

# **DIGIFONICA INTERNATIONAL INC.**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following information, prepared as of November 29, 2011, should be read in conjunction with the unaudited condensed consolidated financial statements of Digifonica International Inc. (the "Company" or "Digifonica") for the nine months ended September 30, 2011, together with the audited consolidated financial statements of the Company for the year ended December 31, 2010 and the accompanying Management's Discussion and Analysis ("the Annual MD&A") for that fiscal period as well as the unaudited condensed consolidated financial statements of the Company for the three months ended March 31, 2011 and the accompanying Management's Discussion and Analysis for that fiscal period. The referenced consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). Figures from periods prior to and including December 31, 2009 are in accordance with Canadian generally accepted accounting principles ("CDN GAAP"). All amounts are expressed in Canadian dollars unless otherwise indicated.

Additional information relating to the Company and its operations is available under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com).

All references are to Canadian dollars unless otherwise indicated.

### **FORWARD-LOOKING STATEMENTS**

The Company's financial statements for the three and nine months ended September 30, 2011, and this accompanying MD&A contain statements that constitute "forward-looking statements" within the meaning of National Instrument 51-102, Continuous Disclosure Obligations of the Canadian Securities Administrators.

It is important to note that, unless otherwise indicated, forward-looking statements in this MD&A describe the Company's expectations as of November 29, 2011.

Forward-looking statements often, but not always, are identified by the use of words such as "seek", "anticipate", "believe", "plan", "estimate", "expect", "targeting" and "intend" and statements that an event or result "may", "will", "should", "could", or "might" occur or be achieved and other similar expressions. Forward-looking statements in this MD&A include statements regarding the Company's future plans and expenditures, the satisfaction of rights and performance of obligations under agreements to which the Company is a part, the ability of the Company to hire and retain employees and consultants and estimated administrative assessment and other expenses. The forward-looking statements that are contained in this MD&A involve a number of risks and uncertainties. As a consequence, actual results might differ materially from results forecast or suggested in these forward-looking statements. Some of these risks and uncertainties are identified under the heading "RISKS AND UNCERTAINTIES" in this MD&A. Additional information regarding these factors and other important factors that could cause results to differ materially may be referred to as part of particular forward-looking statements. The forward-looking statements are qualified in their entirety by reference to the important factors discussed under the heading "RISKS AND UNCERTAINTIES" and to those that may be discussed as part of particular forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties, assumptions and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Factors that could cause the actual results to differ include market prices, continued availability of capital and financing, inability to obtain required regulatory approvals and general market conditions. These statements are based on a number of assumptions, including assumptions regarding general market conditions, the timing and receipt of regulatory approvals, the ability of the Company and other relevant parties to satisfy regulatory requirements, the availability of financing for proposed transactions and programs on reasonable terms and the ability of third-party service providers to deliver services in a timely manner.

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Forward-looking statements contained herein are made as of the date of this MD&A and the Company disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or results or otherwise. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements.

## COMPANY DESCRIPTION

Digifonica International Inc. ("Digifonica" or the "Company") was incorporated under the Alberta Business Corporations Act on November 23, 2004. During the year ended December 31, 2010 and the current period the Company ceased operations due to a lack of financing. The main activities in the Company during these periods was maintaining its public listing and keeping the patent applications current. The patents were sold along with the subsidiaries on July 19, 2011. The Company is listed on the TSX Venture Exchange's NEX board under the trading symbol "DIL.H".

## OVERALL PERFORMANCE

The Company is an inactive public company as it ceased activities during the year ended December 31, 2010 due to a lack of financing. The Company focused on maintaining its patent applications in the voice over internet protocol business as well as maintaining its public company listing.

The Company has been considering various restructuring alternatives. As part of the restructuring process, the Company completed a share consolidation effective February 25, 2011, consolidating its common shares on the basis of one (1) new common share for every ten (10) old common shares issued and outstanding at that time. All references to share and per share amounts have been retroactively restated to reflect the share consolidation.

