

## **ZTEST Electronics Inc.**

Management's Discussion and Analysis  
For The Three Month Period Ended March 31, 2016  
(Prepared as at May 24, 2016)

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### **General**

The following management's discussion and analysis ("MD&A") of the financial condition and results of operations of ZTEST Electronics Inc. ("ZTEST" or the "Company") constitutes management's review of the factors that affected the Company's interim condensed consolidated financial and operating performance for the nine months ended March 31, 2016. The MD&A was prepared as of May 24, 2016 and was approved by the Board of Directors on May 24, 2016. It should be read in conjunction with the unaudited interim condensed consolidated financial statements of the Company for the nine months ended March 31, 2016, and the audited consolidated financial statements for the year ended June 30, 2015, 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](http://www.sedar.com).

### **The Company**

The Company is located at 523 McNicoll Avenue, Toronto, Ontario and operates a single business segment designing, developing, and assembling printed circuit boards and other electronic equipment. 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

### **Corporate Performance**

The third quarter of the 2016 fiscal year provided some positive results with improvements in revenues, equity, and capital under management and enhancing its liquidity with growth in working capital and adding to its surplus of current financial assets in excess of financial liabilities.

Cash flows for the nine month period, including cash flows from operating activities, remained positive however utilization in the quarter of \$139,005 in customer deposits and \$25,535 spent on leasehold improvements and small equipment additions turned cash flows for the quarter negative. The leasehold improvements undertaken involved the Company taking advantage of government rebates to transition from traditional incandescent and florescent lighting to more energy efficient LED lighting. This investment is expected to result in lower utility costs over the five years remaining on the Company's lease for its operating facility.

Through three fiscal quarters the Company has generated net income from operations and net income for the period however each of these figures were negative for the most recent quarter. A lower gross margin percentage, increased expenses, and the value attributed to stock options granted during the quarter each contributed to the small loss that was realized.

Management will continue efforts to grow the business and build value for its stakeholders while minimizing business risks and managing cash flows. The following data may provide some additional insights relative to the Company's operating performance and financial position:

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**Corporate Performance - continued**

	For the fiscal years ended:		
	<u>June 15</u>	<u>June 14</u>	<u>June 13</u>
Total Revenues	3,945,720	4,014,268	4,601,698
Net income (loss) income from operations	(33,397)	(21,321)	141,007
Per share - basic	(0.003)	(0.002)	0.017
Net income (loss) for the year	560,333	(18,579)	148,319
Per share - basic	0.053	(0.002)	0.018
Total assets	1,770,999	2,098,100	2,176,189
Total long-term financial liabilities	121,769	158,244	45,788
Total liabilities	720,921	1,638,734	1,759,668

	For the three month periods ended:				
	<u>Mar. 16</u>	<u>Dec. 15</u>	<u>Sept. 15</u>	<u>June 15</u>	<u>Mar. 15</u>
Total Revenues	1,094,232	1,223,691	880,012	1,122,088	1,061,276
Net income (loss) from operations	(15,550)	66,133	(12,066)	111,838	(17,243)
Per share - basic	(0.001)	0.006	(0.001)	0.011	(0.002)
Net income (loss) for the period	(15,550)	65,452	(11,343)	111,838	(17,091)
Per share - basic	(0.001)	0.006	(0.001)	0.011	(0.002)
Total assets	1,843,819	1,890,491	1,820,333	1,770,999	1,600,781
Total long-term financial liabilities	92,149	102,022	111,895	121,769	131,642
Total liabilities	715,377	786,304	781,598	720,921	662,541

	For the three month periods ended:				
	<u>Dec. 14</u>	<u>Sept. 14</u>	<u>June 14</u>	<u>Mar. 14</u>	<u>Dec. 13</u>
Total Revenues	691,622	1,070,734	1,000,676	933,391	945,951
Net income (loss) from operations	(154,718)	26,726	(21,790)	(3,300)	(59,301)
Per share - basic	(0.015)	0.002	(0.002)	(0.000)	(0.006)
Net income (loss) for the period	438,159	27,427	(20,988)	(2,521)	(59,828)
Per share - basic	0.041	0.002	(0.002)	(0.000)	(0.006)
Total assets	1,715,098	1,971,431	2,098,100	2,190,139	1,859,824
Total long-term financial liabilities	141,516	151,388	158,244	177,893	18,830
Total liabilities	759,767	1,484,638	1,638,734	1,709,785	1,381,168

