



# 2001 Annual Report

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**August 17, 2001**

## **To Our Shareholders**

### **Year in Review**

Fiscal 2001 was a difficult year given the challenges we, at Northern Financial Corporation (“Northern” or the “Company”), faced with the serious downturn in the markets. We believe that we have met many of the challenges in implementing our strategy for our traditional and online brokerage businesses.

I want to review a number of the events that took place in the past year to give you an indication of the successes and failures that we encountered.

### **Our FY 2001 Financial Results**

Our financial results are unacceptable. While our revenues increased in Fiscal 2001 to \$5,879,743, compared with \$2,892,340 in the previous year, our loss from brokerage operations, before write-downs, doubled to \$10,501,565 from \$5,281,087 in the previous year.

Our net loss for the year including discontinued operations and write-downs increased substantially to \$19,763,651 (\$0.12 basic net loss per share) from \$5,883,465 (\$0.04 basic net loss per share) in the previous year. The loss from discontinued operations consisted of a write-down of \$5,956,702, resulting from the sale of our mining assets in March 2001, and a write-down of our goodwill by \$2,700,000.

These poor results are substantially attributable to the heavy investment made in our online operations, which we have scaled back substantially. Our online business is very valuable; however it is important for us to generate profitability at the earliest date.

### **Sale of Mining Assets**

With the disposal of the legacy mining assets, Northern finally became a 100% brokerage firm. The total sale price of the mining assets was \$750,000, which was minimal relative to the book value, resulting in the write-down referred to above.

### **Investment Banking Activity**

We generated \$5.9 million in revenue in Fiscal 2001 most of which consisted of investment banking revenue (\$3.2 million) and commission income (\$2.3 million). We participated in some very good financings. We were a co-underwriter in a \$23.16 million financing by Hemosol, a co-underwriter in a \$14.46 million financing by Isotechnika, a co-underwriter in the \$10 million financing by VSM MedTech, a co-underwriter in the \$6.5 million financing by Bioniche, a co-underwriter in the \$10.5 million financing by PanGeo Pharma, sole underwriter of the \$5.78 million financing by Image Sculpting International Inc., and a selling group member in the \$10 million financing by Envoy Communications Group.

### **Sale of Interest In CDNX**

We became a member of the Canadian Venture Exchange (CDNX) by acquiring our share in February 2001 for \$30,000. We sold this share for \$382,000 in July 2001 to the Toronto Stock Exchange. A very good return in five months.

## **Acquisition of CanadaInvestDirect.com**

We acquired CanadaInvestDirect.com (“CID”) from GlobalNetFinancial.com, Inc. (“GlobalNet”) subsequent to the Fiscal 2001 yearend. CID was formerly an online trading competitor of eNorthern, the online trading business of Northern Securities.

To finance the acquisition, \$1,312,000 principal amount of debentures and warrants to acquire 5,248,000 common shares of Northern at a price of \$0.10 for a period of three years were issued. The Northern debentures issued to GlobalNet are payable as to \$906,000 on December 31, 2001 and \$406,000 on June 30, 2002. On their respective maturity dates in December 2001 and June 2002, Northern will have the option to repay \$812,000 principal amount of the debentures in common shares of Northern with the balance of \$500,000 payable in cash.

This was an important acquisition as it added client accounts, significant assets under administration and also provided us with some material cash resources for our brokerage operations. Increasing our online client base is very important to us. This was also an excellent acquisition in that we did not assume any liabilities; all liabilities were reduced in the purchase price paid for CID. We also employed Jeff Langdon of CID as Vice President, Finance of Northern Securities, which appointment is subject to regulatory approval.

## **Our Successful Website**

In May 2000 we went live with our online trading site [www.enorthern.com](http://www.enorthern.com). It has been well received. In their Winter Survey of Online Brokers, Gomez ranked eNorthern as the second best overall online broker in Canada.

We have a very valuable asset in our online trading site and our very strong technology team. Our challenge is to develop scale in the business. Our strategy is to develop alliances with credit unions, insurance companies, financial planners, and asset management firm who wish to provide an online trading capability to their client base. eNorthern is an excellent choice for these companies because there is no threat to our partners’ client base; we are independent from any of the large banks and do not compete with our partners in any of the products that they offer.

To date, alliances have been formed to promote eNorthern as the preferred online trading partner, with Buduchnist Credit Union (November 2000), North Winnipeg Credit Union (March 2001), Federal Employees (Kingston) Credit Union Ltd. (April 2001), and Kingston Community Credit Union Ltd. (May 2001).

## **Direct Trading Access**

Northern was one of Canada’s first online brokers to offer clients the direct routing of their orders to the stock exchanges. The exemptive relief obtained by Northern from the Canadian Securities Administrators allows eNorthern’s online trading clients to process their trades quickly without the need to review client orders to determine if they are consistent with the investor’s risk tolerance and investment objectives.

