31, 2012 | 1,745,311 | 738,430 | 1,852,769 | 166,204 | 155,165 | 20,505 | 2,928,057 | 5,449,800 | 13,056,242 |

## 12. Property, plant and equipment (continued):

(a) In 2012, Jite Kunshan's buildings with a net book value of $1,437,745 (2011: $968,124) and land use rights with a net book value of $1,068,281 (2011-$268,070) were reclassified as investment property as a result of the suspension of the trial operation in the Kunshan plant and end of owner occupation. For more information see Note 13. In connection with the suspension of the trial operation, a 50% impairment provision was set up for the equipment with a net book value of $168,861(RMB 1,066,402) recorded in McVicar Kunshan as at December 31, 2012.

(b) Included in construction in progress is a payment of $366,832 (RMB2.3 million) made by Hongbo in 2005 to the local government for purchase a piece of land for the purposes of business expansion. The finalization of the full purchase of the land-use rights is still pending.

(c) Included in the property, plant and equipment was $54,209 (RMB 339,444) of capitalized interest and $351,300 (RMB 2,200,000) of capitalized consulting fees in connection with the acquisition of Anhui. See note 14(b) (ii) for more information.

(d) In 2012, the Company further wrote off certain idle and obsolete equipment with a net book value of $126,892 (RMB 794,565) as at December 31, 2012 at the Luyuan plant.

## 13. Investment property:

In 2012, the trial operation in Kunshan was suspended by management. As a result, the previous owner-occupied portion of building and land use rights were reclassified from property, plant and equipment as investment property due to a change in a use. The investment property is recorded at cost less accumulated amortization and impairment cost.

On March 23, 2011 the Company signed a rental agreement to lease a building in Kunshan plant to a third party. The term of the lease is from April 1, 2011 to April 1, 2014. Annual rent is $172,476 (RMB 1,080,000). On the signing of the agreement, $100,611 (RMB630,000) was received as half year rent and one month deposit, that was recorded as deferred revenue on the consolidated statement of financial position. As at December 31, 2011 and 2012 the deferred revenue was $29,225 (RMB183,000).

On November 1, 2011, the Company signed another rental agreement to lease a building in Kunshan plant to a third party. The term of the lease is from November 1, 2011 to October 3, 2014. Annual rental is $91,987 (RMB 576,000), one month rental of $7,666 (RMB 48,000) wars received as a deposit. As at December 31, 2012 the deferred revenue was $46,952 (RMB 294,000).

Based on the annual rental of the agreement, the Company has determined there is no impairment loss to the investment property, and the fair value of the investment property, using a discounting cash flow method of valuation with the assumptions of an annual discount rate of 8% and 42 years of annual rental cash flow of $360,277 (pre-tax), is $4,325,737. No independent valuation of the investment property was prepared as management believes that the result will not be materially different from the above calculation using the cash flow method.

(Expressed in Canadian dollars, unless otherwise indicated)

**13. Investment property (continued):**

| Cost | Buildings | Land use rights | Total |
|---|---|---|---|
| Balance, January 1, 2011 | $ - | $ - | $ - |
| Transfer | 1,020,783 | 280,836 | 1,301,619 |
| Foreign currency translation | - | - | - |
| Balance, December 31, 2011 | 1,020,783 | 280,836 | 1,301,619 |
| Transfer | 1,510,302 | 1,119,152 | 2,629,454 |
| Foreign currency translation | (12,003) | (1,048) | (13,051) |
| Balance, December 31, 2012 | $ 2,519,082 | $ 1,398,940 | $ 3,918,022 |

| Accumulated amortization | Buildings | Land use rights | Total |
|---|---|---|---|
| Balance, January 1, 2011 | $ - | $ - | $ - |
| Transfer and depreciation | 52,659 | 12,766 | 65,425 |
| Foreign currency translation | - | - | - |
| Balance, December 31, 2011 | 52,659 | 12,869 | 65,425 |
| Transfer and depreciation | 134,786 | 82,665 | 217,451 |
| Foreign currency translation | (447) | (151) | (598) |
| Balance, December 31, 2012 | $ 186,998 | $ 95,280 | $ 282,278 |

| Net book value | Buildings | Land use rights | Total |
|---|---|---|---|
| December 31, 2011 | $ 968,124 | $ 268,070 | $ 1,236,194 |
| December 31, 2012 | $ 2,332,084 | $ 1,303,660 | $ 3,635,744 |

