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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended May 31, 2014

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 333-132456

**SECURITY DEVICES INTERNATIONAL, INC.**

(Exact Name of Registrant as Specified in its Charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**71-1050654**  
(I.R.S. Employer  
Identification No.)

**1101 Pennsylvania Ave., NW, 6th Floor**  
**Washington, DC 20004**  
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number including area code: (905) 582-6402

N/A

Former name, former address, and former fiscal year, if changed since last report

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Larger accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting company

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of July 15, 2014, the Company had 46,849,285 issued and outstanding shares of common stock.

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**SECURITY DEVICES INTERNATIONAL, INC.**

**INTERIM FINANCIAL STATEMENTS**

**MAY 31, 2014**

**(Amounts expressed in US Dollars)**

**(Unaudited)**

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SECURITY DEVICES INTERNATIONAL, INC.  
INTERIM FINANCIAL STATEMENTS

MAY 31, 2014

(Amounts expressed in US Dollars)  
(Unaudited)

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**SECURITY DEVICES INTERNATIONAL, INC.**  
**Interim Consolidated Balance Sheets**  
**As at May 31, 2014 and November 30, 2013**  
**(Amounts expressed in US Dollars)**

	May 31, 2014 (unaudited) \$	November 30, 2013 (audited) \$
<b>ASSETS</b>		
CURRENT		
Cash and cash equivalent	830,813	1,842,149
Accounts Receivable	12,772	20,351
Inventory (Note 13)	33,024	-
Prepaid expenses and other receivables	61,226	45,372
	<u>937,835</u>	<u>1,907,872</u>
Total Current Assets	937,835	1,907,872
Plant and Equipment (Note 4)	<u>168,223</u>	<u>152,137</u>
<b>TOTAL ASSETS</b>	<u><u>1,106,058</u></u>	<u><u>2,060,009</u></u>
<b>LIABILITIES</b>		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	92,582	106,529
Total Current Liabilities	<u>92,582</u>	<u>106,529</u>
Going Concern (Note 2)		
Related Party Transactions (Note 8)		
Commitments and Contingencies (Note 9)		
Subsequent Events (Note 14)		
<b>STOCKHOLDERS' EQUITY</b>		
Capital Stock (Note 5)		
Preferred stock, \$0.001 par value, 5,000,000 shares authorized, Nil issued and outstanding (2013 - nil). The provisions in the Articles of Incorporation allow the directors to issue preferred stock with multiple votes per share and dividend rights, which would have priority over any dividends paid with respect to the holders of Company's common stock.		
Common stock, \$0.001 par value 100,000,000 shares authorized (2013: 100,000,000), 46,849,285 issued and outstanding (2013: 46,849,285)	46,849	46,849
Additional Paid-In Capital	23,415,458	23,226,988
Deficit	(22,429,888)	(21,320,357)
Accumulated other comprehensive loss	(18,943)	-
Total Stockholders' Equity	<u>1,013,476</u>	<u>1,953,480</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<u><u>1,106,058</u></u>	<u><u>2,060,009</u></u>

See condensed notes to the interim consolidated financial statements.

**SECURITY DEVICES INTERNATIONAL, INC.**  
**Interim Consolidated Statements of Operations and Comprehensive loss**  
**For the Six months and Three Months Ended May 31, 2014 and May 31, 2013**  
**(Amounts expressed in US Dollars)**  
**(Unaudited)**

	For the six months  ended May 31, 2014 \$	For the six months  ended May 31, 2013 \$	For the three months ended May 31, 2014 \$	For the three months ended May 31, 2013 \$
SALES	29,119	-	24,603	-
COST OF SALES	<u>(16,539)</u>	<u>-</u>	<u>(14,365)</u>	<u>-</u>
GROSS PROFIT	12,580	-	10,238	-
EXPENSES:				
Depreciation	21,539	17,181	11,397	8,967
General and administration	<u>1,106,617</u>	<u>927,908</u>	<u>631,922</u>	<u>502,909</u>
TOTAL OPERATING EXPENSES	<u>1,128,156</u>	<u>945,089</u>	<u>643,319</u>	<u>511,876</u>
LOSS FROM OPERATIONS	(1,115,576)	(945,089)	(633,081)	(511,876)
Other expense- Interest	-	(87,321)	-	(50,886)
Other Income-Interest	<u>6,045</u>	<u>-</u>	<u>1,987</u>	<u>-</u>
LOSS BEFORE INCOME TAXES	(1,109,531)	(1,032,410)	(631,094)	(562,762)
Income taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
NET LOSS	(1,109,531)	(1,032,410)	(631,094)	(562,762)
Foreign exchange translation adjustment for the period	(18,943)	-	(18,943)	-
COMPREHENSIVE LOSS	(1,128,474)	(1,032,410)	(650,037)	(562,762)
Loss per share - basic and diluted	<u>(0.02)</u>	<u>(0.03)</u>	<u>(0.01)</u>	<u>(0.02)</u>
Weighted average number of common shares outstanding	<u>46,849,285</u>	<u>32,818,594</u>	<u>46,849,285</u>	<u>33,273,913</u>

See condensed notes to the interim consolidated financial statements.

**SECURITY DEVICES INTERNATIONAL, INC.**  
**Interim Consolidated Statements of Cash Flows**  
**For the Six Months Ended May 31, 2014 and May 31, 2013**  
**(Amounts expressed in US Dollars)**  
**(Unaudited)**

	For the six months ended May 31, 2014 \$	For the six months ended May 31, 2013 \$
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss for the period	(1,109,531)	(1,032,410)
Items not requiring an outlay of cash:		
Fair value of options and warrants (included in general and administration expenses)	188,470	99,245
Depreciation	21,539	17,181
Amortization of debt discount	-	8,022
Changes in non-cash working capital:		
Accounts receivable	7,579	
Prepaid expenses and other receivables	(15,854)	1,073
Inventory	(33,024)	
Deferred costs	-	(61,230)
Accounts payable and accrued liabilities*	(13,947)	231,531
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<u>(954,768)</u>	<u>(736,588)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Acquisition of Plant and Equipment	(37,625)	(45,219)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<u>(37,625)</u>	<u>(45,219)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Loan from related party	-	96,700
Loan from non-related parties	-	531,850
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<u>-</u>	<u>628,550</u>
Effects of foreign currency exchange rate changes	(18,943)	-
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS FOR THE PERIOD</b>	<u>(1,011,336)</u>	<u>(153,257)</u>
Cash, beginning of period	1,842,149	232,471
<b>CASH AND CASH EQUIVALENT END OF PERIOD</b>	<u><u>830,813</u></u>	<u><u>79,214</u></u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOWS:</b>		
<b>INCOME TAXES PAID</b>	<u>-</u>	<u>-</u>
<b>INTEREST PAID</b>	<u>-</u>	<u>-</u>

\*Excludes the conversion of accrued interest for \$40,444 into common shares during the six month period ended May 31, 2013

See condensed notes to the interim consolidated financial statements.

**SECURITY DEVICES INTERNATIONAL, INC.**  
**Interim Consolidated Statement of Changes in Stockholders' Equity**  
(Amounts expressed in US Dollars)  
(Unaudited)

	Number of Common Common Shares		Additional Paid-in	Deficit	Accumulated Other Comprehensive Income (loss)	Total
	Shares	amount	Capital			
	\$	\$	\$	\$	\$	\$
<b>Balance as of November 30, 2012</b>	<b>31,472,433</b>	<b>31,472</b>	<b>18,338,886</b>	<b>(19,296,146)</b>	-	<b>(925,788)</b>
Conversion of convertible debt to common shares	1,801,480	1,802	538,642	-	-	540,444
Conversion of convertible debt to common shares	2,297,044	2,297	795,419	-	-	797,716
Issuance of common shares for cash	9,984,950	9,985	3,059,715	-	-	3,069,700
Common share reconciliation difference with transfer agent	20,000	20	(20)	-	-	-
Relative fair value of detachable 325,000 warrants component of bridge loans financing			77,537	-	-	77,537
Conversion of bridge loans with accrued interest to common shares	1,273,378	1,273	416,809	-	-	418,082
Net loss for the year				(2,024,211)	-	(2,024,211)
<b>Balance as of November 30, 2013</b>	<b>46,849,285</b>	<b>46,849</b>	<b>23,226,988</b>	<b>(21,320,357)</b>	-	<b>1,953,480</b>
Stock based compensation for issue of options			188,470	-	-	188,470
Net loss for the period				(1,109,531)	-	(1,109,531)
Foreign currency translation				-	(18,943)	(18,943)
<b>Balance as of May 31, 2014</b>	<b>46,849,285</b>	<b>46,849</b>	<b>23,415,458</b>	<b>(22,429,888)</b>	<b>(18,943)</b>	<b>1,013,476</b>

See condensed notes to the interim consolidated financial statements.

**SECURITY DEVICES INTERNATIONAL, INC.**  
**Notes to Consolidated Financial Statements**  
**May 31, 2014**  
**(Amounts expressed in US Dollars)**  
**(Unaudited)**

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and therefore do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with U.S. generally accepted accounting principles (GAAP); however, such information reflects all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management, necessary for a fair statement of the results for the interim periods.

The interim unaudited consolidated financial statements should be read in conjunction with the financial statements and Notes thereto together with management's discussion and analysis of financial condition and results of operations contained in the Company's annual report on Form 10-K for the year ended November 30, 2013. In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments of a normal recurring nature considered necessary to fairly state the financial position of the Company at May 31, 2014, the results of its operations for the six -and three-month periods ended May 31, 2014 and May 31, 2013, and its cash flows for the six -month periods ended May 31, 2014 and May 31, 2013. In addition, some of the Company's statements in this quarterly report on Form 10-Q may be considered forward-looking and involve risks and uncertainties that could significantly impact expected results. The results of operations for the six -month period ended May 31, 2014 are not necessarily indicative of results to be expected for the full year.

The Company was incorporated under the laws of the state of Delaware on March 1, 2005. On February 3, 2014 the Company incorporated a wholly owned subsidiary in Canada "Security Devices International Canada Corp". The interim consolidated financial statements for the period ended May 31, 2014 include the accounts of Security Devices International, Inc. (the "Company" or "SDI" ), and its subsidiary Security Devices International Canada Corp. All material inter-company accounts and transactions have been eliminated.