## **Online Private Placements**

In March 2000, our online private placement site at [www.enorthern.com](http://www.enorthern.com) was launched, which complements our online public offering capability.

Northern has encouraged the Ontario Securities Commission (“OSC”) to seize the opportunity to create an environment that is at least comparable to the more competitive position in the United States in the private raising of capital. Northern believes it is imperative that Canadian companies have the ability to raise capital efficiently in Canada and, to that end, it is very important that the rules regarding the raising of private funds make Canada’s capital market competitive with the United States.

In its submission to the OSC, Northern recommended that an investor be qualified if the investor has \$200,000 in financial assets and the investor be limited to investing a maximum of 20% of his financial assets in a private placement. The private placement market needs to be opened up in a proper and careful manner and we believe this limitation is proper and careful.

## **Financings**

In June 2000 we raised \$7 million in a rights offering with our shareholders. A group of individuals, led by management of Northern, purchased the unsubscribed portion of the rights offering to ensure that the offering was fully subscribed. A total of 14,000,000 common shares and 7,000,000 warrants were issued pursuant to the offering.

## **Normal Course Issuer Bid**

In April 2001, Northern implemented a normal course issuer bid which permits the Company to purchase up to 14,522,703 of its common shares for cancellation during the period ending April 25, 2002. The Company intends to take advantage of this bid to invest in its shares from time to time in the market.

## **Change in Management**

In August 2000 we changed our management team. Vic Alboini became President and CEO of Northern, in addition to his responsibility as Chairman and CEO of Northern Securities. We thank Nadir Desai and Wes Roitman for assembling an exceptional technology team to develop our prestigious website for online trading and online financings. Vic Alboini became Chairman of the Board of Northern in December 2000 when Nadir Desai resigned in that capacity.

## **Uniqueness of Northern**

Northern is quite a unique company. It is one of the few publicly traded brokerage firms in Canada. Our objective is to carve out a niche in providing service to small-cap public companies that are engaged in the Knowledge Industries and Natural Resources. We have a traditional investment banking business with full service retail brokerage, institutional brokerage, research, corporate finance and mergers and acquisitions. We have a tremendously innovative website that provides for online trading and online financings.

Our key vision is to provide consistently high quality investment banking services to small cap companies. We strive to meet this standard in many traditional ways and also two unique ways. First, we are one of only two Canadian securities firms that raise capital online for small cap companies. Second, Northern has developed the Nifty Fifty program, which has been specifically designed to provide small cap companies with support for their shares in the market. Stock market liquidity is a major concern for small cap companies. We address this concern by acting as a market maker for small cap companies through our Nifty Fifty program.

On behalf of the Board of Directors we thank our employees and shareholders for their continued support and we look forward to seeing you at our annual meeting to be held at 4:30 pm on Thursday September 27, 2001 at The Toronto Stock Exchange Conference Centre, 130 King Street West (The Exchange Tower) in Toronto.

Vic Alboini  
Chairman and Chief Executive Officer

**NORTHERN FINANCIAL CORPORATION**  
**(FORMERLY DIGITAL GEM CORPORATION)**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2001**



McGovern, Hurley, Cunningham, LLP  
Chartered Accountants

## AUDITORS' REPORT

To the Shareholders of  
**Northern Financial Corporation**  
(formerly Digital Gem Corporation)

We have audited the consolidated balance sheets of Northern Financial Corporation (formerly Digital Gem Corporation) as at March 31, 2001 and 2000 and the consolidated statements of operations and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2001 and 2000 and the results of its operations and cash flows for the years then ended in accordance with generally accepted accounting principles in Canada.

**McGOVERN, HURLEY, CUNNINGHAM, LLP**

A handwritten signature in cursive script that reads "McGovern, Hurley, Cunningham, LLP".


**Chartered Accountants**


TORONTO, Canada  
June 8, 2001


NORTHERN FINANCIAL CORPORATION  
(FORMERLY DIGITAL GEM CORPORATION)  
**CONSOLIDATED BALANCE SHEETS**  
AS AT MARCH 31

	2001 \$	2000 \$
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and cash equivalents	487,589	5,643,058
Deposit with carrying broker	250,000	350,000
Securities owned, at market value (Note 5)	503,893	621,650
Accounts receivable	681,329	802,351
Inventory (Note 6)	-	2,222,499
Prepaid expenses and other	222,357	299,802
Due from clients	-	104,527
Income taxes recoverable	<u>76,825</u>	<u>-</u>
	2,221,993	10,043,887
<b>MINING PROPERTIES</b> (Note 7)	-	3,855,377
<b>CAPITAL ASSETS</b> (Note 8)	1,542,836	2,087,071
<b>RECLAMATION BOND AND DEPOSITS</b>	63,250	113,244
<b>GOODWILL</b> (Note 9)	3,521,512	7,345,564
	<u>7,349,591</u>	<u>23,445,143</u>