**14. Acquisition and divestitures:**

(a) JITE:

(i) In January, 2012 the Company entered into a support agreement with its 56.2% owned subsidiary Jite pursuant to which the Company agreed to offer to acquire, directly or indirectly, all of the 8,788,363 outstanding common shares of Jite which it did not already own and up to an additional 1,186,000 shares issuable upon exercise of existing options of Jite for a cash price of $0.60 per share. During the year, the Company acquired 8,282,925 common shares of Jite had been tendered to McVicar for cash consideration of $0.60 for each share, resulting into McVicar owning 94% of Jite.

On April 16, 2012, the Company entered into an agreement with its 93.67% owned subsidiary Jite pursuant to which Jite has agreed to amalgamate with 1872706 Ontario Limited, a wholly owned subsidiary of McVicar that was newly incorporated on April 12, 2012 for the amalgamation, to form a new corporation to be named Jite Technologies Inc., which would be a wholly owned subsidiary of McVicar. On the Amalgamation each outstanding Jite common share, other than those held by shareholders who exercise their dissent and appraisal rights under section 185 of the Business Corporations Act (Ontario) and by McVicar which were cancelled, were exchanged for one redeemable preferred share of the amalgamated corporation, which were redeemed by the amalgamated corporation at a redemption price of $0.60 per preferred share as soon as the Amalgamation became effective. All of the issued shares of 1872706 Ontario Limited (currently held by McVicar) were exchanged for shares of the amalgamated corporation. Consequently, completion of the Amalgamation will result in McVicar having effectively acquired 100% of the issued shares of Jite.

The Jite stock options were acquired through a payment for options with an option exercise price less than the offer price (“in-the-money”). Of the 1,180,000 stock options outstanding at the time of the offer 820,000 had an exercise price equal to $0.45 per share. The Company purchased 820,000 stock options for a total cost equal to $123,000 at a purchase price per option equal to $0.15. Of the 820,000 stock options purchased, Directors and Officers of Jite and McVicar sold 750,000 stock options for a total payment equal to $112,500. All the options acquired were then cancelled.

As at December 31, 2012 the Company owned 100% of the common shares of Jite, of which 505,438 untendered shares were converted to redeemable preferred shares and were presented for and redeemed for at $0.60 each. While the preference share have been legally redeemed, they will be paid out in future periods when presented with the appropriate documentation from the previous holder of the Jite shares. The transaction with non-controlling interest is treated as transactions with equity owners of the Company.

(Expressed in Canadian dollars, unless otherwise indicated)

**14. Acquisition and divestitures (continued):**

(a) JITE: (continued)

| | Amount $ |
|---|---|
| Consideration for shares acquired | 5,273,018 |
| Consideration for options acquired | 123,000 |
| Total consideration | 5,396,018 |
| Non-controlling interests | (9,546,497) |
| Gain on acquisition of non-controlling interests(i) | (4,150,479) |

The payments for shares were made or will be made based on the following:

| | Shares | $ |
|---|---|---|
| Total to be acquired | 8,788,363 | 5,273,018 |
| Purchased as at December 31, 2012 | 8,282,925 | 4,969,755 |
| Remainder to be paid for redeemed preference shars | | 303,263 |

The movement of the Company's ownership in Jite is as follows:

| | Ownership |
|---|---|
| January 1, 2012 | 56.2% |
| Acquisition | 43.8% |
| December 31, 2012 | 100% |

(i) Includes adjustment to accumulated other comprehensive income for non-controlling interests' share of foreign currency translation adjustments

(Expressed in Canadian dollars, unless otherwise indicated)

## 14. Acquisition and divestitures (continued):

(a) JITE: (continued)