Recently Adopted Accounting Standards

"Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements" ("ASU 2014-10") issued in June 2014, ASU 2014-10 eliminates the distinction of a development stage entity and certain related disclosure requirements, including the elimination of inception-to-date information on the statements of operations, cash flows and stockholders' equity. The amendments in ASU 2014-10 will be effective prospectively for annual reporting periods beginning after December 15, 2014, and interim periods within those annual periods, however early adoption is permitted. The Company evaluated and adopted ASU 2014-10 early for the current period presented.

Management does not believe that any other recently issued, but not yet effective accounting pronouncements, if adopted, would have a material effect on the accompanying consolidated financial statements.

2. NATURE OF OPERATIONS AND GOING CONCERN

The Company is a non-lethal defense technology company, specializing in the development of innovative next generation solutions for security situations that do not require the use of lethal force. SDI has implemented manufacturing partnerships to assist in the deployment of their patented and patent pending family of products. These products consist of the Blunt Impact Projectile 40mm (BIP) line of products, and the Wireless Electric Projectile 40mm (WEP).

The Company's activities are subject to risk and uncertainties including-

The markets for the Corporation's products and services are characterized by rapidly changing technology and evolving industry standards, which could result in product obsolescence or short product life cycles. In addition, The Company does not have adequate revenue to fund all of its operational needs and may require additional financing to continue its operations if it is unable to generate substantial revenue growth. There can be no assurance that such financing will be available at all or on favorable terms.

These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to meet its obligations and continue its operations for its next fiscal year.

The Company has incurred a cumulative loss of \$22,429,888 from inception to May 31, 2014 which includes a non-cash stock based compensation expense of \$6,674,241 for issue of options and warrants. The Company has funded operations through the issuance of capital stock and convertible debentures. The company has started to generate revenue from operations. However, it still expects to incur significant expenses before becoming profitable. The Company's future success is dependent upon its ability to raise sufficient capital or generate adequate revenue, to cover its ongoing operating expenses, and also to continue to develop and be able to profitably market its products. These factors raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.



**SECURITY DEVICES INTERNATIONAL, INC.**  
**Notes to Consolidated Financial Statements**  
**May 31, 2014**  
**(Amounts expressed in US Dollars)**  
**(Unaudited)**

2. NATURE OF OPERATIONS AND GOING CONCERN-Cont'd

In addition to raising funds in the prior years, the Company raised \$160,000 through the issuance of 800,000 common shares during the year ended November 30, 2011. The Company further raised an additional \$878,328 by issue of Convertible Debentures during the year ended November 30, 2011 and \$910,000 during the year ended November 30, 2012. In addition, the Company raised \$649,750 by issuance of 2,165,834 common shares during the year ended November 30, 2012. On August 15, 2013, the Company filed an amended and restated final prospectus (the "Prospectus") in Canada, in the provinces of Alberta, British Columbia and Ontario for listing its shares in these provinces in Canada. On August 27, 2013 the Company completed an initial public offering to raise gross proceeds of CAD \$3,993,980 (US \$3,794,280) through the issuance of 9,984,950 Common Shares at a price of CAD \$0.40 (US \$0.38) per Common Share (the "Issue Price"). The Company's common shares commenced trading on the TSX Venture Exchange ("TSX") under the symbol "SDZ".

3. RESEARCH AND PRODUCT DEVELOPMENT

Research and Product Development costs, including acquired research and product development costs, are charged against income in the period incurred.

**SECURITY DEVICES INTERNATIONAL, INC.**  
**Notes to Consolidated Financial Statements**  
**May 31, 2014**  
(Amounts expressed in US Dollars)  
(Unaudited)

4. PLANT AND EQUIPMENT

Plant and equipment are recorded at cost less accumulated depreciation. Depreciation is provided commencing in the month following acquisition using the following annual rate and method:

Computer equipment	30%	declining balance method
Furniture and Fixtures	30%	declining balance method
Leasehold Improvements		straight line over period of lease
Moulds	20%	straight line over 5 years

	May 31, 2014		November 30, 2013	
	Cost \$	Accumulated Amortization \$	Cost \$	Accumulated Amortization \$
Computer equipment	<u>37,573</u>	<u>32,213</u>	<u>37,573</u>	<u>31,267</u>
Furniture and fixtures	18,027	14,609	18,027	14,006
Leasehold Improvements	23,721	11,604	23,721	10,057
Moulds	<u>209,515</u>	<u>62,187</u>	<u>171,890</u>	<u>43,744</u>
	<u>288,836</u>	<u>120,613</u>	<u>251,211</u>	<u>99,074</u>
Net carrying amount		<u>\$ 168,223</u>		<u>\$ 152,137</u>
Depreciation expense		<u>\$ 21,539 (6 months)</u>		<u>\$ 38,130 (12 months)</u>

5. CAPITAL STOCK

a) Authorized

100,000,000\* Common shares, \$0.001 par value

And

5,000,000 Preferred shares, \$0.001 par value

\*On March 20, 2013 the Company filed with the Secretary of the State of Delaware a certificate of amendment (the "Amendment") to the Company's certificate of incorporation. The Amendment increased the number of authorized shares of the Company's common stock, par value \$0.001, from 50,000,000 to 100,000,000 common shares.

The Company's Articles of Incorporation authorize its Board of Directors to issue up to 5,000,000 shares of preferred stock. The provisions in the Articles of Incorporation relating to the preferred stock allow the directors to issue preferred stock with multiple votes per share and dividend rights, which would have priority over any dividends paid with respect to the holders of SDI's common stock.

b) Issued

46,849,285 Common shares (2013: 46,849,285 Common shares)

**SECURITY DEVICES INTERNATIONAL, INC.**  
**Notes to Consolidated Financial Statements**  
**May 31, 2014**  
**(Amounts expressed in US Dollars)**  
**(Unaudited)**

5. CAPITAL STOCK-Cont'd

c) Changes to Issued Share Capital

Year ended November 30, 2013

During the six month period ended May 31, 2013 the Company issued 1,801,480 common shares for conversion of convertible debentures having face value of \$500,000 and accrued interest of \$40,444. The total debt for \$540,444 was converted into 1,801,480 common shares at \$0.30 per share.

On August 15, 2013, the Company filed an amended and restated final prospectus (the "Prospectus") in Canada, in the provinces of Alberta, British Columbia and Ontario to list its common shares ("Common Shares") on the TSXV.

On August 27, 2013, the Company completed an initial public offering to raise gross proceeds of \$3,794,280 (CAD \$3,993,980) through the issuance of 9,984,950 Common Shares at a price of \$0.38 (CAD\$0.40) per Common Share (the "Issue Price"). The Company incurred expenses of \$724,580 (CAD \$734,565) to raise the capital which included a fee of CAD \$80,000 paid to a former director and CEO in accordance with the terms of an agreement regarding escrow of shares and a cash commission of CAD\$359,458 paid to the Agent. In addition the Company granted an option (the "Agent's Option") to purchase up to 898,645 Common Shares to the Agent and members of its selling group. The Agent's Option entitles the Agent and members of its selling group to purchase Common Shares at a price of CAD\$0.40 (US \$0.38) per Common Share until August 27, 2015.

Upon completion of the Offering, \$700,000 face value of convertible debentures along with \$97,716 of interest was converted to 2,297,044 Common Shares, resulting in the discharge of those debentures (see note 11).

On January 30, 2013, the Company issued a \$199,342 (CAD \$200,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 100,000 shares of the Company's common stock. The warrants have an exercise price of CAD\$0.50 per share and a time to expiration of two years. The relative fair value allocated to warrants and credited to additional paid in capital was \$24,246 (see note 12)

On March 14, 2013, the Company issued a \$97,456 (CAD \$100,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 50,000 shares of the Company's common stock. The warrants have an exercise price of CAD\$0.50 per share and a time to expiration of two years. The relative fair value allocated to warrants and credited to additional paid in capital was \$11,269 (see note 12)

On April 12, 2013, the Company issued a \$197,355 (CAD \$200,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 100,000 shares of the Company's common stock. The warrants have an exercise price of CAD\$0.50 per share and a time to expiration of two years. The relative fair value allocated to warrants and credited to additional paid in capital was \$20,502 (see note 12)

On May 14, 2013, the Company issued a \$147,812 (CAD \$150,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 75,000 shares of the Company's common stock. The warrants have an exercise price of CAD\$0.50 per share and a time to expiration of two years. The relative fair value allocated to warrants and credited to additional paid in capital was \$21,520 (see note 12)

During the quarter ended November 30, 2013, the holder of bridge loans converted the principal and interest totaling \$ 378,525 into common shares at CAD\$0.30 per share, resulting in gain on extinguishment of debt for \$33,501.

Six- months ended May 31, 2014

The Company did not issue any shares during the six month period ended May 31, 2014.

**SECURITY DEVICES INTERNATIONAL, INC.**  
**Notes to Consolidated Financial Statements**  
**May 31, 2014**  
**(Amounts expressed in US Dollars)**  
**(Unaudited)**

6. STOCK BASED COMPENSATION

Effective October 30, 2006 the Company adopted the following stock option and stock bonus plans which were replaced by the Incentive Stock Option Plan (the “2013 Plan”) that was issued in May, 2013.

**Incentive Stock Option Plan.** The Company’s Incentive Stock Option Plan authorizes the issuance of shares of its Common Stock to persons that exercise options granted pursuant to the Plan. Only employees may be granted options pursuant to the Incentive Stock Option Plan. The option exercise price is determined by its directors but cannot be less than the market price of its common stock on the date the option is granted. The Company has reserved 1,000,000 common shares under this plan. No options have been issued under this plan as at February 28, 2014.

**Non-Qualified Stock Option Plan.** SDI’s Non-Qualified Stock Option Plan authorizes the issuance of shares of its Common Stock to persons that exercise options granted pursuant to the Plans. SDI’s employees, directors, officers, consultants and advisors are eligible to be granted options pursuant to the Plans, provided however that bona fide services must be rendered by such consultants or advisors and such services must not be in connection with the offer or sale of securities in a capital-raising transaction. By a resolution of the Board of Directors, the Company amended this plan to increase the number of common shares available under this plan from 2,250,000 to 4,500,000 effective October 10, 2007. The Company further amended its Non-Qualified Stock Option Plan to increase the number of Common Shares available under this plan to 5,000,000 and filed an S-8 registration statement on April 10, 2008.

