

## **ZTEST Electronics Inc.**

Management's Discussion and Analysis

For The Three Month Period Ended December 31, 2010

(Prepared as at February 25, 2011)

---

### **General**

The following Management Discussion and Analysis ("MD&A") has been prepared by the Company's management, without review or comment from the Company's auditors, to accompany the unaudited interim consolidated financial statements of the Company as at December 31, 2010 and should only be read in conjunction with those financial statements. Additional information about the Company can be found at [www.sedar.com](http://www.sedar.com).

### **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.

### **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:

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

<sup>(1)</sup> Denotes member of audit committee

<sup>(2)</sup> Denotes member of compensation committee

## **ZTEST Electronics Inc.**

Management's Discussion and Analysis

For The Three Month Period Ended December 31, 2010

(Prepared as at February 25, 2011)

---

### **Corporate Performance**

During the second quarter of 2011 the Company achieved many positive results. Total revenues of \$1,112,591 make it the third consecutive quarter where revenues exceeded \$1,000,000, the fourth consecutive quarter where revenues exceeded those of the comparable quarter one year earlier, and the third straight quarter where revenues surpassed those reported for the comparable period two years previous. The Company also reported positive cash flows from operations, improved its working capital position, added to its total equity, reduced its total liabilities, and increased the total capital under management. The only negative result is that the Company reported a net loss from operations and a net loss for the period although each of these losses are less than the amount of stock option compensation reported for the period.

The Company made many progressive moves during the global economic downturn including the acquisition of a new line of equipment and the restructuring of many of its financial liabilities. Management asserted that these undertakings, along with other progressive moves, would enable the Company to broaden its product offerings, grow its revenue base and finance that growth internally. The results of the current and other recent quarters tend to support this assertion. Some of the economic uncertainty that precipitated these moves remains however there are many indications, at least domestically, that the worst is now behind us. The Company intends to continue to seek strategic enhancements and to continue to realize continued improvements in liquidity, financial position, and return on investment for the Company's shareholders.

The debt restructuring that was undertaken in previous periods was done as a means of preserving cash flows at a time when revenues were declining. Since revenues began to improve there has been a renewed focus on reducing the amount of debt. As at December 31, 2009 the aggregate carrying value of the Company's short-term and long-term borrowing was \$1,697,150, a figure that was equivalent to 88.5% of the Company's total assets. In the past twelve months the Company has not only reduced this debt burden by \$252,774, or 14.9%, but has also managed to grow its asset base by 15.4%.

With respect to debt, it is also noteworthy that at December 2009 only 58% of the total debt related specifically to the acquisition of equipment. The remaining 42% related to the financing of working capital or to financing historical operations. Not only has the Company succeeded in repaying all of the short-term working capital financing but the recently concluded quarter represents the third consecutive fiscal quarter for which no new working capital financing was required. Not only does this mean that the financing that is not related to equipment acquisitions has been reduced to 34% of the total at December 2010 but it also reinforces the belief that the Company is capable of self-financing its operations.

Notwithstanding all of the positive results achieved thus far in fiscal 2011 there are still some economic conditions that remain beyond the Company's control. At present there is a market-wide shortage of electronic components resulting from demand exceeding supply. This shortage causes delays in the receipt of required components, for both the Company and for the customers that supply their own parts, and the delays force some assembly work to be deferred. This is not only causing the realization of revenues to be delayed but is also creating some situations where the Company has unutilized capacity. Although demand for the Company's assembly and procurement services remain strong, and are even increasing in some instances, the impact of this market situation on immediate results cannot be accurately predicted.

Although Q3 revenues likely will not reach the same level as Q1 or Q2 it is still anticipated that revenues for the immediate future will remain strong thereby allowing the Company to continue its debt reduction, as well as the trends of six consecutive quarters for which total liabilities have declined and four consecutive quarters for which capital under management has increased. Management is aware that progress in each of these areas is symbolic of reduced business risks and will continue to emphasize this in the future.

