

ZTEST Electronics Inc.

Management's Discussion and Analysis
For The Three Month Period Ended March 31, 2014
(Prepared as at May 27, 2014)

General

The following management's discussion and analysis ("MD&A") of the financial condition and results of operations of ZTEST Electronics Inc. ("ZTEST" or the "Company") constitutes management's review of the factors that affected the Company's interim condensed consolidated financial and operating performance for the nine months ended March 31, 2014. The MD&A was prepared as of May 27, 2014 and was approved by the Board of Directors on May 27, 2014. It should be read in conjunction with the unaudited interim condensed consolidated financial statements of the Company for the nine months ended March 31, 2014, and the audited consolidated financial statements for the year ended June 30, 2013, including the notes thereto. Unless otherwise stated, all amounts discussed herein are denominated in Canadian dollars.

Additional information about the Company can be found at www.sedar.com.

The Company

The Company operates a single business segment involving the design, development, and assembly of printed circuit boards. The management of the Company is comprised of the following individuals:

<u>Name</u>	<u>Position(s)</u>
Wojciech Drzazga	Director and CEO
John Perreault ⁽¹⁾	Director and President
K. Michael Guerreiro ⁽¹⁾⁽²⁾	Director
Mike Hiscott ⁽¹⁾⁽²⁾	Director
Michael D. Kindy	VP Finance & CFO
William R. Johnstone	Secretary

⁽¹⁾ Denotes member of audit committee

⁽²⁾ Denotes member of compensation committee

The Board of Directors has a vacancy as a result of the passing of Mr. Arn Schoch in April 2014. There are no immediate plans to fill this vacancy.

Corporate Performance

The Company has essentially broken even thus far in its 2014 fiscal year as it reported net income for the nine month period of \$2,409, inclusive of a loss for the three month period of \$2,527. In spite of these modest operating results the Company has managed to generate positive cash flow from operations, increase its equity and capital under management, repay over \$250,000 in debt, and acquire new equipment that will soon add to the Company's revenue potential.

Cash management has been a focal point for the Company for some time now and the most recent quarter was no exception. Although operations have not yet been as fruitful in fiscal 2014 as had been expected management continues to generate positive cash flows from operations and to nurture its relationships with customers and suppliers. The modest amount of \$2,765 generated in the current quarter raises the positive cash flow from operations for the nine month period to \$205,536. These operating cash flows have funded the repayment of more than \$262,000 in interest bearing debt this fiscal year, including \$53,314 that was repaid in the most recent quarter. Efforts will continue to manage cash flow and to utilize available cash resources in the most effective and strategic manner.

Cash management includes ensuring that investment in long-term assets does not tie up current cash resources. The Company negotiated \$200,000 in new financing and promptly ordered a new machine that will increase production capacity and enable the Company to meet new, more complex, demands that are emerging in the marketplace. The new machine is in process of being installed and is expected to be fully operational for the final month of the current fiscal year.

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Corporate Performance - continued

Management continues to manage and minimize business risks and to build value for stakeholders. The following data, prepared in accordance with International Financial Reporting Standards, may provide some additional insights relative to the Company's operating performance and financial position:

	For the fiscal years ended:				
	<u>June 13</u>	<u>June 12</u>	<u>June 11</u>		
Total Revenues	4,601,698	4,572,417	4,010,068		
Net income (loss) income from operations	141,007	390,936	(178,066)		
Per share	0.017	0.055	(0.031)		
Net income (loss) for the year	148,319	392,778	(180,359)		
Per share	0.018	0.056	(0.031)		
Total assets	2,176,189	2,340,853	2,106,570		
Total long-term financial liabilities	45,788	698,648	1,051,125		
Total liabilities	1,759,668	2,416,943	2,575,438		

	For the three month periods ended:				
	<u>Mar. 14</u>	<u>Dec. 13</u>	<u>Sept. 13</u>	<u>June 13</u>	<u>Mar. 13</u>
Total Revenues	933,391	945,951	1,134,250	1,288,374	1,127,445
Net income (loss) from operations	(3,300)	(59,301)	63,070	81,609	21,311
Per share - basic	(0.000)	(0.006)	0.006	0.008	0.003
Net income (loss) for the period	(2,521)	(58,928)	63,858	83,815	22,379
Per share - basic	(0.000)	(0.006)	0.006	0.008	0.003
Total assets	2,190,139	1,859,824	2,102,184	2,176,189	2,228,452
Total long-term financial liabilities	177,893	18,830	32,498	45,788	57,496
Total liabilities	1,709,785	1,381,168	1,614,305	1,759,668	2,036,126

