

Annual Audited Consolidated Financial Statements

**Knightscove Media Corp.**

August 31, 2008

## **Auditors' Report**

### **To the Shareholders of Knightscope Media Corp.**

We have audited the consolidated balance sheet of **Knightscope Media Corp.** as at August 31, 2008 and the consolidated statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at August 31, 2008 and the results of its operations and its cash flows for the year then ended, in accordance with Canadian generally accepted accounting principles.

The financial statements as at August 31, 2007 and for the year then ended were audited by another firm of chartered accountants, who expressed an opinion without reservation on those statements in their report dated January 28, 2008.

*PKF Hill LLP*

Chartered Accountants, Licensed Public Accountants  
December 19, 2008

**Knightscope Media Corp.**

**CONSOLIDATED BALANCE SHEETS**

As at	August 31, 2008 \$	August 31, 2007 \$
<b>ASSETS</b>		
<b>Current</b>		
Cash	—	4,445
Accounts receivable	240,227	499,591
Inventory	650,187	683,281
Income taxes receivable	56,250	56,250
Prepaid expenses	37,439	6,927
<b>Total current assets</b>	<b>984,103</b>	<b>1,250,494</b>
Licence advances	122,754	12,308
Films in development	349,679	272,570
Film library <i>[note 5]</i>	194,392	297,871
Development costs – video products <i>[note 6[a]]</i>	347,347	197,285
Distribution rights <i>[note 6[b]]</i>	609,418	761,773
Equipment <i>[note 7]</i>	69,249	78,360
Investment - Studio 4 Networks <i>[note 4[a]]</i>	272,852	—
Goodwill <i>[note 4[b]]</i>	792,342	792,342
<b>Total assets</b>	<b>3,742,136</b>	<b>3,663,003</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank debt <i>[note 8]</i>	300,000	303,874
Accounts payable and accrued liabilities	1,614,995	1,984,279
Royalties payable	241,654	147,578
Notes payable <i>[note 9]</i>	250,000	618,117
Convertible promissory notes <i>[note 10]</i>	49,887	47,953
Loans payable <i>[note 11]</i>	742,704	—
<b>Total current liabilities</b>	<b>3,199,240</b>	<b>3,101,801</b>
Commitments and contingencies <i>[note 13]</i>		
<b>Shareholders' equity</b>		
Share capital <i>[note 12[a]]</i>	3,760,785	3,493,603
Contributed surplus <i>[notes 10, 12[b] and [c]]</i>	485,800	462,655
Deficit	(3,703,689)	(3,395,056)
<b>Total shareholders' equity</b>	<b>542,896</b>	<b>561,202</b>
	<b>3,742,136</b>	<b>3,663,003</b>

*See accompanying notes*

On behalf of the Board:

"Rick Ferreira"

\_\_\_\_\_  
Director

"Michael Levine"

\_\_\_\_\_  
Director

**Knightscope Media Corp.**

**CONSOLIDATED STATEMENTS OF LOSS  
AND COMPREHENSIVE LOSS**

	<b>Year ended August 31, 2008</b>	<b>Eight-month period ended August 31, 2007</b>
	\$	\$
<b>Revenue</b> <i>[note 18]</i>	<b>4,248,372</b>	<b>916,145</b>
<b>Expenses</b>		
Cost of goods sold	1,187,400	331,264
Royalty expense	433,468	536,591
Amortization		
Licence advances	36,999	—
Film library	103,479	32,100
Development costs – video products	93,347	17,273
Distribution rights	152,355	59,915
Equipment	42,579	15,944
General and administrative	2,408,327	1,050,661
Interest	99,051	119,855
<b>Net loss before taxes</b>	<b>(308,633)</b>	<b>(1,247,458)</b>
Income taxes <i>[note 15]</i>	—	(49,500)
<b>Net loss for the period</b>	<b>(308,633)</b>	<b>(1,197,958)</b>
<b>Comprehensive loss</b>	<b>(308,633)</b>	<b>(1,197,958)</b>
<b>Loss per share</b> <i>[note 17]</i>		
Basic and diluted	(0.02)	(0.07)
<b>Weighted average number of shares outstanding</b>		
Basic and diluted	19,506,946	15,993,281

*See accompanying notes*

**Knightscope Media Corp.**

**CONSOLIDATED STATEMENTS OF  
CHANGES IN SHAREHOLDER EQUITY**

	<b>Common Shares #</b>	<b>Share Capital Amount \$</b>	<b>Contributed surplus \$</b>	<b>Deficit \$</b>	<b>Total Equity \$</b>
<b>Balance, January 1, 2007</b>	<b>14,468,558</b>	<b>2,037,950</b>	<b>220,837</b>	<b>(2,197,098)</b>	<b>61,689</b>
Private placement <i>[note 12[a][i]]</i>	750,000	245,072	23,239	—	268,311
Private placement <i>[note 12[a][ii]]</i>	646,000	177,583	43,221	—	220,804
Shares issued on acquisition <i>[note 12[a][iii]]</i>	1,000,000	400,000	—	—	400,000
Private placement <i>[note 12[a][iv]]</i>	2,000,000	463,573	146,393	—	609,966
Shares issued for directors, employees and consultants salaries and expenses <i>[note 12[a][v]]</i>	281,250	112,500	—	—	112,500
Broker warrants <i>[note 12[b][ii]]</i>	—	—	40,890	—	40,890
Exercise of warrants <i>[note 12[b][iv]]</i>	150,000	56,925	(11,925)	—	45,000
Net loss for the period	—	—	—	(1,197,958)	(1,197,958)
<b>Balance August 31, 2007</b>	<b>19,295,808</b>	<b>3,493,603</b>	<b>462,655</b>	<b>(3,395,056)</b>	<b>561,202</b>
Shares issued for service <i>[note 12[a][vi]]</i>	200,000	60,000	—	—	60,000
Cancel Common Shares <i>[note 12[a][vii]]</i>	(19,495,808)	—	—	—	—
<b>Balance March 5, 2008</b>	<b>—</b>	<b>3,553,603</b>	<b>462,655</b>	<b>(3,395,056)</b>	<b>621,202</b>

