

ZTEST Electronics Inc.

Management's Discussion and Analysis

For The Year Ended June 30, 2014

(Prepared as at October 28, 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 consolidated financial and operating performance for the year ended June 30, 2014. The MD&A was prepared as of October 28, 2014 and was approved by the Board of Directors on October 28, 2014. It should be read in conjunction with the consolidated financial statements of the Company for the year ended June 30, 2014, 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

Mr. Arn Schoch was a Director of the Company until his death on April 27, 2014. The Board opted to not fill the vacancy that was created.

Corporate Performance

The 2014 fiscal year provided some positive results, as liquidity, total equity, total liabilities and net capital under management all improved. Not everything was positive however as profitability and cash flows from operations each declined.

In recent years the Company has placed a heavy emphasis on cash management and on the strategic utilization of available cash resources to reduce business risks. This has been accomplished through maximizing collections from customers, maintaining good credit relationships with suppliers, pledging cash security in support of bank financing, and the reduction and elimination of debt.

Everything begins with strong cash flows from operations and even though the 2014 cash flows from operations were not as strong as they were in 2013 they were still quite significant at \$271,859. The Company's exceptional collection record continued throughout 2014 with the realization of only \$3,169 in bad debts for the year and ending the year with no accounts receivable more than 60 days old and the expectation of 100% collection. The Company also continued its excellent working relationship with suppliers by fully utilizing but not exceeding their credit terms. Accounts payable did increase by \$29,085 during 2014 however this is primarily due to an increase of \$24,110 in amounts due to related parties, the majority of which was accrued and not yet invoiced to the Company at June 30, 2014.

Another aspect of cash management is determining the timing and extent to which a Company will invest cash resources into its future and determining the best source for that cash. The marketplace in which the Company operates is not only becoming more price sensitive but is also demanding more complex assemblies which include more, and often smaller, componentry. To efficiently satisfy and stay ahead of this market demand additional equipment was required, which in turn meant new financing was required. Initial efforts to obtain commercial financing were unsuccessful but related party financing in the amount of \$200,000 was negotiated and funded equipment purchases for the year in the amount of \$196,414.

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The other aspect of cash management is managing the cash requirements associated with debt repayment in both the near and longer terms. Just prior to the end of the 2013 fiscal year the Company pledged a \$250,000 term deposit as additional security for its bank operating loan which allowed the cessation of an \$800 per month guarantee fee and a reduction in the effective interest rate on amounts borrowed from 10% to 3.5%. In July 2014 the term deposit was released from the pledge making \$250,000 available for cash management purposes. Although the recent release of this security did cause the interest rate on amounts borrowed to increase from 3.5% to 5.5% it also optimized the structure for appropriate working capital financing while simultaneously maximizing the amount of cash available for use.

Although the Company did not have access to the \$250,000 pledged term deposit throughout 2014 it was still able to repay \$374,836 in long term debt, including the retirement of two debentures. This repayment will not only avoid future interest charges but also served to reduce monthly debt payments from \$20,748 as required July 2013 to only \$6,420 required for July 2014, including the monthly interest payments that were required on the related party debt of \$200,000. Simultaneous with the release of the pledged term deposit the Company was also successful in finalizing the terms of new commercial financing to replace the \$200,000 in related party debt. This commercial debt provides an interest rate that is 4.25% lower than the related party debt and is repayable over 5 years while the related party debt was to be repaid over 3 years.