	For the three month periods ended:				
	<u>Dec. 12</u>	<u>Sept. 12</u>	<u>June 12</u>	<u>Mar. 12</u>	<u>Dec. 11</u>
Total Revenues	1,113,223	1,072,656	1,289,855	1,483,588	839,112
Net income (loss) from operations	31,955	6,132	42,073	279,280	(17,116)
Per share - basic	0.004	0.004	0.006	0.040	(0.002)
Net income (loss) for the period	33,336	8,789	44,015	279,280	(17,216)
Per share - basic	0.005	0.004	0.006	0.040	(0.002)
Total assets	2,133,002	2,252,523	2,340,853	2,652,994	2,122,488
Total long-term financial liabilities	66,478	602,565	698,648	785,338	902,553
Total liabilities	2,141,525	2,299,246	2,416,943	2,773,099	2,521,873

There were no cash dividends paid or accrued during any of the periods noted above.

Results of Operations

The Company has reported revenues of \$933,391 and \$3,031,592 for the three and nine month periods ended March 31, 2014. This represents a decline of \$194,054 (17.2%) for the quarter and \$299,732 (9.0%) year-to-date when compared to the periods ended March 31, 2013. Since the start of the 2010 fiscal year short-term revenues have fluctuated having risen in 9 quarters and declined in 10 quarters. On an annual basis however revenues have been on a growth trend having risen in 8 of the past 10 fiscal years including the most recent 4 years. It appears that 2014 revenues will not exceed 2013 levels.

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Results of Operations - continued

The gross margin realized during the third quarter was \$317,806, representing a decline of \$44,224 (12.2%) in comparison to the prior year. Like revenues, the gross margin has now risen in 9 quarters and declined in 10 quarters since the start of the 2010 fiscal year. There is, however, no absolute correlation between revenue and gross margin. In fact, while revenues have grown continuously over the past 4 years, the gross margin has risen twice and declined twice. This is caused by fluctuations in the gross margin percentage due to changes in product mix and other aspects of the cost of product sales.

The cost of product sales for the periods was as follows:

Nine month periods ended March 31	2014	2013	Change
Raw materials and supplies consumed	\$ 1,186,794	\$ 1,464,621	\$ (277,827)
Labour costs incurred	557,487	552,578	4,909
Depreciation	91,660	113,056	(21,396)
Other costs	90,509	86,663	3,846
Net change in finished goods and work in process	17,551	(18,886)	36,437
Total cost of product sales	\$ 1,944,001	\$ 2,198,032	\$ (254,031)

Three month periods ended March 31	2014	2013	Change
Raw materials and supplies consumed	\$ 358,174	\$ 509,292	\$ (151,118)
Labour costs incurred	201,046	189,067	11,979
Depreciation	30,554	38,063	(7,509)
Other costs	34,182	35,640	(1,458)
Net change in finished goods and work in process	(8,248)	(6,647)	(1,601)
Total cost of product sales	\$ 615,708	\$ 765,415	\$ (149,707)

For the three month and nine month periods ended March 31, 2014 the decline in the raw materials and supplies consumed exceeds the total decline in cost of product sales. Furthermore, the decline of 29.6% in the quarter and 18.9% on a year-to-date basis both exceed the declines in revenues for the corresponding periods. This means that a greater proportion of revenues for each of these periods were derived from product assembly. Material costs for the quarter equated to 36.1% of revenues as opposed to 45.2% in Q3 2013 while for the nine month period they were equivalent to 38.7% of revenues as compared to 44.2% at March 31, 2013. This is the fourth consecutive quarter in which this cost is lower as a percentage of sales than it was for the same period one year earlier however that follows a period in which it rose in 10 out of 11 quarters, including the last 6 in a row. A much larger proportion of customers currently opt for the turnkey option, in which the Company provides all components and supplies, so the Company expects these declines to soon cease.

Labour costs incurred is a measure of labour utilized during the period, which is managed based upon the demand for assembly work. Assembly demand in the current quarter was higher as implied by the proportionate decline in component costs. This higher demand, which also resulted in the incurrence of some overtime charges, plus an annual wage increase each contributed to costs being 6% higher when compared to the quarter ended March 31, 2013. The annual wage increase averaged 2.4% and took effect January 1, 2014. Enhanced labour efficiency, and utilization of inventory, kept the quarterly increase from being greater and are also why year-to-date costs are only marginally higher than 2013 levels. Labour costs related to products sold in the period is determined by combining the labour costs incurred with the net change in finished goods and work in process, which is a measure of the change in labour costs included in inventory. On a combined basis the labour costs for the current quarter are 6% higher than 2013 levels while costs for the current nine month period are 8% higher. Labour costs will continue to be managed based upon the demand for assembly services.

