# DIFFERENCE CAPITAL FINANCIAL INC.
# MANAGEMENT DISCUSSION AND ANALYSIS

for the quarter ended September 30, 2014

November 11, 2014

TABLE OF CONTENTS

## MANAGEMENT'S DISCUSSION AND ANALYSIS

November 11, 2014

*This Management's Discussion and Analysis ("MD&A") dated November 11, 2014 presents an analysis of the financial position of Difference Capital Financial Inc. ("Difference Capital" or the "Company") as at September 30, 2014, compared with December 31, 2013, and the results of operations for the three and nine month periods ended September 30, 2014, compared to the three and nine month periods ended September 30, 2013 and the three month period ended June 30, 2014. It is supplementary information and should be read in conjunction with the Company's audited financial statements and accompanying notes as at December 31, 2013 and unaudited interim financial statements and accompanying notes for the period ended September 30, 2014. All dollar amounts in this MD&A are reported in Canadian dollars, unless otherwise stated.*

*Regulatory filings for Difference Capital may be found on SEDAR at www.sedar.com, while other information related to the Company is published on the Company's website at www.differencecapital.com.*

## INTERNATIONAL FINANCIAL REPORTING STANDARDS

On January 1, 2014, the Company adopted International Financial Reporting Standards ("IFRS") for financial reporting purposes, using a transition date of January 1, 2013. The financial statements for the three months ended March 31, 2014, including required comparative information, have been prepared in accordance with IFRS 1, *First-time Adoption of International Financial Reporting Standards*, and with International Accounting Standard ("IAS") 34, *Interim Financial Reporting*, as issued by the International Accounting Standards Board and consistent with IFRS accounting policies that Difference Capital expects to adopt in its financial statements as at and for the year ended December 31, 2014. Previously, the Company prepared its Interim and Annual Financial Statements in accordance with Canadian generally accepted accounting principles ("GAAP"). Unless otherwise noted, 2013 comparative information has been prepared in accordance with IFRS.

The adoption of IFRS has not had a material impact on the Company's operations, strategic directions and cash flow. Refer to the Adoption of International Financial Reporting Standards section included in this MD&A for more detailed information.

## FORWARD-LOOKING STATEMENTS

Certain information contained in this MD&A constitutes forward-looking information, which is information relating to possible events, conditions or results of operations of the Company, which are based on assumptions about future economic conditions and courses of action and which are inherently uncertain. All information other than statements of historical fact may be forward-looking information. Forward-looking information is often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "target", "intend", "could", "might", "should", "believe", and similar words or phrases (including negative variations) suggesting future outcomes or statements regarding an outlook. Forward-looking information in this MD&A includes, but is not limited to, statements with respect to: the Company's investment approach, objectives and strategy, including its focus on specific sectors; the structuring of its investments and its plans to manage its investments; the Company's financial performance; and its expectations regarding the performance of certain sectors.

Forward-looking information involves known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information. The Company believes that the expectations reflected in the forward-looking information are reasonable but no assurance can be given that these expectations will prove to be correct. Some of the risks and other factors which could cause results to differ materially from those expressed in forward-looking information contained in this MD&A include, but are not limited to: the nature of the Company's investments; the available opportunities and competition for its investments; the concentration of its investments in certain industries and sectors; the Company's dependence on its manager and management team; risks affecting the Company's investments; global political and economic conditions; investments by the Company in private issuers which have illiquid securities; management of the growth of the Company; exchange rate fluctuations; and other risks and factors discussed in this MD&A under "Risk Factors".

Although the Company has attempted to identify important factors that could cause actual events or results to differ materially from those described in forward-looking information, there may be other factors that cause events or results to differ from those intended, anticipated or estimated. Readers are cautioned that the foregoing list of risks and factors is not exhaustive. The forward-looking information contained in this MD&A is provided as at the date of this MD&A, based upon the opinions and estimates of management and information available to management as at the date of this MD&A, and the Company undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required by law. Readers are cautioned not to place undue reliance on forward-looking information contained in this MD&A.

## NOTE REGARDING NON-IFRS FINANCIAL MEASURES

This document contains references to "net asset value" (basic and fully diluted) ("Net Asset Value" or "NAV"), which is a non-IFRS financial measure. The Company calculates basic NAV by subtracting the aggregate fair value of the liabilities of the Company from the aggregate fair value of the assets of the Company on the date on which the calculation is being made and NAV per share as NAV divided by the total number of common shares of the Company outstanding as at a specific date. Fully diluted NAV is calculated by taking basic NAV and accounting for any dilutive impact of outstanding securities of the Company that are convertible into or exercisable for common shares as if they had been converted or exercised. The term "net asset value per share" does not have any standardized meaning according to IFRS and therefore may not be comparable to similar measures presented by other companies. Management believes that the measure can provide information useful to its shareholders in understanding the Company's performance and facilitate the comparison of the results of its ongoing operations, and may assist in the evaluation of the Company's business, relative to that of its peers.