**Stock Bonus Plan.** SDI’s Stock Bonus Plan allows for the issuance of shares of common stock to its employees, directors, officers, consultants and advisors. However bona fide services must be rendered by the consultants or advisors and such services must not be in connection with the offer or sale of securities in a capital-raising transaction. The Company has reserved 150,000 common shares under this plan. No options have been issued under this plan as at February 28, 2014.

Effective May 31, 2013, the Company adopted an incentive stock option plan (the “2013 Plan”), which replaces the stock option and stock bonus plans that were in place prior to adoption of the 2013 Plan. All outstanding options to purchase Common Shares granted by the Company under the prior plans are now governed by the 2013 Plan and the prior plans (an Incentive Stock Option Plan, a Non-Qualified Stock Option Plan, and a Stock Bonus Plan) have been terminated.

Year ended November 30, 2013

The Company did not issue any options during the year ended November 30, 2013.

As of November 30, 2013 there was \$Nil of unrecognized expense related to non-vested stock-based compensation arrangements granted.

Six months ended May 31, 2014

On March 19, 2014, the board of directors granted options to five consultants to acquire a total of 400,000 common shares. The 400,000 options were issued at an exercise price of \$0.31 (CAD\$0.35) per share and vest immediately with an expiry term of three years. The fair value of each option used for the purpose of estimating the stock compensation is calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

Risk free rate		2.00%
Expected dividends		0%
Forfeiture rate		0%
Volatility		151.63%
Market price of Company’s common stock on date of grant of options	\$	0.16
Stock-based compensation cost	\$	47,897

On May 9, 2014, the board of directors granted options to one director to acquire a total of 600,000 common shares. These options were issued at an exercise price of \$0.32 (CAD \$0.35) per share and vest immediately with an expiry term of five years. The fair value of each option used for the purpose of estimating the stock compensation is calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

Risk free rate		2.00%
Expected dividends		0%
Forfeiture rate		0%
Volatility		205.42%
Market price of Company’s common stock on date of grant of options	\$	0.24
Stock-based compensation cost	\$	140,573

As of May 31, 2013 there was \$Nil of unrecognized expense related to non-vested stock-based compensation arrangements granted.

**SECURITY DEVICES INTERNATIONAL, INC.**  
**Notes to Consolidated Financial Statements**  
**May 31, 2014**  
**(Amounts expressed in US Dollars)**  
**(Unaudited)**

7. STOCK PURCHASE WARRANTS

Year ended November 30, 2013

On March 14, 2013, the Company issued a \$97,456 (CAD \$100,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 50,000 shares of the Company's common stock. The warrants have an exercise price of \$0.47 (CAD\$0.50) per share and a time to expiration of two years. The relative fair value allocated to warrants and credited to additional paid in capital was \$11,269

On April 12, 2013, the Company issued a \$197,355 (CAD \$200,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 100,000 shares of the Company's common stock. The warrants have an exercise price of \$0.47 (CAD\$0.50) per share and a time to expiration of two years. The relative fair value allocated to warrants and credited to additional paid in capital was \$20,502

On May 14, 2013, the Company issued a \$147,812 (CAD \$150,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 75,000 shares of the Company's common stock. The warrants have an exercise price of \$0.47 (CAD\$0.50) per share and a time to expiration of two years. The relative fair value allocated to warrants and credited to additional paid in capital was \$21,520

Six month period ended May 31, 2014

The Company did not issue any warrants during the period ended May 31, 2014.

8. RELATED PARTY TRANSACTIONS

The following transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Six months ended May 31, 2014

The directors were compensated as per their consulting agreements with the Company. The Company expensed a total of \$125,233 as management fees to its two directors and expensed a total of \$3,600 as automobile allowance.

The Company expensed \$12,000 for services provided by the CFO of the Company and \$114,573 for services provided by a corporation in which the Chief Operating Officer has an interest.

The Company reimbursed \$66,763 to directors and officers for travel and entertainment expenses incurred for the Company.

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8. RELATED PARTY TRANSACTIONS-Cont'd

Six months ended May 31, 2013

The directors were compensated as per their consulting agreements with the Company. The Company expensed a total of \$147,600 as management fees to its three directors and expensed a total of \$3,600 as automobile allowance.

The Company expensed \$24,250 for services provided by the CFO of the Company and \$120,000 for services provided by a corporation in which the Chief Operating Officer has an interest.

The Company reimbursed \$87,019 to directors and officers for travel and entertainment expenses incurred for the Company.

On March 4, the board of directors granted 100,000 warrants as an incentive to a director who provided a working capital loan of \$96,700 (CAD \$100,000). These warrants were issued at an exercise price of \$0.50 per share and vest immediately with an expiry term of two years. The Company expensed \$15,637 as compensation expense.

9. COMMITMENTS

a) Consulting agreements:

The directors of the Company executed consulting agreements with the company on the following terms:

Effective January 1, 2013, SDI executed an agreement with a company in which a director, Allen Ezer, has an interest in, for a period of two years to pay compensation of \$8,500 per month with a 5% increase on the first anniversary date for services rendered. Either party may terminate the consulting agreement by giving 30 days written notice.

Agreement with the Chief Executive Officer Greg Sullivan to pay compensation of \$12,000 per month, with an annual 5% increase and a car allowance of \$600 per month. The agreement expires on December 31, 2016. The monthly remuneration will increase with accomplishment of milestones. The agreement may be terminated with mutual consent or by the Chief Executive Officer giving three weeks notice.

Effective October 4, 2012, SDI executed an agreement with a company in which the Chief Operating Officer Dean Thrasher has an interest in, for a period of two years which expires on September 30, 2014 for services rendered. The total consulting fees are estimated at \$480,000 for the two year period. SDI paid cash and expensed \$240,000 during the year ended November 30, 2013. SDI paid cash and expensed \$114,573 during the six month period ended May 31, 2014. The company may also accept common shares at \$0.45 per common share in lieu of cash. As of November 30, 2013, the company has not exercised its right to accept this compensation in shares.

Effective January 1, 2013, SDI executed an agreement with a non-related consultant to pay compensation of \$7,000 per month. The consultant is to assist with sales initiatives, demos and participate in trade shows. The agreement is for a period of one year and was renewed for an additional period of one year. Either party may terminate the consulting agreement by giving 30 days written notice.

Effective January 1, 2013, SDI executed an agreement with another non-related consultant to pay compensation of \$7,000 per month. The consultant is to assist with sales initiatives, demos and participate in trade shows. The agreement is for a period of one year and is pending renewal. Either party may terminate the consulting agreement by giving 30 days written notice.

Effective November 1, 2013, SDI executed an agreement with a non-related consultant to pay compensation of \$5,000 per month. The consultant has agreed to provide corporate market advisory services. The agreement is for a period of a minimum of three months and will continue unless otherwise terminated by either party by giving 30 days written notice.

Effective April 2014, SDI executed an agreement with a non-related consultant to set up its social media site and optimization of search engine at a start up fee for CAD\$3,000 (Phase 1) and payment of CAD\$1,500 per month along with 100,000 stock options at \$0.32 (CAD\$0.35) when Phase 2 of the project is being implemented.

b) The Company has commitments for leasing office premises in Oakville, Ontario, Canada to April 30, 2018 at a rent of \$5,890 (CAD \$6,399) per month.

c) The Company has commitments for leasing office premises in Tampa, Florida, USA to June 30, 2014 at a rent of \$1,418 per month.

CONTINGENCIES

In November of 2013, a former officer filed a suit against the Company in the Ontario Superior Court of Justice (Province of Ontario) seeking, among other things, \$60,000 in damages for wrongful dismissal, damages of \$35,000 on account of vacation pay and damages to be determined for out of pocket expenses, breach of contract, unjust enrichment and loss of business opportunity. Management of the Company believes this suit is without merit and the Company intends to vigorously defend against the suit and as such no provision for any potential payment has been expensed.

10. EXCLUSIVE SALES AND SUPPLY AGREEMENTS

a) Sales Agreement

SDI entered into an agreement (the "Teaming Agreement") dated November 30, 2011 with Chemring Ordnance, Inc. ("Chemring") pursuant to which both agreed to establish a co-operative and supportive team to develop the best marketing, management and technical approach for the worldwide manufacture and sale of 40mm less than blunt trauma ammunition. The Teaming Agreement provides for SDI and Chemring to create a team for the purpose of preparing competitive, cost effective proposals in response to requests for proposals and obtaining and performing any contracts that result therefrom.

Pursuant to the Teaming Agreement, if a contract is awarded, each of SDI and Chemring will perform the work to be done by it as specified in the Teaming Agreement and will share the revenue as set out in the Teaming Agreement. Either party who initiated the proposal that led to the contract will be the prime contact for that

customer. Upon a contract being awarded to either SDI or Chemring, it will subcontract with the other for the other's share of the work. In accordance with the Teaming Agreement, the BIP ammunition sold will have Chemring's branding unless otherwise agreed by the parties.

The Teaming Agreement will terminate on December 20, 2016. The Teaming Agreement may also expire if a time period of two years from the effective date of the agreement passes without a bona fide arms length contract being executed and delivered with respect to BIP ammunition. It will also terminate if either party is in material breach of the Agreement or a subcontract that hasn't been resolved, if any required governmental licenses or approvals or permits are revoked, in the event of a debarment or suspension of a party at the option of the other party, and by the mutual written agreement of the parties. The Company's relationship with Chemring will now be focused more on marketing the products to the Company's global sales channels.

b) Supply agreement

The Company entered into a Development, Supply and Manufacturing Agreement with the BIP Manufacturer on July 25, 2012. This Agreement provides the Company to order and purchase only from the BIP Manufacturer certain 40MM assemblies and components for use by the Company to produce less-lethal and training projectiles as described in the Agreement. The Agreement is for a term of five years with an automatic extension for an additional year if neither party has given written notice of termination prior to the end of the five year period.

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11. CONVERTIBLE DEBENTURES AND DEFERRED FINANCING COSTS

**Year ended November 30, 2013**

During the six month period ended May 31, 2013 the Company issued 1,801,480 common shares for conversion of convertible debentures having face value of \$500,000 and accrued interest of \$40,444. The total debt for \$540,444 was converted into 1,801,480 common shares at \$0.30 per share.

On August 27, 2013, upon completion of the Offering, \$700,000 face value of convertible debentures along with \$97,716 of interest was converted to 2,297,044 Common Shares, resulting in the discharge of those debentures. In addition, the Company repaid the balance of \$30,000 face value of convertible debenture not converted along with accrued interest of \$3,877 and also repaid interest of \$3,024 not converted to common shares.