APPROVED ON BEHALF OF THE BOARD:

  
\_\_\_\_\_, Director

  
\_\_\_\_\_, Director



NORTHERN FINANCIAL CORPORATION  
(FORMERLY DIGITAL GEM CORPORATION)  
**CONSOLIDATED BALANCE SHEETS**  
AS AT MARCH 31

	2001 \$	2000 \$
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	2,014,770	1,809,988
Securities sold, at market value (Note 5)	-	43,350
Due to clients	-	102,098
Debentures payable	-	1,700,000
Current portion of lease inducement	-	48,000
Current portion of long-term debt (Note 10)	316,546	139,154
Income taxes payable	-	48,284
Due to issuer	-	1,000,000
Due to related party (Note 17(b))	<u>304,146</u>	<u>-</u>
	2,635,462	4,890,874
<b>LEASE INDUCEMENT</b>	-	164,000
<b>LONG-TERM DEBT</b> (Note 10)	<u>447,742</u>	<u>442,983</u>
	<u>3,083,204</u>	<u>5,497,857</u>
<b>SHAREHOLDERS' EQUITY</b>		
<b>CAPITAL STOCK</b> (Note 11(a))	69,488,534	63,831,575
<b>WARRANTS</b>	431,542	5,749
<b>DEFICIT</b>	<u>(65,653,689)</u>	<u>(45,890,038)</u>
	<u>4,266,387</u>	<u>17,947,286</u>
	<u>7,349,591</u>	<u>23,445,143</u>

See Accompanying Notes to the Consolidated Financial Statements

NORTHERN FINANCIAL CORPORATION  
(FORMERLY DIGITAL GEM CORPORATION)  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT**  
FOR THE YEARS ENDED MARCH 31

	2001 \$	2000 \$
<b>REVENUES</b>		
Underwriting and advisory	3,202,476	749,069
Commissions earned	2,288,777	1,633,501
Interest	388,490	285,751
Trading	<u>-</u>	<u>224,019</u>
Total revenues	<u>5,879,743</u>	<u>2,892,340</u>
<b>OPERATING EXPENSES</b>		
General and administrative	4,848,455	3,212,471
Brokerage operations	6,306,321	2,380,743
Trading losses	1,434,904	-
Bad debt provision	1,253,295	-
Website development costs	433,070	1,483,673
Interest expense	260,016	67,818
Depreciation and amortization	<u>1,845,247</u>	<u>1,028,722</u>
Total operating expenses	<u>16,381,308</u>	<u>8,173,427</u>
Loss before the undernoted	(10,501,565)	(5,281,087)
Write down of goodwill	<u>2,700,000</u>	<u>-</u>
Loss before income taxes	(13,201,565)	(5,281,087)
Income taxes recoverable (payable)	<u>59,200</u>	<u>(49,049)</u>
Loss from continuing operations	(13,142,365)	(5,330,136)
Discontinued operations (Note 4)		
Net operating loss	(664,584)	(553,329)
Loss on disposal of net assets	<u>(5,956,702)</u>	<u>-</u>
<b>NET LOSS FOR THE YEAR</b>	(19,763,651)	(5,883,465)
<b>DEFICIT, beginning of year</b>	<u>(45,890,038)</u>	<u>(40,006,573)</u>
<b>DEFICIT, end of year</b>	<u>(65,653,689)</u>	<u>(45,890,038)</u>
<b>LOSS PER SHARE FROM CONTINUING OPERATIONS - Basic (Note 16)</b>	(0.08)	(0.04)
<b>LOSS PER SHARE – Basic (Note 16)</b>	(0.12)	(0.04)
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b>	166,815,925	141,787,923

See Accompanying Notes to the Consolidated Financial Statements

NORTHERN FINANCIAL CORPORATION  
(FORMERLY DIGITAL GEM CORPORATION)  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
FOR THE YEARS ENDED MARCH 31