## ABOUT DIFFERENCE CAPITAL

Difference Capital is a specialty finance company focused on creating shareholder value through strategic investments in, and advisory services for, growth companies, particularly in the technology, media and healthcare sectors, as well as opportunistic investments in undervalued financial assets and real property. The Company's investment strategy is currently primarily, albeit not exclusively, focused on investments in debt and equity securities in later stage privately held target companies ("Target Companies").

The Company believes that its continued growth and success is strongly linked to its management team and human capital in addition to its strong partnerships with current and potential investee partners. The

Company has assembled a dynamic management team, which brings together different skillsets that uniquely position it to identify investment opportunities and add value to these investments, thus driving returns for its shareholders. The Company believes that having management aligned with shareholders will be a key driver of long-term performance. As of November 11, 2014, management and directors own approximately 25% of the Company's issued and outstanding common shares.

Difference Capital Management Inc. (the "Manager"), the manager of the Company, is responsible for the Company's entire portfolio and considers the business to be comprised of one operating segment. Investment decisions are based on the strategy/disciplines outlined below, and performance is evaluated on an overall basis.

The Company is located in the Province of Ontario, Canada and its principal address is 130 Adelaide Street West, Suite 1010, Toronto, Ontario, M5H 3P5. The Company's registered office is located at Wildeboer Dellelce Place, Suite 800, 365 Bay Street, Toronto, Ontario, M5H 2V1. The Company is a reporting issuer in the provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland and Labrador.

## BUSINESS STRATEGY

The Company provides investors with an opportunity to gain exposure to unique investments and also income from advisory services. The Company generally, albeit not exclusively, seeks to invest in the mid to later stages of a Target Company's development or in emerging technologies that are developed and validated but may be in the early stage of commercialization. This strategy allows the Company to invest in enterprises that are commercially viable and have visibility toward high growth. In the past, the Company has also made significant investments in early stage private companies as well as opportunistic investments in distressed United States real estate. The Company no longer seeks to allocate capital to real estate investments, and is in fact in the mode of divesting such assets. The Company is not bound to commit to any particular sector, thereby allowing for diversification; however, the present focus is generally on technology-related, media-related and healthcare-related, intellectual property-rich Target Companies. This approach may change over time as market conditions change and the capital markets respond. The Company evaluates each opportunity on its merits. The Company enters investments at a stage where potential exists to maximize strong returns and manages risk by applying the considerable business expertise of its directors and officers to the investments undertaken. With the continued investment of the Company's resources into strategically targeted sectors, the Company is well positioned to benefit from a global economic recovery and positive trends in Canadian and international growth companies. There are very few merchant banks in Canada focused on this sector, providing an opportunity for our team to capitalize on evolving growth trends.

While the Company has in the past made aggregate investments in the securities of a single issuer of up to $30 million, typical investment allocations range from $2.0 million to $5.0 million. When investments are made, they may be accompanied by share purchase warrants to enhance the return on account of increased risk. Debt placements often include conversion rights and in some cases are accompanied by bonus shares or warrants, and may be secured by tangible assets of sufficient value to safeguard the investment.

In pursuit of returns, the Company, when appropriate, employs the following disciplines:

- The Company seeks to invest in post-early/seed stage financing rounds of Target Companies.
- The Company seeks investments that include as many of the following characteristics as possible: (i) a product/service with national/international market potential; (ii) an established business model with

high gross margins that support strong competitive advantages; (iii) the ability to sustain growth rate in excess of 25% per annum; (iv) protected intellectual property; (v) scalability; and (vi) currently generating revenue in excess of several million dollars.

- At this time, the Company seeks investments primarily, albeit not exclusively, in the technology, media and healthcare sectors where we have developed domain expertise and focuses on investments with clear paths to liquidity in a two to three year period. As investment issuers need to be managed for cash flow in order to reduce financing risks associated with delayed liquidity events, certain sectors will not be considered by the Company.
- The Company has a target rate of return when entering an investment in a Target Company of greater than a typical equity index return. Returns are expected to materialize partially from income on its debt and convertible debenture holdings, but primarily through capital gains based on the growth of its equity and equity-linked securities.
- The Company acquires a detailed knowledge of the business and sector of the Target Company.
- Where appropriate, the Company seeks board representation or board observation rights.
- The Company utilizes the services of independent advisors and consultants to acquire additional information about Target Companies where appropriate.

The Manager also considers opportunistic investments that come to its attention through its proprietary deal flow. The Manager has extensive experience with a variety of asset classes and strategies including real estate, arbitrage, structured products, long/short equity, market-making, and proprietary trading. The Manager is well-positioned to evaluate unique investments that offer significant potential returns on both an absolute and risk-adjusted basis. Such opportunities exist due to structural, market, legal, regulatory, tax, informational or other idiosyncratic inefficiencies. It is the Company's plan that should it identify a strategy or asset class that it believes merits significant investment beyond its own allocation, the Company may choose to contribute such assets to a separate vehicle and offer to existing shareholders and other potential investors the ability to co-invest with the Company in this new entity. Since 2013, the Company has chosen to deemphasize alternative asset classes in order to focus its efforts on late stage, pre-IPO growth companies.

