

ZTEST Electronics Inc.

Management's Discussion and Analysis
For the Six Month Period Ended December 31, 2019
(Prepared as at February 26, 2020)

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 six months ended December 31, 2019. The MD&A was prepared as of February 26, 2020 and was approved by the Board of Directors on February 26, 2020. It should be read in conjunction with the unaudited interim condensed consolidated financial statements of the Company for the six months ended December 31, 2019, and the audited consolidated financial statements for the year ended June 30, 2019, 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

ZTEST is located at 523 McNicoll Avenue, Toronto, Ontario. Through its wholly-owned subsidiary, Permatest Electronics Corporation (PEC), the Company operates a single business segment designing, developing, and assembling printed circuit boards and other electronic equipment. The Company's shares trade on the Canadian Securities Exchange under the symbol "ZTE".

The Company held its annual general meeting on January 8, 2019 resulting in the re-election of the Steve Smith, K. Michael Guerreiro and Brendan Purdy. The inaugural meeting of the Board was held immediately following the annual general meeting, during which the Officers of the Company were reappointed and the Audit Committee was reformed. In November 2019, Zachery Dingsdale was appointed to the Board and he was then appointed to the Audit Committee in January 2020, following the resignation of Brendan Purdy from the Board on January 17, 2020.

<u>Name</u>	<u>Position(s)</u>
Steve Smith ⁽¹⁾ K. Michael Guerreiro ^(1*)	Chairman, President & Chief Executive Officer Director (Independent), Director of PEC, Director of Conversance Inc.
Brendan Purdy ⁽²⁾ Zachery Dingsdale ⁽³⁾	Director (Independent) Director (Independent)
Michael D. Kindy, CPA, CA William R. Johnstone, LLB	VP Finance & Chief Financial Officer Corporate Secretary
Wojciech Drzazga John Perreault William J. Brown	Director and Officer of PEC Officer of PEC Director of PEC

* Acts as Committee Chair

⁽¹⁾ Member of the audit committee

⁽²⁾ Resigned from the Board January 17, 2020.

⁽³⁾ Appointed to the audit committee January 2020.

Corporate Performance

The second fiscal quarter of 2020 continued to present challenges to the Company as revenues, for the second consecutive quarter, were less than they had been in corresponding quarters one year previous. The Company has received production orders from its customers however the deliveries under those orders has been scheduled over longer periods of time than what was initially anticipated, contributing to lower periodic revenues. Revenues for the most recent quarter were 24.5% lower than at December 2018 and year-to-date revenues are 17.2% less than they were for the same period last year.

As one should anticipate, like revenues, gross margins have also declined. Margins for the quarter are down 24.8% and margins for the six month period are 16.1% lower than at December 31, 2018. Prior to the start of the 2020 fiscal year, gross margins had been declining as a percentage of revenues and management took steps to try to halt that trend. Furthermore, it is common for margins as a percentage of revenue to decline when revenues decline due to declining economies of scale. Management is therefore modestly encouraged that the percentage decline in the margins, thus far in this fiscal year, is lower than the corresponding decline in revenues.

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Corporate Performance - continued

The Company also continues to experience pressure on cash flows and liquidity. Operations for the most recent three months utilized net cash of \$107,573. For the first six months of the year, operations have utilized \$164,825 in cash. Some of this cash utilization can be offset through managing other working capital items but the Company is aware that such management is only a short-term solution. To address this matter, the Company announced in January that it was initiating a private placement financing and a debt settlement. The private placement will raise up to \$300,000 in gross proceeds for working capital purposes through the sale of up to 2,000,000 units. Each unit is comprised of one common share and one share purchase warrant with each warrant entitling the holder to acquire one common share for \$0.25 for a period of one year from the closing date. The debt settlement will result in the issuance of 1,023,000 common shares in settlement of \$153,500 that is currently owed to related parties.

Management continues to strive for enhanced revenues and operating results and to meet and overcome challenges if and when they arise. Some of the Company's materials are acquired directly or indirectly from China. It is possible that the COVID-19 outbreak, that originated in China in December 2019 and is not yet contained, may have an impact upon the supply of some of those items. Should supply difficulties arise, it is probable that there will be a negative impact upon the Company's production and revenues.