	<b>Subordinate- Voting Shares #</b>	<b>Multiple- Voting Shares #</b>	<b>Share Capital Amount \$</b>	<b>Contributed surplus \$</b>	<b>Deficit \$</b>	<b>Total Equity \$</b>
<b>Balance March 5, 2008</b>	<b>—</b>	<b>—</b>	<b>3,553,603</b>	<b>462,655</b>	<b>(3,395,056)</b>	<b>621,202</b>
Issuance of Shares <i>[note 12[a][vii]]</i>	9,747,904	—	—	—	—	—
Issuance of Shares <i>[note 12[a][vii]]</i>	—	9,747,904	—	—	—	—
Equity portion of Debt <i>[note 10]</i>	—	—	—	227	—	227
Shares for service <i>[note 12[a][viii]]</i>	370,000	—	85,100	—	—	85,100
Shares for service <i>[note 12[a][viii]]</i>	128,571	—	45,000	—	—	45,000
Private placement <i>[note 12[a][ix]]</i>	400,000	—	100,000	—	—	100,000
Issuance of Warrants <i>[note 12[b][iii]]</i>	—	—	(22,918)	22,918	—	—
Net loss for the period	—	—	—	—	(308,633)	(308,633)
<b>Balance, August 31, 2008</b>	<b>10,646,475</b>	<b>9,747,904</b>	<b>3,760,785</b>	<b>485,800</b>	<b>(3,703,689)</b>	<b>542,896</b>

*See accompanying notes*

**Knightscope Media Corp.**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

	<b>Year ended</b> <b>August 31, 2008</b>	<b>Eight-month</b> <b>period ended</b> <b>August 31, 2007</b>
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net loss for the period	<b>(308,633)</b>	<b>(1,197,958)</b>
Add items not affecting cash		
Amortization		
Licence advances	36,999	—
Film library	103,479	32,100
Development costs – video products	93,347	17,273
Distribution rights	152,355	59,915
Equipment	42,579	15,944
Shares issued for service	190,100	112,500
Non-cash interest and financing costs	2,161	79,189
	<b>312,387</b>	<b>(881,037)</b>
Changes in non-cash working capital balances:		
Accounts receivable	259,364	10,884
Inventory	33,094	(100,439)
Income taxes receivable	—	(49,500)
Prepaid expenses	(30,512)	3,985
Accounts payable and accrued liabilities	(369,284)	511,266
Royalties payable	94,076	71,191
<b>Cash flows from operating activities</b>	<b>299,125</b>	<b>(433,650)</b>
<b>INVESTING ACTIVITIES</b>		
Advances to Studio 4 Networks	(272,852)	—
Acquisition of Morningstar Entertainment Inc.	—	(341,516)
Acquisition of licence advances	(147,445)	(12,308)
Investment in films in development	(105,172)	(57,925)
Investment in development costs – video products	(243,409)	(87,992)
Purchase of equipment	(33,468)	(11,480)
<b>Cash flows from investing activities</b>	<b>(802,346)</b>	<b>(511,221)</b>
<b>FINANCING ACTIVITIES</b>		
Bank debt	(3,874)	18,881
Repayments of notes payable	(368,117)	—
Proceeds from loans payable	1,100,000	—
Repayment of loans payable	(357,296)	(300,000)
Proceeds from share and warrant issuances	100,000	1,139,971
Funding received for films in development	28,063	43,823
Exercise of stock options and warrants	—	45,000
<b>Cash flows from financing activities</b>	<b>498,776</b>	<b>947,675</b>
<b>Net increase (decrease) in cash</b>	<b>(4,445)</b>	<b>2,804</b>
Cash, beginning of period	<b>4,445</b>	1,641
<b>Cash, end of period</b>	<b>—</b>	<b>4,445</b>

See accompanying notes [note 19]

## **Knightscope Media Corp.**

# **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

August 31, 2008

## **1. NATURE OF BUSINESS**

### **Operations**

Knightscope Media Corp. [the "Company" or "Knightscope"] is a Canadian entertainment company specializing in the distribution, acquisition and creation of live action feature films and television productions for the whole family under its brand "Knightscope Family Films". Through its family brand and wholly owned subsidiary, Morningstar Entertainment Inc. ["Morningstar"] [note 4[b]], the Company acquires, develops and distributes family oriented films in the television and DVD markets.

Knightscope is an issuer listed on the TSX Venture Exchange ["TSXV"]. The Company completed a capital reorganization on March 5, 2008 exchanging each outstanding common share (19,495,808) for one half subordinate voting share ('KC.A') and a one half multiple voting share ('KC.B') (9,747,904 shares of each share class were listed as of March 5, 2008) [note 12[a][vii]].

### **Going concern**

These consolidated financial statements have been prepared on a going concern basis, which presumes that Knightscope will be able to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. At August 31, 2008, the Company had an accumulated deficit of approximately \$3.7 million and a working capital deficit of approximately \$2.2 million. The Company's ability to continue as a going concern is dependent upon its ability to generate sufficient future cash flow and obtain sufficient financing to fund its business until it achieves consistently profitable operations.

With the acquisition of Morningstar on May 18, 2007, a Canadian DVD distribution company which has been operating for over 15 years, and Knightscope's continued financing endeavors, the Company believes it will be able to meet its short-term cash flow requirements. However, the success of obtaining additional financing cannot be predicted at this time.

These consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying consolidated financial statements.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ["GAAP"]. The significant accounting policies are summarized as follows:

### **Basis of consolidation**

The consolidated financial statements include the assets, liabilities, and operating results of the Company and its wholly owned subsidiaries; Knightscope Family Films Inc., 2096013 Ontario

## **Knightscope Media Corp.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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Inc. and Morningstar [note 4[ b]]. Morningstar's operations were consolidated from the date of acquisition of May 18, 2007. In 2007, the Company changed its fiscal year end from December 31 to August 31, resulting in an eight-month transition year starting January 1, 2007 and ending August 31, 2007. Comparative financial data is presented for the eight-month transition period ending August 31, 2007.