The Manager operates a complementary equity capital markets advisory and consulting business to assist corporate clients with strategic financial markets advice. The Manager's advisory and consulting services are focused on delivering impartial, creative, and long-term ideas to clients by a management team with diverse and complementary skill sets. The model focuses on a relationship-driven approach that provides advice tailored to each client's specific needs and circumstances to ensure delivery of individual solutions. The Manager works with advisory clients' senior management to deliver solutions for a range of issues.

The Company has executed a management agreement with the Manager, dated January 18, 2013 with effect as of May 29, 2012, as amended by an amending agreement dated March 26, 2014 with effect as of July 1, 2013 (the "Management Agreement"). As compensation for its management services, the Company pays the Manager an annual management fee (the "Management Fee") in the amount equal to 2% plus HST of the net asset value of the Company, as determined by subtracting the aggregate fair value of the liabilities of the Company (excluding any convertible debentures or debentures that have a term of greater than one year, in each case, for greater certainty, debentures that have been issued by the Company which includes the Company's current unsecured subordinated debentures) from the aggregate fair value of the assets of the Corporation on the date on which the calculation is being made, calculated and payable monthly as of the last business day of each month. Under the Management Agreement, the Company is entitled to receive 40% of any advisory or consultancy fees, net of direct expenses, earned by the Manager. As there are no direct expenses associated with this revenue stream and the Company has significant operating tax loss carry forwards, Difference Capital's entire advisory revenue stream effectively flows straight through to net income.

## RESULTS OF OPERATIONS

| *($000's, except per share amounts)* | 2014 | | | 2013 | | | | 2012 |
|---|---|---|---|---|---|---|---|---|
| | **Q3** | **Q2** | **Q1** | **Q4** | **Q3** | **Q2** | **Q1** | **Q4** |
| Net realized gain (loss) on disposals of investments and marketable securities | 340 | 1,015 | 3,053 | (731) | (87) | 1,037 | 1,460 | 2,535 |
| Net change in unrealized gain (loss) on investments and marketable securities | (9,958) | (11,217) | 1,151 | (17,138) | 1,865 | (2,410) | (550) | 5,242 |
| Other income | 1,675 | 1,848 | 1,979 | 1,950 | 1,725 | 1,121 | 1,067 | 533 |
| Total expenses | (4,103) | (4,641) | (3,325) | (3,804) | (3,031) | (945) | (1,107) | (2,557) |
| Net income (loss) | (12,046) | (12,995) | 2,858 | (19,723) | 472 | (1,197) | 870 | 5,753 |
| Earnings (loss) per share | (0.31) | (0.33) | 0.07 | (0.52) | 0.01 | (0.04) | 0.03 | 0.23 |
| | | | | | | | | |
| Total assets | 139,925 | 157,125 | 169,280 | 168,814 | 189,279 | 95,410 | 93,922 | 93,342 |
| Total liabilities | 47,927 | 52,255 | 50,884 | 53,276 | 53,117 | 5,839 | 3,153 | 3,487 |
| Net asset value | 91,998 | 104,870 | 118,396 | 115,538 | 136,162 | 89,572 | 90,769 | 89,855 |
| Shares outstanding | 38,350 | 38,856 | 39,132 | 39,132 | 39,318 | 27,312 | 27,312 | 11,883 |
| Net asset value per share | 2.40 | 2.70 | 3.03 | 2.95 | 3.46 | 3.27 | 3.32 | 3.29 |
| Share price* | 1.37 | 1.74 | 2.23 | 2.75 | 3.05 | 3.90 | 3.80 | 3.40 |

**post share consolidations*

### Quarter Ended September 30, 2014

For the quarter ended September 30, 2014, the Company reported a net loss of $12.0 million, or $0.31 per share compared to a net income of $0.5 million, or $0.01 per share for the quarter ended September 30, 2013 and a net loss of $13.0 million, or $0.33 per share for the quarter ended June 30, 2014.

The Company realized a $0.3 million gain on dispositions of investments and marketable securities during the quarter ended September 30, 2014 compared with $0.1 million in realized loss during the quarter ended September 30, 2013 and a realized gain of $1.0 million during the second quarter of 2014. The realized gain during the third quarter was primarily attributed to a $1.7 million gain on the disposition of common shares in BENEV Capital Inc. ("BENEV Capital"), offset by realized losses on the dispositions of shares in other publicly traded positions.