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Results of Operations - continued

Depreciation costs are calculated as a percentage of the carrying value of equipment and have been declining in recent periods. Depreciation costs are expected to rise when the new equipment is placed into active use during the fourth quarter.

Other costs include repairs and maintenance, stencils and tooling, packaging, and freight costs net of amounts recovered. Each of these costs is incurred on an as-needed basis without any specific correlation with revenues. Each of these costs is closely monitored and is within management expectations so they will not be further elaborated upon.

Selling, general and administrative expenses for the periods were as follows:

Nine month periods ended March 31	2014	2013	Change
Employee and consultant compensation	\$ 641,951	\$ 581,998	\$ 59,953
Occupancy costs	200,692	194,376	6,316
Professional fees	61,108	54,599	6,509
Shareholder services	22,997	29,684	(6,687)
Insurance	24,950	16,861	8,089
Other costs	37,087	38,277	(1,190)
Total selling, general and administrative	\$ 988,785	\$ 915,795	\$ 72,990

Three month periods ended March 31	2014	2013	Change
Employee and consultant compensation	\$ 191,199	\$ 182,854	\$ 8,345
Occupancy costs	67,964	61,458	6,506
Professional fees	25,534	22,233	3,301
Shareholder services	9,826	8,346	1,480
Insurance	8,630	6,270	2,360
Other costs	10,515	9,375	1,140
Total selling, general and administrative	\$ 313,668	\$ 290,536	\$ 23,132

Compensation costs were higher during the periods ended March 31, 2014 as a result of increased consulting services and increased directors' fees. Consulting fees for the quarter were \$5,675 higher as a result of increased services provided by the Company's CFO while directors' fees were \$2,250 higher as a result of increased compensation rates and the fact that there were 3 independent directors during the 2014 period. The increase for the nine month period ended March 31, 2014 includes the amounts described above plus \$44,000 in charges incurred earlier in the year when the Company retained the services of two consultants to advise upon and assist with potential new business prospects.

Occupancy costs consist primarily of rent and utility charges for the Company's operating facility. Rent charges have remained comparable for the three and nine month periods however utility costs have increased reflecting the higher usage arising from colder temperatures and higher rates.

Professional fees are comprised of the cost of legal services as well as the cost of the annual financial statement audit. Audit costs have remained consistent from period to period. Legal costs were higher in the recent quarter due to involvement with the new related party financing and other prospective business matters. Year-to-date expenses also include the legal costs arising from the general shareholders meeting held December 2013.

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Results of Operations - continued

Shareholder services include the cost of public disclosures, distribution of materials to shareholders, stock exchange fees, and transfer agent fees. The Company incurred higher regulatory fees in the recent quarter as a result of the new related party financing and other prospective business matters. The costs for the nine month period include the costs related to the general shareholders meeting held December 2013 however the costs for the meeting held September 2012 were significantly higher. New rules permitted the electronic distribution of many documents in December 2013 while physical copies had to be sent by mail in 2012.

Insurance costs have risen in the 2014 year as a result of the introduction of a new liability policy.

The remaining elements of SG&A are individually insignificant and, in aggregate, represent less than 5% of total SG&A for the periods presented. These expenses are closely monitored by management and do not warrant detailed investigation or elaboration.

The Company's financing costs for the periods were as follows:

Nine month periods ended March 31	2014	2013	Change
Interest expense ó long term (cash based)	\$ 15,594	\$ 54,642	\$ (39,048)
Interest expense ó long term (accretion)	8,437	16,556	(8,119)
Interest expense ó other	3,117	447	2,670
Loan guarantee fees	-	7,200	(7,200)
Total financing expenses	\$ 27,148	\$ 78,845	\$ (51,697)
Three month periods ended March 31	2014	2013	Change
Interest expense ó long term (cash based)	\$ 5,803	\$ 16,180	\$ (10,377)
Interest expense ó long term (accretion)	660	3,888	(3,228)
Interest expense ó other	2,335	150	2,185
Loan guarantee fees	-	2,400	(2,400)
Total financing expenses	\$ 8,798	\$ 22,618	\$ (13,820)

As at March 31, 2014 the Company has reported long-term debt of \$293,233 including \$196,137 in new debt which originated in January 2014. In comparison total long-term debt at March 31, 2013 was \$711,936. The Company had been aggressively pursuing the repayment of its long-term debt and had reduced the March 2013 balance by \$260,097 by June 2013 and by a further \$345,760 by December 2013. This significant decline in the amount of long-term debt gave rise to the reductions in cash based interest and interest accretion noted above.