	2001 \$	2000 \$
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) for the year	(19,763,651)	(5,883,465)
Adjustments for:		
Depreciation and amortization	2,033,899	1,270,110
Write down of goodwill	2,700,000	-
Loss on disposal of assets	-	80,569
Common shares issued for services	-	163,300
Lease inducement amortization	(32,000)	(28,000)
Loss on termination of lease	28,671	-
Loss on sale of mining related assets	<u>5,956,702</u>	<u>-</u>
	<u>(9,076,379)</u>	<u>(4,397,486)</u>
Changes in non-cash working capital balances:		
Securities owned	117,757	(621,650)
Accounts receivable	16,899	(511,985)
Inventory	128,086	78,966
Prepaid expenses and other	77,445	(299,802)
Deposit with carrying broker	100,000	(350,000)
Due from clients	104,527	(104,527)
Income taxes (recoverable) payable	(125,109)	48,284
Decrease in reclamation bond and deposits	49,994	15,981
Accounts payable and accrued liabilities	205,945	1,265,766
Due to related party	304,146	-
Securities sold	(43,350)	43,350
Due to clients	(102,098)	102,098
Due to issuer	<u>(1,000,000)</u>	<u>1,000,000</u>
	<u>(165,758)</u>	<u>666,481</u>
Cash flows used in operating activities	<u>(9,242,137)</u>	<u>(3,731,005)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of capital assets (net)	(677,496)	(401,903)
Proceeds from sale of capital assets	-	112,549
Acquisition of subsidiaries	-	(1,597,986)
Net proceeds from sale of mining related assets	<u>616,209</u>	<u>-</u>
Cash flows used in investing activities	<u>(61,287)</u>	<u>(1,887,340)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Debenture payable	(1,700,000)	1,700,000
Proceeds from issuance of common stock	-	7,327,250
Proceeds from exercising stock options	-	539,363
Proceeds from exercising stock warrants	-	2,237,810
Proceeds from rights offering, net of issue costs	6,082,752	-
Stock issuance costs	-	(499,350)
Principal repayments on long-term debt	<u>(234,797)</u>	<u>(99,481)</u>
Cash flows from financing activities	<u>4,147,955</u>	<u>11,205,592</u>
(Decrease) increase in cash and cash equivalents	(5,155,469)	5,587,247
Cash and cash equivalents, beginning of year	<u>5,643,058</u>	<u>55,811</u>
Cash and cash equivalents, end of year	<u><u>487,589</u></u>	<u><u>5,643,058</u></u>

See Accompanying Notes to the Consolidated Financial Statements

**1. ORGANIZATION AND BASIS OF PRESENTATION**

In 1999, the Company acquired Northern Securities Inc. ("Northern"), a member firm of the Investment Dealers Association ("IDA"). Northern entered into an agreement to act as a Type 2 introducing broker to National Bank Financial Corp. ("National Bank") and the Correspondent Network ("CN") (Note 3). In 2000 the Company acquired the operating assets of St. James Securities Inc., also a member firm of the IDA. The Company carries on a traditional brokerage business in retail and institutional sales, research, corporate finance and mergers and acquisitions. The Company also carries on an online brokerage business focusing on online securities trading, online public offerings, and online private placements. Prior to the acquisition of Northern, the Company was engaged in the business of mining sapphire-bearing properties, acquiring sapphire rough and heat-treating, cutting and marketing sapphires. The Company has had limited operating revenues from its sapphire operations. On March 29, 2001, the Company sold all of its sapphire and mining assets (Note 4).

The Company has sustained net losses and negative cash flows from operations since its inception. At March 31, 2001, the Company's main operating subsidiary, Northern Securities Inc., entered into level 2 Early Warning; however, Northern Securities Inc. had positive risk adjusted capital as at that date. The Company's ability to meet its obligations in the ordinary course of business is dependent upon its ability to achieve profitable operations or raise additional financing through public or private equity financings, or other sources of financing to fund operations. However, there is no assurance that the Company will achieve profitable operations or that it will be able to raise adequate financing from other sources. Management believes that its current funds, plus the funds acquired upon the acquisition of CanadaInvestDirect.com (see Note 19), will be sufficient to enable the Company to meet its planned expenditures through at least March 31, 2001. If anticipated operating results are not achieved, management has the intent and believes it has the ability to delay or reduce expenditures so as not to require additional financial resources if such resources were not available on terms acceptable to the Company.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies of the Company are in accordance with generally accepted accounting principles in Canada and are consistent with that of the previous year. Outlined below are those policies considered particularly significant:

Principles of Consolidation:

These consolidated financial statements include the accounts of the Company and all its subsidiaries.

Cash and Cash Equivalents:

The Company considers all highly liquid debt instruments with an original maturity date of twelve months or less to be cash equivalents. The Company's cash and cash equivalents consist of cash held in banks in Ontario, Canada and Montana, U.S.A. Included in cash and cash equivalent are amounts on deposit with the carrying broker which are available for withdrawal on demand.

Reclamation Bond Deposits:

Reclamation bond deposits are held in the Company's name in escrow until the related reclamation activities are completed.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

**Goodwill:**

Goodwill represents the excess of purchase price paid on acquisition over the value assigned to identifiable net assets acquired. Goodwill is amortized on a straight-line basis, over periods from 7 to 10 years, based on management's opinion of the future benefits from the acquisition.

The Company assesses the recoverability of its goodwill by determining whether the unamortized balance over its remaining life can be recovered through forecasted cash flows. If undiscounted forecasted cash flows indicate that the unamortized amounts will not be recovered, an adjustment will be made to reduce the net amounts to an amount consistent with the forecasted future cash flows discounted at a rate commensurate with the risk associated when estimating future discounted cash flows. Future cash flows are based on trends of historical performance and management's estimate of future performance, giving consideration to existing and anticipated competitive and economic conditions.