During the third quarter of 2014, the Company recorded $10.0 million of net change in unrealized depreciation on investments and marketable securities, compared to a net change in unrealized appreciation of $1.9 million in the third quarter of 2013. The net change in unrealized depreciation recorded during the quarter was primarily due to fair value adjustments in privately held investments including Lignol Energy Corporation ("Lignol Energy"), Cricket Media Corporation, Fem Med Formulas Limited Partnership ("Fem Med"), WG Limited ("World Gaming") and iPowow! Inc. as well as marked-to-market losses in publicly listed securities including Aurinia Pharmaceuticals Inc. and Lignol Energy. The net change in unrealized depreciation was partially offset by approximately $1.8 million of net change in unrealized appreciation of foreign exchange during the quarter.

Other income for the quarter ended September 30, 2014 was $1.7 million, in line with $1.7 million during the same period in 2013 and $1.8 million during the previous quarter. Included in other income were interest and dividend income from the investment portfolio totaling $1.6 million, up from $1.3 million in the same period of 2013. Also included in other income was the 40% revenue participation in Difference

Capital Management's advisory revenue business of $0.1 million, compared to $0.4 million in the third quarter of 2013.

Total expenses during the quarter ended September 30, 2014 were $4.1 million compared to $3.0 million for the quarter ended September 30, 2013 and $4.6 million for the prior quarter ended June 30, 2014. The year-over-year increase in total expenses was primarily due to increased professional fees associated with the BENEV Capital investment and the Lignol Energy receivership proceedings. In addition, total expenses were impacted by a $0.6 million provision for uncollectible receivables recorded during the third quarter of 2014, primarily due to uncertainty as to the full collectability of interest on the Fem MED loan and Lignol Energy promissory note. The increase in total expenses during the quarter was partially offset by $0.5 million of gain recognized on the repurchase of convertible debentures.

**Nine Months Ended September 30, 2014**

For the nine months ended September 30, 2014, the Company reported a net loss of $22.2 million, or $0.57 per share, versus a net gain of $0.1 million, or $0.00 per share, for the nine months ended September 30, 2013.

The Company recorded $4.4 million of net realized gain on dispositions of investments and marketable securities during the nine months ended September 30, 2014 compared with $2.4 million in net realized gain in the prior year. Realized gains during the nine months ended September 30, 2014 included investments in BENEV Capital Inc., Enterprise Group, Inc., Amaya Gaming Group Inc. and NeuLion Inc.

For the nine months ended September 30, 2014, the Company recorded $20.0 million of net change in unrealized depreciation on investments and marketable securities, compared to a net change in unrealized depreciation of $1.1 million during the same period last year. A significant portion of the net change in unrealized depreciation recorded during the current nine-month period was attributed to investments in World Gaming and Lignol Energy.

Other income for the nine months ended September 30, 2014 increased to $5.5 million compared to $3.9 million in the prior year. Other income included interest and dividend income from the investment portfolio totaling $4.9 million, versus $3.0 million in the same period of 2013. Also included in other income was the 40% revenue participation in Difference Capital Management's advisory revenue business of $0.6 million, compared to $0.8 million in 2013.

Total expenses during the nine months ended September 30, 2014 were $12.1 million compared to $5.1 million for the nine months ended September 30, 2013. The year over year increase in total expenses was primarily due to increased management fees from a higher Net Asset Value ($2.4 million compared to $1.9 million 2013), and financing costs associated with the issuance of convertible debentures in July 2013 ($4.2 million compared to $1.4 million in 2013). In addition, the increase in total expenses during the nine months ended September 30, 2014 was attributed to a $1.9 million provision for uncollectible receivables, primarily due to uncertainty as to the full collectability of interest on World Gaming, Fem Med and Lignol Energy debt investments.

## LIQUIDITY AND CAPITAL RESOURCES

During the quarter ended September 30, 2014, cash provided by operating activities was $12.1 million, compared to cash used in operating activities of $41.6 million in the same period of 2013. The Company received $17.3 million in net proceeds from disposals of investments, predominantly from the sale of BENEV Capital shares and spent $1.1 million in net purchases of marketable securities in the third quarter of 2014 compared to $25.1 million in net purchases of investments and $14.9 million in net purchases of marketable securities in the same period last year.

The Company had $17.7 million of cash and cash equivalents as at September 30, 2014, compared to $9.5 million as at June 30, 2014. Total investable assets, calculated as Net Asset Value excluding the convertible debentures outstanding, as of September 30, 2014 were $138.3 million, down from $154.5 million at June 30, 2014.

As at September 30, 2014, the Company's investment and marketable securities portfolios decreased to $118.0 million from $143.7 million at June 30, 2014.

Accrued interest, prepaid expenses and other receivables increased to $4.2 million from $3.9 million at June 30, 2014.

The Company's accounts payable and accrued liabilities, including management fees and performance fees payables, increased to $0.9 million during the period ended September 30, 2014.

As at September 30, 2014, the Company accrued $0.7 million of interest payable on the Debentures. The next coupon payment is on January 31, 2015.

As at September 30, 2014, the Company had $51.8 million in outstanding principal on its Debentures with a total carrying value of $46.3 million in long-term debt and $3.8 million in equity.