Interest expense ó other includes interest on a note payable, on the bank operating loan, and miscellaneous interest charges. The note payable arose in December 2013 as a means of settling the final portion of a long-term debt so there were no comparable interest costs that arose prior to this date. The Company also drew upon its bank operating line in March 2014 giving rise to additional new interest charges. The note payable is being repaid in monthly payments with a maturity scheduled for October 2014 so interest charges will continue to arise. The Company may also utilize its operating loan facility when it considers it prudent to do so and this too, if done, will give rise to future interest costs.

Until May 2013 the bank operating loan was secured, in part, by a guarantee provided by a third party for which that party was entitled to a guarantee fee of \$800 per month. In May 2013 the Company replaced that guarantee with its own term deposit pledged as security thereby eliminating the guarantee fees.

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Liquidity

As at March 31, 2014 the Company reported a working capital deficiency of \$96,378 representing an improvement of \$99,686 for the nine month period, virtually unchanged for the quarter, and an improvement of \$351,115 in comparison to March 31, 2013. The deficiency includes \$776,792 in current liabilities that have been outstanding since June 2007, are not secured, bear no interest or other charges, and for which there are no immediate plans for settlement. Management does not consider the working capital deficiency to be a significant source of business risk and will continue to focus on maximizing cash flows from operations as opposed to managing this deficiency.

The Company utilizes long term debt as a means of financing new equipment acquisitions and of settling other obligations whenever suitable terms can be negotiated. The Company obtained new long-term financing of \$200,000 from related parties to finance a new equipment purchase. The Company has taken delivery of new machinery, at a cost of \$187,742, which is not yet operational. Additional costs of approximately \$10,000 are expected to be incurred in making this machine operational near the end of this month.

A debenture that matured December 2013 required a final payment at maturity which was settled through a combination of cash and a note which is being repaid over a ten month period ending October 2014. The Company's working capital financing requirements are currently being met through the bank operating line.

In addition to satisfying the cost of operations the Company must also address the payment or other settlement of the following amounts as at March 31, 2014:

	Due by <u>Mar. 2015</u>	Due by <u>Mar. 2017</u>	Due by <u>Mar. 2019</u>	Due after <u>Mar. 2019</u>	Total <u>Due</u>
Note payable	\$ 100,698	\$ -	\$ -	\$ -	\$ 100,698
Long-term debt ^(1,2)	78,610	136,995	43,213	-	258,818
Operating leases	<u>90,314</u>	<u>194,435</u>	<u>208,694</u>	<u>215,486</u>	<u>708,929</u>
Actively serviced obligations	<u>269,622</u>	<u>331,430</u>	<u>251,907</u>	<u>215,486</u>	<u>1,068,445</u>
Repurchase of preferred shares ^(3,4)	665,501	-	-	-	665,501
Settlement of dividends payable ⁽⁵⁾	263,337	-	-	-	263,337
Debenture ⁽⁶⁾	<u>39,600</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>39,600</u>
Past-due obligations	<u>968,438</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>968,438</u>
All obligations	<u>\$ 1,238,060</u>	<u>\$ 331,430</u>	<u>\$ 251,907</u>	<u>\$ 215,486</u>	<u>\$ 2,036,883</u>

(1) Amount excludes a debenture which was past due per ⁽⁶⁾ below.

(2) Long-term debt has a carrying value lower than its face value. The unaudited condensed interim consolidated financial statements as at March 31, 2014 report these obligations based upon its carrying value while the figures reported above represent the non-discounted cash payments to be made.

(3) The repurchase price includes \$473,855 reported as a current liability plus paid up capital of \$191,646 that is included in share capital.

(4) Obligation came due May 2004 as to \$160,000 and May 2007 as to \$505,501. No settlement terms have been established.

(5) Obligation arose at various dates up to May 2007. No settlement terms have been established.

(6) Obligation matured December 2005. No settlement terms have been established.

Capital Resources

The Company has a \$250,000 line of credit with its financial institution of which \$15,000 had been drawn as at March 31, 2014. The loan bears interest at the TD Bank prime lending rate plus 0.5%, is due upon demand, and is secured by a \$250,000 term deposit and a general security agreement covering the assets of PEC. The term deposit bears interest at 1.25% and matured April 19, 2014 at which time the principal was reinvested at 1.25% until July 19, 2014.

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Capital Resources - continued

During the period, the Company made payments aggregating \$187,745 and took delivery of equipment. Installation of this equipment will cost approximately \$10,000 and should be completed, with the machine fully operational, around the end of May. This acquisition was funded by \$200,000 in new debt from related parties which is unsecured, bears interest at 9%, is payable as to interest only until October 2014, and is then repayable over three years. The lenders also received 400,000 share purchase warrants each of which entitle them to acquire a common share at a price of \$0.10 until October 31, 2017.