This resulted in the complete discharge of all convertible debt.

12. CONVERTIBLE BRIDGE LOANS

**Year ended November 30, 2013**

***\$199,342 (CAD \$200,000) Convertible Bridge Loan***

On January 30, 2013, the Company issued a \$199,342 (CAD \$200,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). The holder has the option at any time prior to the maturity date to demand the payment of principal and interest (the "Demand Date"). Therefore, the principal amount of the note and interest is payable at the earlier of the demand date or the maturity date. In the event the holder demands payment, the Company has ten days to make payment. In the event the Company does not make payment within the ten day period, the holder has the option to convert the outstanding principal, interest, and top-up mechanism into common stock. The conversion price of the note is equal to the twenty day moving average of the trading market price on the date of conversion ("variable conversion price"). The holder is entitled to the maximum allowable discount. As a top-up mechanism, on or before the maturity date, the Company is required to pay the holder \$11,961. This top-up mechanism is payable in addition the 6% interest due on the note. In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 100,000 shares of the Company's common stock. The warrants have an exercise price of CAD\$0.50 per share and a time to expiration of two years.

The Company evaluated the terms and conditions of the convertible bridge loan and detachable warrants under the guidance of ASC 815. Even though the instrument's conversion price used to calculate the settlement amount is not fixed the embedded conversion feature is still considered "indexed to an entity's own stock" under the guidance of ASC 815 because the only variables that could affect the settlement amount are inputs to the fair value of a fixed-for-fixed forward or option on equity shares. However, the conversion feature did not meet the conditions for equity classification provided in paragraphs 11 through 35 of ASC 815-40-25 because due to the variable conversion price contained in the contracts, the number of shares that could be required to be delivered upon net-share settlement is essentially indeterminate. Therefore, the conversion feature requires bifurcation and liability classification. There were no terms or features contained in the warrant agreement that would preclude the warrants from achieving equity classification.

The following table reflects the allocation on the financing date:

Convertible Bridge Loans	\$	199,342
		<u>Face Value</u>
Proceeds	\$	(199,342)
Embedded conversion feature		159,268
Paid in capital (warrants)		24,246
Convertible bridge loans		15,828

On September 16, 2013, the holder converted the bridge loan (\$199,342), accrued interest (\$7,504), and top-up mechanism (\$11,961) totaling \$218,807 into 736,078 shares of common stock. Prior to the conversion, the discount of \$183,514 was amortized up to face value using the effective interest method.

***\$97,456 (CAD \$100,000) Convertible Bridge Loan***

On March 14, 2013, the Company issued a \$97,456 (CAD \$100,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). The holder has the option at any time prior to the maturity date to demand the payment of principal and interest (the "Demand Date"). Therefore, the principal amount of the note and interest is payable at the earlier of the demand date or the maturity date. In the event the holder demands payment, the Company has ten days to make payment. In the event the Company does not make payment within the ten day period, the holder has the option to convert the outstanding principal, interest, and top-up mechanism into common stock. The conversion price of the note is equal to the twenty day moving average of the trading market price on the date of conversion ("variable conversion price"). The holder is entitled to the maximum allowable discount. As a top-up mechanism, on or before the maturity date, the Company is required to pay the holder \$5,847. This top-up mechanism is payable in addition the 6% interest due on the note. In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 50,000 shares of the Company's common stock. The warrants have an exercise price of CAD\$0.50 per share and a time to expiration of two years.



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12. CONVERTIBLE BRIDGE LOANS - Cont'd

The Company has evaluated the terms and conditions of the convertible bridge loan and detachable warrants under the guidance of ASC 815. Even though the instrument's conversion price used to calculate the settlement amount is not fixed the embedded conversion feature is still considered "indexed to an entity's own stock" under the guidance of ASC 815 because the only variables that could affect the settlement amount are inputs to the fair value of a fixed-for-fixed forward or option on equity shares. However, the conversion feature did not meet the conditions for equity classification provided in paragraphs 11 through 35 of ASC 815-40-25 because due to the variable conversion price contained in the contracts, the number of shares that could be required to be delivered upon net-share settlement is essentially indeterminate. Therefore, the conversion feature requires bifurcation and liability classification. There were no terms or features contained in the warrant agreement that would preclude the warrants from achieving equity classification.

The following table reflects the allocation on the financing date:

Convertible Bridge Loans	\$	97,456 Face Value
Proceeds	\$	(97,456)
Embedded conversion feature		56,477
Paid in capital (warrants)		11,269
Convertible bridge loans		29,710

On September 16, 2013, the Company repaid the bridge loan (\$97,456), accrued interest (\$2,980), and top-up mechanism (\$5,847) totaling \$106,283 in full. As a result of the repayment, a gain on extinguishment of debt amounting to \$11,107 was recorded. Prior to the repayment, the discount of \$67,746 was amortized up to face value using the effective interest method.

***\$197,355 (CAD \$200,000) Convertible Bridge Loan***

On April 12, 2013, the Company issued a \$197,355 (CAD \$200,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). The holder has the option at any time prior to the maturity date to demand the payment of principal and interest (the "Demand Date"). Therefore, the principal amount of the note and interest is payable at the earlier of the demand date or the maturity date. In the event the holder demands payment, the Company has ten days to make payment. In the event the Company does not make payment within the ten day period, the holder has the option to convert the outstanding principal, interest, and top-up mechanism into common stock. The conversion price of the note is equal to the twenty day moving average of the trading market price on the date of conversion ("variable conversion price"). The holder is entitled to the maximum allowable discount. As a top-up mechanism, on or before the maturity date, the Company is required to pay the holder \$11,841. This top-up mechanism is payable in addition the 6% interest due on the note. In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 100,000 shares of the Company's common stock. The warrants have an exercise price of \$0.50 per share and a time to expiration of two years.

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12. CONVERTIBLE BRIDGE LOANS - Cont'd

The Company has evaluated the terms and conditions of the convertible bridge loan and detachable warrants under the guidance of ASC 815. Even though the instrument's conversion price used to calculate the settlement amount is not fixed the embedded conversion feature is still considered "indexed to an entity's own stock" under the guidance of ASC 815 because the only variables that could affect the settlement amount are inputs to the fair value of a fixed-for-fixed forward or option on equity shares. However, the conversion feature did not meet the conditions for equity classification provided in paragraphs 11 through 35 of ASC 815-40-25 because due to the variable conversion price contained in the contracts, the number of shares that could be required to be delivered upon net-share settlement is essentially indeterminate. Therefore, the conversion feature requires bifurcation and liability classification. There were no terms or features contained in the warrant agreement that would preclude the warrants from achieving equity classification.

The following table reflects the allocation on the financing date:

Convertible Bridge Loans	\$	197,355
		Face Value
Proceeds	\$	(197,355)
Embedded conversion feature		105,423
Paid in capital (warrants)		20,502
Convertible bridge loans		71,430

On September 16, 2013, the Company repaid the bridge loan (\$197,355), accrued interest (\$5,093), and top-up mechanism (\$11,841) totaling \$214,289 in full. As a result of the repayment, a gain on extinguishment of debt amounting to \$22,394 was recorded. Prior to the repayment, the discount of \$125,925 was amortized up to face value using the effective interest method.

***\$147,812 (CAD \$150,000) Convertible Bridge Loan***

On May 14, 2013, the Company issued a \$147,812 (CAD \$150,000) 6% convertible bridge loan with a term to July 30, 2013 (the "Maturity Date"). The holder has the option at any time prior to the maturity date to demand the payment of principal and interest (the "Demand Date"). Therefore, the principal amount of the note and interest is payable at the earlier of the demand date or the maturity date. In the event the holder demands payment, the Company has ten days to make payment. In the event the Company does not make payment within the ten day period, the holder has the option to convert the outstanding principal, interest, and top-up mechanism into common stock. The conversion price of the note is equal to the twenty day moving average of the trading market price on the date of conversion ("variable conversion price"). The holder is entitled to the maximum allowable discount. As a top-up mechanism, on or before the maturity date, the Company is required to pay the holder \$8,869. This top-up mechanism is payable in addition the 6% interest due on the note. In connection with the issuance of the bridge loan, the Company issued detachable warrants to purchase 75,000 shares of the Company's common stock. The warrants have an exercise price of CAD\$0.50 per share and a time to expiration of two years.

The Company has evaluated the terms and conditions of the convertible bridge loan and detachable warrants under the guidance of ASC 815. Even though the instrument's conversion price used to calculate the settlement amount is not fixed the embedded conversion feature is still considered "indexed to an entity's own stock" under the guidance of ASC 815 because the only variables that could affect the settlement amount are inputs to the fair value of a fixed-for-fixed forward or option on equity shares. However, the conversion feature did not meet the conditions for equity classification provided in paragraphs 11 through 35 of ASC 815-40-25 because due to the variable conversion price contained in the contracts, the number of shares that could be required to be delivered upon net-share settlement is essentially indeterminate. Therefore, the conversion feature requires bifurcation and liability classification. There were no terms or features contained in the warrant agreement that would preclude the warrants from achieving equity classification.

The following table reflects the allocation on the financing date:

Convertible Bridge Loans	\$	147,812
		Face Value
Proceeds	\$	(147,812)
Embedded conversion feature		101,422
Paid in capital (warrants)		21,520
Convertible bridge loans		24,870

On September 16, 2013, the holder converted the bridge loan (\$147,812), accrued interest (\$3,037), and top-up mechanism (\$8,869) totaling \$159,718 into 537,300 shares of common stock. Prior to the conversion, the discount of \$122,942 was amortized up to face value using the effective interest method.

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13. INVENTORY

Inventory as of May 31, 2014 consist of Blunt Impact Projectiles 40mm which are held at the BIP manufacturer.