The following data may provide some additional insights relative to the Company's operating performance and financial position:

	For the fiscal years ended:		
	June 2019	June 2018	June 2017
Total Revenues	4,399,062	3,686,132	3,754,883
Net loss from operations	(274,085)	(856,314)	(203,576)
Per share - basic	(0.013)	(0.046)	(0.014)
Net loss for the year	(344,186)	(883,756)	(497,880)
Per share - basic	(0.017)	(0.047)	(0.035)
Total assets	2,268,045	2,226,121	1,783,512
Total long-term financial liabilities	-	3,291	42,784
Total liabilities	943,985	783,898	862,688

	For the fiscal quarters ended:			
	Dec. 2019	Sept. 2019	June 2019	Mar. 2019
Total Revenues	828,703	880,703	1,269,697	1,065,043
Net loss from operations	(148,254)	(98,229)	5,518	(102,068)
Per share - basic	(0.007)	(0.005)	0.000	(0.005)
Net loss for the period	(162,103)	(120,642)	(11,385)	(127,279)
Per share - basic	(0.008)	(0.006)	(0.001)	(0.006)
Total assets	2,120,412	2,314,453	2,268,045	2,463,838
Total long-term financial liabilities	26,809	54,201	-	-
Total liabilities	1,079,097	1,111,035	943,985	1,128,394

	For the fiscal quarters ended:			
	Dec. 2018	Sept. 2018	June 2018	Mar. 2018
Total Revenues	1,097,839	966,483	1,010,852	729,743
Net income (loss) from operations	(73,351)	(104,184)	(12,076)	(741,021)
Per share - basic	(0.004)	(0.005)	(0.001)	(0.038)
Net income (loss) for the period	(87,749)	(116,203)	(29,583)	(750,957)
Per share - basic	(0.004)	(0.006)	(0.001)	(0.038)
Total assets	2,373,935	2,287,820	2,226,121	2,224,813
Total long-term financial liabilities	-	-	3,291	13,164
Total liabilities	1,004,124	956,800	783,898	753,008

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

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Results of Operations

As noted previously, revenues and gross margins have each declined in the periods ended December 2019 in comparison to December 2018. To better understand gross margins one must look more closely at cost of product sales. The different elements of cost of product sales for the periods ended December 31 are as follows:

Six month periods ended December 31	2019	2018	Change
Raw materials and supplies consumed	\$ 810,906	\$ 1,021,701	\$ (210,795)
Labour costs incurred	373,384	386,893	(13,509)
Depreciation	23,727	29,520	(5,793)
Other costs	58,617	66,355	(7,738)
Net change in finished goods and work in process	(30,118)	(3,835)	(26,283)
Total cost of product sales	\$ 1,236,516	\$ 1,500,634	\$ (264,118)

Three month periods ended December 31	2019	2018	Change
Raw materials and supplies consumed	\$ 405,123	\$ 568,200	\$ (163,077)
Labour costs incurred	179,173	187,157	(7,984)
Depreciation	11,891	14,760	(2,869)
Other costs	28,718	29,542	(824)
Net change in finished goods and work in process	(2,222)	(10,732)	8,510
Total cost of product sales	\$ 622,683	\$ 788,927	\$ (166,244)

Raw materials and supplies consumed have declined for both the three and six month periods ended December 31, 2019, in comparison to the same period one year earlier. One can anticipate a decline in material costs whenever revenues decline however there was also a decline when considering the material costs as a percentage of periodic revenues. Since customers are not obligated to have materials supplied by the Company and since each circuit board design is unique, there never has been, and will never be, absolute correlation between material costs and periodic revenues. In recent periods, there has been a range of percentages that these costs typically equate to. The current period costs are lower but remain within this range of expected values. Management consistently promotes the benefits customers will derive from our provision of necessary materials, however management also has no control over this choice and recognizes that this frequently leads to cost variances, particularly over shorter time periods.

The cost of labour incurred in any given period is reflective of the Company's continual efforts to match, as closely as possible, labour supply with current and expected future demand. As an element of this supply management it is common for labour supply costs to move in the same direction as revenues, albeit with a lesser variance than revenues. This common result was realized this period as labour supply costs have declined 3.5% year-to-date including a 4.3% decline in the most recent quarter.