Related Party Transactions

The Company has a long-term debt, with a face value of \$58,818 and a carrying value of \$57,496, which is payable to 1114377 Ontario Inc., a company which is controlled by the spouse of Mr. W. Drzazga, the CEO and a Director of the Company. At its inception the loan provided the Company with cash for working capital purposes. The interest rate charged on the loan is consistent with the rates that were being charged to the Company by non-related parties for similar debts as at the date the loan originated.

The Company two long-term debts, with aggregate face value of \$200,000 and aggregate carrying value of \$196,137, that are payable to 1114377 Ontario Inc. and Michael D. Kindy, the Company's CFO. The proceeds of these loans were used to fund the acquisition and installation of equipment.

The following balances are due to related parties as at March 31 of each year:

	<u>2014</u>	<u>2013</u>
Loan payable to 1114377 Ontario Inc. at prime +8% ⁽¹⁾	\$ 58,818	\$ 93,767
Loan payable to 1114377 Ontario Inc. at 9% ⁽²⁾	\$ 150,000	\$ -
Loan payable to Michael D. Kindy at 9% ⁽³⁾	\$ 50,000	\$ -
Salaries and benefits payable ⁽⁴⁾	\$ 1,065	\$ 1,811
Consulting fees payable ⁽⁴⁾	\$ 36,200	\$ 36,875
Legal fees payable ⁽⁴⁾	\$ 10,695	\$ 14,099

⁽¹⁾ This is the face value of this obligation. It is reported in the unaudited condensed interim consolidated financial statements at the discounted value of \$57,496. As additional compensation for having advanced these funds the creditor was granted an option that gives it the right to acquire a 24% interest in Permatest Electronics Corporation for \$200,000 on or before May 1, 2015.

⁽²⁾ This is the face value of this obligation. It is reported in the unaudited condensed interim consolidated financial statements at the discounted value of \$147,103. The creditor was granted 300,000 warrants as additional compensation for having advanced these funds. Each warrant has an exercise price of \$0.10 and an expiry date of October 31, 2017.

⁽³⁾ This is the face value of this obligation. It is reported in the unaudited condensed interim consolidated financial statements at the discounted value of \$49,034. The creditor was granted 100,000 warrants as additional compensation for having advanced these funds. Each warrant has an exercise price of \$0.10 and an expiry date of October 31, 2017.

⁽⁴⁾ Reported in the unaudited condensed interim consolidated financial statements as an element of accounts payable and accrued liabilities.

The Company compensates its key management personnel for services rendered. These include salaries and benefits paid to Wojciech Drzazga (CEO) and John Perreault (President), consulting fees paid to Michael D. Kindy (CFO), legal fees and stock issuance fees paid to a legal firm in which William R. Johnstone (Corporate Secretary) is a partner, Directors' fees, and share-based payments. The Compensation rates are agreed to by the key management personnel and are predicated upon prevailing market rates.

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Related Party Transactions - continued

The following expenses have arisen as a result of transactions involving the related parties defined above:

	<u>2014</u>	<u>2013</u>
Salaries and benefits ⁽¹⁾	\$ 186,582	\$ 186,052
Consulting fees ⁽¹⁾	31,838	27,248
Directors' fees ⁽¹⁾	27,450	20,700
Legal fees ⁽²⁾	34,143	29,759
Stock issuance fees ⁽³⁾	-	6,000
Interest expense ó long term	<u>11,418</u>	<u>9,490</u>
Cash based expenditures	<u>\$ 291,431</u>	<u>\$ 279,249</u>
Share-based payments	<u>\$ 49,705</u>	<u>\$ 20,578</u>

⁽¹⁾ Reported in the unaudited condensed interim consolidated financial statements as an element of employee and consultant compensation.

⁽²⁾ Reported in the unaudited condensed interim consolidated financial statements as an element of professional fees.

⁽³⁾ Reported in the unaudited condensed interim consolidated financial statements as an element of share capital.

The following stock options have been issued to Directors and/or Officers of the Company and were outstanding as at March 31, 2014:

<u>Description</u>	<u>Expiry Date</u>	<u>Number of Common shares</u>
Stock options @ \$0.10 per share ⁽¹⁾	Nov. 2015	250,000
Stock options @ \$0.10 per share ⁽²⁾	Sept. 2017	155,000
Stock options @ \$0.15 per share ⁽³⁾	Mar. 2018	200,000
Stock options @ \$0.10 per share ⁽³⁾	Dec. 2018	600,000

⁽¹⁾ 50,000 options were exercised during the period leaving the above noted balance outstanding.

