ZTEST Electronics Inc.

Managementøs Discussion and Analysis
For The Three Month Period Ended December 31, 2013
(Prepared as at February 25, 2014)

General

The following managementøs discussion and analysis (ñMD&Aò) of the financial condition and results of operations of ZTEST Electronics Inc. (ñZTESTò or the ñCompanyò) constitutes managementøs review of the factors that affected the Companyøs interim condensed consolidated financial and operating performance for the three months ended December 31, 2013. The MD&A was prepared as of February 25, 2014 and was approved by the Board of Directors on February 25, 2014. It should be read in conjunction with the unaudited interim condensed consolidated financial statements of the Company for the three months ended December 31, 2013, 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, which has not changed since the preceding fiscal year end, is comprised of the following individuals:

Name	**Position(s)**
Wojciech Drzazga	Director and CEO
John Perreault [(1)]	Director and President
K. Michael Guerreiro [(1) (2)]	Director
Mike Hiscott [(1) (2)]	Director
Arn Schoch	Director
Michael D. Kindy	VP Finance & CFO
William R. Johnstone	Secretary

(1) Denotes member of audit committee
(2) Denotes member of compensation committee

Corporate Performance

During the second quarter of 2014 the Company experienced, what it believes to be, a temporary decline in demand and this translated into lower revenues and the realization of a loss for just the second time in the past ten quarters. Although the quarterly loss contributed to a decline of $9,223 in total equity and $17,954 in capital under management it did not prevent a $10,748 improvement in working capital or the generation of $134,090 in cash flow from operations.

The working capital improvement was aided by the partial refinancing of a debenture that matured in December. The debenture had a balance of $203,665 due at maturity and this was settled through a cash payment of $58,930 and the issuance of a short-term note in the amount of $144,735. The note will be repaid by way of monthly payments from January to October.

The Company also took steps to address a limitation in its production capabilities by ordering a new machine. This new machine will not only increase capacity but will also enable the Company to produce more complex products in accordance with existing customer demand. The acquisition, which was financed through $200,000 in new debt, was finalized in January and the machine is currently in transit from the European supplier.

Management continues to grow the business, to manage and minimize business risks, to manage cash flows, 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 Companyøs operating performance and financial position:

Corporate Performance - continued

	For the fiscal years ended:		
	June 13	June 12	June 11
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:				
	Dec. 13	Sept. 13	June 13	Mar. 13	Dec. 12
Total Revenues	945,951	1,134,250	1,288,374	1,127,445	1,113,223
Net income (loss) from operations	(59,301)	63,070	81,609	21,311	31,955
Per share - basic	(0.006)	0.006	0.008	0.003	0.004
Net income (loss) for the period	(58,928)	63,858	83,815	22,379	33,336
Per share - basic	(0.006)	0.006	0.008	0.003	0.005
Total assets	1,859,824	2,102,184	2,176,189	2,228,452	2,133,002
Total long-term financial liabilities	18,830	32,498	45,788	57,496	66,478
Total liabilities	1,381,168	1,614,305	1,759,668	2,036,126	2,141,525

	For the three month periods ended:				
	Sept. 12	June 12	Mar. 12	Dec. 11	Sept. 11
Total Revenues	1,072,656	1,289,855	1,483,588	839,112	959,862
Net income (loss) from operations	6,132	42,073	279,280	(17,116)	86,699
Per share - basic	0.004	0.006	0.040	(0.002)	0.012
Net income (loss) for the period	8,789	44,015	279,280	(17,216)	86,699
Per share - basic	0.004	0.006	0.040	(0.002)	0.012
Total assets	2,252,523	2,340,853	2,652,994	2,122,488	2,033,096
Total long-term financial liabilities	602,565	698,648	785,338	902,553	962,334
Total liabilities	2,299,246	2,416,943	2,773,099	2,521,873	2,415,265

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

Results of Operations

The Company has reported revenues of $945,951 for the quarter and $2,080,201 for the six months ended December 31, 2013. This represents a decline of $167,272 (15.0%) for the quarter and $105,678 (4.8%) for the six month period when compared to the same periods that ended December 31, 2012. The revenue decline for the quarter, which follows an increase in Q1, means that the lack of consistent quarterly growth or contraction now extends to thirteen fiscal quarters. Although management believes the recent decline in production volumes to be temporary it remains far too early to predict whether annual revenues will increase for the seventh time in eight years.