The net change in finished goods and work in process is a measure of the change in labour costs included in inventory. This cost must be combined with labour supply costs to determine the net labour costs included in cost of product sales. The aggregate costs of \$343,266 for the six month period, represent a 10.4% reduction from last year while costs for the quarter of \$176,951 are virtually identical to the \$176,425 incurred one year prior. As noted previously, the Company continually strives to match labour supply with current and expected future demand. There are times however, like the recent quarter, where this matching is less feasible due to changes in customer orders, paid public holidays, and other factors beyond the Company's control.

Depreciation is a function of time and the carrying value of the manufacturing equipment in use. No significant additions have been necessary in recent years so depreciation costs continued to decline. Management continually evaluates equipment needs and monitors the equipment market for opportunities, but there are no major equipment additions currently being investigated.

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. These costs are closely monitored and are 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 December 31 were as follows:

Six month periods ended December 31	2019	2018	Change
Employee and consultant compensation	\$ 481,076	\$ 499,991	\$ (18,915)
Occupancy costs	138,518	128,334	10,184
Professional fees	34,595	30,535	4,060
Shareholder services	6,746	16,494	(9,748)
Insurance	16,144	15,727	417
Other costs	22,110	27,082	(4,972)
Total selling, general and administrative	\$ 699,189	\$ 718,163	\$ (18,974)

Three month periods ended December 31	2019	2018	Change
Employee and consultant compensation	\$ 230,628	\$ 253,632	\$ (23,004)
Occupancy costs	67,772	59,965	7,807
Professional fees	21,421	15,876	5,545
Shareholder services	3,496	13,244	(9,748)
Insurance	8,072	7,799	273
Other costs	12,906	14,183	(1,277)
Total selling, general and administrative	\$ 344,295	\$ 364,699	\$ (20,404)

Employee and consultant compensation costs, which include salaries, benefits, consulting fees, and independent directors' fees, declined 9% in the current quarter providing for a reduction of almost 4% on a year-to-date basis. Most individual elements of this cost category were quite comparable from one period to the other, with the exception being a voluntary reduction in directors fees executed by two independent directors which is not expected to recur.

Occupancy costs underwent a change in the current period with the adoption of IFRS 16. In prior periods the monthly base rental payments were charged as occupancy costs. Under IFRS 16 the base rental payments are now applied as a reduction of the Company's lease liability while depreciation of the right-of-use asset is now accounted for as occupancy costs. The lease payments made in the first six months of the year were \$53,871 and the depreciation charges were \$51,399 so reported occupancy costs are \$2,472 less than they would have been before the adoption of IFRS 16. In spite of this IFRS 16 cost reduction, occupancy costs rose by \$7,807 in the quarter and \$10,184 for the first 6 months. This increase is primarily due to a hydro rebate program that was in effect during the 2nd quarter of 2019 but did not recur during the current quarter. The Company's lease runs through March 2021 and occupancy costs are expected to remain generally comparable throughout that lease term.

Professional fees are comprised of fees for legal services, costs for income tax filings, and a prorated portion of the estimated cost of the upcoming audit of the annual financial statements. Audit fees and tax filing fees have each risen in the current year, primarily due to the timing of billings received and adjustments to prior estimates. Legal fees were essentially comparable, albeit marginally lower at December 2019 as compared to December 2018.

Shareholder services have declined in the current periods as a result of costs incurred during the December 2018 period with respect to the general meeting of shareholders held during that period. No similar charges were incurred during the current year.

Insurance expense and other costs are all closely monitored, are within management expectations, and are reasonably consistent from period to period.

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Results of Operations - continued

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

Six month periods ended December 31	2019	2018	Change
Interest expense ó long term	\$ 5	\$ 896	\$ (891)
Interest expense ó other	3,381	4,975	(1,594)
Interest expense ó lease liability	4,286	-	4,286
Financing fees	7,121	8,963	(1,842)
Total financing expenses	\$ 14,793	\$ 14,834	\$ (41)

Three month periods ended December 31	2019	2018	Change
Interest expense ó long term	\$ -	\$ 387	\$ (387)
Interest expense ó other	1,953	2,487	(534)
Interest expense ó lease liability	1,967	-	1,967
Financing fees	3,652	5,758	(2,106)
Total financing expenses	\$ 7,572	\$ 8,632	\$ (1,060)

The Company had a single long-term debt instrument, which matured in the first month of the current fiscal year, such that there was virtually no expense incurred. With no long-term debt at this time there will be no expense for the foreseeable future.