⁽²⁾ 25,000 options were exercised during the period leaving the above noted balance outstanding.

⁽³⁾ As a consequence of the death of Mr. Arn Schoch in April 2014, 200,000 options with an initial expiry date of Mar. 2018 and 100,000 options with an expiry date of Dec. 2018 will now expire April 2015.

Convertible Instruments and Other Securities

The Company has the following securities issued and outstanding:

<u>Share capital</u>	<u>Quantity</u>	<u>Amount</u>
Common shares, June 30, 2013	10,573,696	\$ 22,330,215
Stock options exercised	75,000	7,500
Plus: value previously attributed to options	<u> </u>	<u>5,338</u>
Common shares, Mar. 31, 2014 and as at the date of this document	<u>10,648,696</u>	<u>\$ 22,343,053</u>
 <u>Preferred shares</u>	 <u>Quantity</u>	 <u>Amount</u>
Series A preferred shares	166,667	\$ 160,000
Series C preferred shares	288,858	<u>505,501</u>
		665,501
Less: amount accounted for as paid in capital		<u>(191,646)</u>
Liability element of preferred shares at Mar. 31, 2014 and as at the date of this document		<u>\$ 473,855</u>

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Convertible Instruments and Other Securities - continued

In addition to the shares issued and outstanding the Company has issued share purchase warrants and stock options as incentives to various parties. The following list itemizes the common shares that have been reserved to satisfy the conversions and exercise of warrants and options along with the expiry date associated therewith.

<u>Shares reserved</u>	<u>Expiry Date</u>	<u>Number of Common shares</u>
Common shares to be issued for Class A shares		8,246
Stock options @ \$0.10 per share	Nov. 2015	250,000
Warrants @ \$0.10 per share	Feb. 2016	1,100,000
Warrants @ \$0.10 per share	Mar. 2016	900,000
Stock options @ \$0.10 per share	Sept. 2017	155,000
Warrants @ \$0.10 per share	Oct. 2017	400,000
Stock options @ \$0.15 per share	Mar. 2018	200,000
Stock options @ \$0.10 per share	Mar. 2018	<u>600,000</u>
Shares reserved as at Mar. 31, 2014 and as at the date of this document		<u>3,613,246</u>
 <u>Fully diluted position</u>		
Shares issued		10,648,696
Shares reserved		<u>3,613,246</u>
Fully diluted position as at Mar. 31, 2014 and as at the date of this document		<u>14,261,942</u>

Additional disclosures relative to stock options are as follows:

	<u>Common Shares Under Option</u>	<u>Number of Options Vested</u>	<u>Exercise Price/Option</u>	<u>Expiry Date</u>
Granted March 11, 2013	200,000 ⁽²⁾	200,000	\$ 0.15	Apr. 11, 2015
Granted Dec. 31, 2013	100,000 ⁽²⁾	100,000	\$ 0.10	Apr. 31, 2015
Granted Nov. 30, 2010	275,000 ⁽¹⁾	275,000	\$ 0.10	Nov. 30, 2015
Granted Sept. 14, 2012	130,000 ⁽¹⁾	130,000	\$ 0.10	Sept. 14, 2017
Granted Dec. 31, 2013	500,000 ⁽¹⁾	500,000	\$ 0.10	Dec. 31, 2018

The Company has no ability to cause these options to be exercised.

	<u>Common Shares Under Option</u>	<u>Weighted Average Price/Option</u>	<u>Weighted Average Expiry Date</u>
Balance, June 30, 2013	680,000	\$ 0.115	Jan. 20, 2017
Exercised during the period	(75,000)	\$ 0.100	Feb. 8, 2017
Granted during the period	<u>600,000</u>	\$ 0.100	Dec. 31, 2018
Balance, Mar. 31, 2014	1,205,000	\$ 0.108	Jan. 7, 2018
Amended after March 31, 2014 ⁽²⁾	(300,000)	\$ 0.132	Jun. 17, 2018
Amended after March 31, 2014 ⁽²⁾	<u>300,000</u>	\$ 0.132	Apr 27, 2015
Balance as at the date of this document	<u>1,205,000</u>	\$ 0.108	Mar. 28, 2017

⁽¹⁾ Stock options held by Directors and Officers of the Company.

⁽²⁾ Stock options held by a former Director of the Company. The expiry date of these options was revised, in accordance with the option agreement, to be one year subsequent to the date of death.