(ii) In 2011, the Company acquired the remaining 60% equity interest in Shenzhen Relisen Electronic Co., Ltd. ("Relisen") that was owned by unrelated third parties. After the transaction the Company owns 100% of Relisen. The price for the 60% equity interest of Relisen was $520,960 (RMB3,200,000) that were to be made on three instalments, of which $52,096 (RMB320,000) was paid on signing of the agreement, $416,768 (RMB2,560,000) on the close of the transaction, and $52,096 (RMB320,000) nine months after the signing of the agreement. As at December 31, 2012, $23,682 (RMB 142,290) remained unpaid. The Company used step acquisition accounting for the acquisition in 2011. The Company has determined that the ownership interest of the 40% of Relisen held before the acquisition had a fair value of $347,601 (RMB2,135,145) and a carrying value of the date of acquisition. The identified assets and liabilities of Relisen at acquisition are as follows:

| | $ | RMB |
|---|---|---|
| Cash | 14,085 | 86,515 |
| Accounts receivable | 765,285 | 4,700,772 |
| Inventories | 1,194,563 | 7,337,608 |
| Equipment | 1,456,509 | 8,878,303 |
| Accounts payable | (2,119,524) | (13,019,190) |
| Due to related parties | (298,998) | (1,836,597) |
| Other current liabilities | (231,148) | (1,419,828) |
| Deferred tax asset | 99,353 | 610,277 |
| | 880,125 | 5,337,860 |

The Company recorded a gain of $158,816 (RMB975,531) in connection with the step acquisition in 2011.

(b) MAM:

(i) In June 2012, the Company acquired the remaining common shares of Changlong that the Company did not hold. The Company purchased the common shares representing 8% of the outstanding shares for $352,880 (RMB 2,000,000). The transaction with non-controlling interests is treated as transactions with equity owners of the Company.

| | Amount $ |
|---|---|
| Amount paid for shares acquired | 352,880 |
| Non-controlling interests | (238,630) |
| Loss on acquisition of non-controlling interests | 114,250 |

**14. Acquisition and divestitures (continued):**

(b) MAM: (continued)

(ii) In August 2012, the Company won an open bid auction to acquire a 100% equity interest in Anhui Linghua Co. Ltd. (“Anhui”), a chemical company located in the Xiangyu Chemical Industrial Park, Dongzhi County, Chizhou City, Anhui province China, for a total purchase price of RMB37,500,000 (approximately $6.0 million). Anhui Linghua has 200 mu (approximately 130,000 square meters) of land and infrastructure for a chemical operation. Pursuant to the purchase agreement, the acquisition was solely comprised of the land use rights, building and equipment, excluding any liabilities for the periods prior to the acquisition date, for which the local government, as a guarantor of any unsettled existing and contingent liabilities, will be responsible for the final settlement.

Since the acquisition was legally completed through the purchase of a 100% equity interest in Anhui, certain existing assets and liabilities in the net amount of $1,440,468(RMB 9,019,839), primarily consisting of an outstanding bank loan, were included in the Anhui’s records on the date of acquisition, although these were not considered to be part of the acquisition pursuant to the purchase agreement. However, the Company is legally liable for the repayment of the outstanding bank loan when it is due. As a result, a supplementary agreement was reached between the Company and the seller, authorizing the Company to (i) directly repay the bank loan to the bank when it is due by withholding the same amount from the purchase price, (ii) pay the interest for the outstanding bank loan for the period after the date of acquisition. The outstanding bank loan in the amount of $1,597,000 (RMB 10,000,000) is due on April 28, 2013, bearing interest rate of 10.1%, and is included in the short-term borrowings of the consolidated financial statements.

The Company is currently still negotiating with the local tax authority relating to a potential tax impact of the acquisition. As there is uncertainty to the final result of negotiation, no amounts for the deferred tax assets was recognized.

Currently, Anhui is still under its stage of construction, and the Company is working on a business development plan for the Anhui plant. As a result, the Company has determined that the acquisition of Anhui does not constitute an acquisition of a business, and has accounted for the acquisition as a purchase of land use rights and construction in progress.