Interest expense ó other represents interest arising from the use of the Company's operating line as well as miscellaneous interest charges incurred. The Company made less use of its bank operating line in the first two quarters of the current fiscal year, leading to the reduction in interest costs.

As noted previously, the company adopted IFRS 16 Leases effective July 1, 2019. At adoption, the Company recognized a lease liability based on the present value of the remaining lease payments and this liability is subjected to interest accretion over the life of the lease. Prior to July 31, 2019 there was no lease liability recognized and as a result there is no similar expense in the comparative period.

The Company is subject to an agreement with a related party whereby it may offer to sell specific accounts receivable to that related party. If the related party accepts, they assume all collection risks associated with that receivable in exchange for a discount from the face value of the receivable. The discount is accounted for as financing fees at the time of the sale.

Liquidity

At December 31, 2019, the Company had a working capital deficiency of \$32,525 (June 30, 2019 ó Working capital of \$292,444) and current financial assets of \$361,201 (June 30, 2019 ó \$591,575) available to settle current financial liabilities of \$1,052,288 (June 30, 2019 ó \$943,985). The Company also has access to a \$250,000 bank operating line, of which \$140,000 (June 30, 2019 ó \$150,000) had been drawn as of December 31, 2019.

Subsequent to December 31, 2019, the Company entered into an agreement to settle \$153,500 in debt owing to related parties in exchange for 1,023,000 common shares. This settlement has not closed as of the date of this document. The debt being settled is included in financial liabilities at December 31, 2019 and contributed to the working capital deficiency.

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, 2019:

	Due by Dec. 2020	Due by Dec. 2021	Due after Dec. 2021	Total Due
Lease liability	\$ 103,503	\$ 26,809	\$ -	\$ 130,312

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Capital Resources

The Company has a \$250,000 commercial line of credit from which \$75,000 (June 30, 2019 - \$150,000) was drawn as at September 30, 2019. The loan bears interest at the TD Bank prime lending rate plus 2.5%, is due upon demand, and is secured by a general security agreement covering the assets of PEC.

The Company has not issued any securities since June 30, 2019. In January 2020 the Company announced a non-brokered private placement whereby it will raise up to \$300,000 in gross proceeds through the issuance of up to 2,000,000 working capital units. Each working capital unit will be comprised of one common share and one share purchase warrant with each warrant entitling the holder to acquire one common share for \$0.25 for a period of one year following closing. Eligible Finders may receive up to 7% of the value of the proceeds of the sale of working capital units in cash and up to 7% of the number of working capital units sold in the form of broker warrants. Each broker warrant will entitle the holder to acquire one common share at a price of \$0.15 for one year from closing. There have been no closings as yet and this private placement remains open.

Related Party Transactions

The Company had transactions during the period with key management personnel and with 1114377 Ontario Inc., a company controlled by the spouse of a Director of Permotech Electronics Corporation. These include consulting fees paid to Steve Smith (President and CEO), consulting fees paid to Michael D. Kindy (CFO), Directors' fees paid to independent Directors, salaries and benefits paid to Wojciech Drzazga and John Perreault as officers of Permotech Electronics Corporation, legal fees paid to a legal firm in which William R. Johnstone (Corporate Secretary) is a partner, financing fees paid to 1114377 Ontario Inc., and share-based payments related to key management personnel. Compensation rates are agreed to by the related parties and are predicated upon prevailing market rates. The following expenses, involving these related parties, have arisen during the reporting periods:

Six month periods ended December 31	2019	2018
Salaries and benefits ⁽¹⁾	\$ 134,542	\$ 133,001
Consulting fees ⁽¹⁾	96,000	90,719
Directors' fees ⁽¹⁾	15	24,450
Legal fees ⁽²⁾	17,985	18,035
Accounting fees ⁽²⁾	3,500	1,750
Financing fees	7,116	8,395
Legal fees accounted for as share issuance costs	-	6,000
Cash based expenditures	\$ 259,158	\$ 282,350
Share-based payments	\$ -	\$ -

⁽¹⁾ Charged to net income as an element of employee and consultant compensation.