With the July 2014 improvements to working capital and long-term financing the Company now believes that it has achieved an appropriate financing structure that has significantly diminished the borrowing costs as well as the pressure on monthly cash flows. Efforts will continue to be made to maximize profitability and the resulting cash flows from operations and to utilize available cash resources strategically to minimize business risks and to maximize the value derived for its 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 14</u>	<u>June 13</u>	<u>June 12</u>		
Total Revenues	4,014,268	4,601,698	4,572,417		
Net income (loss) income from operations	(21,321)	141,007	390,936		
Per share - basic	(0.002)	0.017	0.055		
Net income (loss) for the year	(18,579)	148,319	392,778		
Per share - basic	(0.002)	0.018	0.056		
Total assets	2,098,100	2,176,189	2,340,853		
Total long-term financial liabilities	158,244	45,788	698,648		
Total liabilities	1,638,734	1,759,668	2,416,943		
	For the three month periods ended:				
	<u>June 14</u>	<u>Mar. 14</u>	<u>Dec. 13</u>	<u>Sept. 13</u>	<u>June 13</u>
Total Revenues	1,000,676	933,391	945,951	1,134,250	1,288,374
Net income (loss) from operations	(21,790)	(3,300)	(59,301)	63,070	81,609
Per share - basic	(0.002)	(0.000)	(0.006)	0.006	0.008
Net income (loss) for the period	(20,988)	(2,521)	(58,928)	63,858	83,815
Per share - basic	(0.002)	(0.000)	(0.006)	0.006	0.008
Total assets	2,098,100	2,190,139	1,859,824	2,102,184	2,176,189
Total long-term financial liabilities	158,244	177,893	18,830	32,498	45,788
Total liabilities	1,638,734	1,709,785	1,381,168	1,614,305	1,759,668

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

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Corporate Performance - continued

	For the three month periods ended:				
	<u>Mar. 13</u>	<u>Dec. 12</u>	<u>Sept. 12</u>	<u>June 12</u>	<u>Mar. 12</u>
Total Revenues	1,127,445	1,113,223	1,072,656	1,289,855	1,483,588
Net income (loss) from operations	21,311	31,955	6,132	42,073	279,280
Per share - basic	0.003	0.004	0.004	0.006	0.040
Net income (loss) for the period	22,379	33,336	8,789	44,015	279,280
Per share - basic	0.003	0.005	0.004	0.006	0.040
Total assets	2,228,452	2,133,002	2,252,523	2,340,853	2,652,994
Total long-term financial liabilities	57,496	66,478	602,565	698,648	785,338
Total liabilities	2,036,126	2,141,525	2,299,246	2,416,943	2,773,099

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

Results of Operations

After having essentially broken even for the first nine months, the Company has reported a net loss from operations of \$21,321 and a net loss of \$18,579 for the 2014 fiscal year. Losses were reported in each of the last three fiscal quarters and these are the first quarterly and annual losses reported since the periods ended June 30, 2011. There are many factors that contribute to the Company's operating results and the highlights are discussed below.

Product sales for the final quarter of 2014 were \$1,000,676 raising the annual total to \$4,014,268. Although these sales figures are each lower than 2013 levels management contends that assembly volumes rose marginally while the majority of the declines are attributed to reduced materials sales associated with turnkey work. The other factor contributing to 2014 sales figures is a slight increase in market sensitivity to product pricing. Materials sales are not only dependent upon the volume of materials being sold but also on the underlying value of the individual materials being sold. While the Company may make suggestions with respect to materials specifications the product design, including the individual components to be used in product assembly, are entirely at the customer's discretion.

Gross margins rose from 33.91% of revenues in 2013 to 34.15% of revenues in 2014 however this higher percentage, applied to lower revenues, still translated into a decline of almost \$190,000 for the year. The 2014 gross margin percentage was not enhanced in the final quarter when the margins were 30.12% of sales. The gross margin percentages, when considered over short periods of time, can be favourably or adversely affected by temporary cost avoidance or increases. This was certainly the case in the final quarter of 2014 as the receipt and installation of new equipment contributed to higher depreciation and maintenance costs for the period, each of which is an element of the cost of product sales.

The different elements of cost of product sales, and the changes realized, are as follows:

Years ended	June 14	June 13	Change
Raw materials and supplies consumed	\$ 1,588,919	\$ 2,044,591	\$ (455,672)
Labour costs incurred	761,263	753,901	7,362
Depreciation	141,355	151,033	(9,678)
Other costs	138,285	125,700	12,585
Net change in finished goods and work in process	13,462	(33,878)	47,340
Total cost of product sales	\$ 2,643,284	\$ 3,041,347	\$ (398,063)

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Results of Operations - continued