#### **Use of estimates**

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the consolidated balance sheet date and the reported amounts of revenue and expenses during the reporting period. The most significant assumptions made by management in the preparation of the Company's consolidated financial statements include the determination of any impairment and the useful lives of licence advances, films in development, film library, development costs – video products, distribution rights, equipment and goodwill, determining the allowance for accounts receivable, estimating the provision for sales returns, estimation of the fair value of stock-based compensation and warrants and the determination of valuation allowance for income taxes. Actual results could differ from those estimates.

#### **Inventory**

Inventory comprises completed DVDs as well as the materials and packaging required to produce individual DVDs. Inventory is valued at the lower of cost and market value, determined on a first-in first-out basis. Market value for materials used in the production of a DVD is its replacement cost and for finished DVD units it is net realizable value.

In determining market value, the Company considers factors such as shrinkage, the aging and the demand for inventory, past experience with specific customers and the ability to redistribute inventory through other distribution channels.

#### **Licence advances**

Licence advances (formerly called 'royalty advances') are prepayments made to producers to secure the right to distribute specific DVD titles. These prepayments are capitalized and amortized on a straight-line basis over the life of the licence agreement. In most cases the term of the licence agreement is five years.

#### **Films in development**

Investment in film properties represents the amortized costs of film productions developed, produced and exploited by the Company and participation in properties produced and exploited by third parties. Costs capitalized include production costs and financing costs, capitalized interest and overhead costs incurred on commencement of principal photography.

Costs of developing and producing films are capitalized and amortized using the individual film-forecast-computation method, whereby capitalized costs and estimated total costs of participations

## **Knightscope Media Corp.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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and residuals are charged to amortization expense on a program-by-program basis in the ratio that current period's revenue bears to management's estimate of ultimate revenue expected to be recognized from the exploitation, exhibition or sale of programs. Ultimate revenue is projected for periods not exceeding 10 years from the date of delivery.

Properties are stated at the lower of amortized cost and estimated net realizable value as determined on an individual basis. Net realizable values of the films are determined using management's future revenue estimates. Revenue estimates will be reviewed periodically and should an event or change in circumstance indicate that the fair value of the film is less than its amortized cost, an adjustment would be made to reflect that change. These adjustments could have a material effect on results of operations in future periods.

Estimates of future revenue involve measurement uncertainty and it is therefore possible that reductions in the carrying value of investment in film may be required as a consequence of changes in management's estimates of future revenue streams.

#### **Film library**

The capitalized costs of the acquisition of the Company's film library include the purchase price and other acquisition costs. Amortization is calculated using the individual film-forecast-computation method.

#### **Development costs – video products**

Development costs relate to the design and development of video products including authoring (the production of a DVD master), design, artwork and film translation. The Company capitalizes development costs that meet specific criteria related to the technical, market and financial feasibility. Once the product is ready for production and distribution, the costs are amortized on a straight-line basis over the estimated useful life of the product. The current estimated useful life of capitalized development costs is five years. The Company writes down the carrying value of development costs to their fair value when the value is determined to be impaired.

#### **Distribution rights**

The value of acquired distribution rights to licensed films is estimated using discounted future cash flows for individual titles at the Company's weighted average cost of capital. Distribution rights are amortized over their remaining useful life, in most cases, a licence period of five years.

Management periodically reviews the carrying value of the distribution rights whenever events or changes in circumstances indicate that the carrying amount of the distribution rights may not be recoverable which is determined by comparing the carrying amount to the estimated undiscounted future net cash flows. The Company writes down the costs associated with distribution rights to their fair value when the value is determined to be impaired.

## **Knightscope Media Corp.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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#### **Equipment**

Equipment is recorded at cost less accumulated amortization. Amortization is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Computer equipment	5 years
Computer software	2 years
Office furniture	5 years
Leasehold improvements	5 years

The Company reviews the recoverability of equipment annually or more frequently, if events or circumstances indicate that the carrying amount may not be recoverable. Recoverability is measured by comparing the carrying amounts of a group of assets to future undiscounted cash flows expected to be generated by that group of assets. When an asset is not recoverable, the impairment loss recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value.

#### **Investment – Studio 4 Networks**

The Company accounts for its investment in Studio 4 Networks using the cost method of accounting.

#### **Goodwill**

Goodwill represents the excess of the purchase consideration over the fair value of the net tangible and intangible assets acquired at the date of acquisition.

Goodwill is not amortized and is tested for impairment annually. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is not required. The fair value of the reporting unit is principally based on management's estimates of future discounted cash flows.

The second step is carried out when the carrying amount of a reporting unit exceeds its fair value, in which case the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. When the carrying amount of a reporting unit's goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess.

The Company is also required to evaluate goodwill for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Certain indicators of potential impairment that could impact the Company's reporting unit include, but are not limited to, the following: [a] a significant long-term adverse change in the North American home entertainment industry that is expected to cause a substantial decline in DVD sales and/or gross margins and [b] a significant technological change that results in a substantially more cost-effective method of distribution of films.

## Knightscope Media Corp.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The Company has calculated the fair value of its reporting units as at August 31, 2008 and compared this to the carrying amount and determined that no impairment of goodwill existed.

#### Financial instruments

The Company adopted The Canadian Institute of Chartered Accountants ["CICA"] Handbook Sections 3855, "Financial Instruments – Recognition and Measurement"; 3861, "Financial Instruments – Disclosure and Presentation"; 3865, "Hedges" and 1531, "Comprehensive Income" on January 1, 2007. These standards reflect that fair value, not historical cost, is the appropriate way for measuring certain financial instruments. The adoption of the new standards resulted in changes in the accounting of financial instruments as well as the recognition of certain adjustments as described below.

This standard requires the Company to classify financial assets and liabilities according to their characteristics and management's intentions for the purposes of ongoing measurement. Classification for financial assets include:

- a) held for trading – measured at fair value with changes in fair value recorded in net income;
- b) held to maturity – recorded at amortized cost using the effective interest rate method, with gains and losses recognized in net income in the period that the asset is de-recognized or impaired;
- c) available for sale – measured at fair value with changes in fair value recognized in other comprehensive income for the current period until realized through de-recognition or impairment; and
- d) loans and receivables – recorded at amortized cost using the effective interest rate method, with gains and losses recognized in net income in the period that the asset is de-recognized or impaired.