## ZTEST Electronics Inc.

Management's Discussion and Analysis

For The Three Month Period Ended December 31, 2010

(Prepared as at February 25, 2011)

### Corporate Performance - continued

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

|                                       | For the fiscal years ended: |                |                |
|---------------------------------------|-----------------------------|----------------|----------------|
|                                       | <u>June 10</u>              | <u>June 09</u> | <u>June 08</u> |
| Total Revenues                        | 3,837,630                   | 3,435,283      | 4,066,902      |
| Net income (loss) from operations     | 266,210                     | (165,302)      | 250,963        |
| Per share <sup>(1)</sup>              | 0.051                       | (0.031)        | 0.048          |
| Net income (loss) for the period      | 380,613                     | (196,656)      | 237,958        |
| Per share <sup>(1)</sup>              | 0.072                       | (0.037)        | 0.045          |
| Total assets                          | 2,255,703                   | 2,119,699      | 1,591,396      |
| Total long-term financial liabilities | 1,352,187                   | 1,390,403      | 497,844        |
| Total liabilities                     | 2,786,454                   | 3,037,900      | 2,401,374      |

  

|                                       | For the three month periods ended: |                 |                |                |                |
|---------------------------------------|------------------------------------|-----------------|----------------|----------------|----------------|
|                                       | <u>Dec. 10</u>                     | <u>Sept. 10</u> | <u>June 10</u> | <u>Mar. 10</u> | <u>Dec. 09</u> |
| Total Revenues                        | 1,112,951                          | 1,118,324       | 1,408,769      | 888,849        | 777,838        |
| Net (loss) income from operations     | (51,768)                           | 91,021          | 267,162        | 48,105         | (19,073)       |
| Per share <sup>(1)</sup>              | (0.010)                            | 0.017           | 0.051          | 0.009          | (0.004)        |
| Net (loss) income for the period      | (51,768)                           | 86,883          | 381,565        | 48,105         | (19,073)       |
| Per share <sup>(1)</sup>              | (0.010)                            | 0.017           | 0.073          | 0.009          | (0.004)        |
| Total assets                          | 2,212,766                          | 2,250,671       | 2,255,703      | 1,895,945      | 1,918,100      |
| Total long-term financial liabilities | 1,227,289                          | 1,115,540       | 1,352,187      | 1,348,797      | 1,350,369      |
| Total liabilities                     | 2,639,707                          | 2,694,540       | 2,786,454      | 2,814,543      | 2,884,984      |

  

|                                       | For the three month periods ended: |                |                |                |                 |
|---------------------------------------|------------------------------------|----------------|----------------|----------------|-----------------|
|                                       | <u>Sept. 09</u>                    | <u>June 09</u> | <u>Mar. 09</u> | <u>Dec. 08</u> | <u>Sept. 08</u> |
| Total Revenues                        | 762,174                            | 785,581        | 690,777        | 928,499        | 1,030,426       |
| Net (loss) income from operations     | (29,984)                           | (180,183)      | (26,845)       | 601            | 41,125          |
| Per share <sup>(1)</sup>              | (0.006)                            | 0.035          | (0.005)        | 0.000          | 0.008           |
| Net (loss) income for the period      | (29,984)                           | (211,537)      | (26,845)       | 601            | 41,125          |
| Per share <sup>(1)</sup>              | (0.006)                            | (0.041)        | (0.005)        | 0.000          | 0.008           |
| Total assets                          | 1,959,494                          | 2,119,699      | 1,291,890      | 1,322,065      | 1,566,082       |
| Total long-term financial liabilities | 1,416,359                          | 1,390,403      | 474,187        | 414,131        | 442,318         |
| Total liabilities                     | 2,907,491                          | 3,037,900      | 2,084,721      | 2,088,625      | 2,334,073       |

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

<sup>(1)</sup> Earnings per share figures for each period have been restated to give retroactive effect to the share consolidation transaction that occurred April 2010.