The gross margin realized during the second quarter amounted to $330,243 or 34.9% of revenues. This represents a decline of $39,890 (10.8%) in comparison to the prior year when the gross margin was 33.2% of revenue. The gross margin for the six month period also declined in value but rose as a percentage of sales. The value decline was limited to $1,477 as the margin climbed from 34.5% of revenues to 36.1%. Although this is the third consecutive quarter in which the gross margin percentage rose it is also the sixth time in the last thirteen quarters meaning there is no clear trend. To Each aspect of the cost of product sales has an impact on gross margin percentage.

Results of Operations - continued

The cost of product sales for the periods ended December 31 was comprised of the following elements:

Six month periods ended December 31	2013	2012	Change
Raw materials and supplies consumed	$ 828,620	$ 955,329	$ (126,709)
Labour costs incurred	356,441	363,511	(7,070)
Depreciation	61,106	74,993	(13,887)
Other costs	56,450	51,022	5,428
Net change in finished goods and work in process	25,799	(12,238)	38,037
Total cost of product sales	$ 1,328,416	$ 1,432,617	$ (104,201)

Three month periods ended December 31	2013	2012	Change
Raw materials and supplies consumed	$ 375,115	$ 488,261	$ (113,146)
Labour costs incurred	176,595	187,601	(11,006)
Depreciation	30,553	37,496	(6,943)
Other costs	26,222	25,316	906
Net change in finished goods and work in process	7,223	4,416	2,807
Total cost of product sales	$ 615,708	$ 743,090	$ (127,382)

The most significant change in cost of product sales comes from the raw materials and supplies consumed which is indicative of the volume of turnkey sales. Not only has the cost of this element declined by more than 23% for the quarter and almost 13% for the year to date but it has also declined as a percentage of periodic revenues. For the second consecutive quarter this cost is equal to approximately 40% of revenues while for the three and six month periods ended December 2012 it was almost 44%. This was the third consecutive quarter for which there has been a modest decline in comparison to the same period one year earlier however this follows a period of nine out of ten fiscal quarters where the percentage rose, sometimes by significant amounts. The current 40% rate is significantly higher than was experienced historically and management expects the demand for turnkey sales to remain strong.

Labour costs incurred is a measure of labour utilized during the period and this is managed based upon the demand for assembly work. These costs declined by almost 6% in the most recent quarter and by less than 1% on a year to date basis. This means that the decline in demand experienced during the most recent quarter was approximately equal to the increase that arose in Q1. 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. The impact on cost of products sold was 4% lower in the last quarter but was 9% higher for the six month period. This fits with expectations since revenues derived from assembly work were also lower during the quarter and higher on a year to date basis.

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.

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 which can lead to fluctuations from one period to the next. Each of these costs is closely monitored and is within management expectations so they will not be further elaborated upon.

Results of Operations - continued

Selling, general and administrative expenses for the periods ended December 31 were as follows:

Six month periods ended December 31	2013	2012	Change
Employee and consultant compensation	$ 450,752	$ 399,144	$ 51,608
Occupancy costs	132,728	132,918	(190)
Professional fees	35,574	32,366	3,208
Shareholder services	13,171	21,338	(8,167)
Insurance	16,320	10,591	5,729
Other costs	26,572	28,902	(2,330)
Total selling, general and administrative	$ 675,117	$ 625,259	$ 49,858

Three month periods ended December 31	2013	2012	Change
Employee and consultant compensation	$ 205,400	$ 197,348	$ 8,052
Occupancy costs	64,515	64,679	(164)
Professional fees	23,172	14,710	8,462
Shareholder services	11,666	6,047	5,619
Insurance	8,160	5,295	2,865
Other costs	17,628	21,187	(3,559)
Total selling, general and administrative	$ 330,541	$ 309,266	$ 21,275

Compensation costs were higher during the periods ended December 31, 2013 primarily as a result of increased consulting services. The Company retained the services of two consultants to assist with and advise upon potential new business prospects. One consultant completed their tasks during the first quarter while the other completed their services in October.

Occupancy costs consist primarily of rent and utility charges for the Companyós operating facility. Base rental costs increased approximately 4% January 1, 2013 however this increase continues to be offset by lower utility and common area costs.

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 but legal costs have increased in the recent quarter primarily due to the costs associated with the general shareholders meeting that was held December 2013.

Shareholder services include the cost of public disclosures and distribution of materials to shareholders, stock exchange fees, and transfer agent fees. The costs were higher in the recent quarter due to the general shareholders meeting that was held December 2013 but remain lower on a year to date basis as the costs of the meeting held September 2012 were significantly higher. New rules permit the electronic distribution of many documents in place of sending physical copies by mail as was still required in 2012.