**Web Site Development Costs**

All web site development and marketing costs were expensed.

**Capital Assets:**

Capital assets are recorded at cost less accumulated depreciation. Depreciation is provided on a declining-balance basis at the following annual rates:

Office equipment	20%
Leasehold improvements	20%
Computer hardware	30%
Equipment under capital lease	30%
Computer software	100%

**Revenue Recognition:**

Securities transactions and related revenue are recorded on a trade-date basis. Revenue from selling gemstones is recognized at the time of delivery.

**Foreign Currency Translation:**

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing at the statement date. Capital assets are translated at the rates prevailing at the dates of acquisition. Long-term monetary assets and liabilities with a fixed or ascertainable life are translated at the statement date rate; any resulting gain or loss thereon is amortized over the life of the item. Revenue and expense items, other than amortization, are translated at the average rate of exchange for the year. An exchange gain or loss that arises on translation or settlement of a foreign currency denominated monetary item is included in the determination of net income for the period.

**Use of Estimates:**

The preparation of financial statements in conformity with generally accepted accounting principles in Canada requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Future Income Taxes:

Future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount and their tax bases. Future income tax assets are recognized for the benefit of any deductions or losses available to be carried forward to future periods for tax purposes that are likely to be realized. These amounts are measured using enacted or substantively enacted tax rates and are re-measured annually for changes in these rates. Any future income tax assets are reassessed each year to determine if a valuation allowance is required. Any effect of the re-measurement or reassessment is recognized in the period of the change.

**3. INTRODUCING BROKER AGREEMENT**

National Bank and CN, the carrying brokers, perform certain trading and clearing activities for the clients of the Company, according to an introducing broker agreement (the "Agreement") between National Bank, CN and the Company. As a Type 2 introducing broker, the Company does not carry client accounts, nor receive, deliver or hold cash or securities in connection with such clients. At March 31, 2001, the Company had cash and securities on deposit with National Bank having a market value of \$461,179 (2000 - \$645,431). The amount receivable from the carrying broker of \$200,676 (2000 - \$156,122) is due on demand.

National Bank and CN perform their services for a flat fee per trade, subject to certain additional charges. Interest related to client accounts is also split according to the Agreement.

**4. DISCONTINUED OPERATIONS**

On March 28, 2001, the Company sold its sapphire assets for gross proceeds of \$276,000 (US\$175,000). On March 29, 2001, the Company sold its mining equipment and properties for gross proceeds of \$158,000 (US\$100,000) and \$354,000 (US\$225,000) respectively.

The results of operations of this division for the period of April 1, 2000 to March 29, 2001 are included in the discontinued operations – net operating loss. Comparative figures have been restated to conform with this basis of presentation.

Sales for the period amounted to \$553,997 (2000 - \$713,396)

Net loss from discontinued operations comprises:

Loss from operations for the period April 1, 2000 to March 29, 2001	\$ 664,584
Loss on disposal of net assets (gross proceeds of \$788,150)	<u>5,956,702</u>
	<u>\$6,621,286</u>

The approximate carrying values of this segment's remaining underlying net assets as at March 31, 2001 are:

Cash	\$ 12,000
Due from purchaser	355,000
Deposits	<u>63,000</u>
	430,000
Accounts payable and accrued liabilities	<u>(430,000)</u>
	<u>\$ -</u>

Continued...

NORTHERN FINANCIAL CORPORATION  
(FORMERLY DIGITAL GEM CORPORATION)  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
MARCH 31, 2001

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**5. SECURITIES OWNED AND SECURITIES SOLD**

Securities owned at market, consist of the following:

	<u>2001</u>	<u>2000</u>
	\$	\$
Equities	<u>503,893</u>	<u>621,650</u>

Securities sold at market, consist of the following:

	<u>2001</u>	<u>2000</u>
	\$	\$
Equities	<u>-</u>	<u>43,350</u>

**6. INVENTORY**

Inventory consists of the following:

	<u>2001</u>	<u>2000</u>
	\$	\$
Raw material	-	768,847
Finished sapphire stones	-	1,312,796
Finished jewelry	-	140,856
	<u>-</u>	<u>2,222,499</u>

On March 28, 2001, the Company sold its sapphire assets for gross proceeds of \$276,000 (US\$175,000) (Note 4).

**7. MINING PROPERTIES**

Mining properties consist of the following:

	<u>2001</u>	<u>2000</u>
	\$	\$
Gem Mountain	-	7,212,529
Other	-	14,334
	<u>-</u>	<u>7,226,863</u>
Less: Accumulated depletion	<u>-</u>	<u>(3,371,486)</u>
	<u>-</u>	<u>3,855,377</u>

On March 29, 2001, the Company sold its mining properties for gross proceeds of \$354,000 (US\$225,000) (Note 4).