### Results of Operations

For the second quarter of 2011 the Company has reported total revenues in the amount of \$1,112,951 thereby increasing the year to date total to \$2,231,275. Each of these figures represents a significant increase over fiscal 2010 figures when quarterly revenues amounted to \$777,838 and the six month total was \$1,540,012. The current period amounts represent a continuance of the resurgence that the Company has realized following the economic downturn that caused depressed revenue figures for approximately six quarters, including the three and six month periods ended December 31, 2009.

Although revenues continued to be strong the profitability slipped a little bit in the second quarter of 2011. The incurrence of stock option compensation and higher than normal direct labour costs contributed to the recognition of a loss from operations and a net loss for the three month period in the amount of \$51,768. This exceeds the corresponding losses reported for the three months ended December 2009 when both the loss from operations and the net loss amounted to \$19,073. As a result of the profit reported in Q1 2011 the Company remains profitable for the six month period having reported net income from operations of \$39,253 and, after giving recognition to a loss on the sale of equipment, has reported net income for the period of \$35,115.

## **ZTEST Electronics Inc.**

Management's Discussion and Analysis

For The Three Month Period Ended December 31, 2010

(Prepared as at February 25, 2011)

---

### **Results of Operations - continued**

The increased revenues for the current period helped to generate higher gross margin as it rose from \$286,204 in Q2 2010 to \$373,675 for the current quarter. The year to date margin is also higher having risen to \$803,233 from \$572,601. Although the gross margin for the current periods are substantially more than they were in the corresponding periods one year earlier, the growth realized is less than the corresponding growth in periodic revenues. This decline in margin as a percentage of revenues is attributed to an increase in direct labour costs as well as a shift in product mix. Labour costs, as explained below, were a bit of an anomaly in Q2 2011 and are expected to stabilize in the immediate future. Product mix varies continuously and has always caused the periodic gross margin to fluctuate as a percentage of revenue.

Direct labour costs for the current periods ended December 2010, net of the amount charged to inventory, amounted to \$348,646 for the quarter and \$610,458 for the six month period. The year to date figure is 34.5% greater than the amount of \$453,727 for the corresponding period ended December 2009 which is within expectations given the increase of 44.8% in revenues between those same periods. Quarterly results however have been skewed by the timing of the completion of a particularly labour intensive order. Labour costs for the current quarter are 61.5% greater than the \$215,866 incurred one year earlier. Part of this corresponds with the 43.1% revenue increase that was realized but certainly not all of it. At the beginning of the current quarter there was a total of \$92,892 in labour charges included in inventory. This was an unusually high figure which related primarily to a single order that required a higher than average amount of labour. This particular order was completed during the current quarter and the corresponding labour costs became an element of direct labour costs for the period. Orders of this nature are unusual but not unique and this one was notable only because of its timing. Although the costs were impactful they are not disproportionately significant when averaged over a six month period rather than a three month period.

The element of cost of sales that is most closely correlated with product mix is the cost of components sold. These costs amounted to \$264,876 in the current quarter and \$562,608 for the first six months of the 2011 fiscal year. These figures are not only greater than the amounts of \$164,865 and \$294,706 incurred during the corresponding periods in fiscal 2010 but they are also greater when taken as a percentage of revenues. These costs are inversely correlated with gross margin, when each is computed as a percentage of revenues, and the rise in costs during the current periods contributed to the reduction of gross margin as a percentage of sales. The Company recognizes and promotes the costs effectiveness associated with procuring components on its customers' behalf but this is an added service that some customers do not opt to take advantage of. Since this service is clearly discretionary it will continue to vary from period to period and will continue to have an impact upon gross margin percentages.

After labour and component costs the next most significant element of cost of sales is the amortization of production equipment. No significant equipment acquisitions have occurred since May 2009 and as a result amortization costs have fallen from \$62,629 and \$125,259 for the three and six month periods ended December 2009 to \$50,520 and \$111,215 for the December 2010 periods. The Company is currently having a new machine installed and when this machine, expected to have a cost of \$80,000, is operational an increase in amortization costs will arise.