Effective July 19, 2011, the Company sold all of its subsidiaries, including its wholly-owned subsidiaries Digifonica (International) Limited and Digifonica Canada Limited, to the President of the Company for proceeds of \$1. The subsidiaries held all patent technologies that were written-down to a value of \$1. Included in the subsidiaries was \$1,025,572 of liabilities. The liabilities are no longer liabilities of the Company.

On October 11, 2011, the Company announced that it had agreed to terms, subject to regulatory approval, on a private placement of up to 30,000,000 units at a price of \$0.05 per unit for gross proceeds of \$1,500,000. Each unit is comprised of one common share and one share purchase warrant. Each share purchase warrant entitles the holder thereof the right to purchase one common share at \$0.10 per share until one year after closing. Proceeds of the private placement will be used for general working capital.

## RESULTS OF OPERATIONS

*Nine months ended September 30, 2011*

The Company recorded net income of \$715,351 (\$0.18 per share) for the nine months ended September 30, 2011 as compared to a net loss of \$124,869 (\$0.03 per share) for the nine months ended September 30, 2010. The table below details certain non-cash or unusual transactions that for the purposes of this discussion have been adjusted out of the reported net income (loss) to produce an adjusted net loss that forms a better basis for comparing the period over period operating results of the Company.

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	Nine months ended September 30, 2011 (\$)	Nine months ended September 30, 2010 (\$)
Net (loss) income for the period as reported	715,351	(124,869)
Foreign exchange loss (gain)	11,603	(13,150)
Gain on forgiveness of debt	(40,110)	-
Gain on sale of subsidiaries	(1,025,422)	-
Adjusted net loss for the period	(338,578)	(138,019)

<sup>(1)</sup> Adjusted net loss for the period is not a term recognized under IFRS.

Comments regarding certain of these items are as follows:

- Foreign exchange loss (gain) is based on fluctuations in the exchange rate between the Canadian dollar and the US dollar/British pound. Certain liabilities are denominated in US dollars and British pounds.
- The gain on forgiveness of debt is based on settling liabilities for amounts below book value.
- The gain on sale of subsidiaries is calculated by subtracting the net book value of the subsidiaries from the gross proceeds (\$1). The subsidiaries had nominal assets (\$151) and liabilities totaling \$1,025,572.

The increase in adjusted net loss recorded in the nine months ended September 30, 2011 as compared to the nine months ended September, 2010 is the net result of changes to a number of expenses. Of note are the following items:

- Accounting fees (\$32,170 vs. \$5,307) increased due to accruing audit fees for fiscal 2011 (\$15,000) and additional 2010 audit fees (\$7,500). The remaining increase was due to restructuring the Company and the IFRS conversion.
- Consulting fees (\$102,760 vs. \$47,362) increased due to recognizing fees charged by former directors and officers of the Company.
- Legal fees (\$49,830 vs. \$57) are comprised primarily of fees relating to restructuring the Company.
- Office and miscellaneous fees (\$128,011 vs. \$56,753) increased due primarily to recognizing as a bona fide liability an account written down (\$63,832) in a previous fiscal year.
- Interest expense (\$25,807 vs. \$14,445) is comprised of interest on past due liabilities.

### *Three months ended September 30, 2011*

The Company recorded net income of \$993,140 (\$0.26 per share) for the three months ended September 30, 2011 as compared to a net loss of \$30,737 (\$0.01 per share) for the three months ended September 30, 2010. The variation is primarily due to recording a gain on forgiveness of debt of \$22,754 and a gain on sale of subsidiaries of \$1,025,422 during the period.

## **SELECTED QUARTERLY FINANCIAL INFORMATION**

The following table sets out financial information for the past eight quarters:

	<b>Three Months Ended (\$)</b>			
	<b>September 30, 2011</b>	<b>June 30, 2011</b>	<b>March 31, 2011</b>	<b>December 31, 2010</b>
Total Revenues	-	-	-	-
Net Income (Loss)	993,140	(128,404)	(149,385)	(517,288)
Net Income (Loss) Per Share (basic and diluted) <sup>(1)</sup>	0.26	(0.03)	(0.04)	(0.13)

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	Three Months Ended (\$)			
	September 30, 2010	June 30, 2010	March 31, 2010	December 31, 2009
Total Revenues	-	-	-	-
Net Loss	(30,737)	(61,296)	(32,836)	(3,531,568)
Net Loss Per Share (basic and diluted) <sup>(1)</sup>	(0.01)	(0.02)	(0.01)	(1.01)

<sup>(1)</sup> The basic and diluted loss per share calculations result in the same amount.

