



Inventronics Limited

[www.inventronics.com](http://www.inventronics.com)

*Designing and Manufacturing  
Custom Metal Enclosures*

**1st Quarter Report**  
for the period ending March 31, 2004

## Management's Discussion & Analysis – Q1 2004

1 of 7

### **Overview**

Inventronics Limited designs, manufactures and integrates custom metal enclosures and related products for the communications, electronics and other industries in North America. The metal enclosures function as permanent packaging and are used in outdoor or indoor applications to house and protect passive and/or active components. These products are custom designed and manufactured to suit the needs of each customer for each application. In many circumstances, the customer's components are incorporated into the enclosures, which are delivered directly to the end user, providing a complete outsourcing service.

The following discussion and analysis presents the results from operations of the Corporation for the quarters ended March 31, 2004 and 2003. The majority of the Corporation's revenues are generated through the sale of finished enclosures to one principal customer, which accounted for approximately 82% of the Corporation's first-quarter 2004 sales.

### **Comparison of the quarters ended March 31, 2004 and 2003**

#### **Sales**

Inventronics' sales for the three months ended March 31, 2004 were \$3,264,000, which was very consistent in dollar value with the sales of \$3,281,000 achieved in the same period last year. The volumes in the first quarter of 2004 have increased significantly over the same period last year, but due to the 17% decline in the US dollar against the Canadian dollar, the sales value for the quarters are nearly equal.

The first quarter is the seasonal low point in sales for the Corporation each year. Sales for the balance of 2004 are expected to strengthen as spending in the Corporation's core market, telecommunications infrastructure, continues to recover from the lows experienced in early 2003. Maintenance and capital spending programs for the major telecommunications providers across North America are projected to be modestly higher for 2004 compared to 2003.

Sales diversification into new markets with new customers is continuing to reveal opportunities for Inventronics to gain business outside of its core market. These opportunities are resulting in limited initial volumes that are being leveraged into more significant relationships as we continue working with the identified customers.

#### **Costs and Expenses**

Operational efficiency improvements are continuing to be identified and realized as production volumes



increase. These efficiencies are responsible for holding cost of sales as a proportion of sales constant at approximately 88%, quarter-over-quarter, notwithstanding the sales volume increases. Raw material cost increases, particularly with respect to sheet metal, incurred in the first quarter have offset some of the benefits achieved through reduced plant fixed costs and improved manufacturing efficiencies. Efforts to pass on these significant raw material cost increases through revised product pricing to customers are continuing.

Plant fixed costs incurred in the first quarter of 2004 were reduced by \$92,000 or 10% from those recorded in the same period last year. Ongoing process enhancements are having the desired effect of reducing or eliminating fixed costs required to support the current sales levels.

Selling and administrative expenses in the quarter were also reduced by \$219,000 or 48% compared to the same period last year. This dramatic reduction is a result of staff reduction actions taken in March and September of 2003, which aligned spending with the sales being achieved. Fixed cost expenditures, whether for plant, sales or administration, are very tightly controlled and are focussed upon targeted initiatives.

The Corporation's 2004 first-quarter EBITDA of \$151,000 is the first time EBITDA has been positive in the first quarter since 2000. This is an important indicator that the cost-cutting measures and operational changes undertaken over the past three years has repositioned Inventronics to take advantage of an upturn in market demand.

Interest costs increased to \$223,000 in the first quarter from \$201,000 in the same period of 2003. Debt service costs related to the subordinated promissory notes continue to make up the majority of the quarterly interest cost.

### **Net Loss**

The net loss of \$269,000, or 4 cents per share, for the three months ended March 31, 2004 compares favourably with the net loss of \$491,000, or 7 cents per share, in the prior year. This reduction in the first-quarter loss has been achieved through cost reductions and efficiency gains, notwithstanding the quarter-over-quarter currency loss of more than \$400,000.

### **Liquidity and Capital Resources**

Inventronics' working capital position was \$229,000 at March 31, 2004 compared to \$971,000 at March 31, 2003. The Corporation received waivers of default from its lenders pertaining to certain financial ratio covenants related to its financing arrangements as at March 31, 2004. Management is in the process of finalizing amended financing arrangements to clear this default condition in relation to the financial ratios. The Corporation has a \$1.0-million committed facility to meet operating requirements and a \$1.5-million term facility available should it be required to support the contingent liability related to a former subsidiary (see Note 4).