During the quarter, shareholders' equity decreased by $12.9 million to $92.0 million at September 30, 2014.

In December 2013, the Company obtained approval from the Toronto Stock Exchange under the normal course issuer bid (the "NCIB") to purchase for cancellation up to 1,000,000 of its common shares and up to $2.0 million principal amount of its convertible debentures, through to December 4, 2014. In August 2014, the Company received approval from the TSX to amend its NCIB in order to increase the maximum principal amount of convertible debentures that may be purchased under the NCIB from $2 million to $4.4 million. During the quarter ended September 30, 2014, the Company repurchased $4.0 million principal amount of the Debentures, for an aggregate consideration of $3.2 million, and 505,800 common shares for total consideration of $0.7 million.

Net Asset Value as at September 30 was $92.0 million or $2.40 per share compared to 104.9 million, or $2.70 per share, as at June 30, 2014, and $115.5 million, or $2.95 per share as at December 31, 2013.

Subsequent to September 30, 2014, the Company entered into an agreement to sell its interests in Chieftain Residential Limited Partnership for aggregate proceeds of US $10.2 million. The transaction is expected to close in the fourth quarter of 2014.

The Company believes it has adequate working capital to support its operations. The Company's primary use of cash is to make investments and to pay for operating expenses.

## INVESTMENTS

The table below provides a summary of the Company's investments as at September 30, 2014:

| Investment | Investment Type | Industry Sector | Geographic Sector | Average Cost ($000) | Fair Value ($000) |
|---|---|---|---|---|---|
| Appinions Inc. | convertible debentures | Ad-tech | United States | 2,048 | 2,040 |
| | equity securities | | | 1,748 | 1,800 |
| Aurinia Pharmaceuticals | equity securities | Healthcare | Canada | 2,096 | 3,385 |
| | warrants | | | 113 | 525 |
| Baanto International Ltd. | convertible debentures | Hardware | Canada | 2,700 | 2,700 |
| | equity securities | | | 300 | 300 |
| Blue Ant Media Inc. | equity securities | Media | Canada | 4,787 | 4,787 |
| Bluedrop Performance Learning Inc. | convertible debentures | Edu-tech | Canada | 3,000 | 3,000 |
| BrainScope Company Inc. | equity securities | Healthcare | United States | 1,563 | 1,728 |
| BTI Systems Inc. | equity securities | Hardware | Canada | 1,887 | 1,995 |
| BuildDirect.com Technologies Inc. | equity securities | e-Commerce | Canada | 6,500 | 6,500 |
| Carta Solutions Holding Corporation | units | Payments | Canada | 3,505 | 3,986 |
| Cardiac Dimensions Pty. Ltd. | equity securities | Healthcare | United States | 2,182 | 2,242 |
| Chieftain Residential Limited Partnership | partnership interest | Real Estate | United States | 7,485 | 8,406 |
| | promissory note | | | 2,538 | 2,802 |
| Crailar Technologies Inc. | convertible debentures | Clean-tech | Canada | 5,000 | 1,969 |
| Difference RM Holding Corporation | equity securities | Real Estate | United States | 5,432 | 6,120 |
| Cricket Media Group Ltd. | convertible debentures | Edu-tech | United States | 6,500 | 4,875 |
| Fem MED Formulas Limited Partnership | secured convertible debentures | Healthcare | Canada | 2,500 | 625 |
| GuestLogix Inc. | debentures | Payments | Canada | 1,950 | 1,950 |
| | warrants | | | 50 | 220 |
| Hootsuite Media Inc. | equity securities | Media-tech | Canada | 2,080 | 2,130 |
| InfraReDx, Inc. | convertible debentures and | Healthcare | United States | 5,093 | 8,681 |
| | preferred shares warrants | | | | |
| iPowow! Inc. | equity securities | Media-tech | Canada | 4,393 | 3,815 |
| | loan | | | 400 | 400 |
| Lignol Energy Corporation | equity securities | Clean-tech | Australia | 5,557 | - |
| | secured grid promissory note | | | 12,285 | 1,000 |
| QuickPlay Media Inc. | equity securities | Media-tech | Canada | 2,365 | 2,365 |
| SHOP.CA Network Inc. | equity securities | e-Commerce | Canada | 1,600 | 2,780 |
| Thunderbird Films Inc. | equity securities | Media | Canada | 6,000 | 6,000 |
| Vena Solutions Canada Inc. | convertible debentures | Enterprise Software | Canada | 3,000 | 3,000 |
| | Units | | | 500 | 500 |
| Vision Critical Communications Inc. | equity securities | Ad-tech | Canada | 3,500 | 3,500 |
| Enhanced Systems Technologies | equity securities | Clean-tech | Australia/Asia | 3,335 | - |
| WG Limited ("World Gaming") | convertible debentures | Gaming | Canada | 21,782 | 13,069 |
| | equity securities | | | 4,677 | 216 |
| Other debt | debt securities | | | 2,410 | 1,490 |
| Other equity | equity securities, warrants and units | | | 7,396 | 5,994 |
| | | | | **150,257** | **116,895** |

Significant purchases, sales and changes in valuation of investments during the quarter ended September 30, 2014 included the following:

*Appinions Inc. ("Appinions")*
During the quarter ended September 30, 2014, the Company agreed to convert US$0.8 million of the 10.0% convertible senior unsecured debentures with a maturity of September 19, 2014 plus outstanding accrued interest into common shares of Appinions at the conversion price of US$0.858 per common share.