Three month periods ended	June 14	June 13	Change
Raw materials and supplies consumed	\$ 402,125	\$ 579,970	\$ (177,845)
Labour costs incurred	203,776	201,323	2,453
Depreciation	49,695	37,977	11,718
Other costs	47,776	39,037	8,739
Net change in finished goods and work in process	(4,089)	(14,992)	10,903
Total cost of product sales	\$ 699,283	\$ 843,315	\$ (144,032)

As previously alluded to, the cost of raw materials and supplies consumed is down fairly substantially in 2014. The annual figure is down 22.3% and the final quarter is 34.6% lower than 2013 levels. The current year result is in contrast to 2013 and 2012 when the Company reported annual increases of 16% and 47% respectively. The Company experienced a significant surge in demand for turnkey services in the third quarter of its 2012 fiscal year. Prior to that time the cost of materials was consistently less than 50% of total cost of product sales, often significantly less. Even with the costs being lower in each of the six most recent quarters than they were in comparable period one year earlier they are still consistently more than 50% of costs of goods sold. The 2014 annual total represents 56.8% of the total cost of products sold and is still almost 46% higher than 2011 or pre-surge levels. The Company actively promotes turnkey assembly, which incorporates the procurement of components and supplies, as a cost-effective option for its customers and anticipates that material costs will continue to be a significant element of its cost of product sales going forward.

Labour costs, or the amounts expended upon labour, have remained very comparable throughout 2014 with the fourth quarter reflecting an increase of 1.2% in comparison to 2013 levels while the annual increase was marginally less than 1%. These results are consistent with expectations as the Company operated in each period with very comparable number of personnel.

The net change in finished goods and work in process is essentially a measurement of the change in labour costs that are included as an element of inventory. The amount of labour costs attributable to the products sold therefore is determined by adding this inventory change to the labour costs for the period. This indicates that aggregate labour charges were higher for the year and period ended June 30, 2014 than they were during the comparable periods in 2013. These higher costs are reflective of increased demand for labour during the 2014 fiscal year.

Depreciation costs are calculated as a percentage of the carrying value of equipment. Annual depreciation costs for 2014 are lower than they were in 2013 which is reflective of the fact that there had been no major equipment additions in recent years, at least until the fourth quarter. Throughout the 2014 fiscal year the Company had been investigating and negotiating the acquisition of equipment at a cost of approximately \$195,000. This equipment arrived during the third quarter of 2014, installation and set-up was completed, and the equipment was made operational during the final quarter. Depreciation expense is recorded only once machinery is operational and accordingly the expense rose during the fourth quarter of 2014. There are no major equipment additions currently being investigated or considered although management remains diligent in monitoring the equipment market for opportunities that could help to further increase productivity or profitability.

Other costs include repairs and maintenance, stencils and tooling, packaging, and freight costs net of amounts recovered. The quarterly and annual increase in 2014 are almost entirely attributable to increased repairs and maintenance costs as the Company took advantage of the opportunity presented when the new machinery became operational in the final quarter to complete servicing of other equipment. Each aspect of other costs is incurred on an as-needed basis without any specific correlation with revenues which can lead to fluctuations from one period to the next. Each of these costs is constantly monitored and is within management expectations so they will not be further elaborated upon.

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Results of Operations - continued

Selling, general and administrative expenses for the periods ended June 30 were as follows:

Years ended	June 14	June 13	Change
Employee and consultant compensation	\$ 856,871	\$ 832,729	\$ 24,142
Occupancy costs	264,970	258,703	6,267
Professional fees	75,703	66,024	9,679
Regulatory fees	25,390	30,677	(5,287)
Bad debts	3,169	-	3,169
Other costs	80,944	70,908	10,036
Total selling, general and administrative	\$ 1,307,047	\$ 1,259,041	\$ 48,006

Three month periods ended	June 14	June 13	Change
Employee and consultant compensation	\$ 214,920	\$ 250,731	\$ (35,811)
Occupancy costs	64,278	64,327	(49)
Professional fees	14,595	11,425	3,170
Regulatory fees	2,393	993	1,400
Bad debts	3,169	-	3,169
Other costs	18,907	15,770	3,137
Total selling, general and administrative	\$ 318,262	\$ 343,246	\$ (24,984)

Compensation costs rose by 2.9% for the year even though they declined by 14.3% in the final quarter in comparison to 2013 levels. During the fourth quarter of 2013 the Company retained two consultants, at an aggregate cost of \$32,000 for the quarter, to investigate potential new business opportunities. Although each of these consultants did continue their services into the 2014 year, at an aggregate cost of \$44,000, none of this cost arose in the fourth quarter. Also contributing to the annual cost increase was an \$8,000 increase in fees for services rendered by the Company's CFO and a \$5,000 increase in Directors' fees, each of which was incurred prior to the fourth quarter.