### **Risk Factors**

The success of the Corporation is dependent on a number of factors. These factors include the ability to manage and adequately finance growth; the ability to meet commitments to lenders; the Canadian dollar exchange rates; the ability of the Corporation's former subsidiary to service its debt obligations; the need to satisfy changing and increasingly complex customer requirements; dependence on a small number of customers and a limited number of key personnel and suppliers; fluctuations in the price of commodity materials, particularly sheet metals; and competition from companies with greater resources.

## Annual Information

(\$'000's except per share amounts)

## For the Years Ended December 31

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Sales	\$ 13,951	\$ 25,567	\$ 48,203
EBITDA before restructuring costs	449	113	(153)
Earnings (loss) from continuing operations	(1,505)	(4,958)	(2,913)
Net earnings (loss)	(1,505)	(7,376)	(4,295)
Total assets	11,394	13,693	27,870
Total liabilities	7,429	8,305	15,495
Basic and diluted earnings (loss) per share	(0.22)	(1.07)	(0.62)
Book value per share	0.58	0.78	1.82

## Quarterly Information

<u>2003</u>	<u>Total</u>	<u>Dec 31</u>	<u>Sept 30</u>	<u>June 30</u>	<u>Mar 31</u>
Sales	\$13,951	\$3,682	\$3,457	\$3,531	\$3,281
EBITDA before restructuring costs	449	149	188	155	(43)
Net earnings (loss)	(1,505)	(273)	(475)	(266)	(491)
Basic and diluted earnings (loss) per share	(22)¢	(4)¢	(7)¢	(4)¢	(7)¢

  

<u>2002</u>	<u>Total</u>	<u>Dec 31</u>	<u>Sept 30</u>	<u>June 30</u>	<u>Mar 31</u>
Sales	\$ 25,567	\$ 4,522	\$ 6,464	\$ 8,247	\$6,334
EBITDA before restructuring costs	113	110	103	(37)	(63)
Earnings (loss) from continuing operations	(4,958)	(570)	(2,419)	(1,707)	(262)
Net earnings (loss)	(7,376)	(676)	(2,508)	(3,444)	(748)
Basic and diluted earnings (loss) per share	\$(1.07)	(10)¢	(36)¢	(57)¢	(4)¢

The significant downturn in the telecom industry, which began in 2001, forced Inventronics to dispose of its UK subsidiary, Eurocraft Enclosures Limited of Dudley, England, in 2002. Eurocraft had been acquired in 2001 for the strategic purposes of serving Inventronics' largest North American-based customer in the United Kingdom, diversifying Inventronics' customer base; and increasing Inventronics' overall sales and income. The Corporation also closed its Sherwood Park facility in October 2002 (transferring all production to Brandon, Manitoba) and refinanced its balance sheet in November 2002.

The Corporation sold its design subsidiary, Pacific Design Engineering (1996) Ltd. located in Burnaby, B.C., in 2001 due to a lack of strategic synergy.

\$ 000's (Unaudited)	As at March 31, 2004	As at December 31, 2003
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ -	\$ -
Accounts receivable	1,583	1,616
Inventories	1,363	1,239
Prepaid expenses	38	52
	<u>2,984</u>	<u>2,907</u>
Capital assets	7,295	7,473
Other assets <i>[note 4]</i>	997	1,014
	<u>\$ 11,276</u>	<u>\$ 11,394</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank operating line <i>[note 3]</i>	\$ 763	\$ 588
Accounts payable and accrued charges	1,407	1,409
Current portion of capital lease obligations	585	576
	<u>2,755</u>	<u>2,573</u>
Capital lease obligations	779	928
Subordinated promissory notes	3,992	3,873
Other deferred liabilities	54	55
	<u>7,580</u>	<u>7,429</u>
Contingent liability and guarantee <i>[note 4]</i>		
<b>Shareholders' equity</b>		
Share capital	14,447	14,447
Deficit	(10,751)	(10,482)
	<u>3,696</u>	<u>3,965</u>
	<u>\$ 11,276</u>	<u>\$ 11,394</u>