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

**Results of Operations**

Revenues for the recently concluded quarter were \$1,094,232 making this the sixth time in the eight most recent quarters that revenues exceeded \$1,000,000 and maintaining the quarterly average in 2016 above this same threshold. Thus far in the 2016 fiscal year, revenues are 13.3% greater than they were in 2015. This also marks the fourth quarter, out of the last five, for which revenues increased in comparison to the same period one year earlier. While the marketplace remains highly competitive the Company believes it has withstood the effects of market consolidation and the relocation of previously significant customers to the US.

Gross margins realized during the recent quarter amounted to \$327,370 or 29.9% of revenues which compares favourably to the March 2015 results of \$270,844 and 25.5% of product sales. The March 2015 results included untypical sales of materials to departing customers in the amount of \$128,514, and for which the materials cost was \$125,257. If these unusual sales had not occurred then the gross margins for that period would have been \$267,587 and 28.7% of revenues. While still less than was realized in 2016 the disparity is not as great as it appears at first glance.

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**Results of Operations - continued**

Gross margins for the nine month period amounted to 33% of product sales which continues to be ahead of the 2015 rate of 27.7%, or 28.9% if the unusual sale noted above is disregarded. Maximization of gross margins is always an objective however percentages will fluctuate from period to period with changes in production volumes and product mix. The figures to March 31, 2016 are in line with expectations.

The cost of product sales for the periods ended March 31 was as follows:

Nine month periods:	2016	2015	Change
Raw materials and supplies consumed	\$ 1,424,074	\$ 1,335,888	\$ 88,186
Labour costs incurred	554,433	500,399	54,034
Depreciation	79,816	99,269	(19,453)
Repairs and maintenance	40,806	33,220	7,586
Other costs	73,923	66,260	7,663
Net change in finished goods and work in process	(31,265)	6,710	(37,975)
Total cost of product sales	\$ 2,141,787	\$ 2,041,746	\$ 100,041

Three month periods:	2016	2015	Change
Raw materials and supplies consumed	\$ 514,733	\$ 581,973	\$ (67,240)
Labour costs incurred	189,067	146,509	42,558
Depreciation	26,790	33,090	(6,300)
Repairs and maintenance	25,265	8,889	16,376
Other costs	24,462	21,331	3,131
Net change in finished goods and work in process	(13,455)	(1,360)	(12,095)
Total cost of product sales	\$ 766,862	\$ 790,432	\$ (23,570)

Material costs for the three month period ended March 31, 2016 are, on the surface, less than the amount incurred for the comparable period one year earlier. The 2015 amount, however, included materials with a cost of \$125,257 which were sold to departing customers. It is common for the Company to sell excess parts to customers when production of the related product ceases however the values involved are almost always incidental. Exclusion of the amount from the 2015 figures enhances comparability and results in there being a cost increase of \$58,017 for the most recent quarter and \$213,443 for the nine month period. Although the costs rose in value they have declined as a percentage of revenues. For the three and nine month periods ended March 2016 these costs represented 47.0% and 44.5%, respectively, of periodic revenues. For the comparable periods ended March 2015 they were 48.9% and 44.9%. These variances are relatively small, and well within expected levels of fluctuation, however the lower percentages support that a greater proportion of the 2016 periodic revenues were derived from assembly work. Although the Company consistently promotes turnkey services as a cost effective solution for its customers it remains a discretionary service and accordingly costs are expected to vary from period to period.

Labour cost incurred, a measure of labour paid for during the period, rose of 29% for the quarter and 11% for the nine month period. In December 2014 the Company implemented a government approved work-share program which did not recur in the current year. Looking back to the periods ended March 31, 2014, when no work-share was in effect, the three-month costs were \$201,046 and the nine-month costs were \$557,487 or reasonably comparable to the March 2016 results.