Classification for financial liabilities include:

- a) held for trading – measured at fair value with changes in fair value recorded in net income; and
- b) other – measured at amortized cost using the effective interest rate method, with gains and losses recognized in net income in the period that the liability is de-recognized.

In accordance with the new standards, the Company's financial assets and liabilities are generally classified and measured as follows:

Cash	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
	Licence advances	Loans and receivables
	Amortized cost	
Bank debt	Other liabilities	Amortized cost
Accounts payable	Other liabilities	Amortized cost
Other accrued liabilities	Other liabilities	Amortized cost
Loans payable	Other liabilities	Amortized cost
Notes payable	Other liabilities	Amortized cost
Convertible promissory notes	Other liabilities	Amortized cost
Royalties payable	Other liabilities	Amortized cost

## Knightscope Media Corp.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Other consolidated balance sheet accounts, are not within the scope of the new accounting standards as they are not financial instruments.

On January 1, 2007, the Company recorded the following adjustments to the consolidated balance sheets to adopt the new requirements:

	<b>As at January 1, 2007</b>
	\$
Financing costs	(50,000)
Loans payable	(50,000)

The principal changes in the accounting for financial instruments and hedges are described below:

#### **[a] Comprehensive loss**

Comprehensive loss is comprised of the Company's net loss and other comprehensive loss. During the fiscal year ended August 31, 2008, the Company did not have any items that met the criteria for recognition as comprehensive loss.

#### **[b] Hedges and derivatives**

The new accounting standards require that hedging derivatives be recorded at fair value in the consolidated balance sheet. The Company does not engage in any formal hedging activities with third party institutions. As a result, there is no impact of this change in accounting policy in the consolidated financial statements.

#### **[c] Effective interest method**

Prior to January 1, 2007, long-term debt deferred financing costs were recorded in the consolidated balance sheets as assets and were amortized over the life of the debt on a straight-line basis. The new standards require that the effective interest method be used to amortize financing costs whereby the amount recognized as expense varies over the life of the debt based on the balance outstanding. In addition, the financing costs are recorded in the consolidated balance sheets as a reduction of the outstanding debt balance. As at January 1, 2007, financing costs were adjusted to reflect what the balance would have been had the effective interest method been used from the inception date of the debt. In addition, deferred financing costs and loan payable were adjusted to reflect the recording of the financing costs as a reduction of loan payable rather than as assets.

#### **Revenue recognition**

The Company earns revenue from the production of film and television products and from the sales of home entertainment products.

Revenue from theatrical, DVD, video, pay and specialty television licensing is recognized on meeting all recognition requirements of AICPA Statement of Position 00-2 "Accounting by producers or distributors of films" ["SOP 00-2"]. The conditions are as follows: [i] persuasive evidence of a sale or licensing arrangement with a customer exists; [ii] the film is complete and is

## **Knightscope Media Corp.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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available for delivery; [iii] the licence period of the arrangement has begun; and [iv] the arrangement fee is fixed or determinable. Cash received in advance of the film being available for delivery is recorded as deferred revenue until all the foregoing conditions of revenue recognition have been met.

Revenue from royalties, distribution fees and government incentives is recognized on receipt or evidence that collection is reasonably assured.

Revenue for home entertainment products, net of an allowance for estimated DVD returns, is recorded when the products are shipped to customers and collectability is reasonably assured.

#### **Stock-based compensation**

All stock-based awards granted to employees and non-employees are measured using a fair value based method. The fair value of stock options granted is recognized on a straight-line basis over the applicable stock option vesting period as compensation expense included in the consolidated statement of loss and comprehensive loss and contributed surplus within shareholders' equity on the consolidated balance sheet. On the exercise of stock options, the total of the consideration received and the related accumulated contributed surplus is credited to share capital. The Company has estimated the fair value of the stock options using the Black-Scholes option pricing model.

#### **Income taxes**

The Company follows the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases. The Company provides a valuation allowance to reduce future tax assets when it does not appear more likely than not that the asset will be realized.

#### **Loss per share**

Basic loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period. All dilutive instruments such as stock options were excluded from the calculation of diluted loss per share as the effect of including them would have been anti-dilutive. Generally, diluted loss per share would be calculated by dividing net loss by the weighted average number of common shares outstanding during the period after giving effect to potentially dilutive financial instruments. The dilutive effect of stock options is determined using the treasury stock method.

#### **Future accounting changes**

The CICA has recently issued five new accounting standards that could impact the Company, as follows:

Section 1400, Going Concern, effective for fiscal years beginning on or after January 1, 2008. This section requires management to make an assessment of an entity's ability to

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### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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continue as a going concern and to disclose material uncertainties related to events or conditions that may cast doubt upon the entity's ability to continue as a going concern.

Section 1535, Capital Disclosures, effective for fiscal years beginning on or after October 1, 2007. This section describes the required disclosure of the Company's objectives, policies and processes for managing capital, as well as its compliance with any externally imposed capital requirements.

Section 3064, Goodwill and Intangibles, effective for fiscal years beginning on or after October 1, 2008. This section establishes standards for identifying, recognizing and measuring intangible assets. It clarifies which expenditures should be recognized as an expense, unless certain recognition criteria are met. Subsequent measurement of intangibles and goodwill has not changed.

Section 3862, Financial Instruments - Disclosure, and Section 3863, Financial Instruments - Presentation, effective for fiscal years beginning on or after October 1, 2007. Section 3862 requires extensive disclosures of financial instruments, focussing on their impact on financial position and performance, but also on risk of recognized and unrecognized financial instruments. Section 3863 carries forward unchanged the presentation requirements of Section 3861.

The CICA plans to converge Canadian generally accepted accounting principles with International Financial Reporting Standards ("IFRS") over a transition period expected to end in 2011.

The impact of the adoption of these new standards on the consolidated financial statements is not expected to be material. The impact of the transition to IFRS on the Company's statements has not yet been determined.

### **3. CHANGES IN ACCOUNTING POLICIES**

The Company did not change any of its stated accounting policies during the year ended August 31, 2008.