See accompanying notes

# Statements of Net Loss and Deficit

5 of 7

## \$ 000's (Unaudited)

Three months ended March 31	2004	2003
<b>SALES</b>	<b>\$ 3,264</b>	<b>\$ 3,281</b>
<b>COSTS AND EXPENSES</b>		
Cost of sales	2,880	2,872
Selling and administration	233	452
Depreciation and amortization	197	247
	<b>3,310</b>	<b>3,571</b>
<b>Operating loss</b>	<b>(46)</b>	<b>(290)</b>
Interest expense – Current	24	(3)
– Long term	209	204
Income tax recovery	-	-
<b>Net loss</b>	<b>(269)</b>	<b>(491)</b>
Deficit, beginning of the period	<b>(10,482)</b>	<b>(8,977)</b>
Deficit, end of the period	<b>\$ (10,751)</b>	<b>\$ (9,468)</b>
<b>Earnings (loss) per share</b> <i>[note 2]:</i>		
Basic	<b>(4) ¢</b>	<b>(7) ¢</b>
Diluted	<b>(4) ¢</b>	<b>(7) ¢</b>

See accompanying notes

## \$ 000's (Unaudited)

Three months ended March 31	2004	2003
<b>OPERATING ACTIVITIES</b>		
Net loss from continuing operations	\$ (269)	\$ (491)
Items not involving cash	376	286
	107	(205)
Changes in non-cash working capital balances	(123)	(397)
	(16)	(602)
<b>FINANCING ACTIVITIES</b>		
Repayment of capital lease obligations	(139)	(129)
	(139)	(129)
<b>INVESTING ACTIVITIES</b>		
Acquisition of capital assets	(22)	(58)
Funding of other asset <i>[note 3]</i>	-	(250)
Other	2	-
	(20)	(308)
Increase (decrease) in cash and cash equivalents	(175)	(1,039)
Cash and cash equivalents, beginning of the period	(588)	1,060
<b>Cash and cash equivalents, end of the period</b>	<b>\$ (763)</b>	<b>\$ 21</b>
<b>Supplemental disclosure of cash paid for:</b>		
Interest	\$ 44	\$ 161
Income taxes	\$ -	\$ -

**\$ 000's (Unaudited)****1. SIGNIFICANT ACCOUNTING POLICIES**

These unaudited interim financial statements have been prepared using policies and methods applied in the preparation of the Corporation's annual audited financial statements for the year ended December 31, 2003. The unaudited interim financial statements do not conform in all respects to the requirements of generally accepted accounting principles for annual financial statements. Accordingly, these interim financial statements should be read in conjunction with the Corporation's 2003 annual audited financial statements.

**2. EARNINGS (LOSS) PER SHARE**

Earnings (loss) per share is calculated using the weighted average number of common shares outstanding, which totalled 6,875,726 at March 31, 2004 (March 31, 2003 - 6,875,726). For the three months ended March 31, 2004 and 2003, diluted loss per share does not differ from the basic loss per share since the conversion of outstanding stock options and warrants would have an anti-dilutive effect.

**3. BANK CREDIT FACILITIES**

At March 31, 2004, the Corporation received waivers of compliance from its lenders related to the financial covenants contained in the credit facilities. All other terms related to the credit facilities remain unchanged from those described in the December 31, 2003 financial statements.

**4. CONTINGENT LIABILITY AND GUARANTEE**

On September 17, 2002, the Corporation completed the sale of all classes of outstanding shares of its wholly owned subsidiary, Eurocraft Enclosures Limited, for no net proceeds.

At March 31, 2004, the Corporation continued to have a letter of credit in the amount of £620 (CA\$1,488) outstanding in support of the long-term debt obligation of Eurocraft Enclosures Limited. The Corporation entered into an agreement whereby it made interest and principal payments on the Eurocraft term debt obligations until October 31, 2003. At the end of this period, Eurocraft resumed making these payments and will repay the amounts paid by the Corporation on behalf of Eurocraft, interest free, commencing January 2006. Principal on the Eurocraft term loan is repayable over 36 months commencing January 2003 at the rate of £30 (CA\$72) per month. As each monthly principal payment is made, the Corporation's letter of credit obligation automatically reduces by an equivalent amount. At March 31, 2004, the Corporation has a long-term receivable discounted to a present value of \$746 reflected within Other Assets.

**5. COMPARATIVE FIGURES**

Certain 2004 comparative figures have been reclassified to conform to the current period's presentation.