

## **Cencotech Inc.**

### **MANAGEMENT DISCUSSION AND ANALYSIS FOR THE THREE MONTHS ENDED JANUARY 31, 2007**

The following is a discussion and analysis of the results of operations and financial condition of the Company for the three months ended January 31, 2007 and 2006 along with certain factors that may affect the Company's prospective financial condition and results of operations.

**The discussion and analysis contains forward-looking statements, which involve risks and uncertainties. Actual events could differ from those anticipated in these forward-looking statements.**

#### **Overview**

The Company is an active participant in the development and production of currency inventory management and control systems for financial institutions, large retailers, casino and mass transit operators, and various government agencies.

The Company's strategic direction has been to enhance its position as a supplier of efficient solutions. Part and parcel of this strategy has been to invest in its existing business, continue to introduce new products, research opportunities in new industry sectors and complete strategic alliances to extend the technological and market reach of the Company. To achieve the objectives of these strategies it is critical that alliances reached with larger participants in the market are actively productive. While the Company has achieved a profitable year in fiscal 2006, the alliances entered into by the Company have not yet reached a point where they are generating consistent sales. As a consequence, the Company continues to reevaluate its direction and is considering a number of options in order to realize upon the strategic value of its innovative solutions.

The Company's software products have demonstrated their value in use to the licensees of the products. The DOS based Currency Controller product has a history of solid performance in major North American financial institutions. The next generation of this product, a 32-bit, Java based iteration of the Currency Controller, trademarked by the Company, as "CC-32™" continues to be adopted by users in the market as a replacement for the DOS version of the Currency Controller and as a replacement for competitor systems with fewer features. As this market has evolved over the years, however, the Company's competitors are offering a variety of supplementary systems in concert with the currency management and control software. The open design nature of the CC-32 solution and its ability to interface to other systems employed by the user is a major selling point of this product. The features of the CC-32™ coupled with the apparent new direction of the Federal Reserve Bank in the United States to off-load some of its currency processing functions to the commercial banks, may be expected to lead to increased customer interest in this product. Subsequent to October 31, 2006, the Company entered into a new alliance with a larger participant in the United States market consistent with our strategy of extending the market reach for the Company's products.

The Company's self-service devices, specifically the CashNET product, are now being accepted by retail operators as efficient and safe currency counting and management devices.

On December 15<sup>th</sup>, 2006, the Company's wholly-owned subsidiary, NamSys Inc. ("NamSys"), completed an agreement to sell intellectual property rights and inventory related to the Commercial Self Serve products for a purchase price of \$1,500,000; see Subsequent Event and Contingent Liability below. Under this agreement, NamSys will continue to sell the self service products to its clients and will in addition receive royalties from the purchaser on sales of these products to the marketplace by parties other than NamSys. Further, NamSys will benefit from software license fees for the use of NamSys' software employed in the self service products.

The Company's liquidity position as at January 31, 2007 has improved from the year earlier position. In December 2006, the Company realized some return on the significant development and organizational expenditures with the sale of the intellectual property rights and inventory related to the Commercial Self Serve products.

While the Company has historically funded its activities through cash flow from operations, the issuance of debt and the sale of common shares and warrants or convertible debentures, there can be no assurance that new third party funds will be available on terms acceptable to the Company.

### Quarterly Financial Data

The table below presents selected financial data of the Company for each of the eight fiscal quarters ended January 31, 2007:

	Fiscal quarter ended							
	Jan. 31 2007	Oct. 31 2006	July 31 2006	April 30 2006	Jan 31 2006	Oct. 31 2005	July 31 2005	April 30 2005
	(in thousands of dollars)							
Revenue	153	1,317	271	243	146	235	579	390
Gross profit	119	601	174	163	117	(112)	275	266
Net income (loss)	926	645	(116)	(74)	(245)	(149)	74	26
Net income (loss) per share	0.04	0.03	(0.01)	(0.00)	(0.01)	(0.00)	0.00	0.00