### **4. INVESTMENTS AND ACQUISITION**

#### **[a] Investment – Studio 4 Networks**

A letter of intent was entered into to acquire Studio 4 Networks ("Studio 4"), a Los Angeles-based broadband and video-on-demand ["VOD"] broadcaster. Offering its programming across multiple platforms including cable, satellite and broadband, Studio 4 operates three cable VOD channels [Studio 4 Learning, Fitness and Kids] and two internet video sites [www.studio4kids.tv and www.studio4fitness.tv], which provide family friendly programming complementary to Knightscope's core product.

Additionally, Studio 4 has entered into strategic partnerships with print publishers such as Parenting, Babytalk and Self magazines to create multiplatform ad packages in the magazine print pages and on their respective web priorities. Studio 4's revenues are derived from advertising,

## Knightscope Media Corp.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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subscription, sponsorship, pay per view and other fees. Studio 4's content library of over 400 hours of licensed and original productions is focused on the kids' edutainment, adult education and fitness categories.

The initial letter of intent has expired. Knightscope and Studio 4 have subsequently agreed that further Knightscope advances will be on account of equity based on a valuation of Studio 4 of \$7,000,000. To date, cash advances totaling \$272,852 have been made to Studio 4 in respect of this agreement.

#### **[b] Morningstar**

On May 18, 2007, the Company completed its acquisition of Morningstar by acquiring all of the issued and outstanding shares of Morningstar. The purchase consideration of \$1,332,484 was payable in the form of cash of \$125,000, a series of notes payable with estimated fair value of \$788,830 as well as the issuance of 1,000,000 common shares of Knightscope. The fair value of the common shares was \$400,000. The costs of the transaction were \$18,654. At the acquisition date, the notes payable had a face value totaling \$825,000 and earned interest at 6% per annum. The notes payable were due on June 15, July 25 and November 15, 2007. As at August 31, 2008, all notes have been repaid with the exception of two outstanding to the founders of Morningstar [note 9].

Morningstar's operations are consolidated from the date of acquisition being May 18, 2007. The acquisition of Morningstar has been accounted for using the purchase method. Consideration paid has been allocated to net tangible and intangible assets acquired on their respective fair values and the excess has been recorded as goodwill. Development costs – video products have been valued using replacement cost and distribution rights have been valued using discounted cash flows from the respective titles.

The purchase price allocation for the Morningstar acquisition is detailed below:

<b>Net assets acquired:</b>	<b>\$</b>
Accounts receivable	1,102,309
Income taxes receivable	6,750
Inventory	582,842
Prepaid expenses	6,208
Development costs – video products	126,566
Equipment	68,515
Distribution rights	821,688
Goodwill	792,342
Bank debt	(284,993)
Accounts payable and accrued liabilities	(1,813,356)
Royalties payable	(76,387)
	<hr/>
Fair value of net assets acquired	1,332,484

**Knightscope Media Corp.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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<b>Purchase consideration consists of:</b>	<b>\$</b>
Cash	125,000
Notes payable	788,830
Common shares	400,000
Acquisition costs	18,654
<b>Total purchase consideration</b>	<b>1,332,484</b>

**5. FILM LIBRARY**

<b>As at August 31,</b>	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net book value</b>
	\$	\$	\$
2007	376,885	79,014	297,871
2008	316,885	122,493	194,392

During 2008, a prior year acquisition of \$60,000 was fully amortized, disposed of and removed from the accounts.

**6. DEVELOPMENTS COSTS – VIDEO PRODUCTS AND DISTRIBUTION RIGHTS**

**[a] Development costs – video products**

<b>As at August 31,</b>	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net book Value</b>
	\$	\$	\$
2007	214,558	17,273	197,285
2008	457,967	110,620	347,347

Additions to development costs – video products relate to authoring, design and film work DVD costs.

**[b] Distribution rights**

<b>As at August 31,</b>	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net book Value</b>
	\$	\$	\$
2007	821,688	59,915	761,773
2008	821,688	212,270	609,418

## Knightscope Media Corp.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### 7. EQUIPMENT

The Company's equipment consists of the following:

	August 31, 2008			August 31, 2007		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
	\$	\$	\$	\$	\$	\$
Computer equipment	86,894	63,097	23,797	35,833	10,908	24,925
Computer software	53,377	39,037	14,340	43,804	12,036	31,768
Office furniture	25,965	19,263	6,702	25,251	7,195	18,056
Leasehold improvements	34,150	9,740	24,410	4,000	389	3,611
	200,386	131,137	69,249	108,888	30,528	78,360

#### 8. BANK DEBT

Morningstar has a \$300,000 demand operating facility in place with a major Canadian bank (\$275,000 utilized at August 31, 2008) which was renewed in July 2008 and bears interest at prime plus 1.5%. Substantially all of the assets of Morningstar are pledged as collateral against this credit facility.

#### 9. NOTES PAYABLE

As at August 31, 2008, the Company had outstanding notes payable in respect of the Morningstar acquisition [note 4[b]] in the aggregate principal amount of \$250,000 consisting of two promissory notes to the vendors in the principal amount of \$125,000 each. The notes yield an interest rate of 6% payable upon payment of the principal. The holders of the two outstanding notes have deferred repayment until the Company completes a future financing. These notes are secured in third position by substantially all of the assets of Morningstar behind the bank credit facility [note 8] and loans payable [note 11].

#### 10. CONVERTIBLE PROMISSORY NOTES

As at August 31, 2007, the Company had outstanding convertible promissory notes in the aggregate principal amount of \$50,000 consisting of two subordinated unsecured convertible promissory notes each in the principal amount of \$25,000. The notes were issued for cash. They have a term of two years which matured on March 22, 2008, and yielded an interest rate of 13%, payable semi-annually, payable in March and September. The convertible promissory notes were not secured by assets of the Company.

At the debt-holder's option, the debt was convertible into common shares of the Company at a rate of \$0.30 per share in the year ending March 22, 2008. The face value of the convertible debentures had been allocated between liability and equity based on the estimated fair value of the loan payable and the conversion feature.

## Knightscope Media Corp.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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As at August 31, 2007, the liability component of the loan payable consisting of the initial fair value of \$45,913 and accretion of the loan discount of \$2,040 was presented as a current liability. The remaining discount of \$2,047 was amortized over the remaining life of the loan payable as accreted interest. The fair value of the equity component of \$4,087 was recorded as a credit to contributed surplus.