*BuildDirect.com Technologies Inc. ("BuildDirect")*
During the quarter ended September 30, 2014, the Company invested an additional $1.5 million in BuildDirect in the form of common shares at a price that is subject to final adjustment upon completion of the financing which is anticipated during the fourth quarter of 2014. Subsequent to quarter end, the Company invested an additional $0.5M in BuildDirect under the same terms and conditions.

*Carta Solutions Holding Corporation ("Carta")*
During the quarter ended September 30, 2014, the Company invested an additional $1.5 million in Carta through the purchase of 1.5 million units (the "2014 Carta Units") at a price of $1.00 per unit. Each 2014 Carta unit comprises of one common share of Carta and one common share purchase warrant, with each whole warrant exercisable for a further common share at an exercise price of $1.25 until June 30, 2017.

The Company also holds 2.5 million units of Carta at a cost of $0.80 per unit (the "2013 Carta Units"). Each 2013 Carta Unit consists of one common share of Carta and ¼ common share purchase warrant, with each whole warrant exercisable for a further common share at an exercise price of $1.25 until June 30, 2016. The Company also holds 0.5 million common share purchase warrant, with each whole warrant exercisable for a further common share at an exercise price of $1.00 until May 20, 2017. During the quarter ended September 30, 2014, approximately $0.3 million change in appreciation was recorded for the 2013 Carta Units based on the recent 2014 Carta Units financing.

*Cricket Media Corporation ("Cricket Media")*
The Company holds $3.0 million of Cricket Media secured convertible debentures that pay 6.5% interest per annum and $3.5 million of secured convertible debentures that pay 10.0% interest per annum which all have a maturity date of October 31, 2016. In September 2014, Cricket Media publicly announced the execution of its option to extend the maturity date of these convertible debentures from October 31, 2014 to October 31, 2016. During the quarter, the Company recorded approximately $1.3 million in unrealized depreciation for the Cricket Media convertible debentures.

*Fem Med Formulas Limited Partnership ("Fem Med")*
The Company holds $2.5 million of Fem Med secured convertible debentures that accrue 8% interest per annum and have a maturity date of August 31, 2015. During 2013, the Company recorded approximately $0.6 million in unrealized depreciation for the Fem Med debentures. During the quarter ended September 30, 2014, the Company recorded a further $1.3 million in unrealized depreciation for the Fem Med debentures.

*Hootsuite Media Inc. ("Hootsuite")*
During the quarter ended September 30, 2014, the Company invested in 5.0 million Class B preferred shares in Hootsuite for total consideration of US $1.9 million. Hootsuite provides a web-based social media management platform for businesses and organizations to collaboratively execute campaigns across various social networks.

*iPowow! Inc. ("iPowow")*
During the quarter ended September 30, 2014, the Company invested an additional $0.3 million in Ipowow in the form of short term loan to iPowow,  The Company also recorded approximately $0.6 million of unrealized depreciation on the common shares of iPowow.

*Lignol Energy Corporation ("Lignol")*
During the quarter ended September 30, 2014, the Company placed Lignol in receivership and appointed The Bowra Group Inc. as the receiver.  The Company is currently working with the receiver to maximize the recoverable value through the sale of Lignol assets.

The Company reduced the fair value of the promissory note to $1 million as at September 30, 2014, which represented estimated net recoverable value of the Lignol assets. The common shares of Lignol are currently halted and as such, the Company ascribed no value to these shares as at September 30, 2014.

*Vena Solutions Canada Inc. ("Vena Solutions")*
During the quarter ended September 30, 2014, the Company invested an additional $0.5 million in Vena through the purchase of 238,095 units (the "Vena Units") at a price of $2.10 per unit. Each Vena Unit comprises of one Class G common share in the capital of Vena Solutions Canada Inc. at $1.995 per share and one Class G common share in the capital of Vena Solutions International Inc. at $0.105 per share).

*Waterloo Innovation Network I Limited Partnership ("WIN I LP")*
During the quarter ended September 30, 2014, the Company invested $2.0 million in limited partnership units of WIN I LP. WIN I LP is an investment fund which invests in venture stage communications and information technology based businesses principally originating in North America.

*WG Limited ("World Gaming")*
During the quarter ended September 30, 2014, the Company recorded a further $0.3 million in unrealized depreciation of its investments in World Gaming during the quarter.