<sup>(2)</sup> Information for 2011 and 2010 is presented in accordance with IFRS while information for three months ended December 31, 2009 is presented in accordance with CDN GAAP.

## LIQUIDITY AND CAPITAL RESOURCES

The Company's operations consumed approximately \$347,000 of cash (before working capital items) for the nine months ended September 30, 2011 (2010 - \$126,000). The Company's aggregate operating, investing, and financing activities during the nine months ended September 30, 2011 resulted in an increase in its cash balance from \$238 at December 31, 2010 to \$1,103 at September 30, 2011. The Company's working capital deficiency at September 30, 2011 was \$1,447,518 (December 31, 2010 - \$2,162,870).

Effective July 19, 2011, the Company disposed of all of its subsidiaries including liabilities that amounted to \$1,025,572.

On October 11, 2011, the Company announced that it had agreed to terms, subject to regulatory approval, on a private placement of up to 30,000,000 units at a price of \$0.05 per unit for gross proceeds of \$1,500,000. Proceeds of the private placement will be used for general working capital.

## INVESTING AND FINANCING ACTIVITIES

During the nine months ended September 30, 2011, the Company received \$32,000 from a shareholder as a non-interest bearing due on demand loan. The Company received \$41,996 from a director as a non-interest bearing due on demand loan. The Company also received \$55,452 from a third-party as a non-interest bearing due on demand loan. The Company had no investing activities.

## RELATED PARTY TRANSACTIONS

The Company incurred the following charges with directors and officers of the Company and/or companies controlled by them for the three and nine months ended September 30, 2011 and 2010:

	Three months ended		Nine months ended	
	September 30, 2011	2010	September 30, 2011	2010
	\$	\$	\$	\$
Consulting fees	-	47,362	66,590	47,362
	-	47,362	66,590	47,362

Included in accounts payable and accrued liabilities as at September 30, 2011 is \$251,507 (December 31, 2010 - \$244,242) due to current and former directors and officers of the Company and/or companies controlled by them. The amounts owing are unsecured, non-interest bearing and due on demand. At September 30, 2011, \$41,996 (December 31, 2010 - \$nil) of the demand loans are due to a director of the Company.

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Included in loans from shareholders as at September 30, 2011 is \$165,164 (December 31, 2010 - \$139,356) due to former directors of the Company. The amounts owing were unsecured, non-interest bearing and due on demand.

Key management includes the directors of the Company. The compensation paid or payable to key management for services during the three and nine months ended September 30, 2011 and 2010 is as follows:

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Consulting fees	-	47,362	66,590	47,362
	-	47,362	66,590	47,362

## **INTERNATIONAL FINANCIAL REPORTING STANDARDS (“IFRS”)**

Effective January 1, 2011 Canadian publicly listed entities were required to prepare their financial statements in accordance with IFRS. Due to the requirement to present comparative financial information, the effective transition date is January 1, 2010. The nine months ended September 30, 2011 is the Company's third reporting period under IFRS.

The Company identified four phases to the Company's conversion: scoping and planning, detailed assessment, implementation and post-implementation. The Company has now completed its IFRS conversion project through the implementation phase. The post-implementation phase will continue in future periods.

Note 12 of the accompanying condensed consolidated financial statements provides details of the IFRS 1, First-Time Adoption of IFRS, exemptions. No adjustments were made to the Company's statements of financial position at September 30, 2010 or December 31, 2010. No adjustments were made to the statements of operations and comprehensive loss or statements of cash flows during the nine months ended September 30, 2010.

The conversion to IFRS has had no impact on the financial record keeping, internal controls and financial disclosures of the Company due to the exploration and project development nature of the Company's business. Accounting systems have been assessed to ensure accurate reporting under IFRS, both internally and externally.