(Expressed in Canadian dollars, unless otherwise indicated)

## 14. Acquisition and divestitures (continued):

(b) MAM: (continued)

The assets at acquisition date are as follows:

| | RMB | $ |
|---|---|---|
| Land use rights | 9,801,561 | 1,565,309 |
| Building | 15,927,214 | 2,543,576 |
| Equipment | 14,310,669 | 2,285,414 |
| Total | 40,039,444 | 6,394,299 |
| Considerations paid: | | |
| Capitalized interest and expense(*) | 2,539,444 | 405,549 |
| Cash paid or payable | 37,500,000 | 5,988,750 |
| Total | 40,039,444 | 6,394,299 |

Note: Capitalized interest and expense was comprised of capitalized interest of $54,249 (RMB 339,444) on the outstanding bank loan, and capitalized consulting fees of $351,300 (RMB 2,200,000) in connection with the acquisition of Anhui.

As at December 31, 2012, $4,375,780 (RMB 27,400,000) of the total purchase price was paid. The remaining amount is comprised of $1,597,000 (RMB 10,000,000) that was withheld for the repayment of the outstanding bank loan when it is due and $159,700 (RMB 1,000,000) that will be paid upon transfer of ownership certificate.

## 15. Goodwill:

| | Goodwill in Jite | Goodwill in MAM | Total value |
|---|---|---|---|
| Balance, January 1, 2011 | $ 2,659,121 | $ 3,734,514 | $ 6,393,635 |
| Impairment | (2,701,413) | – | (2,701,413) |
| Foreign exchange | 42,292 | 264,807 | 307,099 |
| Balance, December 31, 2011 | $ - | $ 3,999,321 | $ 3,999,321 |
| Foreign exchange | - | (47,023) | (47,023) |
| Balance, December 31, 2012 | $ - | $ 3,952,298 | $ 3,952,298 |

(Expressed in Canadian dollars, unless otherwise indicated)

**15. Goodwill (continued):**

During the second quarter of 2012, due to the recent relocations of the Changlong and Luyuan facilities and the possible need to re-locate the Hongbo facility, the Company decided to reduce goodwill related to MAM to nil. As at December 31, 2012, management believes that the key assumptions used in Q2'12 about relocation of Hongbo facility was not appropriate due to the further discussions with the local government. Currently, the Company is still negotiating with the local government about relocation of Hongbo facility, and accordingly the uncertainty associated with possible relocation cannot be reliably determined. As a result, management used value in use to determine the recoverable amount of goodwill in MAM at the year-end. The preparation of the forecast requires a number of key assumptions such as volume, price, product mix, which will create a basis for future growth and gross margin. These figures are set in relation to historic figures and anticipated market growth. The key assumption applied to determine the fair value was a multiplier equivalent to 8 (2011-8) times EBITDA. The recoverable amount of MAM continues to be higher than its carrying value, based on its value in use. Management believes that any reasonably possible adverse change in the key assumptions would not reduce the recoverable amount below its carrying amount.

In 2011, an impairment loss of goodwill in Jite was recognized due to profits continuing to be lower than expected by management. Management used the fair value less costs to sell approach to determine the recoverable amount. The basis of this was based on the post year-end transactional value established by the privatization transaction that occurred in Jite in which McVicar acquired 37.47% of Jite.

**16. Shareholder's equity:**

(a) Authorized and issued:

The Company's authorized share capital stock consists of an unlimited number of common shares.

Issued and outstanding:

| Common shares | shares | Number of Amount |
|---|---|---|
| Balance, December 31, 2012 | 35,627,320 | $ 26,084,508 |

In January 2011 the Company conducted a normal course issuer bid (shares buy back) that allowed the Company to purchase up to a maximum of 1,800,000 of its own common shares representing approximately 4.8% of its 37,427,320 issued and outstanding shares as at January 4, 2011. During the year in 2011 the Company purchased and cancelled 1,793,500 of its own shares at $893,151, of which $1,313,108 was reduced to share capital and the difference credited to retained earnings.