Production supplies represent the items that are used during the assembly process but are not of sufficient relevance for the benefit of tracking their specific usage to exceed the cost of doing so. Handling of these supply items is controlled but no attempt is made to record consumption on an item by item basis. Usage is reasonably correlated with operating volumes but since the timing of replenishment drives the costs incurred the relationship is not absolute. The cost of these supplies amounted to \$31,672 for Q2 2011 and was \$71,248 for the six month period. As expected, the corresponding 2009 figures were lower at \$25,902 and \$46,214 but the variance is not consistent with the change in revenues.

The remaining elements of cost of sales are equipment maintenance, freight, packaging supplies, and other incidental charges. None of the costs incurred for these expenses are significant for any of the periods being discussed. These costs are monitored regularly by management and are within expectations so the variance, if any, in the amounts recognized for each period have not been investigated.

## **ZTEST Electronics Inc.**

Management's Discussion and Analysis

For The Three Month Period Ended December 31, 2010

(Prepared as at February 25, 2011)

---

### **Results of Operations - continued**

Selling, general and administrative expenses ("SG&A") continue to exceed amounts reported in the previous year. Although these costs do not correlate specifically with operating values or volumes some similarities will typically arise given that employee and consultant remuneration represents approximately 63% of total SG&A on a historical basis. Over the three most recent quarters, when revenues have exceeded \$1,000,000, the Company has experienced a return to more historical levels for SG&A. The costs incurred during the quarter ended December 2010 amounted to \$384,142 raising the year to date figure to \$683,354. In contrast the amounts reported at December 2009 were \$259,840 and \$522,855. Although the current period costs, as explained in the following paragraphs, are a little higher than the norm it is unrealistic to anticipate a return to 2009 levels unless economic conditions should decline unexpectedly.

Employee and consultant remuneration increased from \$149,978 for the quarter ended December 2009 to \$255,563 in the current period. The year-to-date figures have also increased from \$306,346 to \$446,162. One significant change in Q2 2011 is the recognition of \$68,696 in stock option compensation. This arose as a consequence of options that were issued to Directors and Officers during the quarter and vested immediately upon issuance. In contrast, compensation expense to December 2009 amounted to only \$186 for the quarter and \$374 for the six month period. Those amounts were due to the vesting of options issued to a consultant many periods before. Historically, stock options were granted annually and vested over a four year period. The current grant represents the first time in almost five years that options have been granted so the vesting period was waived. Even without stock option compensation the current quarter remuneration costs would still have been \$186,867 or more than 24% over 2009 amounts. This hypothetical figure would be very similar to the actual total of \$190,599 reported in the preceding quarter and to the \$192,674 reported for the quarter ended December 2008. As noted previously the increase would better be described as a return to historical levels due to the cessation of cost reduction practices employed during the periods when revenues were depressed as a consequence of the economic downturn.

Occupancy costs for the current quarter amounted to \$79,911 which represents an increase of 4.3% over the \$76,584 reported at December 2009. The costs for the six month periods are also fairly similar having risen 3.4% from \$156,009 in 2009 to \$161,257 currently. These increases are well within expectations and relate to the variance in the demand for utilities and changes in rates related to utilities, realty taxes and common area maintenance charges. The base rent has remained consistent for many periods now but will decline next quarter as the lower lease rates associated with the new lease term that commences January 1, 2011 take effect.

Professional fees amounted to \$19,288 for Q2 2011 making the six-month total \$31,288. These costs are a little higher than the amounts of \$14,350 and \$28,048 reported at December 2009. A portion of the Q2 expense actually relates to Q1 as charges incurred were a little higher than were estimated at the time. Management takes all reasonable steps to limit and control these expenses and there were no specific events that led to the difference between the periods.