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### Results of Operations - continued

The total labour costs included in cost of product sales is determined by combining the labour cost incurred with the net change in finished goods and work in process. These combined figures have risen by 21% for the quarter, still reflecting the impact of the 2015 work-share program noted above. When considered as a percentage of revenues, however, they are far more comparable as they amounted to 16% in 2016 and 15.6% of 2015 revenues, adjusted to remove the parts sales. This minor increase is expected given that a greater proportion of revenues were derived from assembly work. Costs for the nine month period have declined from 18.8% of revenues to 16.4%. This is the lingering effect of the anomalous period ended December 2014, prompting the start of the work-share program.

Depreciation has no correlation with operating volumes as it is purely a function of time and the carrying value of the manufacturing equipment in use. There have been no significant acquisitions since the final quarter of the 2014 fiscal year and no major equipment additions are currently being investigated. Management remains diligent in monitoring the equipment market for opportunities that could help increase productivity or profitability.

Repair and maintenance costs for the quarter were higher in 2016 than they had been in 2015 due to the timing of a reasonably significant repair completed during the period. The Company has a recurring maintenance program in effect however that does not lead to consistency in the timing or extent of repairs that arise from time to time. The nine month results are far less dissimilar reflecting that a repair had occurred in the first quarter of the 2015 period. The Company will continue its program of regular maintenance and will undertake additional repair and maintenance whenever it may be warranted.

Other costs include 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.

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

Nine month periods ended March 31	2016	2015	Change
Employee and consultant compensation	\$ 606,460	\$ 591,234	\$ 15,226
Occupancy costs	200,108	196,626	3,482
Professional fees	64,625	46,911	17,714
Shareholder services	30,543	19,942	10,601
Insurance	23,923	25,698	(1,775)
Other costs	47,846	34,888	12,958
<b>Total selling, general and administrative</b>	<b>\$ 973,505</b>	<b>\$ 915,299</b>	<b>\$ 58,206</b>

Three month periods ended March 31	2016	2015	Change
Employee and consultant compensation	\$ 201,372	\$ 184,614	\$ 16,758
Occupancy costs	63,468	64,726	(1,258)
Professional fees	14,462	17,946	(3,484)
Shareholder services	2,945	6,631	(3,686)
Insurance	7,551	8,208	(657)
Other costs	13,868	9,952	3,916
<b>Total selling, general and administrative</b>	<b>\$ 303,666</b>	<b>\$ 292,077</b>	<b>\$ 11,589</b>

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### Results of Operations - continued

Compensation costs include salaries and benefits, consulting fees and directors' fees. The increase in the quarter of the current year, which is essentially equal to the increase year-to-date, represents a return to typical cost levels. The costs for the quarter ended March 2015 were reduced as a result of the work-share program. While each of the component costs reflects minor variations there have been no tangible changes in personnel or in the nature or quantity of services incurred.

Occupancy costs consist primarily of rent and utility charges for the Company's operating facility. Basic rental charges increase by approximately 2% in January of each year. The remaining cost variance is due to changes in utility rates and usage, property tax rates, and other common area costs associated with the lease. The lease for the Company's operating facility runs through March 2021 and these costs are expected to remain generally comparable throughout that lease term.

Professional fees, which are comprised of legal fees and the cost of annual financial reporting, continue to be higher on a year-to-date basis in spite of a decline in quarterly costs. There were no noteworthy changes in the current quarter meaning that the cost decrease was reflective of the typical ebb and flow associated with these services. The year-to-date expenses continue to reflect the incremental costs associated with the Company having moved its share listing from the Canadian Venture Exchange to the Canadian Securities Exchange.

Shareholder services include the cost of public disclosures, distribution of materials to shareholders, stock exchange fees, and transfer agent fees. The nine-month expenses include incremental costs associated with the Company having moved its share listing from the Canadian Venture Exchange to the Canadian Securities Exchange. The costs for the current quarter are beginning to reflect the costs saving that this listing change was expected to provide.