**8. CAPITAL ASSETS**

	<u>2001</u>	<u>2000</u>
	\$	\$
Equipment under capital lease	1,079,975	673,387
Computer software	496,843	167,170
Office equipment	464,363	541,461
Leasehold improvements	228,505	293,889
Computer hardware	88,586	-
Art	11,079	11,079
Mining plant and equipment	-	1,678,863
	<u>2,369,351</u>	<u>3,365,849</u>
Less: Accumulated amortization	<u>(826,515)</u>	<u>(1,278,778)</u>
	<u>1,542,836</u>	<u>2,087,071</u>

On March 29, 2001, the Company sold its mining equipment for gross proceeds of \$158,000 (US\$100,000) (Note 4).

Continued...

NORTHERN FINANCIAL CORPORATION  
(FORMERLY DIGITAL GEM CORPORATION)  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
MARCH 31, 2001

**9. GOODWILL**

	<u>2001</u>	<u>2000</u>
	\$	\$
Opening balance	7,345,564	8,197,751
Less: Accumulated amortization	(1,124,052)	(852,187)
Less: Write down	<u>(2,700,000)</u>	<u>-</u>
	<u>3,521,512</u>	<u>7,345,564</u>

As at March 31, 2001, management performed an assessment of the carrying value of the goodwill. Management determined that a permanent impairment in the value of the goodwill related to the Digital Fluid acquisition had occurred and, accordingly, the value of this goodwill at March 31, 2001 was written down by \$2,700,000 to \$2,624,787. The goodwill related to the purchase of Northern Securities Inc. (\$896,725) was not written down.

**10. LONG-TERM DEBT**

Long-term debt, having a carrying amount which approximates fair value, consists of the following:

	<u>2001</u>	<u>2000</u>
	\$	\$
Obligation under capital leases (Note 13(f))	764,288	582,137
Less: Current portion	<u>(316,546)</u>	<u>(139,154)</u>
	<u>447,742</u>	<u>442,983</u>

The obligations under capital lease are secured by capital assets having a net book value of approximately \$800,000.

**11. CAPITAL STOCK**

**(a) Share Capital:**

Authorized:

Unlimited number of common shares

2,000,000 voting, convertible, redeemable preference shares

Issued:

169,500,857 common shares

\$69,488,534

Transactions during the year are as follows:

	<u>Shares</u>	<u>Amount</u>
	#	\$
Balance, March 31, 1999	105,447,977	47,068,958
Exercise of stock warrants	3,427,400	2,232,061
Exercise of stock options	8,115,000	539,363
Private placements	18,063,888	7,327,250
Issued on purchase of Digital Fluid	19,999,980	6,999,993
Issued for services	446,612	163,300
Share issue costs	<u>-</u>	<u>(499,350)</u>
Balance, March 31, 2000	155,500,857	63,831,575
Rights offering (net)	<u>14,000,000</u>	<u>5,656,959</u>
Balance, March 31, 2001	<u>169,500,857</u>	<u>69,488,534</u>

Continued...

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**11. CAPITAL STOCK** (Continued)

**(b) Stock Options:**

Pursuant to a stock option plan approved by the board of directors, 28,400,000 common shares have been authorized for issuance to various directors, employees and consultants of the Company. As at March 31, 2001, there were 26,134,940 options issued and outstanding expiring at various dates to March 8, 2011.

	<u>Number of Common Shares</u> #	<u>Weighted Average Exercise Price</u> \$
Outstanding, beginning of year	19,611,640	0.55
Granted during the year	15,109,700	0.12
Cancelled during the year	<u>(8,586,400)</u>	0.54
Outstanding, end of year	<u>26,134,940</u>	0.30

**(c) Stock Warrants:**

As at March 31, 2001, the following stock warrants are outstanding:

<u>Date of Grant</u>	<u>Date of Expiry</u>	<u>Stock Warrants Granted</u>	<u>Exercise Price</u> \$
June 4, 1999	June 4, 2001	2,000,000	1.00
June 4, 1999	June 4, 2001	2,572,600	0.65
June 4, 1999	June 4, 2001	250,000	0.85
December 30, 1999	December 30, 2001	500,000	0.60
February 28, 2000	February 28, 2003	1,200,000	0.60
June 9, 2000	June 1, 2001	<u>7,000,000</u>	0.75
		<u>13,522,600</u>	

**12. INCOME TAXES**

(a) The tax effects of temporary differences that give rise to future income tax assets as at March 31, 2001 are as follows:

Future tax assets	
Non-capital losses carried forward	\$ 6,769,426
Share issue costs	401,789
Capital assets	440,128
Resource properties	<u>1,962,832</u>
	9,574,175
Valuation allowance	<u>(9,574,175)</u>
Total	\$ <u>          -</u>

(b) The Company is not planning to incur costs to maintain the inactive U.S. companies since there is little likelihood of utilizing the U.S. tax losses due to restrictive rules relating to ownership changes and continuation of the loss business. Accordingly, the potential benefit of these losses has not been recognized in the accounts. The Company has loss carry-forwards in Canada of approximately \$16,000,000 (2000 - \$7,450,000), which under certain circumstances may be utilized to offset future taxable income. These losses begin to expire in 2005. The benefit of these losses has not been recognized in the accounts.