There are no other expenses that were individually significant elements of SG&A for either the current or comparable periods. These remaining expenses include regulatory fees, insurance and other miscellaneous charges. Each of these costs is monitored closely by management and is only noteworthy in the event that something out of the ordinary arises and nothing has.

Interest expense for the current three and six month periods amounted to \$37,425 and \$75,079. As noted previously the Company has made a concerted effort to reduce its debt burden and this has resulted in a 15.8% reduction in costs for the quarter and 17.1% year-to-date when compared to December 2009 amounts. One year ago, interest on short-term borrowings was \$3,446 for the three month period and \$7,409 for the six month period and no similar costs arose in the current periods as there were no short term borrowings. The benefit of the debt reduction does not stop there however as interest on long term debts was also greater in the fiscal 2010 periods at \$39,906 for the quarter and \$80,544 for six months. While the incurrence of new debt may arise in the appropriate circumstances there is currently no expectation of new debt and accordingly interest costs should continue to be less than those incurred during the preceding year.

## ZTEST Electronics Inc.

Management's Discussion and Analysis

For The Three Month Period Ended December 31, 2010

(Prepared as at February 25, 2011)

---

### Liquidity

For the fourth consecutive quarter the Company has realized a reduction in its working capital deficiency. As at December 31, 2010 the deficiency amounted to \$131,199 representing a decline of \$19,211 during the quarter and \$640,300 in the past twelve months. These working capital improvements coincide with growth in net equity and reductions in total liabilities.

During the second quarter total liabilities were reduced by \$54,833 while net equity improved by almost \$17,000. Since December 2009 net equity has increased by almost \$540,000 while total liabilities declined by \$245,277. It is anticipated that debt and equity improvements will continue but also that working capital improvements may become more difficult to achieve. The additional pressure on working capital is due to the fact that the current portion of long term debt is growing as the debts progress towards maturity. Working capital improved in each of the first two fiscal quarters of this year even though the current portion of long term debt rose by approximately \$40,000 in each period but this should not be interpreted to mean that further improvements will occur.

It should be noted that the working capital deficiency continues to include the sum of \$781,656 which remains in current liabilities on account of preferred shares that matured during Q4-2007, the unpaid dividends thereon, and a debenture that matured December 2005. No repayments of these obligations have occurred subsequent to their maturity dates and will not occur unless suitable repayment arrangements can be negotiated.

In addition to satisfying the cost of operations the Company must also address the payment or other settlement of the following amounts:

|                                     | Due by<br><u>Dec. 2011</u> | Due by<br><u>Dec. 2013</u> | Due by<br><u>Dec. 2015</u> | Due after<br><u>Dec. 2015</u> | Total<br><u>Due</u> |
|-------------------------------------|----------------------------|----------------------------|----------------------------|-------------------------------|---------------------|
| Repurchase of preferred shares      | 665,501                    | -                          | -                          | -                             | 665,501             |
| Settlement of dividends payable     | 268,201                    | -                          | -                          | -                             | 268,201             |
| Matured debenture                   | 39,600                     | -                          | -                          | -                             | 39,600              |
| Other long-term debt <sup>(1)</sup> | 197,216                    | 1,133,193                  | 134,410                    | -                             | 1,464,819           |
| Operating leases                    | 81,486                     | 172,932                    | 181,986                    | 549,352                       | 985,756             |
| Total                               | <u>1,252,004</u>           | <u>1,306,125</u>           | <u>316,396</u>             | <u>549,352</u>                | <u>3,423,877</u>    |

<sup>(1)</sup> Other long-term debt includes three obligations that each has a carrying value that is lower than their respective face values. The financial statements as at December 31, 2010 report these obligations based upon their carrying values while the figures reported above represent the non-discounted cash payments to be made in accordance with the face value amounts.