Occupancy costs consist primarily of rent and utility charges for the Company's operating facility plus the costs of security, cleaning and waste removal. The Company has leased its business premises until March 2021 so the base rent, which increased approximately \$2,250 year over year, will remain reasonably consistent on an annual basis. None of the other occupancy costs are subject to long-term agreements so will fluctuate in accordance with market prices and the Company's requirements.

Professional fees are comprised of the cost of legal services as well as the cost of the annual financial statement audit. Audit expenses have remained comparable between the 2013 and 2014 periods. Incremental legal costs include dealing with some governance and inter-corporate matters during the final quarter as well as the related party financing and prospective business matters which were dealt with earlier in the fiscal year.

Regulatory fees include all public disclosure, stock exchange and transfer agent fees incurred. During 2013 the Company completed a private placement and exchanged common shares for Class A shares thereby contributing to the higher costs in that year. The charges in the fourth quarter of 2014 include final regulatory costs associated with the related party financing that was completed in the preceding quarter.

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 continuously monitored by management and do not warrant detailed investigation or elaboration.

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Results of Operations - continued

Even though the Company put new financing in place to fund the acquisition of equipment the debt load, and the associated costs of financing, continues to decline. They are comprised of interest on long-term debt, other interest expense, and loan guarantee fees as follows:

Years ended	June 14	June 13	Change
Interest expense ó long term (cash based)	\$ 21,636	\$ 65,559	\$ (43,923)
Interest expense ó long term (accretion)	9,149	20,593	(11,444)
Interest expense ó other	4,614	596	4,018
Loan guarantee fees	-	8,800	(8,800)
Total financing expenses	\$ 35,399	\$ 95,548	\$ (60,149)

Three month periods ended	June 13	June 13	Change
Interest expense ó long term (cash based)	\$ 6,042	\$ 10,917	\$ (4,875)
Interest expense ó long term (accretion)	712	4,037	(3,325)
Interest expense ó other	1,497	149	1,348
Loan guarantee fees	-	1,600	(1,600)
Total financing expenses	\$ 8,251	\$ 16,703	\$ (8,452)

Interest expense ó long term consists of the interest amounts being paid (cash based) in accordance with the face value of long term debt instruments plus accretion of the difference between those face values and their carrying amounts. During the 2014 fiscal year the Company repaid \$374,836 in long-term debt thereby eliminating two debentures and reducing a term loan, each of which required the payment of interest and the recognition of accretion costs. In January 2014 two new term loans were added and they too required the payment of interest and the recognition of accretion costs however the aggregate cost of this new debt was lower than the aggregate cost of the debts repaid. In July 2014 the two new term loans were repaid in their entirety using the proceeds of a new commercial term loan. The commercial loan has a lower rate of interest than the debts that were repaid and will not result in the recognition of interest accretion. This is expected to contribute to a further reduction of long-term financing costs in the immediate future.

Interest expense ó other increased during 2014 due primarily to the Company having repaid a portion of one of the debentures with a short-term note. This note was then repaid, in full, prior to the end of the fiscal year but during the six month period that the note was outstanding the associated interest costs were included in other interest.

Throughout most of the 2013 fiscal year the Company's bank operating loan was secured, in part, by the personal guarantee of an unrelated individual. As compensation for providing the guarantee the individual received a fee of \$800 per month. That personal guarantee was removed in May 2013 when the Company pledged its own \$250,000 term deposit as additional security for the operating loan. In July 2014 the Company obtained the release of the \$250,000 term deposit and the operating loan is now secured by a general security agreement covering the assets of Permotech Electronics Corporation.