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Convertible Instruments and Other Securities - continued

Additional disclosures relative to share purchase warrants are as follows:

	Number of <u>Warrants</u>	Value of <u>Warrants</u>	Exercise Price per <u>Warrant</u>	<u>Expiry Date</u>
Issued Mar. 24, 2011	900,000	\$ 38,818	\$ 0.10	Mar. 24, 2016
Issued Feb. 4, 2013	1,100,000	37,859	\$ 0.10	Feb. 4, 2016
Issued Jan. 10, 2014	<u>400,000</u>	<u>4,219</u>	\$ 0.10	Oct. 31, 2017
	<u>2,400,000</u>	<u>\$ 80,896</u>		

	Number Of <u>Warrants</u>	Weighted Average Price <u>Per Warrant</u>	Weighted Average <u>Expiry Date</u>
Balance, June 30, 2013	2,000,000	\$ 0.100	Feb. 26, 2016
Issued during the period	<u>400,000</u>	\$ 0.100	Oct. 31, 2017
Balance, Mar. 31, 2014 and as at the date of this document	<u>2,400,000</u>	\$ 0.100	Jun. 7, 2016

Changes in Accounting Policy

The accounting policies followed by the Company are established in accordance with International Financial Reporting Standards (IFRS) and once policies are established they will not, as a matter of policy, be revised unless IFRS changes. The following changes to IFRS were adopted July 1, 2013 without impact upon the amounts or disclosures presented in the March 31, 2014 unaudited condensed interim consolidated financial statements.

IFRS 10, *Consolidated Financial Statements*, replaces the consolidation guidance in IAS 27, *Consolidated and Separate Financial Statements*, and SIC-12, *Consolidation — Special Purpose Entities*, by introducing a single consolidation model for all entities based on control, irrespective of the nature of the investee.

IFRS 13, *Fair Value Measurement*, replaces the guidance on fair value measurement in existing IFRS accounting literature with a single standard. It defines and provides guidance on determining fair value and requires disclosures about fair value measurements, but does not change the requirements regarding which items are measured or disclosed at fair value.

IAS 28, *Investments in Associates and Joint Ventures*, amended in 2011, effective for annual periods beginning on or after January 1, 2013 prescribes the accounting for investments in associates and establishes the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

Accounting Standards Effective For Future Periods

IFRS 9, *Financial Instruments: Classification and Measurement*, issued in December 2009, effective for annual periods beginning on or after January 1, 2015, with early adoption permitted, introduces new requirements for the classification and measurement of financial instruments. Management anticipates that this standard will be adopted in the Company's financial statements for the year beginning July 1, 2015 and has not yet considered the potential impact of its adoption.

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Financial Instruments

The Company's financial instruments are comprised of the following:

Financial assets:

Cash and cash equivalents
Restricted cash
Accounts receivable

Classification

Fair value through profit and loss
Loans and receivables
Loans and receivables

Financial liabilities:

Customer deposits
Accounts payable and accrued liabilities
Dividends payable
Preferred shares
Long-term debt

Classification

Other financial liabilities
Other financial liabilities
Other financial liabilities
Other financial liabilities
Other financial liabilities

Fair value through profit and loss:

Financial assets are designated as fair value through profit and loss if they were acquired principally for the purpose of selling in the short term. Fair value through profit and loss assets are recognized and carried at their fair value.

Loans and receivables:

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Other financial liabilities:

Other financial liabilities are recognized initially at fair value net of any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial instrument and of allocating interest and any transaction costs over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial instrument to the net carrying amount on initial recognition. Other financial liabilities are de-recognized when the obligations are discharged, cancelled or expired.

Impairment of financial assets:

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the assets have been negatively impacted.

Evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

The carrying amount of financial assets is reduced by any impairment loss directly for all financial assets with the exception of accounts receivable, where the carrying amount is reduced through the use of an allowance account. When an account receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in income for the period.

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Financial Instruments - continued

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through income for the period to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

Financial instruments recorded at fair value:

Financial instruments recorded at fair value on the consolidated statement of financial position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- Level 3 valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

As of June 30, 2013 and 2012 cash and cash equivalents and restricted cash are measured at fair value and are classified within Level 1 of the fair value hierarchy.

Financial instruments recorded at amortized cost:

Financial instruments recorded at amortized cost on the consolidated statement of financial position are amortized using the market rates of interest prevailing at the inception of the financial instrument applied to expected future cash flows. The amortized cost is recomputed in the event that the underlying terms, and therefore the expected future cash flows, of the financial instrument are altered with any change in the amortized cost being charged to income of the period. Dividends payable and preferred shares are each carried at historical cost as the future cash flows cannot be reasonably estimated.

Impairment of non-financial assets

At the end of each reporting period, the Company reviews the carrying amounts of its non-financial assets with finite lives to determine whether there is any indication that those assets have suffered an impairment loss. Where such an indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss is recognized in the income for the period.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in income for the period.