## Results of Operations

*Three months ended January 31, 2007 Compared to Three months ended January 31, 2006*

### **Revenue**

	2007	2006	Change	% Change
Software	157,513	133,861	23,652	17.7%
Self-service systems	(4,193)	11,400	(15,593)	(136.8)%
Peripheral resales	-	508	(508)	(100.0)%
	153,319	145,769	7,550	5.2%

Revenues in the three months ended January 31, 2007 improved in comparison to the same period in the prior year. Revenues in both periods were predominantly from the sale of Software. The Company's total sales for the three months ended January 31, 2007 were \$153,319 as compared to \$145,768 for the corresponding period in 2006, an increase of \$7,550 or 5.2%. As noted earlier, the sales cycle of the Company's products is quite long and unit selling prices are relatively high, leading to revenue fluctuations period to period.

**Software Sales** - The Company generates software revenue from the sale of license agreements to use its software products, upgrading existing license holder's systems, training, consulting and from recurring revenues for maintenance and product support. The majority of the Company's customers renew their product support agreements annually, in order to stay current with new features and developments. Software revenue totaled \$157,513 for the three months ended January 31, 2007, an increase of \$23,652 or 17.7% as compared to the corresponding three months the previous year. Currency Controller license revenue in the first quarter of 2007 was \$41,040. There was no Currency Controller license revenue in the comparable period in 2006. In the first quarter, 2007, Software revenue represented the total revenue for the quarter as compared to 91.8% in 2006. In the first quarter of 2007 revenue related to upgrading existing systems of \$10,440 represents an increase of \$10,440 compared to the corresponding period in 2006. Consulting revenue in the first quarter of 2007 of \$4,360 are comparable to the \$4,778 recognized in the first quarter of 2006. Recurring product support revenue for the three months ended January 31, 2007 totaled \$101,673 compared to \$129,083 for the corresponding three months the previous year, a decrease of \$27,410 or 21.2%. The recurring product support revenue declined in the first quarter of 2007 compared to the same quarter in 2006 as certain customers elected not to renew their product support agreements for the older software product. This is consistent with the results identified in previous quarters of 2006. Recurring revenue represented 66.3% of total sales revenue in the three months ended January 31, 2007, as compared to 88.6% in the same three months of fiscal 2006. This percentage decrease from same quarter in fiscal 2006 is the net result of certain customers electing not to renew their product support agreements.

*Self-service System Sales* - Self-service system sales included the sale of systems, license fees for the software employed in the systems and recurring product support maintenance fees.

As identified above, the Company's wholly-owned subsidiary, NamSys Inc. ("NamSys"), completed an agreement in December 2006 to sell intellectual property rights and inventory related to the Commercial Self Serve products. Under this Agreement, NamSys will continue to sell the self service products to its clients and will in addition receive royalties from the purchaser on sales of these products to the marketplace by parties other than NamSys. There were minimal adjustments to the Self-service system revenue in the three months ended January 31, 2007 compared to \$11,400 in the comparable period of fiscal 2006. The Self-service revenue in the first quarter of 2006 represented a license fee from a licensed distributor for the license to manufacture a specific product, the Rolled Coin Dispenser. The benefits from the new arrangements are expected to be realized in the months ahead.

*Peripheral Resales* - Peripheral resales record the sale of other vendors' products, to the Company's clients, concurrent with the implementation of a solution by the Company. The peripherals are not integral parts of the Company's systems, but may be required to operate such systems. If the client does not already own such peripherals, the Company acts as a reseller of such products. Peripheral products include computer processing units, optical imaging scanners and upgraded telecommunications circuit boards. There was no revenue from the sale of peripherals during the three months ended January 31, 2007 as compared to \$508 in the comparable period of fiscal 2006, a minimal change

### **Cost of Goods Sold**

*Three months ended January 31, 2007 Compared to Three months ended January 31, 2006*

Cost of goods sold for the three months ended January 31, 2007 was \$119,249 compared to \$116,939 in the corresponding period in 2006. The corresponding gross margins were 77.9% in 2007 and 80.2% in 2006. The total gross margin is affected by the sales mix of the three product groups which have different gross margins and the inventory provision.