On March 22, 2008, upon maturity, the two outstanding convertible promissory notes were extended to March 22, 2009. The notes, upon extension, yield 12%, payable semi-annually in March and September. The convertible promissory notes are not secured by assets of the Company. At the debt-holder's option, the debt is convertible into subordinate voting shares of the Company at a rate of \$0.25 per share in the year ending March 22, 2009. The equity value of the convertible notes was calculated to be \$227 and was applied to contributed surplus.

The Black-Scholes option pricing model was employed using the following assumptions to calculate the fair value of the equity portion of the convertible promissory notes issued in 2008:

Risk-free interest rate	2.55%
Dividend yield	0%
Volatility	75%
Expected life	1 year

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#### 11. LOANS PAYABLE

[a] During September 2007, a loan in the principal amount of \$600,000 was provided by GC-Global Capital Corp. ("Global"). The loan bears interest at 12% per annum, payable monthly, with a structuring fee of 2% at closing. The loan was initially repayable on March 15, 2008. The due date has been extended to March 31, 2009, however, Knightscope has the right to pre-pay the loan at any time prior to that date.

As consideration for Global's agreement to provide the loan, the Company has agreed to issue 200,000 common shares of Knightscope, at a deemed price of \$0.30 per share [note 12 [a][vi]].

During November and December of 2007, an additional loan of \$100,000 was provided by Global. This bridge loan, due March 31, 2009, bears interest at 1% per month, payable monthly and a consulting fee of \$5,000 at closing.

At August 31, 2008, \$342,704 is outstanding.

[b] On May 23, 2008, the Company secured additional bridge financing from a private lender in the amount of \$400,000, due on May 26, 2009, at 18% per annum, of which \$300,000 was used to repay existing loans provided by Global [note 11[a]]. The remainder was used for general corporate purposes.

The loans in [a] and [b] are secured pari passu by a first ranking security interest in the non-consolidated Knightscope Media Corp.'s assets including all rights to the film library and a second ranking security interest in Morningstar's assets including rights to its DVD library.

## Knightscope Media Corp.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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## 12. SHAREHOLDERS' EQUITY

### [a] Share capital

The Company has authorized an unlimited number of subordinate voting (KC.A) and multiple voting (KC.B) shares with no par value. Changes in share capital starting on January 1, 2007 through to August 31, 2008 are listed in the consolidated statement of changes in shareholders' equity.

- [i] During March 2007, the Company issued 750,000 common shares in a private placement at a share price of US\$0.33 per share less estimated transaction costs of \$21,513 for net proceeds to the Company of \$268,311. Each common share was issued with a 1/2 warrant attached, or 375,000 warrants, with a term of two years, exercisable into common stock at a price per share of US\$0.43 in year 1 and US\$0.50 in year 2. The value of the warrants was calculated to be \$23,239 and was applied to contributed surplus.
- [ii] During May 2007, the Company issued 646,000 common shares in a private placement at a share price of US\$0.33 per share less estimated transaction costs of \$12,916 for net proceeds to the Company of \$220,804. Each common share was issued with a 1/2 warrant attached, or 323,000 warrants, with a term of two years, exercisable into common stock at a price per share of US\$0.43 in year 1 and US\$0.50 in year 2. The value of the warrants was calculated to be \$43,221 and was applied to contributed surplus.
- [iii] On May 18, 2007, 1,000,000 common shares were issued to vendors of Morningstar at a fair value of \$400,000 in satisfaction of the Company's stock payment under the Morningstar acquisition agreement *[note 4[b]]*.
- [iv] During June 2007, the Company issued 2,000,000 common shares in a private placement at a share price of US\$0.33 per share less estimated transaction costs of \$48,989 for net proceeds to the Company of \$650,856. Each common share was issued with a 1/2 warrant attached, or 1,000,000 warrants, with a term of two years, exercisable into common stock at a price per share of US\$0.43 in year 1 and US\$0.50 in year 2. The value of the warrants was calculated to be \$146,393 and was applied to contributed surplus.
- [v] During August 2007, the Company issued 50,000 common shares to satisfy a loan extension fee totalling \$20,000 to Global related to the extension of their \$250,000 loan which was fully repaid in June 2007. Knightscope also issued 50,000 common shares for consulting services to satisfy debts totalling \$20,000. Additionally, 156,250 common shares were issued in August to five non-insider directors to satisfy annual director fees of \$12,500 each for a total of \$62,500. Lastly, Knightscope issued 25,000 common shares to an employee of the Company in a share for debt transaction related to a bonus in the amount of \$10,000.
- [vi] During September 2007, the Company issued 200,000 common shares to satisfy a loan financing fee totalling \$60,000 to Global related to the initial \$600,000 bridge loan provided *[note 11[a]]*. As consideration for Global's agreement to provide the loan, the Company issued 200,000 common shares of Knightscope, at a deemed price of \$0.30 per share. The shares issued were subject to a four-month hold period to January 27, 2008.

## Knightscope Media Corp.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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- [vii] On March 5, 2008, Knightscope completed a capital reorganization to exchange each issued and outstanding common share of the Company for one-half of a Multiple Voting Share and one-half of a Subordinate Voting Share. Both classes commenced trading on the TSX Venture Exchange at the opening on March 5, 2008, and the common shares of the Company were de-listed on the same date. An unlimited number of Multiple Voting Shares and an unlimited number of Subordinate Voting Shares have been authorized with no par value of which 9,747,904 shares of each class are issued and outstanding. The stock symbols for the Subordinate and Multiple Voting Shares are 'KC.A' and 'KC.B' respectively. Both classes are fully participating and the Multiple Voting carry 50 votes per share and the Subordinate Voting class carries one vote per share.
- [viii] On June 11, 2008 the Company issued 370,000 subordinate voting shares to satisfy a consulting fee totalling \$85,100 to Global at a deemed value of \$0.23 per share. The Company additionally issued 128,571 subordinate voting shares at a deemed value of \$0.35 per share to Lane Capital Markets also to satisfy a consulting fee of \$45,000. The shares issued were subject to a four-month hold period.
- [ix] On July 22, 2008 the Company completed a private placement with an accredited investor by issuing 400,000 subordinate voting shares at a deemed value of \$0.25 for net proceeds of \$100,000 to Knightscope. Each share was issued with one full warrant attached convertible into subordinate voting shares at an exercise price of C\$0.50 for a term of two years. The value of the warrants was calculated to be \$22,918 and was applied to contributed surplus.