The Company has assessed the assets of all its operating entities and has determined that there is no impairment of its non-financial assets.

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Risk Factors

Events seemingly unrelated to the Company, 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 hamper the Company's ability to access credit when needed or rapid changes in foreign exchange rates may adversely affect its financial results. Finally, a reduction in credit, combined with reduced economic activity, may adversely affect businesses and industries that constitute a significant portion of the Company's customer base. As a result, these customers may need to reduce their purchases, or the Company may experience greater difficulty in collecting amounts due from them. Any of these events, or others caused by uncertainty in world financial markets, may have a material adverse effect on the Company's business, operating results, and financial condition.

In addition to the foregoing, the Company is exposed to credit risk, concentration of credit risk, liquidity risk, and currency risk. The Company's primary risk management objective is to protect earnings and cash flow and, ultimately, shareholder value. Risk management strategies, as discussed below, are designed and implemented to ensure that the Company's risks and the related exposure are consistent with its business objectives and risk tolerance. There have been no changes to the risk management strategies during the current year.

Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company's primary exposure to credit risk is in its accounts receivable. In an effort to mitigate this risk, management actively manages and monitors its receivables and obtains pre-payments where warranted. Bad debt experience has not been significant and it has been determined that no allowance is required as all amounts outstanding are considered collectible.

Concentration of credit risk

Concentration of credit risk arises when a significant portion of the financial assets subject to credit risk arise from a single or limited number of sources. During the current period, one of the Company's customers accounted for more than 20% (27%) of total revenue (2013 ó 1 at 37%). Amounts due from this customer accounted for 2% of the Company's accounts receivable at March 31, 2014 (June 30, 2013 - 24%). The loss of this customer or significant curtailment of purchases by this customer could have a material adverse effect on the Company's results of operations and financial condition. The Company monitors the relationship with this customer closely and ensures that every customer is subject to the same risk management criteria.

Liquidity risk

Liquidity risk arises through the excess of financial obligations over available financial assets due at any point in time. The Company has financial assets of \$807,326 available to settle current financial liabilities of \$1,531,892. Current financial liabilities include a long-term debt instrument, preferred shares and dividends payable, with an aggregate carrying amount of \$776,792 (June 2013 - \$776,792), which are past due and for which the timing of future cash flows are undetermined. The Company manages its liquidity risk through the management of its capital which incorporates the continuous monitoring of actual and projected cash flows to ensure that it has sufficient liquidity to meet its operating commitments without incurring unacceptable losses or risking damage to the Company's reputation.

Market risks

The Company is exposed to currency risk related to accounts receivable and accounts payable denominated in US dollars and the potential for future cash flows to fluctuate because of changes in foreign exchange rates. Currency risk is closely monitored but not actively managed. During the period the Company incurred a loss on foreign exchange in the amount of \$826 (Mar. 2013 ó \$2,897).

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Risk Factors - continued

Sensitivity to market risks

At March 31, 2014 the Company had US\$46,253 (2012 óUS\$214,010) included in accounts receivable. A 5% increase in the value of the Canadian dollar relative to the US dollar would result in a reduction of \$2,588 in future cash inflow.

At March 31, 2014 the Company had US\$177,223 (2012 ó US\$105,654) included in accounts payable. A 5% decrease in the value of the Canadian dollar relative to the US dollar would result in an increase of \$9,870 in future cash outflow.

The existence of both accounts receivable and accounts payable denominated in US\$ does not serve as a hedge with respect to currency risk.

Based upon observations of recent market trends management believes that each of these outcomes is possible but most likely exceed the Company's immediate market risk exposures.

Forward-looking Information

Certain statements in this MD&A may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company and its subsidiary, or the industry in which they operate, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this report, the words "estimate", "believe", "anticipate", "intend", "expect", "plan", "may", "should", "will", the negative thereof or other variations thereon or comparable terminology are intended to identify forward-looking statements. Such forward-looking statements reflect the current expectations of the management of the Company with respect to future events based on currently available information and are subject to risks and uncertainties that could cause actual results, performance or achievements to differ materially from those expressed or implied by those forward-looking statements, such as reduced funding, long sales cycles, currency and interest rate fluctuations, increased competition and general economic and market factors and including the risk factors summarized below under the heading "Risk Factors". New risk factors may arise from time to time and it is not possible for management of the Company to predict all of those risk factors or the extent to which any factor or combination of factors may cause actual results, performance or achievements of the Company to be materially different from those expressed or implied in such forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. Although the forward-looking statements contained in this MD&A are based upon what management believes to be reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward-looking statements. The forward-looking statements contained in this MD&A speak only as of the date hereof. The Company does not undertake or assume any obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, except as required by law.