Liquidity

As at June 30, 2014 the Company reported a working capital deficiency of \$92,087 representing an improvement of \$103,977 for the year, including an improvement of \$4,291 in the final quarter. 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 as opposed to managing this deficiency.

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Liquidity - continued

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 in January of \$200,000, from related parties, to finance a new equipment purchase. This financing was replaced by a commercial term loan in July 2014. The Company's short-term financing requirements are expected to be met through a \$250,000 bank operating line of which \$25,000 was drawn as of June 30, 2014.

In addition to satisfying the cost of operations the Company must also address the payment or other settlement of the following amounts as at June 30, 2014:

	Due by June 2015	Due by June 2017	Due by June 2019	Due after June 2019	Total Due
Long-term debt ^(1,2,3)	\$ 83,007	\$ 78,986	\$ 78,986	\$ 3,290	\$ 244,269
Operating leases	<u>90,993</u>	<u>196,924</u>	<u>210,053</u>	<u>188,550</u>	<u>686,520</u>
Actively serviced obligations	<u>173,000</u>	<u>275,910</u>	<u>289,039</u>	<u>191,840</u>	<u>930,789</u>
Repurchase of preferred shares ^(4,5)	665,501	-	-	-	665,501
Settlement of dividends payable ⁽⁵⁾	263,337	-	-	-	263,337
Debenture ⁽⁵⁾	<u>39,600</u>	-	-	-	<u>39,600</u>
Past-due obligations	<u>968,438</u>	-	-	-	<u>968,438</u>
All obligations	<u>\$ 1,142,438</u>	<u>\$ 275,910</u>	<u>\$ 289,039</u>	<u>\$ 191,840</u>	<u>\$ 1,899,227</u>

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

(2) Long-term debt was altered July 2014 when the proceeds of a new 5-year term loan in the amount of \$197,463 were used to repay two terms loans, in their entirety, with aggregate face value of \$200,000 and for which no principal payments were due in July. The principal repayments listed above are reflective of the payments due after giving effect to the new term loan and the corresponding retirement.

(3) Long-term debt includes one obligation for which the carrying value is lower than its face value. The financial statements as at June 30, 2014 report this obligation based upon its carrying values while the figures reported above represent the non-discounted cash payments to be made.

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

(5) Amounts are past due, unsecured, bear no interest, and no settlement terms have been established.

Capital Resources

The Company has access to a \$250,000 revolving line of credit from its financial institution of which \$25,000 had been drawn upon as at June 30, 2014. At June 30, 2014 the loan, which is due upon demand, bore interest at the prime lending rate plus 0.5% and was secured by a \$250,000 term deposit and by a general security agreement covering the assets of Permtech Electronics Corporation. In July 2014 the TD Bank removed the requirement for the pledge of the \$250,000 term deposit and increased the interest rate to the prime lending rate plus 2.5%.

The Company negotiated new term financing, with related parties, in the aggregate amount of \$200,000. This debt bore interest at 9%, was repayable as to interest only for 10 months, and then repayable through fixed monthly payments over the ensuing 3 years to mature October 31, 2017. The lenders also received 400,000 share purchase warrants with each warrant entitling the holder to acquire one common share for \$0.10 until October 31, 2017. In July 2014 the TD Bank funded a new 5-year term loan which is unsecured, bears interest at the prime lending rate (currently 3.0%) plus 1.75%, matures July 2019, and is repayable in monthly principal payments of \$3,291 plus applicable interest. The proceeds of this loan were used to retire the \$200,000 in related party term loans.

During the year 75,000 stock options were exercised for aggregate proceeds of \$7,500.

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Related Party Transactions

The Company has an outstanding loan payable to 1114377 Ontario Inc. (ø1114377ö), 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.

As at June 30, 2014 the Company had outstanding term loans payable to 1114377 and to Mike Kindy, the Company's CFO. These loans were negotiated when commercial financing was not available to the Company. The proceeds were used to fund the acquisition and installation of equipment. The repayment terms included interest at 9%, a 10-month interest only period, and then a 3-year repayment term. The creditors also received 400,000 share purchase warrants with each warrant having an exercise price of \$0.10 and will expire on October 31, 2017, being the maturity date for the loans. In July 2014 the Company received \$197,463 from its bank under a 5-year term loan with interest at the TD Bank prime lending rate (currently 3.0%) plus 1.75%. The proceeds were used to retire the related party term loans.