Software margin for the three months ended January 31, 2007 was 78.8% as compared to 78.9% in the three months ended January 31, 2006.

The margin impact of Self-service systems is negligible with no revenues in the first quarter of 2007. In the comparable period for 2006 the revenue of \$11,400 represented a license fee which had no cost associated with it.

There was no sale of peripheral items in the three months ended January 31, 2007 consequently there was no margin. The margin for the sale of peripheral items in the three months ended January 31, 2006 was minimal.

### **Gross Profit**

*Three months ended January 31, 2007 Compared to Three months ended January 31, 2006*

The sales mix between software, self service systems and peripherals can dramatically impact the Company's Gross Profit in any given reporting period. Gross Profit can also be affected by changes in the exchange rate between Canadian and U.S. dollars. As a result of

the sales mix and the strength of the Canadian dollar versus the U.S. dollar, the Gross Profit achieved in the first three months of fiscal 2007 was \$119,249 or 77.9%, compared to Gross Profit for the corresponding period in 2006 of \$116,939 or 80.2%, a decrease in Gross Profit percentage of 2.3 percentage points. This change is minor as the revenue in both periods was primarily higher margin Software revenue representing all of the 2007 revenue and 91.8% of the 2006 revenue.

### ***Selling Expense***

Selling expenses are comprised of direct selling and marketing expenses and the salaries of employees whose principal function is sales and marketing. Selling expenses for the three months ended January 31, 2007, consistent with the prior year, continued at a reduced level. The selling expenses for the first quarter of 2007 totaled \$33,100 an increase of \$1,254 or 3.9% from \$31,846 in the corresponding period of 2006. The reduced level has been maintained by continuing to pass more of the sales management responsibilities to distributors. As a result of these factors, selling expense was 21.6% of revenue in fiscal 2007 as compared to 21.8% in 2006.

### ***General and Administrative Expenses***

General and administrative (“G&A”) expense consists primarily of salaries, benefits, corporate maintenance charges, occupancy, professional fees, foreign exchange gains and losses and travel.

G&A expense totaled \$211,815 in the three months ended January 31, 2007 as compared to \$204,123 in 2006 an increase of \$7,692 or 3.8%. The G&A expense ratio as compared to revenue was 138.2% in 2007 as compared to 140.0% in 2006, an improvement of 1.8 percentage points from 2006. The primary elements of the G&A expenses being salaries and benefits and occupancy have remained relatively consistent compared to the first quarter of 2006.

### ***Amortization***

Amortization for the three months ended January 31, 2007 of \$20,799 decreased by \$1,005 or 1.7% from \$21,804 in the first three months of fiscal 2006.

### ***Interest Expense on Convertible Debentures and Secured Debt***

The principal amount of convertible debentures outstanding at January 31, 2007 and 2006 was \$1,000,000. In the three months ended January 31, 2007 the convertible debenture interest was \$30,246 as it was in the comparable period in 2006.

The Company’s secured debt is currently \$200,000 (October 31, 2006 - \$1,500,000) and bears interest at 10% per annum, reduced from 15% effective December 15, 2006. Interest expense on the secured debt to January 31 in 2007 was \$36,974 (2006 - \$49,500).

### ***Provision for Income Taxes***

The Company adopted section 3465 of the Canadian Institute of Chartered Accountants (CICA) Handbook regarding accounting for income taxes. This section requires the use of the

asset and liability method for income taxes. Under the asset and liability method, assets or liabilities are recognized for the future income tax consequences attributable to differences between the financial statement carrying values and their respective income tax basis (temporary differences).