## **FINANCIAL INSTRUMENTS**

### **Classification of Financial Instruments**

The Company's financial instruments consist of cash, other receivables, accounts payable and accrued liabilities, demand loans, note payable in default, subscriptions payable and loans from shareholders. The Company designated its cash as a fair value through profit or loss financial asset. The other receivables are designated as loans and receivables, which are measured at fair value. The accounts payable and accrued liabilities, demand loans, note payable in default, subscriptions payable and loans from shareholders are designated as other financial liabilities, which are measured at amortized cost.

### **Fair Value of Financial Instruments**

The Company classified the fair value of the financial receivables according to the following fair value hierarchy based on the amount of observable inputs used to value the instruments:

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- Level 1 – Values based on unadjusted quoted prices available in active markets for identical assets or liabilities as of the reporting date.
- Level 2 – Values based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace. Prices in Level 2 are either directly or indirectly observable as of the reporting date.
- Level 3 – Values based on prices or valuation techniques that are not based on observable market data.

The value of cash has been assessed based on the fair value hierarchy described above and is classified as Level 1. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy.

Discussions of risks associated with financial assets and liabilities are detailed below:

## Foreign Exchange Risk

The Company has financial instruments denominated in U.S. dollars (“US\$”) and Great Britain Pounds (“GBP”). Accounts exposed to foreign exchange risk as of September 30, 2011 are:

	US\$	GBP
Cash	-	-
Accounts payable and accrued liabilities	(54,239)	(106,173)
Note payable in default	(82,055)	-
Net exposure to foreign currencies	(136,294)	(106,173)

## Credit Risk

Credit risk arises from cash held with banks and financial institutions. The maximum exposure to credit risk is equal to the carrying value of the financial assets. The Company's cash is primarily held with the Royal Bank of Canada.

## Interest Rate Risk

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The risk that the Company will realize a loss is limited because at present the Company's liabilities are non-interest bearing or have fixed interest rates.

## Liquidity Risk

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they become due. The Company manages its liquidity risk by continuously monitoring forecasted and actual cash flows, as well as anticipated investing and financing activities. The Company has a working capital deficiency at September 30, 2011. On October 11, 2011, the Company announced that it had agreed to terms, subject to regulatory approval, on a private placement of up to 30,000,000 units at a price of \$0.05 per unit for gross proceeds of \$1,500,000.

## OUTSTANDING SHARE DATA

Authorized: Unlimited common shares without par value.  
Unlimited preferred shares issuable in series.

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All share information is reported as of November 29, 2011 in the following table:

Type of Security	Number	Exercise Price (\$)	Expiry Date
Issued and outstanding common shares	3,877,197	N/A	N/A
Options	29,000	10.00	June 2, 2013
Options	40,000	11.00	June 2, 2013
Total	3,946,197		

Of the 3,877,197 common shares outstanding, 573,902 are held in escrow.

## **RISKS AND UNCERTAINTIES**

The Company has incurred significant losses since inception. The continued operations of the Company are dependent on its ability to generate future cash flow and obtain additional financing. The Company has traditionally financed its cash requirements through the issuance of common shares. If the Company is unable to generate cash from operations or obtain additional financing its ability to continue as a going concern could be impeded.

## **DISCLOSURE CONTROLS AND PROCEDURES**

In connection with National Instrument 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings) ("NI 52-109"), the Chief Executive Officer and Chief Financial Officer of the Company have filed a Venture Issuer Basic Certificate with respect to the financial information contained in the interim consolidated financial statements for the nine months ended September 30, 2011 and this accompanying MD&A (together the "Interim Filings").

In contrast to the full certificate under NI 52-109, the Venture Issuer Basic Certificate does not include representations relating to the establishment and maintenance of disclosure controls and procedures and internal control over financial reporting, as defined in NI 52-109. For further information the reader should refer to the Venture Issuer Basic Certificates filed by the Company with the Interim Filings on SEDAR at [www.sedar.com](http://www.sedar.com).

## **OUTLOOK**

The Company is considering restructuring alternatives in order to eliminate the working capital deficiency and complete a reactivation.