The Company compensates its key management personnel for services rendered including salaries and benefits paid to the CEO and the President, consulting fees paid to the CFO, legal fees paid to a legal firm in which the Corporate Secretary is a partner, Directors' fees, and share-based payments. Compensation rates are agreed to by the key management personnel and are predicated upon prevailing market rates.

The following balances are due to related parties as at June 30 of each year:

	<u>2014</u>	<u>2013</u>
Loan payable to 1114377 Ontario Inc. at prime +8% ⁽¹⁾	46,806	85,935
Loan payable to 1114377 Ontario Inc. at 9% ⁽²⁾	150,000	-
Loan payable to the Company's CFO at 9% ⁽²⁾	50,000	-
Salaries and benefits payable ⁽³⁾	3,793	1,019
Consulting fees payable ⁽³⁾	44,800	24,602
Legal fees payable ⁽³⁾	3,129	1,991

⁽¹⁾ This is the face value of this obligation. It is reported in the consolidated financial statements at a discounted value. 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 Permotech Electronics Corporation for \$200,000 on or before May 1, 2015.

⁽²⁾ Retired in July 2014 as described above.

⁽³⁾ Reported in the consolidated financial statements as an element of accounts payable and accrued liabilities. Aggregate value of \$51,722 (2013 - \$27,612)

The following expenses have arisen during the years ended June 30 as a result of transactions involving the related parties defined above:

	<u>2014</u>	<u>2013</u>
Salaries and benefits ⁽¹⁾	\$ 254,006	\$ 257,715
Production wages ⁽²⁾	3,569	500
Consulting fees ⁽¹⁾	40,609	32,348
Directors' fees ⁽¹⁾	35,100	29,850
Legal fees ⁽³⁾	38,053	26,034
Interest expense ó long term	18,150	12,309
Share issuance costs ⁽⁴⁾	-	6,000
Cash based expenditures	<u>\$ 389,487</u>	<u>\$ 364,756</u>
Share-based payments	<u>\$ 49,705</u>	<u>\$ 42,118</u>

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

⁽²⁾ Reported in the consolidated financial statements as an element of cost of goods sold.

⁽³⁾ Reported in the consolidated financial statements as an element of professional fees.

⁽⁴⁾ Fees charged by legal firm in which the Corporate Secretary is a partner.

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Related Party Transactions - continued

The following stock options have been issued to Directors and/or Officers of the Company and were outstanding as at June 30, 2014:

<u>Description</u>	<u>Expiry Date</u>	<u>Number of Common shares</u>
Stock options @ \$0.10 per share ⁽¹⁾	Nov. 2015	275,000
Stock options @ \$0.10 per share ⁽²⁾	Sept. 2017	130,000
Stock options @ \$0.15 per share ⁽³⁾	Apr. 2015	200,000
Stock options @ \$0.10 per share ⁽³⁾	Apr. 2015	100,000
Stock options @ \$0.10 per share	Dec. 2018	500,000

⁽¹⁾ 25,000 options were exercised during the year leaving the above noted balance outstanding.

⁽²⁾ 50,000 options were exercised during the year leaving the above noted balance outstanding.

⁽³⁾ A director of the Company passed away April 27, 2014. In accordance with the terms of the option agreement his options are revised to set the expiry as one year following the date of death.

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		5,338
Common shares, June 30, 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	505,501
		665,501
Less: amount accounted for as paid in capital		<u>(191,646)</u>
Liability element of preferred shares at June 30, 2014 and as at the date of this document		<u>\$ 473,855</u>

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 ⁽¹⁾		8,246
Stock options @ \$0.15 per share	Apr. 2015	200,000
Stock options @ \$0.10 per share	Apr. 2015	100,000
Stock options @ \$0.10 per share	Nov. 2015	275,000
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	130,000
Warrants @ \$0.10 per share	Oct. 2017	400,000
Stock options @ \$0.10 per share	Mar. 2018	500,000
Shares reserved as at June 30, 2014 and as at the date of this document		<u>3,613,246</u>

⁽¹⁾ During the 2013 fiscal year the shareholders approved the issuance of 99,454 common shares in exchange for the 1,193,442 Class A Special Shares then outstanding. 91,208 common shares have been issued to date, representing the entitlement of the Class A shareholders the Company was able to identify. The remaining common shares will be issued only in the event the remaining Class A shareholders identify themselves to the Company.