### Capital Resources

Management continually evaluates the Company's equipment requirements and monitors the marketplace for opportunities to upgrade existing equipment at favourable prices. During the second quarter the Company took delivery of a refurbished machine that is expected to provide greater capability and capacity than the one the Company is currently utilizing. The installation of this machine, which is expected to cost approximately \$80,000 to acquire and install, is currently in process. Deposits aggregating \$47,871 had been paid as at December 31, 2010 and the remaining costs are expected to be paid from working capital once the machine is operational.

The Company does not have any loan facilities in place to provide for future working capital requirements, if any, or for future capital acquisitions. The Company has, however, reserved 2,700,000 common shares in connection with a proposed financing transaction. Under the terms of this financing the Company would issue up to 1,800,000 units at \$0.075 each for gross proceeds of up to \$135,000. Each unit would be comprised of one common share and one-half share purchase warrant with each full warrant entitling the holder to acquire an additional common share for \$0.15 for a period of five years from the closing date of the transaction. This financing has not yet opened and, accordingly, no units had been subscribed for or issued as of the date of this document.

## ZTEST Electronics Inc.

Management's Discussion and Analysis

For The Three Month Period Ended December 31, 2010

(Prepared as at February 25, 2011)

---

### Related Party Transactions

The Company has participated in a number of transactions with the Company's Officers, Directors, their spouses, companies that are considered related as a consequence of the involvement of one or more of these individuals, and a corporation that holds more than 10% of the Company's issued common shares.

The majority of these related party transactions involve the provision of financing to the Company along with the corresponding interest expense. All related party transactions are in the normal course of operations and have been carried out on the same terms as those accorded to unrelated parties.

The following balances are due to the related parties defined above as at the following dates:

|                            | 2010           |                | 2009           |                |
|----------------------------|----------------|----------------|----------------|----------------|
|                            | <u>Dec. 31</u> | <u>June 30</u> | <u>Dec. 31</u> | <u>June 30</u> |
| Loan payable at prime + 8% | 196,068        | 199,042        | -              | -              |
| Notes payable at 12.0%     | -              | -              | 72,822         | 116,572        |
| Term loan payable at 8.0%  | -              | -              | 37,971         | 37,971         |
| Term loans payable at 12%  | -              | -              | 161,383        | 161,383        |

The following income and expense items have arisen as a result of transactions involving the related parties defined above:

|                              | 2010           |                | 2009           |                |
|------------------------------|----------------|----------------|----------------|----------------|
|                              | <u>Dec. 31</u> | <u>June 30</u> | <u>Dec. 31</u> | <u>June 30</u> |
| Interest expense – long term | 10,749         | 22,954         | 10,985         | 20,981         |
| Interest expense – other     | -              | 9,002          | 7,121          | 14,588         |

The following stock options have been issued to Directors and/or Officers of the Company and remain outstanding as at the date of this document:

| <u>Description</u>               | <u>Expiry Date</u> | <u>Number of Common shares</u> |
|----------------------------------|--------------------|--------------------------------|
| Stock options @ \$2.04 per share | June 2011          | 75,000                         |
| Stock options @ \$0.10 per share | Nov. 2015          | <u>900,000</u>                 |
|                                  |                    | <u>975,000</u>                 |

### Convertible Instruments and Other Securities

As at December 31, 2010, and as at the date of this document, the Company had the following securities issued and outstanding:

| <u>Description</u>                            | <u>Quantity</u> | <u>Amount</u>        |
|---|-----------------|----------------------|
| Common shares                                 | 5,262,488       | \$ 21,681,409        |
| Paid in capital of preferred shares           |                 | 191,646              |
| Class A special shares                        | 1,193,442       | <u>100,000</u>       |
|   |                 | <u>\$ 21,973,055</u> |
| Series A preferred shares                     | 166,667         | 160,000              |
| Series C preferred shares                     | 288,858         | <u>505,501</u>       |
|   |                 | 665,501              |
| Less: amount accounted for as paid in capital |                 | <u>191,646</u>       |
| Liability element of preferred shares         |                 | 473,855              |
| Less: amount reported as a current liability  |                 | <u>(473,855)</u>     |
| Equity element of preferred shares            |                 | <u>\$ -</u>          |

In addition to the shares issued and outstanding the Company has reserved shares in relation to a proposed financing transaction and for the potential exercise of stock options as reflected in the following chart.