Insurance coverages and costs remain comparable while other costs continue to reflect the impact of the Company's initiation of advertising in the United States. All other aspects of other costs are individually insignificant and, in aggregate, represent less than 5% of total SG&A. These expenses are closely monitored by management and are within expectations.

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

Nine month periods ended March 31	2016	2015	Change
Interest expense ó long term (cash based)	\$ 4,902	\$ 9,220	\$ (4,318)
Interest expense ó long term (accretion)	-	4,372	(4,372)
Interest expense ó other	441	1,368	(927)
<b>Total financing expenses</b>	<b>\$ 5,343</b>	<b>\$ 14,960</b>	<b>\$ (9,617)</b>

Three month periods ended March 31	2016	2015	Change
Interest expense ó long term (cash based)	\$ 1,544	\$ 2,407	\$ (863)
Interest expense ó long term (accretion)	-	306	(306)
Interest expense ó other	136	191	(55)
<b>Total financing expenses</b>	<b>\$ 1,680</b>	<b>\$ 2,904</b>	<b>\$ (1,224)</b>

The Company has, in recent periods, significantly reduced and simplified its debt load. At present there is a single interest bearing debt, being the commercial financing associated with the equipment addition completed in the final quarter of the 2014 fiscal year. Historically there were obligations measured at amortized cost, using the effective interest method, which gave rise to interest accretion. It is anticipated that the present debt structure will persist for the foreseeable future.

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### Results of Operations - continued

Interest ó other represents miscellaneous interest charges incurred while the nine month period ended March 2015 also includes interest arising from the brief use of the operating line.

### Liquidity

The Company continues to have a strong working capital position with a balance of \$697,935 at March 31, 2016. This improved by \$17,332 during the quarter, is \$98,783 greater than it was at the start of the fiscal year, and \$237,763 more than at March 31, 2015. At March 31, 2016 the Company had current financial assets of \$819,269 available to settle current financial liabilities of \$623,228. The Company also has access to a \$250,000 bank operating line, which was not drawn upon as of March 31, 2016 or during the nine month period then ended.

In addition to satisfying the cost of operations the Company must also address the payment or other settlement of the following amounts as at March 31, 2016:

	Due by Mar. 2017	Due by Mar. 2019	Due by Mar. 2021	Due after Mar. 2021	Total Due
Long-term debt	39,493	78,986	13,163	-	131,642
Operating leases	100,273	208,694	215,486	-	524,453
All obligations	\$ 139,766	\$ 287,680	\$ 228,649	\$ -	\$ 656,095

### Capital Resources

The Company has a \$250,000 commercial line of credit from which nothing was drawn as at March 31, 2016 or June 30, 2015. 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.

### Related Party Transactions

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 and accounting fees paid to Michael D. Kindy (CFO), legal fees paid to a legal firm in which William R. Johnstone (Corporate Secretary) is a partner, Directors' fees, and share-based payments. The Compensation rates are agreed to by the key management personnel and are predicated upon prevailing market rates. The following expenses have arisen involving these related parties:

	<u>2016</u>	<u>2015</u>
Salaries and benefits <sup>(1)</sup>	\$ 199,265	\$ 200,865
Consulting fees <sup>(1)</sup>	28,800	28,800
Directors' fees <sup>(1)</sup>	21,390	20,700
Legal fees <sup>(2)</sup>	30,062	16,588
Accounting fees <sup>(2)</sup>	7,000	-
Interest expense ó long term	-	7,261
Cash based expenditures	<u>\$ 286,517</u>	<u>\$ 274,215</u>
Share-based payments	<u>\$ 39,805</u>	<u>\$ -</u>

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

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

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### Related Party Transactions - continued

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

	<u>2016</u>	<u>2015</u>
Salaries and benefits payable <sup>(1)</sup>	\$ 13,712	\$ 6,455
Consulting fees payable <sup>(1)</sup>	\$ 113,000	\$ 74,600
Legal fees payable <sup>(1)</sup>	\$ 5,180	\$ 2,000
Loan payable to 1114377 Ontario Inc. at prime +8% <sup>(2)</sup>	\$ -	\$ 4,875

<sup>(1)</sup> Reported in the unaudited condensed interim consolidated financial statements as an element of accounts payable and accrued liabilities.