ZTEST Electronics Inc.

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Convertible Instruments and Other Securities - continued

Fully diluted position

Shares issued	10,648,696
Shares reserved	<u>3,613,246</u>
Fully diluted position as at June 30, 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>Weighted Average Price/Option</u>	<u>Weighted Average Expiry Date</u>
Balance, June 30, 2013	680,000	\$0.115	Jan. 20, 2017
Issued during the year	600,000	\$0.100	Dec. 31, 2018
Exercised during the year	(75,000)	\$0.100	Feb. 8, 2017
Amended during the year ⁽¹⁾	(300,000)	\$0.132	June 17, 2018
Amended during the year ⁽¹⁾	<u>300,000</u>	\$0.132	Apr. 27, 2015
Balance, June 30, 2014 and as at the date of this document	<u>1,205,000</u>	\$0.108	Mar. 28, 2017

All stock options have vested and are held by Directors, former Directors and Officers of the Company. The Company has no ability to cause these options to be exercised.

⁽¹⁾ Options are held by the estate of a former Director. The expiry dates were amended to be one year following the date of death.

Additional disclosures relative to share purchase warrants are as follows:

	<u>Number of Warrants</u>	<u>Weighted Average Price/Warrant</u>	<u>Weighted Average Expiry Date</u>
Balance, June 30, 2013	2,000,000	\$0.100	Feb. 26, 2016
Issued during the year	<u>400,000</u>	\$0.100	Oct. 31, 2017
Balance, June 30, 2014 and at the date of this document	<u>2,400,000</u>	\$0.100	June 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 in IFRS were adopted during the year without impact upon the amounts or disclosures presented in these consolidated financial statements:

IFRS 10, *Consolidated Financial Statements*, replaced 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*, replaced 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, 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.

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Accounting Standards Effective For Future Periods

IFRS 9, *Financial Instruments*: effective for annual periods beginning on or after January 1, 2018, with early adoption permitted, establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of the financial statements for their assessment of the amounts, timing and uncertainty of future cash flows. Management anticipates that this standard will be adopted in the Company's financial statements for the year beginning July 1, 2018 and has not yet considered the potential impact of its adoption.

IFRS 15, *Revenue from Contracts with Customers*: effective for annual periods beginning on or after January 1, 2017, with early adoption permitted, replaces existing revenue standards and interpretations with a single standard and provides additional guidance on revenue recognition for contracts with customers. Management anticipates that this standard will be adopted in the Company's financial statements for the year beginning July 1, 2017 and has not yet considered the potential impact of its adoption.

Financial Instruments

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

Financial assets:

Cash and cash equivalents
Restricted cash equivalents
Accounts receivable

Classification

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

Financial liabilities:

Bank operating loan
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.

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Financial instruments - continued

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.

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, 2014 and 2013 cash and cash equivalents and restricted cash equivalents 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.

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.

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Risk Factors - continued

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 year, one of the Company's customers accounted for more than 20% (25%) of total revenue (2013 636%). Amounts due from this customer accounted for 9% of the Company's accounts receivable at June 30, 2014 (2013 - 24%). The loss of this customer or significant curtailment of purchases by such 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 reported a working capital deficiency of \$92,087 (2013 - \$196,064). This includes financial liabilities (a specific long-term debt instrument plus preferred shares and dividends payable) with an aggregate carrying amount of \$776,792 (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 (*note 12*) 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. The Company has reported a foreign exchange gain of \$3,581 (2013 6 loss of \$18,775).

Sensitivity to market risks

At June 30, 2014 the Company had US\$99,330 (2013 6US\$131,220) 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 \$5,325 in future cash inflow.

At June 30, 2014 the Company had US\$233,439 (2013 6 US\$186,818) 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 \$12,516 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.

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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.