#### [b] Warrants

As at August 31, 2008, the Company had outstanding warrants as described below:

Description	Issue date	Expiry date	Exercise price	Number of warrants	Convertible into voting shares
Warrants issued on private placement [i]	March 22, 2007	March 22, 2009	US\$0.43/US\$0.50	375,000	375,000 [v]
Warrants issued on private placement [i]	May 14, 2007	May 14, 2009	US\$0.43/US\$0.50	323,000	323,000 [v]
Warrants issued on private placement [i]	June 15, 2007	June 15, 2009	US\$0.43/US\$0.50	1,000,000	1,000,000 [v]
Broker warrants issued on private placement [ii]	June 15, 2007	June 15, 2009	US\$0.33	195,600	195,600 [v]
				1,893,600	1,893,600

  

Description	Issue date	Expiry date	Exercise price	Number of warrants	Convertible into Sub-voting shares
Warrants issued on private placement [iii]	July 22, 2008	July 22, 2010	C\$0.50	400,000	400,000
				400,000	400,000

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- [i] During March, May and June 2007, the Company had a series of private placements of voting shares where each share was issued with one half warrant attached. The warrants had a term of two years and exercisable into voting shares at a price per share of US\$0.43 in the first year and US\$0.50 in the second year. The fair values of the warrants for the March 22, May 14 and June 15, 2007 private placements were \$23,239, \$43,221 and \$146,393, respectively, and were applied to contributed surplus.
- [ii] During June 2007, the private placement agent was issued 6% broker warrants. A total of 195,600 broker warrants were issued with a term of two years, exercisable into common stock at a price of US\$0.33 per share. The value of the broker warrants was calculated to be \$40,890 and was applied to contributed surplus.
- [iii] On July 23, 2008, the private placement investor was issued 400,000 warrants for a two year term, convertible into subordinate voting shares at an exercise price of C\$0.50. The value of the warrants was calculated to be \$22,918 and was applied to contributed surplus.
- [iv] During fiscal 2007, 150,000 warrants which were issued on March 22, 2006 were exercised for cash proceeds of \$45,000, and accordingly \$11,925 was transferred from contributed surplus to share capital.
- [v] Warrants issued prior to March 5, 2008 and convertible into common shares have been amended to be convertible into one half of one subordinate voting share and one half of one multiple voting share.

The Black-Scholes option pricing model was employed using the following assumptions to calculate the fair value of warrants issued during the periods ended 2008:

Risk-free interest rate	<b>3.05%</b>
Dividend yield	<b>0%</b>
Volatility	<b>75%</b>
Expected life	<b>2 years</b>

#### [c] Stock options

The Company has adopted an incentive stock option plan for the benefit of its directors, officers and technical consultants whereby a maximum of 10% of the issued and outstanding shares of the Company are reserved for issuance pursuant to the exercise of stock options to be granted to directors, officers and technical consultants.

The number of shares reserved for issuance to any individual director or officer will not exceed 5% of the issued and outstanding shares and the number of shares reserved for issuance to all technical consultants will not exceed 2% of the issued and outstanding shares.

## Knightscope Media Corp.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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A summary of the options outstanding under the plan is presented below.

	Number of options #	Weighted average exercise price \$
<b>Outstanding and exercisable, January 1, 2006</b> [i]	1,325,000	0.25
Exercised [ii]	(300,000)	0.25
Granted [iii]	250,000	0.40
Retired [iv]	(125,000)	0.25
<b>Outstanding and exercisable, December 31, 2006</b>	1,150,000	0.28
Retired [v]	(225,000)	0.32
<b>Outstanding and exercisable at August 31, 2007 and 2008</b>	<b>925,000</b>	<b>0.27</b>

[i] At the time of the Company's initial public offering in October 2004, 375,000 options were issued to directors and officers at an exercise price of \$0.25 per common share, which are to expire in October 2009. A further 300,000 options were issued to the agent involved in the initial public offering at an exercise price of \$0.25 per common share. The fair value of these options determined as at June 30, 2005 has been included in the costs of the reverse takeover transaction.

Additionally during 2005, the Company issued 775,000 options to officers and directors under the Company's incentive stock option plan at an exercise price of \$0.25 per common share. These options are fully vested and expire in December 2010. In October 2005, one director resigned resulting in the retiring of 125,000 options.

[ii] During 2006, the 300,000 agent options were exercised by the agent giving rise to proceeds of \$75,000 to the Company.

[iii] On August 4, 2006, all five non-management members of the Board of Directors were granted options of 50,000 each with an exercise price of \$0.40 per share and a term of five years ending on August 4, 2011.

[iv] On September 28, 2006, 125,000 stock options held by a director that did not stand for election in June 2006 expired and were retired.

[v] In July 2007, 50,000 stock options held by an employee who left the Company expired and were retired, and, in October 2007, 175,000 stock options held by two directors that did not stand for election in July 2007 expired and were retired. No employee or director stock options were granted in the year ended August 31, 2008.

[vi] Options issued prior to March 5, 2008 and convertible into common shares have been amended to be convertible into one half of one subordinate voting share and one half of one multiple voting share.

## Knightscope Media Corp.

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#### 13. COMMITMENTS AND CONTINGENCIES

Knightscope is party to a number of future financial commitments including an operating lease for equipment, a lease of office premises and licence advance commitments. All lease and licence advance costs are expensed as incurred. Net payments under these leases are as follows:

	\$
2009	453,937
2010	253,943
2011	123,089

#### 14. RELATED PARTY TRANSACTIONS

The Company has contracted with 1365106 Ontario Ltd. for the services of Mr. Leif Bristow, its President and CEO. The remuneration is for writing, directing and producing the Company's proprietary products together with day-to-day management of the Company. A formal employment contract was approved by the Compensation Committee of the Board of Directors, which has set Mr. Bristow's remuneration (including a base salary of \$180,000 with a producing fee bonus for each proprietary production up to a maximum compensation of \$450,000 per annum, plus a monthly gas allowance of \$650 to a cap of \$6,500 for the year). The Company accrued a liability of \$53,333 and \$46,364 to reflect salary owing to Mr. Bristow for fiscal 2007 and 2008 respectively. Mr. Bristow is also a shareholder and director of the Company. Mr. Bristow receives the benefit of a \$1,000,000 life insurance policy for which the annual premiums of \$3,600 are paid by the Company.