During the first quarter of 2012, the Company purchased and cancelled 6,500 of its own shares at $2,470, of which $4,759 was a reduction to share capital and the remainder was credited to retained earnings.

(Expressed in Canadian dollars, unless otherwise indicated)

## 16. Shareholder's equity (continued):

(b) Stock-based compensation plan:

The Company has established a common share purchase option plan for directors, officers, employees and consultants. Options are granted at a price no lower than the market price of the common shares at the time of the grant less allowable discounts.

In 2012, $nil (2011: $98,744) stock-based compensation expense was recorded for the options vested in 2011, including $nil (2011: $33,316) from Jite. All of the stock-based compensation expense, $nil (2011: $98,744) was for employees.

A summary of the Company's options granted and exercised is presented below:

| | Options Outstanding | Weighted average exercise price |
|---|---|---|
| Options outstanding, January 1, 2011 | 2,065,000 | $ 0.74 |
| Expired | (175,000) | 1.01 |
| Options outstanding, December 31, 2011 | 1,890,000 | $ 0.71 |
| Expired | (375,000) | 0.54 |
| Options outstanding, December 31, 2012 | 1,515,000 | $ 0.75 |

The following table summarizes information about the options outstanding and exercisable at December 31, 2012:

| | Options outstanding | | Options exercisable | | |
|---|---|---|---|---|---|
| Exercise price | Outstanding number | contractual life (years) | Weighted average remaining exercise price | Weighted average Number exercisable | Remaining contractual life |
| $ 1.10 | 635,000 | 0.75 | $ 1.10 | 635,000 | 0.75 years |
| 0.50 | 880,000 | 2.42 | 0.50 | 880,000 | 2.42 years |
| | 1,515,000 | 1.85 | $ 0.75 | 1,515,000 | 1.85 years |

## 17. Retained earnings (deficit):

Pursuant to Chinese laws all foreign entities are required to set aside 10% of their net income each year as a general reserve fund and an expansion fund until the balance of the fund has reached 50% of the entity's registered capital before the retained earnings can be distributed as dividends. This fund is only eligible for distribution to shareholders at the time of winding up the foreign entity. The funds accumulated as at December 31, 2012 were $1,493,741 (RMB9,272,529) (2011 - $1,098,739; RMB6,799,126) and are included as part of retained earnings. Should the subsidiaries in China declare dividends to shareholders, they would have to accrue the funds sufficiently before distributing dividends.

(Expressed in Canadian dollars, unless otherwise indicated)

## 18. Change in non-cash operating working capital:

| | 2012 | 2011 |
|---|---|---|
| Trade receivables | $ 451,189 | $ 649,266 |
| Other assets | 128,598 | 193,118 |
| Inventories | 1,018,319 | (430,914) |
| Trade payables | 538,313 | 231,952 |
| Taxes payable | 813,942 | (140,300) |
| Deferred revenue | 2,630 | - |
| | $ 2,952,991 | $ 503,122 |

## 19. Commitments and contingencies:

Operating leases:

The Company and its subsidiaries have entered into various operating lease agreements for leased premises in the normal course of operations, with the rents being charged to operations incurred during the year. The consolidated minimum lease payments for all lease agreements in each of the next five years expiring until 2016 are as follows:

| | Total |
|---|---|
| 2013 | $ 596,800 |
| 2014 | 523,853 |
| 2015 | 523,853 |
| 2016 | 261,927 |
| | $ 1,906,433 |

## 20. Capital management:

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Company considers its capital to consist of share capital, retained earnings, accumulated other comprehensive income and contributed surplus. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year over year sustainable profitable growth. The Company's officers are responsible for managing the Company's capital and do so through quarterly meetings and regular review of financial information. The Company's Board of Directors is responsible for overseeing this process.

The Company manages its capital structure with the objective of providing sufficient resources to meet both operating and acquisition requirements, to make sure that the Company could grow steadily in a fast growing economy in China and maximize long-term shareholder value, while remaining a going concern.

