



Inventronics Limited

www.inventronics.com

*Designing and Manufacturing
Custom Metal Enclosures*

2nd Quarter Report
for the period ending June 30, 2004

Management's Discussion & Analysis – Q2 2004

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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 June 30, 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 80% of the Corporation's 2004 year to date sales.

Comparison of the six month periods and quarters ended June 30, 2004 and 2003

Sales

Inventronics' sales for the three months ended June 30, 2004 were \$3,437,000 compared to \$3,531,000 for the same period last year. This brings sales for the six months ended June 30, 2004 and 2003 to \$6,701,000 and \$6,812,000, respectively. Volume gains have been realized in certain markets, but the decline in the US dollar against the Canadian dollar, year over year, had the effect of reducing the sales value of these increased volumes. Almost three quarters of all sales for the first six months of 2004 were denominated in US dollars.

Modestly higher spending in the Corporation's core market, telecommunications infrastructure, is expected to result in higher year end sales for 2004 compared to 2003. Increased sales effort in other markets directed at potential new customers is also expected to produce increased revenues in the latter half of 2004.

Costs and Expenses

Raw material cost increases coupled with reduced net sales values on US-dollar denominated volumes have had a negative impact on margins. Cost of sales as a proportion of sales in the second quarter rose to 87% from 83% for the same period last year. Lean manufacturing initiatives are continuing to be identified and implemented to mitigate the effect of these issues. The current cost structure could be further impacted if sheet metal costs continue to rise and if the US dollar comes under renewed pressure. Efforts to recover lost margins through revised product pricing to customers are also continuing.



Efforts to identify process improvements to contain fixed costs are successfully resulting in cost reductions at the current level of sales. Fixed costs for the first half of 2004 are 25% or \$669,000 lower than those incurred in the first half of 2003. This targeted cost containment program will continue to play an important role in improving Inventronics' economics as volumes increase.

The Corporation's 2004 second-quarter EBITDA, not a measure defined by GAAP, of \$226,000 is a further improvement over the \$151,000 achieved in the first quarter. This brings 2004's year to date EBITDA to a total of \$377,000, which is an important increase over the \$112,000 achieved for the same period in 2003.

Interest costs increased to \$230,000 in the second quarter from \$175,000 in the same period of 2003. Debt service costs related to the Corporation's subordinated promissory notes continue to make up the majority of the quarterly interest cost. All interest recognized in 2004 related to these notes has been added to long-term debt and is payable at maturity in order to reduce the current cash flow impact of these costs.

Net Loss

The net loss of \$198,000, or 3 cents per share, for the three months ended June 30, 2004 compares favourably with the net loss of \$266,000, or 4 cents per share, in the prior year. Inventronics' return to profitability has been slowed as a result of the substantial sheet metal cost increases and currency issues mentioned above.

Liquidity and Capital Resources

Inventronics' working capital position was \$205,000 at June 30, 2004 compared to \$755,000 at June 30, 2003. In the second quarter, the Corporation amended its banking facilities to extend their term to March 31, 2005 and increase the committed operating facility to \$1.25-million from \$1.0-million. The \$1.3-million reducing term facility remained unchanged and is available should it be required to support the contingent liability related to a former subsidiary (see Note 4). The financial covenant thresholds related to these facilities were adjusted to bring them in line with forecast requirements. At June 30, 2004, the Corporation's current assets and current liabilities were higher than forecast and as a result waivers of default were obtained from its lenders pertaining to the debt to tangible net worth financial ratio covenant.

Inventronics' subordinated debt lender also agreed to provide the Corporation with an option to accrue cash interest on a monthly basis until December 31, 2004. Consideration for agreeing to the above-noted amendments and the option to accrue cash interest was paid through the issuance of 100,000 common shares at a price of 27 cents per share.