<sup>(2)</sup> A company controlled by the spouse of Mr. W. Drzazga, the CEO and a Director of the Company.

The following stock options have been issued to Directors and/or Officers of the Company and were outstanding as at March 31, 2016:

<u>Description</u>	<u>Expiry Date</u>	<u>Number of Common shares</u>
Stock options @ \$0.10 per share	Sept. 2017	130,000
Stock options @ \$0.10 per share	Dec. 2018	500,000
Stock options @ \$0.05 per share	Mar. 2021	1,000,000

1,000,000 stock options were granted and 275,000 stock options expired during the period.

### Convertible Instruments and Other Securities

The Company has the following securities issued and outstanding:

<u>Share capital</u>	<u>Quantity</u>	<u>Amount</u>
Common shares, June 30, 2015, Dec. 31, 2015 and as at the date of this document	<u>10,648,696</u>	<u>\$ 22,343,053</u>

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

<u>Shares reserved</u>	<u>Expiry Date</u>	<u>Number of Common shares</u>
Common shares to be issued for Class A shares <sup>(1)</sup>		8,246
Stock options @ \$0.10 per share	Sept. 2017	130,000
Warrants @ \$0.10 per share	Oct. 2017	400,000
Stock options @ \$0.10 per share	Dec. 2018	500,000
Stock options @ \$0.05 per share	Dec. 2018	<u>1,000,000</u>
Shares reserved as at Mar. 31, 2016 and as at the date of this document		<u>2,038,246</u>

<sup>(1)</sup> In the 2013 fiscal year the Company's shareholders approved the issuance of 99,454 common shares in exchange for 100% of the Class A Special Shares outstanding. 91,208 common shares have been issued, representing the entitlement of the identifiable Class A shareholders. 8,246 common shares have been reserved to be issued if and when the remaining Class A shareholders identify themselves to the Company.

### Fully diluted position

Shares issued	10,648,696
Shares reserved	<u>2,038,246</u>
Fully diluted position as at Mar. 31, 2016 and as at the date of this document	<u>12,686,942</u>

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**Convertible Instruments and Other Securities - continued**

Additional disclosures relative to stock options are as follows:

	Common Shares <u>Under Option</u>	Number of <u>Options Vested</u>	Exercise <u>Price</u>	<u>Expiry Date</u>
Granted Sept. 14, 2012	130,000	130,000	\$ 0.10	Sept. 14, 2017
Granted December 31, 2013	500,000	500,000	\$ 0.10	Dec. 31, 2018
Granted March 3, 2016	1,000,000	1,000,000	\$ 0.05	Mar. 3, 2021

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

	Common Shares <u>Under Option</u>	Weighted Average <u>Price/Option</u>	Weighted Average <u>Expiry Date</u>
Balance, June 30, 2015	905,000	\$ 0.10	Nov. 15, 2017
Granted during period	1,000,000	\$ 0.05	Mar. 3, 2021
Expired during period	<u>(275,000)</u>	\$ 0.10	Nov. 30, 2015
Balance, Mar. 31, 2016 and at the date of this document	<u>1,630,000</u>	\$ 0.10	Mar. 23, 2020

Additional disclosures relative to share purchase warrants are as follows:

	Number of <u>Warrants</u>	Value of <u>Warrants</u>	Exercise <u>Price</u>	<u>Expiry Date</u>
Issued Jan. 10, 2014	400,000	<u>\$ 4,219</u>	\$ 0.10	Oct. 31, 2017

	Number of <u>Warrants</u>	Weighted Average <u>Price/Warrant</u>	Weighted Average <u>Expiry Date</u>
Balance, June 30, 2015	2,400,000	\$ 0.10	June 7, 2016
Expired during the period	<u>(1,100,000)</u>	\$ 0.10	Feb. 4, 2016
Balance, Mar. 31, 2016 and at the date of this document	<u>1,300,000</u>	\$ 0.10	Sept. 20, 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. There were no changes in accounting policy during the current period.