There were no changes in the Company's approach to capital management during the years ended December 31, 2012 and 2011. The Company does not pay dividends.

## 21. Financial instruments and risk management:

(a) Fair values:

These estimates are subjective in nature and involve uncertainties in significant matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

As at December 31, 2012, the fair value of trade receivables, account payables, and accrued liabilities, bank accepted notes payable, and short-term borrowings on the consolidated balance sheets approximate carrying value because of the limited term of these instruments.

Short-term investments are stated at fair value, which is based on quoted market price. As at December 31, 2012, all the short-term investments are sold, as compared to its fair value of $2,737,583 on the consolidated balance sheet at December 31, 2011.

The carrying values of the Company's due to and due from related parties balances approximate fair value. The Company's financial instruments that are carried at fair value, consisting of short-term investments, have been classified as Level 1 within the fair value hierarchy.

(b) Financial risk factors:

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

(i) Foreign exchange risk:

Foreign exchange risk is the risk that fluctuations in foreign exchange rates will affect the Company's income or value of or cash flow related to its financial instruments. The Company is exposed to currency risk as substantially all of the assets, liabilities and operations are denominated in RMB. The appreciation or devaluation of RMB against the Canadian dollar may have a positive or negative impact on the results of operations of the Company. At December 31, 2012, substantially all of the Company's cash and all of its debt were denominated in a foreign currency.

The Company and its subsidiaries do not use derivative instruments to reduce their exposure to foreign currency risk.

As at December 31, 2012, the Company held foreign currency cash of RMB 14,358,927 (2011 - RMB 13,220,103) and US$ 5,111,414 (2011 - US$ 6,625,077).

As at December 31, 2012, with other variables unchanged, a +/-1% change in the U.S. dollar to Canadian dollar exchange rate would increase/decrease net income for the year by $58,679(U.S. $58,682), and a +/-1% change in the exchange rate of RMB would increase/decrease the cumulative translation adjustment by $ 21,843 (RMB 137,895).

**21. Financial instruments and risk management (continued):**

(b) Financial risk factors: (continued)

(ii) Credit risk:

Credit risk is the risk of financial loss due to failure of the Company's customer or counterparties to meet its contractual obligations, and arises primarily in relation to trade receivable and due from related parties. Exposure to credit risk is limited, due to the large number of customers. The Company and its subsidiaries perform regular credit assessments of its customers and provide allowances for potentially uncollectible trade receivable based on the credit risk applicable to particular customers, historical experience and other information. In addition, the Company performs periodic credit reviews of its customers, and the customer credit is extended following an evaluation of creditworthiness. All of the Company's trade receivable have been reviewed for collectability.

As at December 31, 2012, trade receivables from one customer was 12% (2011 – 18%) of total trade receivables.

As at December 31, 2012 around 91% (2011 - 77%) of trade and other receivables are outstanding for less than 90 days.

(iii) Interest rate risk:

Interest rate risk is the risk that changes in interest rates will affect the Company's income or value of the holdings of financial instruments. The Company's interest rate risk arises from short term investment balances and interest bearing debt at market interest rates. The Company's current policy is to invest excess cash in investment grade short-term deposit certificates issued by its banking institutions. The Company's interest rates on its debts are based on the prescribed rate of the People's Bank of China which is subject to fluctuation and may result in an increase or decrease in interest expense. As at December 31, 2012, with other variables unchanged, a +/-1% change in the average interest rate charged on the bank loan at Anhui plant described in note 14b (ii) would increase/decrease net income for the year by $7,920 (RMB50,000). The Company does not use derivative instruments to reduce its exposure to interest rate risk.

(iv) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to maintain sufficient readily available sources of funding in order to meet its liquidity requirements at any point in time. The Company achieves this by forecasting cash flows and anticipated investing and financing activities. Senior management is also actively involved in the review and approval of planned expenditures.

As at December 31, 2012, the Company had cash and cash equivalents and restricted cash of $8,593,298 to settle current liabilities of $9,760,913.