14. SUBSEQUENT EVENTS

The Company engaged Fin-XO Securities Inc. to arrange a financing, on a best efforts basis, for gross proceeds totaling no less than CAD\$1,000,000 but no more than CAD\$1,500,000 via convertible debenture. The terms of the convertible debenture include a non-secured instrument, having a thirty-six (36) month maturity, carrying an interest rate of twelve percent (12%) per annum payable in cash on a semi-annual basis. The principal amount of the debentures are convertible at the holder's option at any time into SDI common shares at a conversion price of CAD \$0.50. Upon TSX Venture Exchange approval the private placement is set to close on or before July 31, 2014.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND PLAN OF OPERATION**

### **FOR THE SIX-MONTH AND THREE-MONTH PERIODS ENDED MAY 31, 2014**

The following discussion and analysis of the financial condition and results of Security Devices International, Inc. (also referred to as "we", "us", "our", "SDI", or the "Company"), should be read in conjunction with the Company's financial statements (and related notes) as at November 30, 2013

*The following discussion contains forward-looking statements, which are subject to risks and uncertainties and other factors that may cause SDI's results to differ materially from expectations. When reviewing the Company's forward-looking statements, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. These include risk relating to market fluctuations, performance and strength of the North American and other world economies and foreign exchange fluctuations. These forward-looking statements speak only as of the date hereof. Unless otherwise required by applicable securities laws, the Company disclaims any intention or obligation to update these forward-looking statements. The Company does have an ongoing obligation to disclose material information as it becomes available. The discussion also includes cautionary statements about these matters. You should read the cautionary statements made below as being applicable to all forward-looking statements wherever they appear in this document.*

#### **Business**

##### **History**

Security Devices International Inc. was incorporated on March 1, 2005. The Company began as a research and development company focused on the development of 40mm less-lethal ammunition. The term 40mm refers to the diameter of the bullet (sometimes also referred to as a round or a projectile) and bullets of this size are required for standard issue military riot guns. 40mm bullets are also the emerging standard among riot guns used by police forces and correctional services, although many police forces are currently using 37mm riot guns. 40mm rounds are quickly becoming the industry standard in both military and law enforcement circles.

The Company began with development of a wireless electric projectile (a "WEP"), named the Lektrox. The Company hired Elad Engineering Ltd. ("Elad") a ballistics engineering firm located in Tel Aviv, Israel, to collaborate in the development of the WEP. The WEP uses mini-harpoons to fix the bullet to the target's clothing or body. The bullet contains an electrical system that releases a charge that imitates the electro-neural impulses used by the human body. Sending out a control signal to the muscles, this high-voltage low-current pulse overrides the target's nervous system inducing a muscle spasm that causes the target to fall to the ground helpless.

Commencing in December 2008, the Joint Non-Lethal Weapons Directorate ("JNLWD") of the US Department of Defense, an organization responsible for the development and coordination of non-lethal weapons activities within the United States, tested the WEP through its evaluation facility at Penn State University. The testing evaluated the effectiveness and safety of the electrical output compared to the Government's standard total body effects model. Testing was completed in November 2009 and a report was prepared by Penn State University and submitted to the JNLWD in January 2010. An executive summary was released to the Company indicating a positive outcome. Research and development continued on the WEP until mid-2010.

To reduce kinetic energy levels, the head of the WEP contains a cushioning mechanism composed of a collapsible material that enlarges the contact surface and absorbs part of the impact. In June 2010, the Company began development of a 40mm blunt impact projectile (the "BIP"), which used the cushioning mechanism of the WEP but did not contain the electrical mechanism of the WEP. The BIP used the pain of impact to obtain compliance from the target.

In the fall of 2010 the Company underwent a change in the board of directors and management. Two new directors were appointed and the board of directors appointed a Chief Operating Officer. The Company contracted with Level 4 Capital Corp. to assist with restructuring of the Company, contract negotiations and operational issues.

Early in 2011 the Company decided to focus its attention on the BIP and to discontinue further development work on the WEP. The Company concluded that the cost and time required to complete development and testing of the BIP were significantly less than that required to complete development and testing of the WEP. The BIP is also less expensive to produce than the WEP, and can be sold for a lower price. The Company plans to use revenue received from BIP sales to complete the development and production line for the WEP.

Initially, the Company's products were designed, tested and assembled in Israel. In 2011, the Company moved its engineering, intellectual property and production facilities from Tel Aviv, Israel to the operator (the "BIP Manufacturer") of an injection molding facility outside of Boston, Massachusetts. The BIP Manufacturer has a history of manufacturing 40mm components for the military sector, and provides molding services to the medical, aerospace, petrochemical, commercial, electronics, and defense industries.

The Company attended several military tradeshows through 2011 and signed a teaming agreement with Chemring Ordnance Inc. ("Chemring"), of Perry, Florida in December 2011. The agreement gave Chemring the non-exclusive right to market and sell the BIP worldwide for a five- year term. The Company has retained the right to market the BIP directly to military, law enforcement and government agencies outside of Chemring's sales channels. The Company's relationship with Chemring is now focused more on marketing the products to the Company's global sales channels.

Research and development for the BIP was completed in the summer of 2012.

In October 2012, the Company obtained an ammunition certification from Chemring which meant that the BIP satisfied the standards set by Chemring for products which it would distribute.

In November 2012, the Company obtained a United States Department of Transportation number (DOT#) required in order for the Company to ship BIP rounds.

In June 2012, the Company contracted CRT Less Lethal Inc. ("CRT") to test the BIP. CRT is a Seattle-based company founded in 2003 with expertise in the analysis, evaluation and human effects testing of less-lethal munitions. The testing protocol included accuracy, precision, consistency, muzzle and target energy, impact energy density and effective range of the BIP. Human volunteers were used during the test firing, revealing full effects to the lower body from the blunt trauma of the BIP. Extensive wound profiling from the tests were finalized in a detailed report from CRT. Based on data obtained from the three-stage evaluation, the BIP passed the CRT testing protocol for accuracy, consistency, relative safety and effectiveness.

In July 2012, the Company signed a five-year development, supply and manufacturing agreement with the BIP Manufacturer. An engineering team is available to the Company through the BIP Manufacturer for development of all of the core components of the BIP and any product changes that are necessary.

During 2012, the Company attended several law enforcement tradeshows and conducted live fire demonstrations with government agencies in Canada, and the US. Live fire demonstrations allow the Company to demonstrate the short and long distance firing capabilities, accuracy and relative safety of the BIP.

In 2012, the Company began the development of five new less-lethal ammunition rounds. These new rounds will be a modified version of the BIP, four of which will carry a payload, including; BIP MP (temporary powder-based marking agent), BIP ML (semi-permanent liquid marking agent), BIP OC (Oleoresin Capsicum A a pepper spray liquid), BIP MO (malodorant liquid), and the BIP TR (training round). The Company is in the final stages of testing the payload rounds.

In 2013, the Company moved its full manufacturing operations to a supply manufacture and engineering company in the Boston, MA area. This allowed the Company to become fully autonomous from its previous partner, Chemring Ordnance of Florida, USA. SDI decreased its manufacturing costs in this process and is in full control of its manufacturing and logistics processes as a result.

The Company undertook an Initial Public Offering (IPO) in January 2013, and became a public reporting issuer on the TSX-Venture Exchange in September 2013.

SDI continued to sign distributors, agents and referral agents to market and sell SDI's innovative non-lethal ammunition, globally. At year-end, SDI had signed a total of 9 distributors or agents, covering the following Countries: Canada, Israel, Saudi Arabia, Jordan, Oman, Kuwait, Bahrain, Turkey, Portugal, Spain, France, California, India, South America, and select African countries.

In June 2013, SDI, through its teaming agreement, Chemring Ordnance supplied the Israel Defense Forces with 900 BIP rounds for testing and evaluation. SDI also received a purchase order from the United States Border Patrol for 110 rounds to be used for testing and evaluation for a procurement that is expected in 2014.

Montreal Police also purchased rounds for testing and evaluation from SDI in 2013.

In the fourth quarter of 2013, SDI sold rounds to Orange County Florida Sheriff's department for use by their SWAT team as well as Campbell County, Virginia for SWAT use, and Indian River Sheriff's Department in Florida for use in their Correctional Services facility.

In November 2013, SDI's BIP rounds were showcased at the International SWAT Competition in Florida. The event hosted 57 SWAT teams from around the world that competed in a week long competition. SDI's BIP rounds were used by the competing teams in the less-lethal competition, giving SDI international exposure for their rounds.

The requests for demonstrations of SDI's products were strong from the Law Enforcement sector in 2013 and SDI staff conducted dozens of multi-agency live fire demonstrations, in 4 countries.

SDI attended and demonstrated to a military agency in an African country. The capability of the BIP round and the Company is currently in the follow up stage with this Agency.

SDI attended and demonstrated to a large Police Force in India. The capability of the BIP round and the Company is currently in the follow up stage with this Agency.

During the six month period, several federal, provincial, state, and municipal government agencies ordered small batches of operational rounds, as well as varied rounds for testing and evaluation, across North America. Some of the agencies were re-orders from previous sales.

SDI began another globally recognized testing protocol with a military agency called HECOE (the Human Effects Centre of Excellence). This world renowned agency is located in the Air Force Research Laboratory (AFRL), in partnership with the US Joint Non-lethal Weapons Directorate (JNLWD). This group conducts research to assist Non-lethal Weapon (NLW) Program Managers across the U.S. Department of Defense (DoD) in assessing effectiveness and risks of NLWs. This information is used to develop dose response curves for the particular systems under review, identify data gaps and determine additional research requirements, and provide this information to those within the DoD who make policy and acquisition decisions.

Also during the quarter, SDI's BIP rounds were used at the Mock Prison Riot in West Virginia. Law enforcement and correctional services officers provided feedback on new technologies (such as SDI's products) to assist in the effectiveness of their jobs. There were tactical teams that measured their skill sets against other teams from around the world at the demonstrations. SDI rounds outperformed several of their competitors.

The Company also performed several live fire demos around North America with positive results.

## **Products**

SDI's business is the development, manufacture and sale of less-lethal ammunition. This ammunition is used by the military and police forces for crowd control.

The Company has two products:

- a) The Company has developed the BIP, a blunt impact projectile which uses pain compliance to control a target. The Company is developing five versions of the standard BIP, four of which contain a payload and one of which is a cheaper cost practice round. A payload is an internal capsule within the BIP, which holds a liquid or powder substance.
- b) The Company has undertaken substantial work to develop the WEP, a wireless electric projective which releases an electrical pulse that induces a muscle spasm and causes the target to fall to the ground helplessly.



## **Less-Lethal Sector**

Both military and law enforcement agencies are seeking alternatives to traditional lethal ammunition. From a military standpoint, the involvement of armed forces in populated areas has created a need for less-lethal ammunition. Police forces also require non-lethal ammunition for riot control and critical incident de-escalation, motivated in part by a desire to avoid expensive litigation.