⁽²⁾ Charged to net income as an element of professional fees.

The following balances are due to related parties, and were reported in the unaudited condensed interim consolidated financial statements as an element of accounts payable and accrued liabilities, as at December 31 of each year:

	2019	2018
Salaries and benefits payable	\$ 17,305	\$ 10,669
Consulting and Director fees payable ⁽¹⁾	\$ 402,913	\$ 262,957
Legal fees payable	\$ 30,887	\$ 30,336

⁽¹⁾ Subsequent to December 31, 2019, the Company entered into an agreement to settle \$153,500 in debt owing to related parties in exchange for 1,023,000 common shares. This settlement has not yet closed.

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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 December 31, 2019:

Description	Expiry Date	Number of Common Shares
Stock options @ \$0.05 per share	Mar. 3, 2021	400,000
Stock options @ \$0.95 per share ⁽¹⁾	Jul. 17, 2020	200,000
Stock options @ \$0.95 per share	Jan. 12, 2023	350,000

⁽¹⁾ Subsequent to December 31, 2019, the Director that holds these options resigned. In accordance with the terms of these options the expiry date was amended from Jan. 12, 2023 to Jul. 17, 2020, which is six months from the date of resignation.

During the period ended December 31, 2019, 200,000 stock options held by a director of Permatest Electronics Corporation expired.

Convertible Instruments and Other Securities

The Company has the following securities issued and outstanding:

Shares issued	Quantity	Amount
Common shares as at June 30, 2019, December 31, 2019, and as at the date of this document	21,103,696	\$23,394,174

The Company also has common shares reserved to satisfy the exercise of warrants and options, and other dilutive factors, as follows:

Shares reserved	Expiry Date	Number of Common Shares
Common shares to be issued for Class A shares ⁽¹⁾		8,246
Warrants @ \$0.30 per share	June 2020	23,800
Warrants @ \$0.40 per share	June 2020	220,000
Warrants @ \$0.30 per share	July 2020	15,400
Warrants @ \$0.40 per share	July 2020	170,000
Stock options @ \$0.95 per share ⁽²⁾	Jul. 2020	200,000
Stock options @ \$0.40 per share ⁽³⁾	Jan. 2021	312,500
Stock options @ \$0.05 per share	Mar. 2021	400,000
Warrants @ \$0.06 per share	Dec. 2021	2,900,000
Stock options @ \$0.15 per share	Dec. 2021	50,000
Stock options @ \$0.95 per share	Jan. 2023	350,000
Shares reserved as at Dec. 31, 2019		4,649,946
Debt settlement ⁽⁴⁾		1,023,000
Shares reserved as at the date of this document		5,672,946

⁽¹⁾ Following the 2013 conversion of Class A Special Shares to common shares, 8,246 common shares remain reserved to be issued if and when the remaining Class A shareholders identify themselves to the Company.

⁽²⁾ Subsequent to December 31, 2019, the Director that holds these options resigned. In accordance with the terms of these options the expiry date was amended from Jan. 12, 2023 to Jul. 17, 2020, which is six months from the date of resignation.

⁽³⁾ After December 31, 2019 these warrants were altered such that they may be exercised at \$0.40 until the earlier of January 31, 2021 and the thirty seventh day after the closing price for the Company's shares has been at least \$0.40 for ten consecutive trading days.

⁽⁴⁾ Subsequent to December 31, 2019, the Company entered into an agreement to settle \$153,500 in debt owing to related parties in exchange for 1,023,000 common shares. This settlement has not yet closed.

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Convertible Instruments and Other Securities - continued

The Company has announced a non-brokered private placement which, upon closing, will result in the issuance of common shares, common share purchase warrants, and broker warrants. There have been no common shares issued or reserved for this private placement as at the date of this document.