## ZTEST Electronics Inc.

Management's Discussion and Analysis  
For The Three Month Period Ended December 31, 2010  
(Prepared as at February 25, 2011)

---

### Convertible Instruments and Other Securities - continued

| <u>Description</u>   | <u>Expiry Date</u> | <u>Number of<br/>Common shares</u> |
|--|--------------------|------------------------------------|
| Stock options @ \$2.04 per share                               | June 2011          | 75,000                             |
| Stock options @ \$0.10 per share                               | Nov 2015           | <u>900,000</u>                     |
| Shares reserved as at December 31, 2010                        |                    | 975,000                            |
| Shares reserved for potential financing <sup>(1)</sup>         |                    | <u>2,700,000</u>                   |
| Shares reserved as at the date of this document                |                    | <u><u>3,675,000</u></u>            |
| Shares issued as at December 31, 2010                          |                    | 5,262,488                          |
| Shares reserved as at December 31, 2010                        |                    | <u>975,000</u>                     |
| Fully diluted position as at December 31, 2010                 |                    | 6,237,488                          |
| Shares reserved subsequent to December 31, 2010 <sup>(1)</sup> |                    | <u>2,700,000</u>                   |
| Fully diluted position as at the date of this document         |                    | <u><u>8,937,488</u></u>            |

<sup>(1)</sup> Subsequent to the balance sheet date the Company reserved the shares associated with a proposed financing arrangement whereby up to 1,800,000 units may be issued at a price of \$0.075 each for gross proceeds of up to \$135,000. Each unit is comprised of one share and one-half share purchase warrant with each full warrant entitling the holder to acquire an additional common share at a price of \$0.10 for a period of 5 years from the closing date.

Additional disclosures relative to stock options are as follows:

|                     | <u>Common Shares<br/>Under Option</u> | <u>Weighted Average<br/>Price/Option</u> | <u>Weighted Average<br/>Expiry Date</u> |
|---------------------|---------------------------------------|--|---|
| Beginning of period | 79,167                                | \$2.031                                  | June 8, 2011                            |
| Expired             | (4,167)                               | \$1.860                                  | July 10, 2010                           |
| Granted             | <u>900,000</u>                        | \$0.100                                  | Nov. 30, 2015                           |
| End of period       | <u><u>975,000</u></u>                 | \$0.250                                  | July 28, 2015                           |

While the remaining stock options are held by related parties, the Company has no ability to cause any of the items noted above to be exercised.

### Changes in Accounting Policy

The accounting policies followed by the Company are established in accordance with Canadian GAAP and once policies are established they will not, as a matter of policy, be revised unless Canadian GAAP changes. The following aspects of Canadian GAAP will be changing in the future and, accordingly, will cause the Company's accounting policies to change:

#### International reporting standards:

In February 2008, the Accounting Standards Board ("AcSB") confirmed that the transition to International Financial Reporting Standards ("IFRS") from Canadian GAAP will occur on January 1, 2011 for public entities. Although early adoption is permissible the Company has determined that it will commence reporting under these new standards for its fiscal year ended June 30, 2012 in accordance with the implementation deadline. While all aspects of the implementation are not yet known with certainty it is anticipated that the financial reporting impact of the transition to IFRS will be minimal.

The changeover to the new standards will occur on July 1, 2011 and the first fiscal period which will be reported upon under the new standards will be the quarter ended September 30, 2011. An initial review of key areas for which changes to accounting policies may be required has been completed and it revealed that changes are expected to be minimal. Notwithstanding this result however, the Company has commenced a comprehensive review of each of its accounting policies to determine what policy alternatives are available under IFRS and the exact extent, if any, that each policy will change. This review will be conducted throughout the 2011 fiscal year. To the extent that policy changes are required, they will be identified, quantified and disclosed in the immediately subsequent MD&A.