Insurance costs have risen in the 2013 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.

Results of Operations - continued

The Companyôs financing costs for the periods ended December 31 were as follows:

Six month periods ended December 31	2013	2012	Change
Interest expense ï long term (cash based)	$ 9,791	$ 38,462	$ (28,671)
Interest expense ï long term (accretion)	7,777	12,668	(4,891)
Interest expense ï other	571	297	274
Loan guarantee fees	-	4,800	(4,800)
Total financing expenses	$ 18,139	$ 56,227	$ (38,088)

Three month periods ended December 31	2013	2012	Change
Interest expense ï long term (cash based)	$ 4,070	$ 18,324	$ (14,254)
Interest expense ï long term (accretion)	3,906	3,782	124
Interest expense ï other	211	148	63
Loan guarantee fees	-	2,400	(2,400)
Total financing expenses	$ 8,187	$ 24,654	$ (16,467)

As at December 31, 2013 the Company reported total long term debt of $106,079 representing a decline of $345,760 during the six month period. In contrast long term debt amounted to $826,207 at December 31, 2012 after having repaid $162,745 since the prior year end. This significant reduction in debt has resulted in the significant reduction in interest expense. The repayments made in 2013 include the final settlement of a debenture for which the face value exceeded the carrying value resulting in additional accretion during the recent fiscal quarter.

Interest expense ï other has been relatively nominal however the settlement of the debenture resulted in the issuance of a note payable which will result in this expense increasing in future periods.

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 allowing the guarantee fees to stop.

Liquidity

As at December 31, 2013 the Company reported a working capital deficiency of $95,939 representing an improvement of $100,125 for the six month period, $10,748 for the quarter and $570,152 in comparison to December 31, 2012. 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. A debenture that matured December 2013 required a final payment at maturity which was settled through a combination of cash and a note repayable over ten months. The Companyôs working capital financing requirements, if any, are expected to be 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 December 31, 2013:

Liquidity - continued

	Due by Dec. 2014	Due by Dec. 2016	Due by Dec. 2018	Due after Dec. 2018	Total Due
Note payable	144,735	-	-	-	144,735
Long-term debt [1, 2]	48,869	19,237	-	-	68,106
Operating leases	89,635	191,945	207,336	242,422	731,338
Actively serviced obligations	283,239	211,182	207,336	242,422	944,179
Repurchase of preferred shares [3, 4]	$ 665,501	$ -	$ -	$ -	$ 665,501
Settlement of dividends payable [5]	263,337	-	-	-	263,337
Debenture [6]	39,600	-	-	-	39,600
Past-due obligations	968,438	-	-	-	968,438
All obligations	$ 1,251,677	$ 211,182	$ 207,336	$ 242,422	$ 1,912,617

(1) Amount excludes a debenture which was past due.
(2) Long-term debt has a carrying value lower than its face value. The unaudited condensed interim consolidated financial statements as at December 31, 2013 report this obligation 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 from which nothing was drawn as at December 31, 2013 or during the six month period. The loan bears interest at the prime lending rate plus 0.5%, is due upon demand, is subject to renewal May 2014, 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 October 21, 2013 at which time the principal was reinvested at 1.25% until January 19, 2014.

In January 2014 the Company made payment of US$170,152 to acquire and initiate delivery of new equipment from a European supplier. The equipment remains in transit as of the date of this document but is expected to be fully operational by the fourth quarter. 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 for ten months 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.

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

Related Party Transactions

The Company has an outstanding loan 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 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 paid to a legal firm in which William R. Johnstone (Corporate Secretary) is a partner, Directorsô fees, and share-based payments. The Compensation rates are agreed to by the key management personnel and are predicated upon prevailing market rates.

Related Party Transactions - continued

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

	2013	2012
Loan payable to 1114377 Ontario Inc. at prime +8% [(1)]	68,106	99,959
Salaries and benefits payable	1,947	1,090
Consulting fees payable [(2)]	25,600	55,188
Legal fees payable [(2)]	3,155	5,570

(1) This is the face value of this obligation. It is reported in the unaudited condensed interim 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 Permatech Electronics Corporation for $200,000 on or before May 1, 2015.