The basic rate of 36.12% was applied to pre-tax income in 2006 (2005 - 36.12%). In the fourth quarter of 2006 there was \$215,000 of future tax benefit recognized as it was determined more likely than not that this benefit would be realized. The benefit was recognized in the first quarter of 2007. There was no future tax benefit or recovery recognized in the corresponding period in 2006.

The Company and/or its subsidiary have losses from prior periods available for carry forward to reduce future years' income for tax purposes. These losses will expire in 2016 and 2015 respectively if not used.

The Company's wholly-owned subsidiary also has investment tax credits of approximately \$253,000 available to reduce future income taxes payable.

### ***Related Party Transactions***

The following summarizes the Company's related party transactions:

- a) Rent and administration in the amount of \$9,500 were paid in the three months ended January 31, 2007 (2006 - \$10,500) to a company that is partially owned by the President of the Company.
- b) Included in accounts payable and accrued liabilities are amounts due to directors of \$46,900 (2006 - \$44,400).
- c) In 2003, a company controlled by the President of Cencotech ("the Secured Lender") entered into a new loan agreement ("the Credit Facility") with the Company on the basis of security purchased from the Company's bank. The Credit Facility with the Company replaced the previous bank loan and temporary loan arrangements which were retired. Interest at the rate of 15% per annum was calculated and compounded monthly until December 15, 2006 at which time the intellectual property rights and inventory related to the Commercial Self Serve products were sold and the Credit Facility paid down. The Credit Facility was renegotiated at that time, including a reduction in the credit availability to a maximum of \$200,000 and the interest rate was reduced to 10% per annum payable monthly. The Credit Facility is secured by a general security agreement constituting first ranking security interest in all property of the Company's subsidiary and a postponement and assignment of claim signed by the Company.

In December 2006, upon closing the sale of the intellectual property rights and inventory related to the Commercial Self Serve products the \$900,000 promissory note was assigned by NamSys Inc. to the Secured Lender as partial payment of the secured debt. In the event the buyer defaults in payment under the promissory note, the Secured Lender has the right to re-assign the promissory note to NamSys Inc. and the indebtedness then owing by NamSys Inc. to the Secured Lender shall be increased by the amount equal to the principal which remains unpaid under the promissory note at the time of default.

The loan negotiations with the related party were undertaken by unrelated members of the parent Company's Board of Directors, expressly established as an ad hoc committee for the purpose of acquiring the necessary financing for the Company.

As at January 31, 2007, the indebtedness under the Credit Facility is \$200,000 (2006 - \$1,500,000). Interest expense related to the Credit Facility during the three months ended January 31 was \$36,974 (2006 - \$49,500).

- d) In December, 2006 the Secured Lender agreed to extend the maturity date of the Credit Facility to March 31, 2007.

The loan negotiations with the related party were undertaken by unrelated members of the parent Company's Board of Directors, expressly established as an ad hoc committee for the purpose of acquiring the necessary financing for the Company.

- e) During the three months ended January 31, 2006, the President of the Company advanced the Company \$75,000 on a short term basis. The advance was on a demand basis without interest and was outstanding at January 31, 2006. The advance was subsequently repaid in April 2006.

These transactions, with the exception of (d) and (e), are in the normal course of operations. They are all measured at the exchange amount, which is the amount of consideration established and agreed to by the parties.

### ***Net Earnings and Earnings Per Share***

As a result of the factors discussed above, net income for the three months ended January 31, 2007 was \$926,325 as compared to net loss in the three months ended January 31, 2006 of \$244,758. As noted above, all product development activity in the Company has been expensed since 1999. As development activity for the existing products has been completed, there was no Development expense in the three months of fiscal 2007 or for the corresponding period in 2006.

Three months to January 31

	2007	2006
Net income (loss)	\$926,325	\$(244,758)
Earnings (loss) per share	\$0.04	\$(0.01)

The diluted income (loss) per share for the three months ended January 31, 2007 and 2006 have not been presented as the exercise of the outstanding stock options and the conversion of convertible debentures would be anti-dilutive.