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

IFRS 15, *Revenue from Contracts with Customers*: effective for annual periods beginning on or after January 1, 2018, with early adoption permitted, replaces existing revenue standards and interpretations with a single standard and provides additional guidance on revenue recognition for contracts with customers. Management anticipates that this standard will be adopted in the Company's financial statements for the year beginning July 1, 2018 and has not yet considered the potential impact of its adoption.



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### **Financial Instruments**

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

#### Financial assets:

Cash and cash equivalents  
Restricted cash equivalents  
Accounts receivable

#### Classification

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

#### Financial liabilities:

Bank operating loan  
Accounts payable and accrued liabilities  
Customer deposits  
Long-term debt

#### Classification

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

#### Fair value through profit and loss:

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

#### Loans and receivables:

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

#### Other financial liabilities:

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

#### Impairment of financial assets:

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

#### Impairment of financial assets - continued:

Evidence of impairment could include:

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

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

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

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### **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 March 31, 2016 and June 30, 2015 cash and cash equivalents are measured at fair value and are classified within Level 1 of the fair value hierarchy.

#### *Financial instruments recorded at amortized cost:*

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

### **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 or cash generating unit (CGU) have suffered an impairment loss. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash flows from other assets or groups of assets. Where such an indication exists, the recoverable amount of the asset or CGU is estimated in order to determine the extent of the impairment loss. The recoverable amount is the higher of an asset's or CGU's fair value less cost to sell or its value in use. Fair value is determined as the amount that would be obtained from the sale of the asset or CGU in an arm's length transaction between knowledgeable and willing parties. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. If the recoverable amount of an asset or CGU is estimated to be less than its carrying amount, the carrying amount of the asset or CGU 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 CGU 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 CGU 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.

## **ZTEST Electronics Inc.**

Management's Discussion and Analysis

For The Three Month Period Ended March 31, 2016

(Prepared as at May 24, 2016)

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### **Risk Factors**

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

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

#### **Credit risk**

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company's primary exposure to credit risk is in its accounts receivable. In an effort to mitigate this risk, management actively manages and monitors its receivables and obtains pre-payments where warranted. It has been determined that no allowance is required, as all amounts outstanding are considered collectible, and no bad debts were recorded in the period ended March 31, 2016 or the fiscal year ended June 30, 2015.

#### **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 nine month period ended March 31, 2016 the Company had 2 major customers who together represented 24% of total revenues. In the comparative nine month period there were 2 major customers representing 30% of revenues. Amounts due from major customers represented 27% of accounts receivable at March 31, 2016 (Mar. 2015 - 25%). 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.

#### **Market risks**

The Company is exposed to interest rate risk due to obligations that have floating interest rates as well as currency risk related to cash, accounts receivable and accounts payable 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 nine month period the Company realized a gain on foreign exchange in the amount of \$4,396 (Mar. 2015 of \$5,867).

#### **Sensitivity to market risks**

At March 31, 2016 the Company had \$131,642 (June 2015 of \$161,262) which bears interest at the TD Bank prime lending rate plus 1.75%. A 1% increase in the TD Bank prime lending rate as at the financial reporting date would result in additional interest expense of \$1,137 over the next 12 month period.

At March 31, 2016 the Company had US\$102,632 (June 2015 of US\$129,966) included in accounts receivable. A 5% increase in the value of the Canadian dollar relative to the US dollar would result in a reduction of \$5,131 in future cash inflow.

At March 31, 2016 the Company had US\$136,391 (June 2015 of US\$128,894) 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 \$6,820 in future cash outflow.

## **ZTEST Electronics Inc.**

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### **Risk Factors - continued**

#### *Sensitivity to market risks - continued*

At March 31, 2016 the Company had US\$23 (June 2015 US\$20,825) included in cash. A 5% increase in the value of the Canadian dollar relative to the US dollar would result in a reduction of \$1 in carrying value.

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

### **Forward-looking Information**

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