Chemical irritants (such as tear gas) have been sporadically used by military and have been adopted by police forces around the world for use in riot control.

Throughout the 1970's and 1980's the military and police forces began to use kinetic energy impact projectiles. These projectiles included wood, rubber and bean-bag material as ammunition. Many of these projectiles are still being used by military and police forces around the world. There has been very little technology progression within this space over the last half a century.

The rubber bullet was developed by the Ministry of Defense for the British Army in Northern Ireland at the request of army officers who wanted a weapon for use in civil disturbances with a range beyond a stone-throwing distance. In management's opinion, rubber bullets are inaccurate and have unpredictable ricochets. In addition, management believes that they have caused numerous severe injuries and several deaths.

The nature of a military's role has changed significantly to the extent that the military becomes actively engaged in the policing of civilian populations. This is where the military in effect, intersects with local police forces to support and uphold national and regional law. Today, military units are involved in ongoing conflicts that bring them into direct contact with civilian populations in Iraq, Afghanistan and various countries in the Middle East. Soldiers who are deployed in humanitarian roles are often subject to rules of engagement, which disallow the use of deadly force unless soldiers encounter a lethal threat. The military requires less-lethal deterrent ammunition for use in crowd and riot control, perimeter security and pilfering situations. In management's opinion, less-lethal ammunition means a greater opportunity to preserve life.

Police and military forces require easily applied options for riot control without the consequences of lethal force. In addition to the litigation, administrative and financial resources required to defend the use of lethal force, there is a moral consideration as well. Police and military forces must balance the risk of injury or death to their own personnel against the risk of injury to civilians, including bystanders. Riot control involves difficult and challenging decision that often must be made within seconds.

Both police and military personnel are demanding access to options that fall somewhere between physically charging into a crowd with batons and firing munitions designed to kill targets. If these personnel are equipped and trained with less-lethal munitions, they are better equipped to diffuse a riot and regain control. By providing soldiers and police with a midlevel force response, appropriate to the level of threat, the chance of an escalation can be reduced. In addition, if this less-lethal response can be employed at a standoff distance, the troops or officers can maintain a buffer zone between themselves and the crowd. The capability to target a specific individual, as opposed to spraying an entire crowd, reduces the risk of injury to innocent bystanders and political backlash.

Conflicts in Iraq and Afghanistan, events such as the August 2011 UK riots, and the June 2012 Quebec student street violence have led governments, police and defense decision-makers to seek cost effective less-lethal weapons. These decision-makers understand that social media will limit the use of lethal weapons and a new generation of less-lethal weapons is required.

## General

- As of July 15, 2014, SDI had consultants and no full-time employees.
- SDI's offices are located at 1101 Pennsylvania Ave., NW, 6th Floor Washington, DC 20004, 4830 West Kennedy Blvd., suite 600, Tampa, Florida, 33609 and 125 Lakeshore Road East, Unit 300, Oakville, Ontario L6J 1H3 Canada. SDI rents its Ontario office at a cost of CAN \$6,399 per month pursuant to a lease which expires on April 30, 2018. SDI rents its Tampa, Florida, USA office at a cost of \$1,418 per month pursuant to a lease which expires on June 30, 2014. The Washington, DC, USA office does not have a lease term and runs month by month
- SDI's website is [www.securitydii.com](http://www.securitydii.com).

## Going Concern

The Company has incurred a cumulative loss of \$22,429,888 from inception to May 31, 2014 which includes a non-cash stock based compensation expense of \$6,674,241 for issue of options and warrants. The Company has funded operations through the issuance of capital stock and convertible debentures. The company has started to generate revenue from operations. However, it still expects to incur significant expenses before becoming profitable. The Company's future success is dependent upon its ability to raise sufficient capital or generate adequate revenue, to cover its ongoing operating expenses, and also to continue to develop and be able to profitably market its products. These factors raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In addition to raising funds in the prior years, the Company raised \$160,000 through the issuance of 800,000 common shares during the year ended November 30, 2011. The Company further raised an additional \$878,328 by issue of Convertible Debentures during the year ended November 30, 2011 and \$910,000 during the year ended November 30, 2012. In addition, the Company raised \$649,750 by issuance of 2,165,834 common shares during the year ended November 30, 2012. On August 15, 2013, the Company filed an amended and restated final prospectus (the "Prospectus") in Canada, in the provinces of Alberta, British Columbia and Ontario for listing its shares in these provinces in Canada. On August 27, 2013 the Company completed an initial public offering to raise gross proceeds of CAD \$3,993,980 (US \$3,794,280) through the issuance of 9,984,950 Common Shares at a price of CAD \$0.40 (US \$0.38) per Common Share (the "Issue Price"). The Company's common shares commenced trading on the TSX Venture Exchange ("TSX") under the symbol "SDZ".

## Significant Quarterly Information

The following represents selected information of the Company for the most recently completed financial quarter ended May 31, 2014

	Three- month period May 31, 2014 (unaudited) \$	Three- month period May 31, 2013 (unaudited) \$
Net loss for the three month period	631,094	562,762
Basic and diluted loss per share	0.01	0.02
	As at <u>May 31,</u> <u>2014</u>	As at <u>November</u> <u>30, 2013</u>
Total assets	1,106,058	2,060,009
Total liabilities	92,582	106,529
Cash dividends per share	-	-



## Results of Operations

SDI was incorporated on March 1, 2005 and for the period from inception to February 28, 2014 has not realized significant revenues. Financial highlights (unaudited) for the three month and six month period ending May 31, 2014 with comparatives are as follows:

Operating Results	For the three months ended	For the three months ended
	May 31, 2014	May 31, 2013
	\$	\$
Sales	24,603	-
Cost of sales	(14,365)	-
Gross Profit	10,238	-
Operating Expenses	(643,319)	(511,876)
Other expenses -Interest	-	(50,886)
Other income-Interest	1,987	-
Net Loss for Period	(631,094)	(562,762)
(Loss) per Share	(\$0.01)	(\$0.02)

Operating Results	For the six months ended	For the six months ended
	May 31, 2014	May 31, 2013
	\$	\$
Sales	29,119	-
Cost of sales	(16,539)	-
Gross Profit	12,580	-
Operating Expenses	(1,128,156)	(945,089)
Other expenses -Interest	-	(87,321)
Other income-Interest	6,045	-
Net Loss for Period	(1,109,531)	(1,032,410)
(Loss) per Share	(\$0.02)	(\$0.03)

The Company's selected information for the six month period ended May 31, 2014 (unaudited) and November 30, 2013 (audited) are as follows:

	May 31, 2014	November 30, 2013
Total current assets	937,835	1,907,872
Total assets	1,106,058	2,060,009
Total current liabilities	92,582	106,529
Total liabilities	92,582	106,529
Stockholders' equity	1,013,476	1,953,480

Net loss for the three months ended May 31, 2014 was \$631,094 (\$0.01 per share) as compared to \$562,762 (\$0.02 per share) for the three month period ended May 31, 2013. The major increase in net loss for the three months in 2014 as compared with 2013 is attributable to the following:

On March 19, 2014, the board of directors granted options to five consultants to acquire a total of 400,000 common shares. The 400,000 options were issued at an exercise price of \$0.31 (CAD\$0.35) per share and vest immediately with an expiry term of three years. The Company expensed stock based compensation expense for \$47,897.

On May 9, 2014, the board of directors granted options to one director to acquire a total of 600,000 common shares. These options were issued at an exercise price of \$0.32 (CAD \$0.35) per share and vest immediately with an expiry term of five years. The Company expensed stock based compensation expense for \$140,573.

## Cash Flows

Net cash used in operations for the six months ended May 31, 2014, was \$954,768 as compared to \$736,588 used for the six months ended May 31, 2013. The major components of change relate to:

1) Items not affecting cash:

a) Stock based compensation of \$188,470 in 2014, as compared to \$99,245 in 2013. The nature of expense for 2014 is duly explained in note above.

2) Changes in non- cash balances relating to operations:

The Company's inventory costs increased by \$33,024 in 2014 as compared to \$nil in 2013. This increase represents the investment in inventory available for sale in next period.

Net cash flow from investing activities was \$37,625 in 2014 as compared to \$ 45,219 for the same period for prior year. During the current period, the Company acquired additional moulds for production of its newer BIP model.

Net Cash flow from financing activities was \$nil in 2014 as compared to an inflow of \$628,550 in 2013.

There was an overall decrease in cash and cash equivalent of \$1,011,336 in 2014 as compared to a decrease in cash and cash equivalent of \$153,257 during 2013.

**Liquidity and Capital Resources**

As at May 31, 2014, cash and cash equivalent was \$830,813, as compared to \$1,842,149 at November 30, 2013. This decrease is mainly attributable to the combination of factors mentioned above under heading "Cash Flows".

At May 31, 2014, the Company had a working capital of \$845,253. The major components are as follows; cash and cash equivalent \$830,813; prepaid expenses and other receivables \$61,226; Inventory for \$33,024; accounts receivable for \$12,772 and accounts payable and accrued liabilities of \$92,582.

At November 30, 2013, the Company had a working capital of \$1,801,343. The major components are as follows; cash and cash equivalent \$1,842,149; prepaid expenses and other receivables \$45,372; accounts receivable for \$20,351 and accounts payable and accrued liabilities of \$106,529.

There are no assurances that the Company can continue to raise equity financing to fund its operations. SDI does not have any commitments or arrangements from any persons to provide SDI with any additional capital it may need. Without additional capital SDI will not be able to fund its anticipated capital requirements outlined above.

**Off-balance sheet arrangements**

The Company has no significant off-balance sheet arrangements at this time.

**Transactions with related parties****Six months ended May 31, 2014**

The directors were compensated as per their consulting agreements with the Company. The Company expensed a total of \$125,233 as management fees to its two directors and expensed a total of \$3,600 as automobile allowance.

The Company expensed \$12,000 for services provided by the CFO of the Company and \$114,573 for services provided by a corporation in which the Chief Operating Officer has an interest.

The Company reimbursed \$66,763 to directors and officers for travel and entertainment expenses incurred for the Company.

**Six months ended May 31, 2013**

The directors were compensated as per their consulting agreements with the Company. The Company expensed a total of \$147,600 as management fees to its three directors and expensed a total of \$3,600 as automobile allowance.

