



Inventronics Limited

www.inventronics.com

*Designing and Manufacturing
Custom Metal Enclosures*

2nd Quarter Report
for the period ending June 30, 2003

Management's Discussion & Analysis – Q2 2003

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OVERVIEW

Inventronics Limited designs and manufactures custom metal enclosures and related products for the communications, electronics and other industries in North America. The enclosures are sophisticated products that address a variety of customer requirements including security, protection from the outside environment, ventilation and thermal management, noise abatement, aesthetics and styling, electromagnetic and seismic compatibility. In many circumstances, Inventronics integrates customer communications, electronics or other components into the enclosures and delivers them directly to the end user, thereby providing a complete outsourcing service. The majority of the Corporation's revenues are generated through the sale of finished enclosures to one principal customer, which accounted for approximately 80% of the Corporation's year-to-date 2003 revenue.

COMPARISON OF THE SIX MONTH PERIODS AND QUARTERS ENDED JUNE 30, 2003 AND 2002

Sales

Constrained spending within the industries served by Inventronics continued throughout the second quarter, resulting in a modest 8-per-cent increase in sales to \$3,531,000 compared to the 2003 first quarter sales of \$3,281,000. The traditional seasonal increase in second quarter sales was much less pronounced in 2003 compared to prior years due to the continuing slowness in the communications industry in the United States. The Corporation's six-month sales of \$6,812,000 to June 30, 2003 were well below the \$14,581,000 achieved in the same period last year. As previously discussed in the first quarter MD&A, the Corporation's principal customer now direct-purchases the components installed by Inventronics in its enclosures, which results in offsetting reductions to sales and cost of sales with no net income effect. This contract alteration accounts for more than \$3.4 million of the reduction in 2003 first-half sales.

Costs and Expenses

Inventronics continued to improve its second-quarter gross margin before depreciation to 17.3% compared to the 6.0% achieved in the same period last year. This margin improvement has principally been achieved through manufacturing efficiencies obtained in the Corporation's Brandon, Manitoba facility and through the elimination of fixed costs related to the permanent closure of its leased Sherwood Park, Alberta facility late in 2002.

Ongoing plant fixed costs incurred in the second quarter of 2003 were reduced \$602,000 or 36% from those recorded in the same period last year, bringing the year-to-date total fixed cost savings to \$1.1 million. Manufacturing efficiency improvements of \$257,000, related to labour management and material utilization were achieved in the second-quarter, bringing the year-to-date total efficiency gains to \$490,000. These operating cost improvements are permanent, and will enable gross margins to continue to strengthen as sales volumes increase.

Selling and administrative expenses in the quarter were also reduced approximately 16% compared to the same period last year. Investments in sales and marketing activities to broaden the Corporation's customer and market base are continuing, with expenditure reductions concentrated in the administrative category.

Interest costs increased to \$175,000 in the second quarter from \$67,000 in the same period of 2002, due to the cost of servicing the subordinated promissory notes issued in the fourth quarter of 2002. This increased debt servicing cost will continue to be a significant variance from prior year results throughout 2003.

Net Loss

The net loss of \$266,000 for the three months ended June 30, 2003 resulted from continued weak sales levels, higher debt service costs and currency exchange losses. The majority of the Corporation's sales are denominated in U.S. funds, and the rapid rise of the Canadian dollar has resulted in currency exchange losses of \$159,000 in the second quarter and \$277,000 year-to-date in 2003.

Liquidity and Capital Resources

Inventronics' working capital position decreased to \$756,000 at June 30, 2003 from \$971,000 at March 31, 2003. This low level of working capital is adequate to support short-term operating requirements although alternatives to increase this working capital position are being examined. The Corporation has a \$1.0-million committed operating facility, which had \$564,000 drawn at June 30, 2003. It also has a \$2.0-million term facility available should it be required to support the contingent liability related to a former subsidiary (see Note 3).

Balance Sheets

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<i>\$ 000's (Unaudited)</i>	<i>As at June 30, 2003</i>	<i>As at December 31, 2002</i>
Assets		
Current		
Cash and cash equivalents	\$ –	\$ 1,060
Accounts receivable	2,276	1,918
Inventories	1,248	1,470
Prepaid expenses	96	97
	3,620	4,545
Capital assets	7,779	8,168
Other assets <i>[note 3]</i>	942	980
	\$ 12,341	\$ 13,693
Liabilities and Shareholders' Equity		
Current		
Bank operating line <i>[note 2]</i>	\$ 564	\$ –
Accounts payable and accrued charges <i>[note 3]</i>	1,749	2,669
Current portion of capital lease obligations	551	524
	2,864	3,193
Capital lease obligations	1,223	1,542
Subordinated promissory notes	3,566	3,511
Other deferred liabilities	57	59
	7,710	8,305
Contingent liability <i>[note 3]</i>		
Shareholders' equity		
Share capital	14,365	14,365
Deficit	(9,734)	(8,977)
	4,631	5,388
	\$ 12,341	\$ 13,693