## MARKETABLE SECURITIES

Marketable securities and marketable securities sold short are acquired principally for the purpose of selling or repurchasing in the near term. Marketable securities include equity securities, debt securities and warrants of public company issuers that are publicly traded on recognized stock exchanges. Marketable securities are carried at their fair value and any changes in fair value are recognized in income as a change in unrealized gain (loss) on investments.

Marketable securities owned and marketable securities sold short consist of the following:

| | September 30, 2014 | | December 31, 2013 | | January 1, 2013 | |
|---|---|---|---|---|---|---|
| | Marketable securities | Securities sold short | Marketable securities | Securities sold short | Marketable securities | Securities sold short |
| | ($000) | ($000) | ($000) | ($000) | ($000) | ($000) |
| Equity securities | 1,116 | - | 3,785 | 780 | 15,723 | - |
| Warrants | - | - | 115 | - | - | - |
| | 1,116 | - | 3,900 | 780 | 15,723 | - |

## RELATED PARTY TRANSACTIONS

Management Agreement

Pursuant to the Management Agreement, as compensation for the management services provided to the Company by the Manager, the Company pays the Manager the Management Fee in the amount equal to 2% plus HST of the Company's monthly management fee net asset value (the "Management Fee NAV"), calculated and payable monthly as of the last business day of each month. The Management Fee NAV is determined by subtracting the aggregate fair value of the liabilities (excluding any convertible debentures or debentures that have a term of greater than one year that have been issued by the Company) from the aggregate fair value of the assets of the Company on the date on which the calculation is being made. In addition to the Management Fee, the Manager is entitled to receive, for each fiscal year of the Company, a performance fee (the "Performance Fee") equal to 20% of any increase in the performance fee net asset value (the "Performance Fee NAV") from the start of the fiscal year in question to the end of that fiscal year (the "Performance Year") less the two-year Government of Canada bond rate (the "Hurdle Rate"), with the Hurdle Rate subject to a maximum of 5%. The Performance Fee NAV is determined by subtracting the aggregate fair value of the liabilities (excluding any convertible debentures or debentures that have a term of greater than one year that have been issued by the Company) from the aggregate fair value of the assets of the Company on the date on which the calculation is being made.

Under the Management Agreement, 40% of any advisory or consultancy fees, net of direct expenses, earned by the Manager shall be remitted to the Company.

For the quarter ended September 30, 2014, management fees of $0.7 million were accrued to the Manager. For the same period, its share of advisory fees of $0.1 million was recorded by the Company.

Other Related Party Transactions

As part of its investment process and where the Company is making a significant investment relative to the total outstanding equity of an investee, the Company may seek representation on the board of directors of such investee companies, or the rights to attend and observe board meetings.

## CONTRACTUAL OBLIGATIONS

The table below is a summary of the Company's contractual obligations at September 30, 2014:

| *(millions of dollars)* | **Total** | **1 year or less** | **2** | **3** | **4** |
|---|---|---|---|---|---|
| Interest on Convertible Debentures | 16,588 | 4,147 | 4,147 | 4,147 | 4,147 |
| Debentures | 51,837 | - | - | - | 51,837 |
| Total | 68,425 | 4,147 | 4,147 | 4,147 | 55,984 |

In addition to the contractual obligations detailed above, the following obligations exist that vary depending upon Net Asset Value and other factors:

- The Company pays management fees to the Manager in the amount equal to 2% plus HST of the management fee NAV, calculated and payable monthly as of the last business day of each month.

- The Company pays a performance fee equal to 20% of any increase in the performance fee NAV from the start of the fiscal year in question to the end of that fiscal year less the Hurdle Rate, with the Hurdle Rate subject to a maximum of 5%.

## CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of the Company's financial statements in accordance with IFRS 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 date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Key areas of estimation where management has made difficult, complex or subjective judgments include the determination of the fair value of certain investments, as further explained below. Actual results could differ from these estimates.

Included in the Company's investment portfolio are the following types of investments:

Common shares and membership units are valued using quoted market prices if they are traded on a recognized stock exchange or over the counter and are generally valued using the last traded market price where the last traded price falls within the bid-ask spread. In circumstances where the last traded price is not within the bid-ask spread, the Company determines the point within the bid-ask spread that is most representative of fair value based on the specific facts and circumstances on the balance sheet dates. The fair value of securities that are subject to trading restrictions are recorded at a value which takes into account the length and nature of the restrictions and the liquidity of the security. Private investments for which no quoted market value exists, or investments in restricted or thinly traded securities, are recorded at estimated fair value. Convertible debentures and convertible debts are valued at par, if the price of the underlying common shares is less than the conversion price; valued as though converted to common shares if the price of the underlying common shares exceeds the conversion price; or valued based on quoted market prices of similar convertible debt investments of the same issuer; or valued at estimated fair value if there is concern of impairment. When these investments are initially recognized, fair value is generally the value of consideration paid. Subsequent to initial recognition, the fair value of these investments is determined by the Company using an appropriate valuation methodology after considering: the history and nature of the business; operating results and financial conditions; the general economic, industry and market conditions; capital market and transaction market conditions; independent valuations of the business; contractual rights relating to the investment; comparable company trading and transaction multiples, where applicable, and other pertinent considerations.