Continued...

**13. COMMITMENTS AND CONTINGENCIES**

- (a) Pursuant to an agreement dated as of November 26, 1993, the Company sold a mining royalty interest for \$396,034. The net proceeds of \$337,455 (after payment of legal and other fees of \$58,589) were reflected as a reduction in the carrying value of mining properties held as of November 26, 1993. The royalty is applicable to (a) sales of all minerals that are produced from any properties held at the date of the agreement by the Company or its affiliates, (b) sales of minerals that are produced from properties acquired after the date of the agreement by the Company or its affiliates, where sapphires are the primary mineral that is, has been or will be mined from the particular property, and (c) sales of all other sapphires by the Company or its affiliates. The royalty is at a rate of 3% of the aggregate of all such sales, until such time as the cumulative royalty paid equals \$396,034, at which time the rate is reduced to 1.5%. Subsequent to the year end, the agreement was terminated with an agreement to make a payment of \$80,000.
- (b) A former employee in the Company's discontinued mining business asserted a claim against the Company and related entities in April 1999 for damages for failing to allow him to exercise certain stock options at an exercise price of \$0.065 for 50,000 common shares and at an exercise price of \$0.07 for 500,000 common shares. The Company commenced a counterclaim against the former employee and has denied the employee's entitlement to exercise any options by virtue of his alleged misconduct and failure to abide by the terms of the agreements. The employee has also asserted a claim for damages for three months severance. The Company denies liability and has asserted just cause for his termination.

In September 1999 the Company asserted claims against such former employee and other parties for damages in the amount of US\$5,000,000 for various breaches relating to the wrongful removal of gemstones and other assets from the Gem Mountain property, wrongfully misappropriating certain of the mining claims in the area and failing to renew certain mining claims, and rescission of the option agreement. The Company subsequently settled its claims as against the other parties; and its claims against the former employee remain outstanding.

- (c) In December, 1999, a legal action was instituted against an inactive subsidiary of the Company for approximately US\$128,000 relating to the alleged breach of a lease contract for premises in Montana, U.S.A. The Company's subsidiary has filed a statement of defence and, at this time, no prediction of the outcome of this action can be determined. No provision has been made in these financial statements in respect of this action.
- (d) Northern Securities Inc. has been added as a defendant in an action commenced against a former client of Northern Securities by a competitor of the former client. The Company considers the action against Northern Securities Inc. to be wholly without merit and intends to defend the action vigorously.
- (e) The future minimum annual payments for each fiscal year on equipment and office premises under existing operating leases approximate the following:

<u>Year</u>	<u>Amount</u>
	\$
2002	276,000
2003	199,000
2004	193,000
2005	161,000
	<u>829,000</u>

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**13. COMMITMENTS AND CONTINGENCIES** (Continued)

- (f) The Company has entered into various leasing agreements for equipment. The following is a summary of future minimum lease payments under the capital leases expiring at various dates to December 2003, together with the present balance of the obligation:

<u>Year</u>	<u>Amount</u> \$
2002	646,322
2003	244,457
2004	<u>41,749</u>
	932,528
Less: Amount representing interest (Note 10)	<u>(168,240)</u>
	<u>764,288</u>

**14. SEGMENTED INFORMATION**

<u>Data by business segment</u>	<u>Sapphire</u> \$ (Note 4)	<u>Brokerage</u> \$	<u>E-Commerce</u> \$	<u>Consolidated</u> \$
For the year ended March 31, 2001				
Revenue		5,519,148	360,595	5,879,743
Interest revenue		235,541	152,959	388,490
Interest expense		106,814	153,202	260,016
Income tax (recovery)		(59,200)	-	(59,200)
Amortization		93,427	1,751,820	1,845,247
As at March 31, 2001				
Segment assets	43,000	2,762,618	4,543,973	7,349,591
For the year ended March 31, 2000				
Revenue		2,892,340	-	2,892,340
Interest revenue		247,449	138,302	385,751
Interest expense		-	67,818	67,818
Income tax expense		49,049	-	49,049
Amortization		31,842	996,880	1,028,722
As at March 31, 2000				
Segment assets	7,082,069	3,384,734	12,978,340	23,445,143

During the year, the Company discontinued its sapphire operations (Note 4), which also represented the majority of its operations in the United States. As a result, there are no material operations outside of Canada.