### **Liquidity and Capital Resources**

#### ***General***

The Company has historically funded its activities through cash flow from operations, bank debt and the sale of Common Shares and warrants or convertible debentures. During the

most recent four year period ended October 31, 2006, the Company also funded all capital expenditures, operations and debt reduction from a combination of cash flow from operations, the sale of Common Shares and warrants and the issuance of new debt and debentures convertible into Common Shares of the Company. In December 2006 sold intellectual property rights and inventory related to the Commercial Self Serve products for \$1,500,000. During fiscal 2006, the Company issued 218,000 common shares pursuant to a rights offering to its shareholders. Total gross proceeds amounted to \$21,800.

Notwithstanding Management's strong belief that the trends in the marketplace with respect to the Company's products are positive and improving, there can be no assurance that third party funding will be available in the future on terms acceptable to the Company.

### ***Cash Flow from Operations***

The Company had negative working capital of \$35,382 at January 31, 2007 compared to the working capital of \$480,882 at October 31, 2006. Excluded from the working capital calculations are: prepaid expenses of \$8,095 (2006-\$5,995), deferred revenue of \$222,387 (2006-\$78,537), the convertible debenture of \$1,000,000 (2006-\$1,000,000), and the current portion of the receivable and related debt associated with the assignment of the Note Receivable resulting from the sale of the intellectual property rights and inventory related to the Commercial Self Serve products of \$282,590 (2006- nil).

For the three months ended January 31, 2007, the Company had cash flow from operations of \$(28,095) as compared to cash flow from operations of \$2,003 in the three months ended January 31, 2006. The change in cash flow from operations is the net result of a \$358,282 increase in accounts receivable in the first quarter of 2007 as compared to a corresponding increase of \$65,803 in 2006. These increases in accounts receivable resulted from greater fourth quarter sales in 2006 compared to 2005. Additional factors contributing to the negative cash flow from operations in the 2007 first quarter were a decrease of \$329,461 in accounts payable in 2007 compared to a decrease of \$3,611 in 2006 and an increase in deferred revenue of \$143,840 as compared to \$205,917 in the same period in 2006. The smaller increase in deferred revenue is the result of fewer customers electing to renew their product support agreements.

### ***BALANCE SHEET***

#### ***Inventory***

The inventory has, until the first quarter of 2007, consisted of electronic, electrical and mechanical components used in the assembly of the self service product lines and items for resale such as computer processing units, optical imaging scanners and upgraded telecommunications circuit boards. The component parts include printers, mag card readers, touch screen units, vaults, bill counts, and various fasteners and custom designed components of the self service products. Some pieces are interchangeable among the various products. The finished goods inventory has included completed self-service products and peripheral items for resale to complement the self-service products.

Given the transaction which NamSys closed on December 15<sup>th</sup>, 2006, as set out above, the carry value of inventory totaling \$131,779 was reclassified to "Assets held for sale" at October 31, 2006. The only inventory remaining on the Company's Balance Sheet at January

31, 2007 is parts service inventory with a carry value of \$28,113 as compared to parts service inventory at October 31, 2006 of \$16,552.

***Intellectual Assets and Property and Equipment***

Intellectual assets and property and equipment are recorded at cost less accumulated amortization and are amortized over their estimated useful lives as follows:

Recognition technology - Hardware	30% declining balance
Trademarks and patents	20% straight-line
Office equipment	20% declining balance
Showroom equipment	3 years straight-line
Leasehold improvements	20% straight-line or over term of lease

On December 15, 2006, the Company's wholly-owned subsidiary, NamSys Inc., entered into an Asset Purchase Agreement to sell intellectual property rights related to the Commercial Self Serve products.