For public company warrants (i.e., the underlying security of which is traded on a recognized stock exchange), the Black-Scholes valuation model is used when there are sufficient and reliable observable market inputs. These market inputs include risk-free interest rate, exercise price, market price at date of valuation, expected dividend yield, expected life of the instrument and expected volatility of the underlying security. To the extent that the market inputs are insufficient or unreliable, the warrants are valued at their intrinsic value, which is equal to the higher of the last traded market price of the underlying security, less the exercise price of the warrant, or nil. For private company warrants, the underlying security of which is not traded on a recognized stock exchange, fair value is determined consistently with other investments that do not have an active market as described above.

## ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Company adopted IFRS effective January 1, 2014 with a transition date of January 1, 2013. The adoption of IFRS has not had a material impact on the Company's operations, strategic directions and cash flow. The Company's IFRS accounting policies are provided in Note 1 to the Interim Financial Statements. In addition, Note 12 to the Interim Financial Statements presents reconciliations between Difference Capital's 2013 GAAP results and the 2013 IFRS results and explanations of the adjustments to transition to IFRS.

IFRS 1, *First-time Adoption of International Financial Reporting Standards* ("IFRS 1"), requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Company will be December 31, 2014. However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters.

The only voluntary exemption adopted by the Company upon transition was the ability to designate financial assets or financial liabilities at fair value through profit or loss ("FVTPL") upon transition to IFRS. All financial assets designated at FVTPL upon transition (see Note 6 to the Interim Financial Statements) were previously carried at their fair value under Canadian GAAP as required by Accounting Guideline 18, Investment Companies.

In accordance with the mandatory exceptions to retroactive restatement under IFRS 1, hindsight was not used to create or revise estimates at the transition date, and accordingly the estimates previously made by the Company under Canadian GAAP are consistent with the application under IFRS, except where necessary to reflect any difference in accounting policies.

## FUTURE ACCOUNTING CHANGES

The Company continues to monitor the potential changes proposed by the International Accounting Standards Board and considers the impact changes in the standards would have on the Company's operations.

IFRS 9 *Financial Instruments* ("IFRS 9")

IFRS 9 will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. The Company is currently evaluating the impact this standard will have on its financial statements.

## RISK FACTORS AND RISK MANAGEMENT

The Company's investment strategy requires assuming risk in exchange for an above average return on investment. Each of Difference Capital's investee companies are subject to the risks inherent in the industry and markets in which they operate. Such risks include market, liquidity and currency risk. Many investee companies are at a stage of development where they may require additional capital to develop their business plans and realize their objectives.

There were no significant or material changes to the Company's risk factors and risk management during the three months ended September 30, 2014. The Company's risks are described in its annual MD&A for the year ended December 31, 2013 which can be found on SEDAR (www.sedar.com). Additional risks not currently known to the Company or that are currently believe to be immaterial, may also affect and negatively impact the Company's business.

## OUTSTANDING SHARE DATA

The Company has two authorized classes of shares: an unlimited number of common shares and an unlimited number of preference shares, issuable in series.

As at November 11, 2014, there were 38,350,434 common shares outstanding. There are no outstanding preference shares.

As at November 11, 2014, there was an aggregate principal amount of $51.8 million of Debentures outstanding, convertible into 9,015,130 common shares at a conversion price of $5.75 per common share.

## DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company's disclosure controls and procedures are designed to provide reasonable assurance the information required to be disclosed by the Company is recorded, processed, summarized and reported within the time periods specified under securities laws and include controls and procedures that are designed to ensure that information is accumulated and communicated to management including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) to allow timely decisions regarding disclosure. The CEO and CFO, together with management, are responsible for the design of the Company's disclosure control and procedures (as defined in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*). Management, under the direction of the CEO and CFO, has evaluated the effectiveness of the disclosure controls and procedures as at September 30, 2014, and has concluded that they are reasonably assured that such controls and procedures were effective.

Management, under the supervision of the CEO and CFO, is responsible for the design and maintenance of adequate internal controls over financial reporting for the purposes of providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. However, due to its inherent limitations, internal controls over financial reporting can only provide reasonable, not absolute, assurance that the financial statements are free of misstatements. Management, under the direction of the CEO and CFO, evaluated the effectiveness of the Company's internal controls over financial reporting as at September 30, 2014 and has concluded that internal control over financial reporting was appropriately designed and operating effectively. There have been no changes during the quarter ended September 30, 2014 in the Company's internal controls over financial reporting that have materially affected, or are reasonable likely to materially affect, the Company's internal controls over financial reporting.