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

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

	2013	2012
Salaries and benefits [(1)]	$ 124,713	$ 123,763
Consulting fees [(1)]	21,379	25,200
Directorsô fees [(1)]	18,300	13,800
Legal fees [(2)]	16,224	12,426
Interest expense ï long term	4,933	6,492
Cash based expenditures	$ 185,549	$ 181,681
Share-based payments	$ 49,705	$ 20,578

(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.

The following stock options have been issued to Directors and/or Officers of the Company and were outstanding as at December 31, 2013:

Description	Expiry Date	Number of Common shares
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	Mar. 2018	200,000
Stock options @ $0.10 per share	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.

Convertible Instruments and Other Securities

The Company has the following securities issued and outstanding:

Share capital	Quantity	Amount
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, Sept. 30, 2013 and as at the date of this document	10,648,696	$ 22,343,053

Convertible Instruments and Other Securities - continued

Preferred shares	Quantity	Amount
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		(191,646)
Liability element of preferred shares at Sept. 30, 2013 and June 30, 2013 and as at the date of this document		$ 473,855

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.

Shares reserved	Expiry Date	Number of Common shares
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
Stock options @ $0.15 per share	Mar. 2018	200,000
Stock options @ $0.10 per share	Mar. 2018	600,000
Shares reserved as at Dec. 31, 2013		3,213,246
Warrants @ $0.10 per share	Oct. 2017	400,000
Shares reserved as at the date of this document		3,613,246

Fully diluted position	
Shares issued	10,648,696
Shares reserved	3,213,246
Fully diluted position as at Dec. 31, 2013	13,861,942
Shares reserved after Dec. 31, 2013	400,000
Fully diluted position as at the date of this document	14,261,942

Additional disclosures relative to stock options are as follows:

	Common Shares Under Option	Number of Options Vested	Exercise Price	Expiry Date
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 March 11, 2013	200,000 (1)	200,000	$ 0.15	Mar. 11, 2018
Granted Dec. 31, 2013	600,000 (1)	600,000	$ 0.10	Dec. 31, 2018

	Common Shares Under Option	Weighted Average Price/Option	Weighted Average Expiry Date
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	600,000	$ 0.100	Dec. 31, 2018
Balance, Dec. 31, 2013 and as at the date of this document	1,205,000	$ 0.108	Jan. 7, 2018

Convertible Instruments and Other Securities - continued

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

Additional disclosures relative to share purchase warrants are as follows:

	Number of Warrants	Value of Warrants	Exercise Price	Expiry Date
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
December 31, 2013	2,000,000	76,677		
Issued Jan. 10, 2014	400,000	2,965	$ 0.10	Oct. 31, 2017
		$ 79,642		

	Number of Warrants	Weighted Average Price/Warrant	Weighted Average Expiry Date
Balance, Dec. 31, 2013 and June 30, 2013	2,000,000	$ 0.100	Feb. 26, 2016
Issued after Dec. 31, 2013	400,000	$ 0.100	Oct. 31, 2017
Balance at the date of this document	2,400,000	$ 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 December 31, 2013 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.

Financial Instruments

The Companyøs financial instruments are comprised of the following:

Financial assets:	*Classification*
Cash and cash equivalents	Fair value through profit and loss
Restricted cash	Loans and receivables
Accounts receivable	Loans and receivables
Financial liabilities:	*Classification*
Customer deposits	Other financial liabilities
Accounts payable and accrued liabilities	Other financial liabilities
Dividends payable	Other financial liabilities
Preferred shares	Other financial liabilities
Long-term debt	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.

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 - continued

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 assetõs 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 armõs 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.

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 Companyõs 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 Companyõs 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 Companyõs business, operating results, and financial condition.

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 Companyø 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 Companyø 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 Companyø 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 (2012 ó none exceeding 20%). Amounts due from this customer accounted for 4% of the Companyø accounts receivable at December 31, 2013 (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 reported a working capital deficiency of $95,939 (June 30, 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 (June 30, 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 Companyø 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 loss of $3,337 (2012 ó $7,905).

Sensitivity to market risks

At December 31, 2013 the Company had US$91,221 (2012 ó US$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 $4,851 in future cash inflow.

At December 31, 2013 the Company had US$106,137 (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 $5,611 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 Companyø immediate market risk exposures.

Forward-looking Information

Certain statements in this MD&A may constitute ñforward-lookingò 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 ñestimateò, ñbelieveò, ñanticipateò, ñintendò, ñexpectò, ñplanò, ñmayò, ñshouldò, ñwillò, 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 ñRisk Factorsò. 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.