The Company expensed \$24,250 for services provided by the CFO of the Company and \$120,000 for services provided by a corporation in which the Chief Operating Officer has an interest.

The Company reimbursed \$87,019 to directors and officers for travel and entertainment expenses incurred for the Company.

On March 4, the board of directors granted 100,000 warrants as an incentive to a director who provided a working capital loan of \$96,700 (CAD \$100,000 ). These warrants were issued at an exercise price of \$0.50 per share and vest immediately with an expiry term of two years. The Company expensed \$15,637 as compensation expense.

## **Commitments**

### **a) Consulting agreements:**

The directors of the Company executed consulting agreements with the company on the following terms:

Effective January 1, 2013, SDI executed an agreement with a company in which a director, Allen Ezer, has an interest in, for a period of two years to pay compensation of \$8,500 per month with a 5% increase on the first anniversary date for services rendered. Either party may terminate the consulting agreement by giving 30 days written notice.

Agreement with the Chief Executive Officer Greg Sullivan to pay compensation of \$12,000 per month, with an annual 5% increase and a car allowance of \$600 per month. The agreement expires on December 31, 2016. The monthly remuneration will increase with accomplishment of milestones. The agreement may be terminated with mutual consent or by the Chief Executive Officer giving three weeks notice.

Effective October 4, 2012, SDI executed an agreement with a company in which the Chief Operating Officer Dean Thrasher has an interest in, for a period of two years which expires on September 30, 2014 for services rendered. The total consulting fees are estimated at \$480,000 for the two year period. SDI paid cash and expensed \$240,000 during the year ended November 30, 2013. SDI paid cash and expensed \$114,573 during the six month period ended May 31, 2014. The company may also accept common shares at \$0.45 per common share in lieu of cash. As of November 30, 2013, the company has not exercised its right to accept this compensation in shares.

Effective January 1, 2013, SDI executed an agreement with a non-related consultant to pay compensation of \$7,000 per month. The consultant is to assist with sales initiatives, demos and participate in trade shows. The agreement is for a period of one year and was renewed for an additional period of one year. Either party may terminate the consulting agreement by giving 30 days written notice.

Effective January 1, 2013, SDI executed an agreement with another non-related consultant to pay compensation of \$7,000 per month. The consultant is to assist with sales initiatives, demos and participate in trade shows. The agreement is for a period of one year and is pending renewal. Either party may terminate the consulting agreement by giving 30 days written notice.

Effective November 1, 2013, SDI executed an agreement with a non-related consultant to pay compensation of \$5,000 per month. The consultant has agreed to provide corporate market advisory services. The agreement is for a period of a minimum of three months and will continue unless otherwise terminated by either party by giving 30 days written notice.

Effective April 2014, SDI executed an agreement with a non-related consultant to set up its social media site and optimization of search engine at a start up fee for CAD\$3,000 (Phase 1) and payment of CAD\$1,500 per month along with 100,000 stock options at \$0.32 (CAD\$0.35) when Phase 2 of the project is being implemented.

b) The Company has commitments for leasing office premises in Oakville, Ontario, Canada to April 30, 2018 at a rent of Canadian \$6,399 per month.

c) The Company has commitments for leasing office premises in Tampa, Florida, USA to June 30, 2014 at a rent of \$1,418 per month.

## **CONTINGENCIES**

In November of 2013, a former officer filed a suit against the Company in the Ontario Superior Court of Justice (Province of Ontario) seeking, among other things, \$60,000 in damages for wrongful dismissal, damages of \$35,000 on account of vacation pay and damages to be determined for out of pocket expenses, breach of contract, unjust enrichment and loss of business opportunity. Management of the Company believes this suit is without merit and the Company intends to vigorously defend against the suit and as such no provision for any potential payment has been expensed.

## **Revenue Recognition**

The Company's revenue recognition policies follow common practice in the manufacturing industry. The Company records revenue when it is realized, or realizable and earned. The Company considers revenue to be realized, or realizable and earned, when the following revenue recognition requirements are met: persuasive evidence of an arrangement exists; the products or services have been accepted by the customer via delivery or installation acceptance; the sales price is fixed or determinable; and collectability is probable. For product sales, the Company determines that the earnings process is complete when title, risk of loss and the right to use product has transferred to the customer.

## **Recently Adopted Accounting Standards**

"Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements" ("ASU 2014-10") issued in June 2014, ASU 2014-10 eliminates the distinction of a development stage entity and certain related disclosure requirements, including the elimination of inception-to-date information on the statements of operations, cash flows and stockholders' equity. The amendments in ASU 2014-10 will be effective prospectively for annual reporting periods beginning after December 15, 2014, and interim periods within those annual periods, however early adoption is permitted. The Company evaluated and adopted ASU 2014-10 early for the current period presented.

Management does not believe that any other recently issued, but not yet effective accounting pronouncements, if adopted, would have a material effect on the accompanying consolidated financial statements.

## **Outstanding share data**

As of July 15, 2014, the Company had 46,849,285 issued and outstanding shares of common stock

## **Risk Factors**

### **Additional Financing**

The Corporation does not have adequate revenue to fund all of its operational needs and may require additional financing to continue its operations if it is unable to generate substantial revenue growth. There can be no assurance that such financing will be available at all or on favorable terms. Failure to generate substantial revenue growth may result in the Corporation looking to obtain such additional financing could result in delay or indefinite postponement of the Corporation's deployment of its products, resulting in the possible dilution. Any such financing will dilute the ownership interest of the Corporation's shareholders at the time of the financing, and may dilute the value of their shareholdings.

### **General Venture Company Risks**

The Common Shares must be considered highly speculative due to the nature of the Corporation's business, the early stage of its deployment, its current financial position and ongoing requirements for capital. An investment in the Common Shares should only be considered by those persons who can afford a total loss of investment, and is not suited to those investors who may need to dispose of their investment in a timely fashion. Investors should consult with their own professional advisors to assess the legal, financial and other aspects of an investment in Common Shares.

### **Uncertainty of Revenue Growth**

There can be no assurance that the Corporation can generate substantial revenue growth, or that any revenue growth that is achieved can be sustained. Revenue growth that the Corporation has achieved or may achieve may not be indicative of future operating results. In addition, the Corporation may increase further its operating expenses in order to fund increase its sales and marketing efforts and increase its administrative resources in anticipation of future growth. To the extent that increases in such expenses precede or are not subsequently followed by increased revenues, the Corporation's business, operating results and financial condition will be materially adversely affected.

**Dependence on Management and Key Personnel**

The Corporation is dependent on certain members of its management. The loss of the services of one or more of them could adversely affect the Corporation. The Corporation's ability to maintain its competitive position is dependent upon its ability to attract and retain highly qualified managerial, specialized technical, manufacturing, sales and marketing personnel. There can be no assurance that the Corporation will be able to continue to recruit and retain such personnel. The inability of the Corporation to recruit and retain such personnel would adversely affect the Corporation's operations and product development.

**Dependence on Key Suppliers**

The Corporation may be able to purchase certain key components of its products from a limited number of suppliers. Failure of a supplier to provide sufficient quantities on favorable terms or on a timely basis could result in possible lost sales.

**Product Liability**

The Corporation may be subject to proceedings or claims that may arise in the ordinary conduct of the business, which could include product and service warranty claims, which could be substantial. If its products fail to perform as warranted and it fails to quickly resolve product quality or performance issues in a timely manner, sales may be lost and it may be forced to pay damages. Any failure to meet customer requirements could materially affect its business, results of operations and financial condition. The occurrence of product defects and the inability to correct errors could result in the delay or loss of market acceptance of its products, material warranty expense, diversion of technological and other resources from its product development efforts, and the loss of credibility with customers, manufacturer's representatives, distributors, value added resellers, systems integrators, original equipment manufacturers and end-users, any of which could have a material adverse effect on the Corporation's business, operating results and financial conditions.

The Corporation currently has general liability insurance which includes product liability coverage. There is no assurance this insurance policy will cover all potential claims which may have a material adverse effect on the business or financial condition of the Corporation. A product recall could have a material adverse effect on the business or financial condition of the Corporation.

**Strategic Alliances**

The Corporation relies upon, and expects to rely upon, strategic alliances with original equipment manufacturers for the manufacturing and distribution of its products. There can be no assurance that such strategic alliances can be achieved or will achieve their goals.

**Marketing and Distribution Capabilities**

In order to commercialize its technology, the Corporation must either acquire or develop an internal marketing and sales force with technical expertise and with supporting distribution capabilities or arrange for third parties to perform these services. In order to market any of its products, the Corporation must either acquire or develop a sales and distribution infrastructure. The acquisition or development of a sales and distribution infrastructure would require substantial resources, which may divert the attention of its Management and key personnel, and defer its product development and deployment efforts. To the extent that the Corporation enters into marketing and sales arrangements with other companies, its revenues will depend on the efforts of others. These efforts may not be successful. If the Corporation fails to develop substantial sales, marketing and distribution channels, or to enter into arrangements with third parties for those purposes, it will experience delays in product sales and incur increased costs.

**Rapid Technological Development**

The markets for the Corporation's products and services are characterized by rapidly changing technology and evolving industry standards, which could result in product obsolescence or short product life cycles. Accordingly, the Corporation's success is dependent upon its ability to anticipate technological changes in the industries it serves and to successfully identify, obtain, develop and market new products that satisfy evolving industry requirements. There can be no assurance that the Corporation will successfully develop new products or enhance and improve its existing products or that any new products and enhanced and improved existing products will achieve market acceptance. Further, there can be no assurance that competitors will not market products that have perceived advantages over the Corporation's products or which render the products currently sold by the Corporation obsolete or less marketable.

The Corporation must commit significant resources to developing new products before knowing whether its investments will result in products the market will accept. To remain competitive, the Corporation may be required to invest significantly greater resources than currently anticipated in research and development and product enhancement efforts, and result in increased operating expenses.

**Competition**

The Corporation's industry is highly competitive and composed of many domestic and foreign companies. The Corporation has experienced and expects to continue to experience, substantial competition from numerous competitors whom it expects to continue to improve their products and technologies. Competitors may announce and introduce new products, services or enhancements that better meet the needs of end-users or changing industry standards, or achieve greater market acceptance due to pricing, sales channels or other factors. Competitors may be able to respond more quickly than the Corporation to changes in end-user requirements and devote greater resources to the enhancement, promotion and sale of their products.