See accompanying notes

Statements of Net Loss and Deficit

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<i>\$ 000's (Unaudited)</i>	<i>Three months ended June 30,</i>		<i>Six months ended June 30,</i>	
	2003	2002	2003	2002
Sales	\$ 3,531	\$ 8,247	\$ 6,812	\$ 14,581
Costs and expenses				
Cost of sales	2,921	7,745	5,793	13,635
Selling and administration	455	539	907	1,046
Depreciation and amortization	244	265	491	529
Restructuring charges <i>[note 4]</i>	–	800	–	800
	3,620	9,349	7,191	16,010
Operating loss from continuing operations	(89)	(1,102)	(379)	(1,429)
Interest expense	175	67	376	142
Income taxes	2	538	2	397
Loss from continuing operations	(266)	(1,707)	(757)	(1,968)
Loss from discontinued operations <i>[note 3]</i>	–	(1,737)	–	(2,224)
Net loss	(266)	(3,444)	(757)	(4,192)
Deficit, beginning of the period	(9,468)	(2,349)	(8,977)	(1,601)
Deficit, end of the period	\$ (9,734)	\$ (5,793)	\$ (9,734)	\$ (5,793)

Basic and diluted loss per share *[note 5]:*

From continuing operations	(4) ¢	(25) ¢	(11) ¢	(29) ¢
From discontinued operations	–	(25) ¢	–	(32) ¢
Basic and diluted loss per share	(4) ¢	(50) ¢	(11) ¢	(61) ¢

See accompanying notes

Statements of Cash Flows

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<i>\$ 000's (Unaudited)</i>	<i>Three months ended June 30,</i>		<i>Six months ended June 30,</i>	
	2003	2002	2003	2002
Operating activities				
Net loss from continuing operations	\$ (266)	\$ (1,707)	\$ (757)	\$ (1,968)
Items not involving cash	285	1,587	571	1,694
	19	(120)	(186)	(274)
Changes in non-cash working capital balances	(180)	122	(577)	(268)
	(161)	2	(763)	(542)
Financing activities				
Repayment of bank term loan	-	(120)	-	(120)
Repayment of capital lease obligations	(163)	(217)	(292)	(409)
	(163)	(337)	(292)	(529)
Investing activities				
Acquisition of capital assets	(44)	(31)	(102)	(88)
Funding of other asset <i>[note 3]</i>	(217)	-	(467)	-
	(261)	(31)	(569)	(88)
Discontinued operations <i>[note 3]</i>				
	-	(45)	-	(90)
Increase (decrease) in cash and cash equivalents	(585)	(411)	(1,624)	(1,249)
Cash and cash equivalents, beginning of the period	21	-	1,060	558
Cash and cash equivalents, end of the period	\$ (564)	\$ (411)	\$ (564)	\$ (691)
Breakdown of cash and cash equivalents:				
Bank operating line	\$ (564)	\$ (411)	\$ (564)	\$ (691)
Supplemental disclosure of cash paid for:				
Interest	\$ 168	\$ 67	\$ 329	\$ 142
Income taxes	\$ 16	\$ 59	\$ 16	\$ 59

See accompanying notes

\$ 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, 2002. 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 2002 annual audited financial statements.

2. BANK CREDIT FACILITIES

At June 30, 2003, the Corporation had a debt to tangible net worth ratio of 2.28:1, which is in violation of the financial covenant to maintain this ratio at less than 2.20:1. The Corporation has received a waiver of compliance from its lender for this covenant violation for the months of June and July and Management is taking steps to rectify this issue.

3. DISCONTINUED OPERATION AND CONTINUING LIABILITY

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 June 30, 2003, the Corporation continued to have a letter of credit in the amount of £886 (CA\$1,985) outstanding in support of the long-term debt obligation of Eurocraft Enclosures Limited. Pursuant to the sale agreement, the Corporation agreed to make monthly interest and principal payments on the Eurocraft term debt obligations until October 31, 2003. At the end of this period, Eurocraft will resume making these payments and will repay the amounts paid by the Corporation on behalf of Eurocraft, interest free, commencing January 2006. Principal on this term loan is repayable over 36 months commencing January 2003 at the rate of £30 (CA\$67) per month. As each monthly principal payment is made, the Corporation's letter of credit obligation automatically reduces by an equivalent amount. As at June 30, 2003, \$275 was included in accrued liabilities to recognize the remaining balance of the Corporation's principal repayment obligations assumed under this agreement. In addition, the related long-term receivable discounted to a present value of \$699, including interest paid to June 30, 2003, has been reflected within Other Assets. The Corporation has entered into monthly forward exchange contracts for the principal portion of these payment obligations to October 31, 2003.

4. RESTRUCTURING CHARGES

At June 30, 2002, a provision was made in recognition of the expected disposition of certain machinery and equipment assets related to the Corporation's former Sherwood Park manufacturing facility. This facility was shutdown in October of 2002 at an aggregate cost of \$2.7 million.

5. 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 June 30, 2003 (June 30, 2002 – 6,875,726). For the six months ended June 30, 2003 and 2002, diluted loss per share is the same as the basic loss per share since the conversion of outstanding stock options and warrants would have an anti-dilutive effect. The potentially dilutive shares excluded from the diluted loss per share calculation totalled 2,465,768 at June 30, 2003 (June 30, 2002 – 1,192,434).

6. STOCK-BASED COMPENSATION

As at June 30, 2003, the fair value of stock options granted to date in 2003 would result in a compensation cost of approximately \$7 as determined using an option-pricing model. The effect on net earnings of this compensation cost is immaterial and has no net effect on the calculation of earnings (loss) per share.

7. COMPARATIVE FIGURES

Certain 2002 comparative figures have been reclassified to conform to the current period's presentation.