## **ZTEST Electronics Inc.**

Management's Discussion and Analysis

For The Three Month Period Ended December 31, 2010

(Prepared as at February 25, 2011)

---

### **Financial Instruments**

The Company has determined the most appropriate classification for its financial instruments such that cash is classified as held for trading and is measured at fair value. Accounts receivable has been classified as loans and receivables and accounts payable, accrued liabilities, customer deposits, deferred revenue, dividends payable, notes payable, long-term debt and preferred shares are classified as other financial liabilities, which are measured at amortized cost. These classifications have remained unchanged since initial recognition.

The carrying amounts of cash, accounts receivable, customer deposits and deferred revenue, accounts payable and accrued liabilities, and notes payable approximate their fair values due to the short-term maturities of these instruments. Long-term debts are recognized initially at fair value. Whenever there is a difference between face value and fair value that difference is amortized on a straight line basis over the remaining term of the debt. It is not practicable to determine the fair value of preferred shares or dividends payable since the timing of cash flows are not known.

### **Risk Factors**

Events seemingly unrelated to us, or to our industry, may adversely affect our finances or operations in ways that are hard to predict or defend against. For example, credit contraction in financial markets may hamper our ability to access credit when needed or rapid changes in foreign exchange rates may adversely affect our financial results. Finally, a reduction in credit, combined with reduced economic activity, may adversely affect businesses and industries that constitute a significant portion of our customer base. As a result, these customers may need to reduce purchases from us, or we 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 our business, operating results, and financial condition.

In addition to the foregoing, the Company is exposed to credit risk, concentration of credit risk, liquidity risk, currency risk, and interest rate 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 risks to which the Company is exposed or to the corresponding risk management strategies during the current period.

#### **Credit risk:**

Credit risk represents the financial loss that the Company would experience if one or more of its customers failed to meet its obligations. The maximum credit exposure is represented by the carrying amount of accounts receivable as reported on the balance sheet. 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 for amounts that may be uncollectible.

#### **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, none of the Company's customers accounted for more than 20% of revenue (2009 – 1 customer at 26.1%). The loss of such a significant customer or significant curtailment of purchases by such customer could have a material adverse affect on the Company's results of operations and financial condition. The Company monitors the relationship with each customer closely and ensures that every customer is subject to the same risk management criteria.

#### **Liquidity risk:**

Liquidity risk represents the potential difficulties that the Company may encounter in meeting obligations associated with financial liabilities. The Company is reporting a working capital deficiency of \$131,119 (June 2010 - \$220,226). This includes a long-term debt, preferred shares and dividends payable, with an aggregate carrying value of \$781,656 (June 2010 - \$781,656), that are each past due. The Company manages its liquidity risk through the management of its capital (see Note 11 to the financial statements) 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.

**ZTEST Electronics Inc.**

Management's Discussion and Analysis

For The Three Month Period Ended December 31, 2010

(Prepared as at February 25, 2011)

---

Currency risk:

Currency risk is the risk that the amount of future cash flows of cash, accounts receivable, accounts payable and accrued liabilities that are denominated in US dollars will fluctuate because of changes in foreign exchange rates. The Company purchases some inventory components and makes some of its product sales in US dollars. The Company monitors its exposure to, but does not actively manage this risk. During the current period the Company reported a net loss on foreign exchange of \$94 (Dec. 2009 – loss of \$5,372).

Interest rate risk:

Interest rate risk represents the possibility that future cash flows arising from financial instruments may fluctuate because of changes in the market rate of interest. The Company has certain long-term debts for which the interest rate is reset periodically in accordance with the prime lending rate of its financial institution. The future monthly payments on these debts will increase or decrease in correlation with the change, if any, in the prime lending rate. The Company manages this risk by establishing fixed interest rates whenever possible.