### 22. Segmented information:

The Company currently operates in two operating segments:

(a) Chemical industry: develops, manufactures and supplies specialized fine chemical products used in pharmaceutical and cosmetic industries; purchases and resells chemical products; and

(b) Technology industry: designs, manufactures and supplies electronic and electrical connection devices for security, industrial control, automation and telecommunication and power supply industries.

Each segment operates as a strategic business unit with separate management. Segment performance is measured primarily upon the basis of segment operating profit. Industry and geographic segment information for the consolidated results in thousands of Canadian dollars are presented below:

(a) Segmented information:

For the year ended December 31, 2012 (in thousands of dollars):

| December 31, 2012 | | Chemical products | | Technology products | | Total |
|---|---|---|---|---|---|---|
| Sales | $ | 13,839 | $ | 15,084 | $ | 28,923 |
| Gross profit | | 4,952 | | 4,175 | | 9,127 |
| Expenses | | | | | | |
| General and administrative | | 2,844 | | 2,948 | | 5,792 |
| Operating income | | 2,108 | | 1,227 | | 3,335 |
| Purchase of property, plant and equipment | | 4,467 | | 94 | | 4,561 |
| Investment property | | - | | 3,636 | | 3,636 |
| Investments in associates | | - | | 107 | | 107 |
| Goodwill | | 3,952 | | - | | 3,952 |

| December 31, 2011 | | Chemical products | | Technology products | | Total |
|---|---|---|---|---|---|---|
| Sales | $ | 14,078 | $ | 16,032 | $ | 30,110 |
| Gross profit | | 3,534 | | 4,227 | | 7,761 |
| Expenses | | | | | | |
| General and administrative | | 3,073 | | 2,977 | | 6,050 |
| Operating (loss) income | | 461 | | 1,250 | | 1,711 |
| Purchase of property, plant and equipment | | 853 | | 497 | | 1,350 |
| Investment property | | - | | 1,236 | | 1,236 |
| Investments in associates | | - | | 82 | | 82 |
| Goodwill | | 3,999 | | - | | 3,999 |

**22. Segmented information (continued):**

(b) Information by geographic area consisted of the following:

For the year ended December 31, 2012 (in thousands of dollars):

| | Canada | US | China and Hong Kong | Other | Total |
|---|---|---|---|---|---|
| Sales | $ 3,463 | $ 2,588 | $ 22,188 | $ 684 | $ 28,923 |
| Property plant and equipment | 16 | - | 13,040 | - | 13,056 |
| Investment property | - | - | 3,636 | - | 3,636 |
| Investments in associates | - | - | 107 | - | 107 |
| Goodwill | - | - | 3,952 | - | 3,952 |

For the year ended December 31, 2011 (in thousands of dollars):

| | Canada | US | China and Hong Kong | Other | Total |
|---|---|---|---|---|---|
| Sales | $ 3,246 | $ 7,391 | $ 18,344 | $ 1,129 | $ 30,110 |
| Property plant and equipment | 17 | - | 10,139 | - | 10,156 |
| Investment property | - | - | 1,236 | - | 1,236 |
| Investments in associates | - | - | 82 | - | 82 |
| Goodwill | $ - | - | 3,999 | - | 3,999 |

(Expressed in Canadian dollars, unless otherwise indicated)

## 23. Income taxes

The income tax expense differs from the amount expected by applying the Canadian statutory rate to income before income taxes for the following reasons:

| | 2012 | 2011 |
|---|---|---|
| Income (loss) before income taxes | $ 3,507,720 | $ (1,197,924) |
| Combined federal and provincial statutory income tax rate | 26.5% | 29.0% |
| Tax expenses (recovery) at statutory rates | $ 929,546 | $ (347,000) |
| Add (deduct): | | |
| Effect of lower tax rates in foreign jurisdictions | (523,351) | (937,418) |
| Stock-based compensation | - | 29,000 |
| Goodwill impairment | - | 783,000 |
| Non-deductible expenses | 78,005 | 175,000 |
| Foreign withholding tax | - | 130,240 |
| Income not subject to tax | (125,809) | - |
| Others | - | 217,169 |
| Prior year tax loss adjustment | (52,697) | - |
| Effect of changes in tax rates and other | (62,563) | - |
| Effect of changes in foreign exchange rates | (4,487) | - |
| Change in deferred tax assets unrecognized | 489,226 | 78,200 |
| Income tax (recovery) expense | $ 727,870 | $ 128,191 |
| Income taxes | | |
| Current income tax expense | $ 1,057,239 | $ 361,196 |
| Deferred income tax benefit | (329,369) | (233,005) |
| | $ 727,870 | $ 128,191 |