Leif Bristow, the President and CEO, is the holder of one of the two unsubordinated unsecured convertible promissory notes [note 10] each in the amount of \$25,000 which were issued by the Company on March 22, 2008. In addition, Mr. Bristow's wife, Agnes Bristow, provided the Company with funds totaling \$65,000 in 2007 and \$18,000 in 2008. As of the date herein, \$78,000 of these advances, which were made on an unsecured and interest-free basis, have been repaid.

At May 31, 2008, the Company had two outstanding notes payable in respect of the Morningstar acquisition in the principal amount of \$125,000 each [note 9]. These notes are held by a former owner of Morningstar, currently an executive of the Company, and his spouse.

One of the directors is the President and CEO of GC-Global Capital [note 11[a]]. One of the directors is founding partner of Lane Capital Markets [note 12[a][viii]].

**Knightscope Media Corp.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**15. INCOME TAXES**

As at August 31, 2008, the income tax recovery differs from the amount obtained by applying the combined federal and provincial income tax rates to loss before income taxes. The difference relates to the following items:

	<b>Year ended August 31, 2008</b>	<b>Eight-month period ended August 31, 2007</b>
	\$	\$
Combined statutory income tax rate	<b>34.37%</b>	36.1%
Expected income tax recovery	(106,077)	(450,582)
Decrease in income tax recovery resulting from:		
Permanent differences	4,125	16,104
Valuation allowance	44,963	338,530
Impact of change in rates on tax loss carryforwards	56,989	46,448
	—	(49,500)

The tax effects of temporary differences and net operating losses that give rise to future tax assets are as follows:

	<b>Year ended August 31, 2008</b>	<b>Eight-month period ended August 31, 2007</b>
	\$	\$
<b>Future tax assets</b>		
Non-capital tax loss carryforwards	1,067,472	1,124,930
Financing costs	76,145	90,038
Cumulative eligible capital	24,220	25,302
Reserve for sales provision	88,331	56,219
Inventory	—	(83,836)
Other	—	3,909
Distribution rights	(158,449)	(198,256)
Total future tax assets	1,097,719	1,018,306
Less valuation allowance	(1,097,719)	(1,018,306)
<b>Net future tax assets</b>	—	—

As at August 31, 2008, the Company's deductible temporary differences for which no related future tax assets have been recognized include accumulated non-capital losses for income tax purposes of \$3,294,148, which can be carried forward to reduce future Canadian taxable income. Since it is not more likely than not that the Company will be able to realize the benefit of the unused tax losses, a valuation allowance in respect of all future income tax assets has been provided.

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The non-capital losses which cannot be carried forward indefinitely expire as follows:

	\$
2011	675,813
2012	738,626
2026	704,838
2027	1,174,871
	<hr/> 3,294,148

## 16. FINANCIAL INSTRUMENTS

### Fair value

The fair values of financial instruments, which include cash, accounts receivable, bank debt, accounts payable and accrued liabilities, notes payable, loans payable and royalties payable approximate their carrying values due to their short-term nature.

### Interest rate risk

The Company has minimal exposure to interest rate risk as the Company is primarily funded by fixed rate debt obligations and equity. The risk associated with debt that is not at a fixed rate of interest is not significant. The Company does not hedge potential exposure to interest rate risk related to this facility.

### Foreign currency risk

Although the Company operates primarily in Canada, it purchases some of its DVD licences from US or internationally based companies, which gives rise to a risk that its earnings may be adversely impacted by fluctuations in foreign exchange conversion rates. As at August 31, 2008 and 2007, the Company had no contractual obligations to buy or sell fixed amounts of foreign currency.

### Credit risk and customer concentration

Concentration of credit risk arises when a group of customers has a similar characteristic, such that their ability to meet their obligations is expected to be affected similarly by changes in economic or other conditions. For the Company, significant concentrations of credit risk are related to the retail markets. Two customers each represent greater than 10% of total sales. The Company mitigates this credit risk through their credit monitoring policies.

## 17. LOSS PER SHARE

Loss per share is calculated based on the weighted average number of common shares outstanding during the period. For the year ended August 31, 2008 and the eight-month period ended August 31, 2007, all dilutive instruments such as stock options, convertible promissory notes and

## Knightscope Media Corp.

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warrants were excluded from the calculation of diluted loss per share, as the effect of including them would have been anti-dilutive.

#### 18. SEGMENTED REPORTING OF REVENUE

Whereas the Company has two operating divisions [note 1], management considers that the Company operates in one business segment, which is the production, licensing and distribution of films and videos. The Company markets its services primarily in Canada.

#### 19. CONSOLIDATED STATEMENT OF CASH FLOWS

Supplemental cash flow information is as follows:

	Year ended August 31, 2008	Eight-month period ended August 31, 2007
	\$	\$
Income taxes paid	—	—
Interest expense paid	96,880	38,528

The non-cash financing and investing transactions that are not reflected in the consolidated statement of cash flows include the following:

- [a] During the year ended August 31, 2008, the Company issued warrants as part of the private placement described in [note 12[a]][ix]]. The fair value of these warrants amounting to \$22,918 has been charged to share capital and credited to contributed surplus.
- [b] During the eight-month period ended August 31, 2007, the Company issued warrants as part of various private placements as described in note 12[b]. The accumulated fair value of these warrants amounting to \$253,743 was charged to share capital and credited to contributed surplus.
- [c] Notes issued in May 2007 as part of the consideration of the acquisition of Morningstar are not reflected in the consolidated financial statements of cash flows. As the notes are settled, the cash amount is included as part of the consideration paid and therefore included in the investing activity.

#### 20. COMPARATIVE AMOUNTS

Certain comparative amounts have been reclassified from those previously presented to conform to the presentation of the 2008 financial statements.