	<b>2007</b>		
	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Intellectual Assets			
Trademarks and patents	<u>100</u>	<u>-</u>	<u>100</u>
	<u>100</u>	<u>-</u>	<u>100</u>
Property and Equipment			
Office equipment	159,873	130,825	29,048
Showroom equipment	13,173	1,209	11,964
Leasehold improvements	<u>182,920</u>	<u>181,125</u>	<u>1,795</u>
	<u>355,966</u>	<u>313,159</u>	<u>42,807</u>
	<u>356,066</u>	<u>313,159</u>	<u>42,907</u>

	2006		
	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$
Intellectual Assets			
Recognition technology - Hardware	12,004	12,004	-
Trademarks and patents	139,739	139,639	100
	<u>151,743</u>	<u>151,743</u>	<u>-</u>
Property and Equipment			
Office equipment	159,873	129,295	30,578
Showroom equipment	13,173	120	13,053
Leasehold improvements	182,920	173,650	9,270
	<u>355,966</u>	<u>303,065</u>	<u>52,901</u>
	<u>507,709</u>	<u>454,708</u>	<u>53,001</u>

Intellectual assets being trademarks and patents are reviewed on an ongoing basis. When events and circumstances indicate that carrying amounts may not be recoverable, a write-down to fair value is charged to income in the period that such a determination is made.

### ***Financing Agreements***

At January 31, 2007, the Company's subsidiary has a \$200,000 (October 31, 2006 - \$1,500,000) secured debt arrangement with a related party plus unpaid interest of \$2,575. The maturity date on the subsidiary's secured loan has been extended to March 31, 2007. The fair value of the secured debt at January 31, 2007 is approximately \$199,000.

As at January 31, 2007, the Company had \$1,000,000 of convertible debentures outstanding which are repayable March 31, 2007. The fair value of the convertible debenture at January 31, 2007 is approximately \$997,000. The \$1,000,000 debenture is secured by a charge against the Company's assets and does not restrict the Company's ability to incur additional debt. The debenture security ranks behind the security of the secured debt of the Company's subsidiary.

### ***Contractual Obligations***

A summary of the Company's contractual obligations at January 31, 2007.

	Payments due by period		
	Total	Less than 1 year	1 – 3 years
Convertible debenture	\$1,000,000	\$1,000,000	-
Secured debt	200,000	200,000	-
Premises lease	55,000	45,000	10,000
Total Contractual obligations	\$1,255,000	\$1,245,000	\$10,000

## **Capital Expenditures**

The Company's primary capital expenditure activities in the past involved the acquisition of deferred development of technology and capital investments. During 2007, capital expenditures were \$10,705 as compared to \$1,935 in fiscal 2006. The majority of these 2007 investments relate to the costs of filing and maintaining intellectual property.

## **Contingent Liability**

On December 15, 2006, the Company's wholly-owned subsidiary, NamSys Inc., completed an Asset Purchase Agreement to sell intellectual property rights and inventory related to the Commercial Self Serve products for a purchase price of \$1,500,000, comprised of \$600,000 cash and a \$900,000 promissory note bearing interest at 7% per annum payable monthly by 36 equal installments of \$27,789 blending interest and principal. These payments are current as of January 31, 2007. To assure the buyer fulfils its commitments and obligations pursuant to the Asset Purchase Agreement, the intellectual property that was sold under this Agreement has been assigned to an escrow agent until the buyer fulfils its commitments and obligations.

Upon closing, the \$900,000 promissory note was assigned by NamSys Inc. to the Secured Lender as partial payment of the secured debt. In the event the buyer defaults in payment under the promissory note, the Secured lender has the right to re-assign the promissory note to NamSys Inc. and the indebtedness then owing by NamSys Inc. to the Secured Lender shall be increased by the amount equal to the amount of principal which remains unpaid under the promissory note at the time of default.

## **Additional Information**

Additional information relating to the Company including the interim and annual financial statements are available on SEDAR at [www.sedar.com](http://www.sedar.com)

## **Outstanding Share Data**

Summary of securities issued and outstanding as at January 31, 2007

<u>Class</u>	<u>Authorized</u>	<u>Issued and Outstanding</u>
Common	Unlimited	22,036,332

On February 15, 2006 pursuant to a rights issue offering that closed on that date, 218,000 common shares were issued.