Fully diluted number of shares	Quantity
Shares issued as at Dec. 31, 2019, and as at the date of this document	21,103,696
Shares reserved as at Dec. 31, 2019	4,649,946
Fully diluted position Dec. 31, 2019	25,753,642
Shares reserved for debt settlement	1,023,000
Fully diluted position as at the date of this document	26,776,642

Additional disclosures relative to stock options are as follows:

	Average Common Shares Under Option	Weighted Price per Option	Average Expiry Date
Balance at June 30, 2019	1,200,000	\$ 0.52	Oct. 12, 2021
Expired during the period	(200,000)	0.35	Jul. 9, 2019
Balance as at Dec. 31, 2019	1,000,000	0.50	Mar. 26, 2022
Altered subsequent to the period ⁽¹⁾	(200,000)	0.95	Jan. 12, 2023
Altered subsequent to the period	200,000	0.95	Jul. 17, 2020
Balance as at the date of this document	1,000,000	\$ 0.50	Sep. 25, 2021

⁽¹⁾ Subsequent to December 31, 2019, the Director that holds these options resigned. In accordance with the terms of these options the expiry date was amended from Jan. 12, 2023 to Jul. 17, 2020, which is six months from the date of resignation.

The following stock options, each of which has vested, are outstanding:

	Common Shares Under Option	Exercise Price	Expiry Date
Granted January 12, 2018	200,000 ⁽¹⁾	\$ 0.95	Jul. 17, 2020
Granted March 3, 2016	400,000 ⁽¹⁾	\$ 0.05	Mar. 3, 2021
Granted December 21, 2016	50,000	\$ 0.15	Dec. 21, 2021
Granted January 12, 2018	350,000 ⁽¹⁾	\$ 0.95	Jan. 12, 2023
Total stock options outstanding	1,000,000		

⁽¹⁾ Directors and/or Officers of the Company hold these options.

The following provides additional details with respect to share purchase warrants to the date of this document:

	Number of Warrants	Weighted Average Price per Warrant	Weighted Average Expiry Date
Balance at June 30, 2019 and December 31, 2019	3,641,700	\$ 0.19	Aug. 16, 2021
Altered after the period	(312,500)	1.10	Jan. 31, 2020
Altered after the period	312,500	0.40	Jan. 31, 2021
Balance as at the date of this document	3,641,700	\$ 0.13	Sep. 27, 2021

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Convertible Instruments and Other Securities - continued

The following weighted average assumptions were used to calculate the fair value of warrants that were issued during the periods ended:

	Dec. 31 2019	June 30 2019
Dividend yield	None issued	Nil
Risk free interest rate (%)	None issued	1.76 to 1.84
Expected stock volatility (%)	None issued	116.25 to 116.52
Expected life (years)	None issued	1.5

The following share purchase warrants are outstanding:

	Number of Warrants	Exercise Price	Expiry Date
Issued Dec. 15, 2016	2,900,000	\$ 0.06	Dec. 15, 2021
Issued Jan. 30, 2018	312,500	\$ 0.40	Jan. 31, 2021
Issued Dec. 28, 2018	220,000	\$ 0.40	June 28, 2020
Issued Dec. 28, 2018	23,800	\$ 0.30	June 28, 2020
Issued Jan. 31, 2019	170,000	\$ 0.40	July 31, 2020
Issued Jan. 31, 2019	15,400	\$ 0.30	July 31, 2020
Total share purchase warrants outstanding	3,641,700		

Changes in Accounting Policy

The Company's accounting policies typically change only when there is a change in IFRS. Effective July 1, 2019 the Company adopted IFRS 16, Leases which eliminates the classification of leases as either operating leases or finance leases and provides a single lessee accounting model, specifying how leases are recognized, measured, presented, and disclosed.

The Company occupies its operating facility under a lease that requires monthly lease payments of \$8,979 until expiry March 2021. A refundable deposit of \$35,000 was paid at the inception of the lease. This lease was previously classified as an operating lease in accordance with IAS 17, with the lease deposit reported as an asset, lease payments charged to net income as occupancy costs, and disclosure of the remaining lease payments as a commitment. The Company adopted IFRS 16 using the modified retrospective approach where comparative amounts are not restated.