At December 31, 2012, the Company and its subsidiaries had approximately $7,637,027 of non-capital losses carried forward to reduce future years' taxable income. The deferred tax benefit of $2,154,725 of these losses has not been recognized. The non-capital losses expire as follows:

| Year of expiry | Canada | China |
|---|---|---|
| 2013 | $ - | $ 104,673 |
| 2014 | 507,614 | 228,298 |
| 2015 | 351,912 | 133,875 |
| 2016 | - | 130,119 |
| 2017 | - | 1,505,374 |
| 2026 | 336,265 | - |
| 2027 | 451,495 | - |
| 2028 | 712,170 | - |
| 2029 | 861,744 | - |
| 2030 | 838,561 | - |
| 2031 | 637,558 | - |
| 2032 | 837,369 | - |
| | $ 5,534,688 | $ 2,102,339 |

(Expressed in Canadian dollars, unless otherwise indicated)

## 23. Income taxes (continued):

The significant components of the Company's deferred tax assets and liabilities are as follows:

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| **Deferred Income Tax Assets** | | |
| Losses carry forwards | $ 2,154,725 | $ 1,837,900 |
| Capital loss | 74,134 | 41,200 |
| Share issuance cost | 19,096 | 37,800 |
| Property, plant and equipment | 205,778 | 90,140 |
| Trade receivables | 157,230 | 57,500 |
| Accounts payable and accrued liabilities | 20,376 | - |
| Inventories | 406,476 | 228,300 |
| Other differences | 1,297 | 1,700 |
| | $ 3,039,112 | $ 2,294,540 |
| Unrecognized deferred taxes | (1,812,626) | (1,323,400) |
| Net deferred income tax assets | $ 1,226,486 | $ 971,140 |

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| **Deferred Income Tax Liabilities** | | |
| Investment in associate | $ 21,355 | $ - |
| Trade receivable | 155,769 | 363,500 |
| Inventories | 30,234 | - |
| Property, plant and equipment | 72,586 | - |
| Accounts payable and accrued liabilities | 11,976 | 65,900 |
| Government grant | 323,349 | 259,892 |
| | $ 615,269 | $ 689,292 |

## 24. Events after the reporting period:

(a) On February 26, 2013, the Company granted incentive stock options in respect of 750,000 shares exercisable at $0.40 per share for a period of five years to directors, officers, employees and consultants of the Company.

(b) The bank loan per note 14(b)(ii) was fully repaid by the Company on April 19, 2013.

| | |
|---|---|
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| **Officers:** | Dr. Gang Chai, Chief Executive Officer<br>Mr. Ming Zhang, Chief Financial Officer |
| **Directors:** | Dr. Gang Chai, Chairman<br>Dr. D. James Misener<br>Dr. Tony Naldrett<br>Dr. Evelyn Su<br>Mr. Colin Digout |
| **Auditors:** | Collins Barrow Toronto LLP<br>11 King Street West, Suite 700<br>Toronto, ON<br>M5H 4C7 |
| **Transfer Agent & Register:** | Equity Financial Trust Company<br>200 University Ave., Suite 400<br>Toronto, ON<br>M5H 4H1 |
| **Legal Counsel:** | Steenberglaw Professional Corporation<br>Barrister & Solicitor<br>220 Bay Street, Suite 700<br>Toronto, ON, M5J 2W4<br>T: (416) 941-9559<br>F: (416) 941-9417 |
| **Listed:** | TSX Venture Exchange: MCV |

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