No common shares are reserved for issuance with respect to Options granted under the Company's stock option plan as at January 31, 2007.

Common shares reserved for issuance with respect to the outstanding convertible debentures as at January 31, 2007.	6,060,606
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## **Disclosure Controls and Procedures and Internal Control over Financial Reporting**

The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining the Company's disclosure controls and procedures and internal control over financial reporting for the issuer. They are assisted in this responsibility by the Management team. The Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures and the design of internal controls at October 31, 2007, have concluded that the Company's disclosure controls and procedures are adequate and effective to ensure that material information relating to the Company and its subsidiary would have been known to them. Through the evaluation of the design of its internal controls the Company has identified certain internal control weaknesses in the financial reporting process, specifically a lack of segregation of duties in the accounting process. This situation is common to many small companies. While this deficiency in segregation of duties could lead to a material misstatement in the financial statements, no such misstatement has occurred. Management believes it has remedied this control weakness by enhancing the review of the accounting process.

## **Critical Accounting Estimates**

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The estimates are made in the context of the assumption that the Company will continue as a going concern

Significant areas requiring the use of estimates relate to:

Collectibility of accounts receivable – Management estimates the collectibility of each account receivable and based on that estimation an estimate of an allowance for doubtful accounts is established. The recording of such an allowance will have a corresponding increase in expenses and a reduction in net income for the period.;

Valuation of inventory - Inventory is valued at the lower of cost and net realizable value. Management reviews the inventory regularly and if in the estimation of Management the net realizable value of the inventory is less than cost, a provision is recorded to reduce the carrying value of the inventory and a corresponding expense is recognized thereby reducing the net income for the period; and

Carrying value of intellectual assets– Management establishes the rate of amortization for intellectual assets. Management assesses the carrying value of these assets based the estimated revenue the products they relate to will generate. This estimation may result in the reduction of the carrying value of these assets and a corresponding increase in expenses and a reduction of net income for the period.

## **Investor Relations**

Personnel employed directly by the Company handle all investor relations. The duties include news releases, investor communications and general day to day operations of this department.

## **Legal Proceedings**

There are no outstanding legal proceedings.

## **Risk Factors**

### ***Seasonality and Inflation***

Although the Company's sale cycle is quite lengthy, sales of the Company's products are generally not seasonal. Inflation, in recent years, has not adversely affected the Company's results of operations and unless inflation increases substantially is not expected to adversely affect the Company in the future.

### ***Market Risks***

Market risks represent the risk of loss that may impact the consolidated financial statements of the Company due to adverse changes in financial market prices and rates. The Company's market risk is primarily the result of fluctuations in interest rates and in foreign currency values, particularly the United States dollar.

### ***Foreign Exchange and Interest Rate Risks***

Management monitors the movement in interest rates and currency exchange rates and, on that basis, decides on the appropriate measures to take. Interest rates and exchange rates at present are such that no measures are being taken at this time.

The Company does not hold or issue financial instruments for trading purposes.

### ***Financing Risk***

There is risk associated with the Company's ability to secure additional or replacement financing for debt instruments presently outstanding.

### ***Dependence on Management***

The Company's success is dependent on its founders, directors and management team. The loss of the services of key personnel could make it more difficult to successfully operate the Company's business and pursue its business goals.

### ***Competition Risk***

The Company's business is in a competitive market and it competes with companies that have greater resources, experience and market stature.

### ***Product Performance Risk***

The Company's products are tested extensively and must meet certain quality assurance tests prior to delivery to customers. However, many of the products sold to the market utilize subassemblies produced by other manufacturers. The Company relies upon the quality assurance processes and representations of the subassembly suppliers. Product failures can result in a number of risks to the business including: market reputational risks and warranty/cost of goods expense risks.

### **Market for Securities**

The Common Shares of the Company are listed and posted for trading on the TSX Venture Exchange under the trading symbol "CTZ".

Toronto, Ontario  
March 28, 2007