Upon adoption of IFRS 16, the Company recognized a lease liability and a right-of-use asset. The lease liability was initially recorded at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate, which was determined to be prime plus 1.75% or 5.7%. The lease liability was subsequently reduced by the lease payments paid and interest, imputed at the discount rate, was added to the obligation. The right-of-use asset was initially recorded at cost, determined to be equal to the present value of the remaining lease payments plus the deposit paid at the inception of the lease. Subsequent to initial recording, the right-of-use asset is measured using the cost model where cost is reduced by any accumulated depreciation, and any accumulated impairment losses, and is adjusted for any remeasurement of the lease liability. Depreciation is calculated on a straight-line basis over the remaining term of the lease and charged to net income as an element of occupancy costs.

There have been no impairment losses and no remeasurement of the lease liability.

Right-of-use asset

Cost recognized upon adoption of IFRS 16	\$	214,897
Depreciation recorded as an element of occupancy costs		(51,399)
Balance at December 31, 2019	\$	163,498

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Changes in Accounting Policy - continued

Lease liability

Present value of lease payments remaining upon adoption of IFRS 16	\$ 179,897
Lease payments paid during period	(53,871)
Interest imputed at 5.7%	4,286
Balance at December 31, 2019	130,312
Less current portion	(103,503)
Balance at December 31, 2019	\$ 26,809

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 period.

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. To help mitigate this risk, management actively manages and monitors its receivables and obtains pre-payments where warranted. It has been determined that all outstanding amounts are collectible. No bad debts were recorded in the periods ended December 31, 2019 or December 31, 2018.

Concentration of credit risk

Concentration of credit risk arises when one or more customers, defined as a major customer, individually account for 10% or more of the Company's revenues during a reporting period. During the six-month period ended December 31, 2019 the Company had 3 major customers who represented 16%, 15% and 13% of total revenues. In the comparative period, there were 2 major customer which represented 13% and 10% of revenues. Amounts due from major customers represented 49.9% of accounts receivable at December 31, 2019 (Dec. 2018 - Nil%). The loss of a major 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 all customers 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. At December 31, 2019 the Company had current financial assets of \$361,201 (June 30, 2019 - \$591,575) available to settle current financial liabilities of \$1,052,288 (June 30, 2019 - \$943,985). The Company manages its liquidity risk through the management of its capital (*note 13*) 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.

Subsequent to December 31, 2019, the Company entered into an agreement to settle \$153,500 in current financial liabilities through the issuance of 1,023,000 common shares.

ZTEST Electronics Inc.

Management's Discussion and Analysis

For the Six Month Period Ended December 31, 2019

(Prepared as at February 26, 2020)

Risk Factors - continued

Market risks

The Company is exposed to interest rate risk due a bank operating loan that has a floating interest rate as well as currency risk related to accounts receivable, accounts payable, customer deposits, and nominal amounts of cash, prepaid expenses, and customer deposits denominated in US dollars. Market risks give rise to the potential for future cash flows to fluctuate because of changes in interest rates or foreign exchange rates. Market risks are closely monitored and attempts are made to match foreign cash inflows and outflows. During the current period the Company reported a foreign exchange loss in the amount of \$3,149 (Dec. 2018 ó loss of \$5,786).

Sensitivity to market risks

At December 31, 2019, the Company had:

- A bank operating loan in the amount of \$140,000 (June 30, 2019 - \$150,000) which bears interest predicated upon the TD Bank prime lending rate. Based upon the current amount due on the operating loan, a 1% increase in the TD Bank prime lending rate, as at the financial reporting date, would result in additional interest expense ó other of \$1,400 over the next 12 month period.
- US\$132,741 (June 30, 2019 ó US\$74,831) included in accounts receivable. A 10% increase in the value of the Canadian dollar relative to the US dollar would result in a reduction of \$4,053 in future cash inflow.
- US\$97,876 (June 30, 2019 ó US\$155,987) included in accounts payable. A 10% decrease in the value of the Canadian dollar relative to the US dollar would result in an increase of \$2,988 in future cash outflow.

Based upon observations of recent market trends management believes that each of these outcomes is possible.

Forward-looking Information

Certain statements in this MD&A may constitute óforward-lookingö 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 óestimateö, óbelieveö, óanticipateö, óintendö, óexpectö, óplanö, ómayö, óshouldö, ówillö, 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 above under the heading óRisk Factorsö.

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.