## **Regulation**

The Corporation is subject to numerous federal, provincial, state and local environmental, health and safety legislation and measures relating to the manufacture of ammunition. There can be no assurance that the Corporation will not experience difficulties with its efforts to comply with applicable regulations as they change in the future or that its continued compliance efforts (or failure to comply with applicable requirements) will not have a material adverse effect on the Corporation's results of operations, business, prospects and financial condition. The Corporation's continued compliance with present and changing future laws could restrict the Corporation's ability to modify or expand its facilities or continue production and could require the Corporation to acquire costly equipment or to incur other significant expense.

## **Intellectual Property**

The Corporation's ability to compete effectively will depend, in part, on its ability to maintain the proprietary nature of its technology and manufacturing processes. Although the Corporation considers certain of its product designs as well as manufacturing processes involving certain of its products to be proprietary, patents or copyrights do not protect all design and manufacturing processes. The Corporation has adopted procedures to protect its intellectual property and maintain secrecy of its confidential business information and trade secrets. However, there can be no assurance that such procedures will afford complete protection of such intellectual property, confidential business information and trade secrets. There can be no assurance that the Corporation's competitors will not independently develop technologies that are substantially equivalent or superior to the Corporation's technology.

To protect the Corporation's intellectual property, it may become involved in litigation, which could result in substantial expenses, divert the attention of its management, cause significant delays and materially disrupt the conduct of its business.

## **Infringement of Intellectual Property Rights**

While the Corporation believes that its products and other intellectual property do not infringe upon the proprietary rights of third parties, its commercial success depends, in part, upon the Corporation not infringing intellectual property rights of others. A number of the Corporation's competitors and other third parties have been issued or may have filed patent applications or may obtain additional patents and proprietary rights for technologies similar to those utilized by the Corporation. Some of these patents may grant very broad protection to the owners of the patents. The Corporation has not undertaken a review to determine whether any existing third party patents or the issuance of any third party patents would require the Corporation to alter its technology, obtain licenses or cease certain activities. The Corporation may become subject to claims by third parties that its technology infringes their intellectual property rights due to the growth of products in its target markets, the overlap in functionality of those products and the prevalence of products. The Corporation may become subject to these claims either directly or through indemnities against these claims that it provides to end-users, manufacturer's representatives, distributors, value added resellers, system integrators and original equipment manufacturers.

Litigation may be necessary to determine the scope, enforceability and validity of third party proprietary rights or to establish the Corporation's proprietary rights. Some of its competitors have, or are affiliated with companies having, substantially greater resources than the Corporation and these competitors may be able to sustain the costs of complex intellectual property litigation to a greater degree and for a longer period of time than the Corporation. Regardless of their merit, any such claims could be time consuming to evaluate and defend, result in costly litigation, cause product shipment delays or stoppages, divert management's attention and focus away from the business, subject the Corporation to significant liabilities and equitable remedies, including injunctions, require the Corporation to enter into costly royalty or licensing agreements and require the Corporation to modify or stop using infringing technology.

The Corporation may be prohibited from developing or commercializing certain technologies and products unless it obtains a license from a third party. There can be no assurance that it will be able to obtain any such license on commercially favourable terms or at all. If it does not obtain such a license, it could be required to cease the sale of certain of its products.

## **Health and Safety**

Health and safety issues related to its products may arise that could lead to litigation or other action against the Corporation or to regulation of certain of its product components. The Corporation may be required to modify its technology and may not be able to do so. It may also be required to pay damages that may reduce its profitability and adversely affect its financial condition. Even if these concerns prove to be baseless, the resulting negative publicity could affect the Corporation's ability to market certain of its products and, in turn, could harm its business and results from operations.

## **Stress in the global financial system may adversely affect the Corporation's operations in ways that may be hard to predict or to defend against**

Recent events have demonstrated that businesses and industries throughout the world are very tightly connected to each other. Thus, events seemingly unrelated to the Corporation, or to its industry, may adversely affect its finances or operations in ways that are hard to predict or defend against. For example, credit contraction in financial markets may hurt the Corporation's ability to access credit when it is needed or rapid changes in foreign exchange rates may adversely affect financial results. Finally, a reduction in credit, combined with reduced economic activity, may adversely affect businesses and industries that collectively constitute a significant portion of the Corporation's customer base. As a result, these customers may need to reduce their purchases of the Corporation's products, or there may be greater difficulty in receiving payment for the products that these customers purchase from the Corporation. Any of these events, or any other events caused by turmoil in world financial markets, may have a material adverse effect on the business, operating results, and financial condition.

## **Insurance and Uninsured Risks**

The Corporation's business is subject to a number of risks and hazards including industrial accidents, labour disputes and changes in the regulatory environment. Such occurrences could result in damage to equipment, personal injury or death, monetary losses and possible legal liability. Although the Corporation maintains liability insurance in amounts which it considers adequate, the nature of these risks is such that liabilities might exceed policy limits, the liabilities and hazards might not be insurable, or the Corporation may elect not to insure against such liabilities due to high premium costs or other reasons, in which event the Corporation could incur significant costs that could have a materially adverse effect upon its financial position.

## **Conflicts of Interest**

Certain directors and officers of the Corporation are or may become associated with other companies in the same or related industries which may give rise to conflicts of interest. Directors who have a material interest in any person who is a party to a material contract or a proposed material contract with the Corporation are required, subject to certain exceptions, to disclose that interest and generally abstain from voting on any resolution to approve the contract. In addition, the directors and the officers are required to act honestly and in good faith with a view to the best interests of the Corporation. The directors and officers of the Corporation have either other full-time employment or other business or time restrictions placed on them and accordingly, the Corporation will not be the only business enterprise of these directors and officers.



**Dividend Policy**

The Corporation has not paid dividends in the past and has no plans to pay dividends for the foreseeable future. The future dividend policy of the Corporation will be determined by its directors.

**Lack of Active Market**

There can be no assurance that an active market for the Common Shares will continue and any increased demand to buy or sell the Common Shares can create volatility in price and volume.

**Market Price of Common Shares**

There can be no assurance that an active market for the Common Shares will be sustained. Securities of small and mid cap companies have experienced substantial volatility in the past, often based on factors unrelated to the financial performance or prospects of the companies involved. These factors include global economic developments and market perceptions of the attractiveness of certain industries. The price per Common Share is also likely to be affected by change in the Corporation's financial condition or results of operations as reflected in its quarterly filings. Other factors unrelated to the performance of the Corporation that may have an effect on the price of Common Shares include the following: the extent of analytical coverage available to subscribers concerning the business of the Corporation may be limited if investment banks with research capabilities do not follow the Corporation's securities; lessening in trading volume and general market interest in the Corporation's securities may affect a subscriber's ability to trade significant numbers of Common Shares, the size of the Corporation's public float may limit the ability of some institutions to invest in the Corporation's securities; a substantial decline in the price of the Common Shares that persists for a significant period of time could cause the Corporation's securities to be delisted from the exchange, further reducing market liquidity. If an active market for the Common Shares does not continue, the liquidity of a subscriber's investment may be limited and the price of the Common Shares may decline. If such a market does not develop, subscribers may lose their entire investment in the Common Shares.

**Political Regulatory Risks**

Any changes in government policy may result in changes to laws affecting the sale of the Corporation's products. This may affect the Corporation's ability to ship product in the future. The possibility that future governments may adopt substantially different policies, may also effect the Corporation's operations. Local governments in all countries the Corporation deals with issue end user certificates to purchase or receive live ammunition from the Corporation. It is the decision of these countries in the Middle East, the United States, Canada, Europe, and the Baltics whether or not they will take possession or purchase such munitions.

**Dividends**

The Corporation has not, since the date of its incorporation, declared or paid any dividends on its Common Shares and does not currently intend to pay dividends. Earnings, if any, will be retained to finance further growth and development of the business of the Corporation.

## Legal proceedings

In November of 2013, a former officer filed a suit against the Company in the Ontario Superior Court of Justice (Province of Ontario) seeking, among other things, \$60,000 in damages for wrongful dismissal, damages of \$35,000 on account of vacation pay and damages to be determined for out of pocket expenses, breach of contract, unjust enrichment and loss of business opportunity. Management of the Company believes this suit is without merit and the Company intends to vigorously defend against the suit and as such no provision for any potential payment has been expensed.

## **Item 4. Controls and Procedures.**

(a) SDI maintains a system of controls and procedures designed to ensure that information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934, as amended ("1934 Act"), is recorded, processed, summarized and reported, within time periods specified in the SEC's rules and forms and to ensure that information required to be disclosed by SDI in the reports that it files or submits under the 1934 Act, is accumulated and communicated to SDI's management, including its Principal Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure. As of May 31, 2014, SDI's Principal Executive Officer and Principal Financial Officer evaluated the effectiveness of the design and operation of SDI's disclosure controls and procedures. Based on that evaluation, SDI's Principal Executive Officer and Principal Financial Officer concluded that SDI's disclosure controls and procedures were not effective due to the following material weakness:

Inherent in any small business is the pervasive problem involving segregation of duties. Since SDI has a small accounting department, segregation of duties cannot be completely accomplished at this stage in its corporate lifecycle.

In order to correct the foregoing material weakness, we have taken and are taking the following remediation measures that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting:

- We have several Directors with business experience and spending time with the business.
- We have established an audit committee of our board of directors. The audit committee will provide oversight of our accounting and financial reporting;
- We have a Chief Financial Officer who has knowledge of, and experience regarding, U.S. GAAP and SEC reporting requirements.

Accordingly, SDI's management has added compensating controls to reduce and minimize the risk of a material misstatement in SDI's annual and interim financial statements.

(b) *Changes in Internal Controls.* There were no changes in SDI's internal control over financial reporting during the quarter ended May 31, 2014 that materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

**PART II**

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The Company did not issue any capital during the period ended May 31, 2014.

**Item 6. Exhibits**

**Exhibits**

[31.1](#) [Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Gregory Sullivan.](#)

[31.2](#) [Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Rakesh Malhotra.](#)

[32](#) [Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Gregory Sullivan and Rakesh Malhotra.](#)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SECURITY DEVICES INTERNATIONAL, INC.

Date: July 15, 2014

By: /s/ Gregory Sullivan

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Gregory Sullivan, President  
and Principal Executive  
Officer

Date: July 15, 2014

By: /s/ Rakesh Malhotra

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Rakesh Malhotra, Principal  
Financial and Accounting  
Officer

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