Continued...

**15. FINANCIAL INSTRUMENTS**

The fair values of the Company's financial assets and financial liabilities approximate their carrying amounts due to their imminent short-term maturity except for securities owned (carried at fair value), stock exchange share and subordinate loans. The Company owns one Class A share in the capital stock of the Canadian Venture Exchange ("CDNX") which was acquired on February 20, 2001 at a price of \$30,000. The fair value of this share is estimated at approximately \$381,000 based upon the agreement to purchase CDNX by The Toronto Stock Exchange Inc.

Fair value estimates are made at the balance sheet date, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

**16. EARNINGS PER SHARE**

Earnings per share is based on the weighted average number of common shares outstanding (basic), adjusted, to the extent they are dilutive, for outstanding stock options and stock purchase warrants (fully diluted). The calculation of fully diluted earnings per share excludes any potential conversion of warrants and options that would increase earnings per share or decrease a loss per share.

**17. RELATED PARTY TRANSACTIONS**

- (a) Pursuant to a standby agreement, a portion of the standby fees in the amount of \$200,000 were paid to former and current officers of the Company as a result of their commitments to purchase shares in a rights offering of the Company.
- (b) The Company received a loan in the amount of \$175,000 from a corporation controlled by an officer of the Company. The Company pledged securities that had a market value of approximately \$79,000 as at March 31, 2001 which securities were realized to reduce part of the loan. Subsequent to the year end, the unpaid balance of the loan in the amount of \$74,000 was replaced by debentures of the Company in the same principal amount, plus warrants to purchase shares of the Company.

To assist the Company with a client financing, a corporation controlled by an officer of the Company agreed to purchase \$150,000 of common shares of the client. The financing assistance was provided conditional upon the Company agreeing to a put arrangement whereby the Company would repurchase the shares in certain circumstances. An amount of \$128,571, which is the difference between the March 31, 2001 market value of the shares and the amount owing under the put arrangement is accrued in the accounts. Subsequent to the year end, the Company and the officer replaced the put arrangement with the issuance of debentures in the principal amount of \$150,000 and warrants. Also, subsequent to the year end the same officer invested an additional \$250,000 in debentures and warrants. In total, these financings resulted in the Company having issued a total of \$474,000 in debentures and 1,896,000 warrants to purchase shares of the Company at a exercise price of \$0.10 per share during a term of three years.

Due to related party is as follows:

Loan	\$175,000
Accrued loss on put arrangement	<u>129,146</u>
	<u>\$304,146</u>

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**18. SUPPLEMENTAL INFORMATION - STATEMENT OF CASH FLOWS**

(a)	<u>2001</u>	<u>2000</u>
	\$	\$
Interest paid	306,408	83,462
Income taxes paid	71,406	11,291

(b) During the year, certain capital assets were acquired at an aggregate cost of \$1,094,444 (2000 - \$967,276) of which \$416,948 (2000 - \$598,178) were acquired by the assumption of capital leases.

**19. SUBSEQUENT EVENT**

Subsequent to the year end, the Company acquired CanadaInvestDirect.com at a price of \$1,312,000 which was paid by the issuance of \$1,312,000 principal amount of debentures and warrants to acquire 5,248,000 shares of the Company at an exercise price of \$0.10 for a term of three years. The debentures are payable as to \$906,000 principal amount on December 31, 2001 and \$406,000 on June 30, 2002. On their respective maturity dates in December 2001 and June 2002, the Company has the option to repay \$812,000 principal amount of the debentures in common shares of the Company with the balance of \$500,000 payable only in cash.

## CORPORATE INFORMATION

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### BOARD OF DIRECTORS

Vic Alboini, *Chairman*

R. Ian Bradley  
*President & Chief Executive Officer*  
*Grand Toys International Inc.*

John S. M. Turner  
*Partner, Fasken, Martineau, DuMoulin*

### MANAGEMENT

Vic Alboini  
*Chairman, President & Chief Executive Officer*

Bob Leshchyshen  
*Head of Corporate Development*

Jeff Langdon  
*Vice President, Finance\*, Northern Securities Inc.*

Terry Bell  
*Vice President, Northern Securities Inc.*

Peter Besler  
*Head of Private Client Group, Northern Securities Inc.*

Roderick L. De Courcy-Ireland  
*Vice President, Institutional Equity Sales, Northern Securities Inc.*

Rickard D, Vernon  
*Vice President, Head of Investment Banking, Northern Securities Inc.*

Michael R. Hamilton  
*Director, Online Sales & Trading, eNorthern*

### SHARE INFORMATION

Listed on the Toronto Stock Exchange under the trading symbol **NFC**

### TRANSFER AGENT

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*\*subject to regulatory approval*