Risk Factors

The success of the Corporation is dependent upon a number of factors. These factors include the ability to manage and adequately finance operations; 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; 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

For the Years Ended December 31

(\$'000's except per share amounts)	<u>2003</u>	<u>2002</u>	<u>2001</u>
Sales	\$ 13,951	\$ 25,567	\$ 48,203
EBITDA before restructuring costs	449	113	(153)
Loss from continuing operations	(1,505)	(4,958)	(2,913)
Net 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 loss per share	(0.22)	(1.07)	(0.62)
Book value per share	0.58	0.78	1.82

Quarterly Information

	<u>Mar 31/04</u>	<u>Dec 31/03</u>	<u>Sept 30/03</u>	<u>June 30/03</u>
Sales	\$3,264	\$3,682	\$3,457	\$3,531
EBITDA before restructuring costs	151	149	188	155
Net loss	(269)	(273)	(475)	(266)
Basic and diluted loss per share	(4)¢	(4)¢	(7)¢	(4)¢

	<u>Mar 31/03</u>	<u>Dec 31/02</u>	<u>Sept 30/02</u>	<u>June 30/02</u>
Sales	\$3,281	\$ 4,522	\$ 6,464	\$ 8,247
EBITDA before restructuring costs & discontinued operations	(43)	110	103	(37)
Net loss	(491)	(676)	(2,508)	(3,444)
Basic and diluted loss per share	(7)¢	(10)¢	(36)¢	(57)¢

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 June 30, 2004	As at December 31, 2003
ASSETS		
Current		
Cash and cash equivalents	\$ -	\$ -
Accounts receivable	1,838	1,616
Inventories	1,424	1,239
Prepaid expenses	91	52
	<u>3,353</u>	<u>2,907</u>
Capital assets	7,158	7,473
Other assets <i>[note 4]</i>	1,005	1,014
	<u>\$ 11,516</u>	<u>\$ 11,394</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank operating line <i>[note 3]</i>	\$ 980	\$ 588
Accounts payable and accrued charges	1,573	1,409
Current portion of capital lease obligations	595	576
	<u>3,148</u>	<u>2,573</u>
Capital lease obligations	628	928
Subordinated promissory notes	4,162	3,873
Other deferred liabilities	53	55
	<u>7,991</u>	<u>7,429</u>
Contingent liability and guarantee <i>[note 4]</i>		
Shareholders' equity		
Share capital <i>[note 5]</i>	14,474	14,447
Deficit	(10,949)	(10,482)
	<u>3,525</u>	<u>3,965</u>
	<u>\$ 11,516</u>	<u>\$ 11,394</u>

See accompanying notes

Statements of Net Loss and Deficit

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\$ 000's (Unaudited)

	Three months ended		Six months ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
SALES	\$ 3,437	\$ 3,531	\$ 6,701	\$ 6,812
COSTS AND EXPENSES				
Cost of sales	2,969	2,921	5,849	5,793
Selling and administration	242	455	475	907
Depreciation and amortization	194	244	391	491
	3,405	3,620	6,715	7,191
Operating earnings (loss)	32	(89)	(14)	(379)
Interest expense – Current	14	5	28	2
– Long term	216	170	425	374
Income taxes	-	2	-	2
Net loss	\$ (198)	\$ (266)	\$ (467)	\$ (757)
Deficit, beginning of the period	(10,751)	(9,468)	(10,482)	(8,977)
Deficit, end of the period	\$ (10,949)	\$ (9,734)	\$ (10,949)	\$ (9,734)
Earnings (loss) per share [note 2]:				
Basic and diluted	(3) ¢	(4) ¢	(7) ¢	(11) ¢

See accompanying notes

\$ 000's (Unaudited)

	Three months ended		Six months ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
OPERATING ACTIVITIES				
Net loss	\$ (198)	\$ (266)	\$ (467)	\$ (757)
Items not involving cash	382	285	758	571
	184	19	291	(186)
Changes in non-cash working capital balances	(202)	(180)	(325)	(577)
	(18)	(161)	(34)	(763)
FINANCING ACTIVITIES				
Repayment of capital lease obligations	(142)	(163)	(281)	(292)
	(142)	(163)	(281)	(292)
INVESTING ACTIVITIES				
Acquisition of capital assets	(59)	(44)	(81)	(102)
Funding of other asset [note 3]	-	(217)	-	(467)
Other	2	-	4	-
	(57)	(261)	(77)	(569)
Increase (decrease) in cash and cash equivalents	(217)	(585)	(392)	(1,624)
Cash and cash equivalents, beginning of the period	(763)	21	(588)	1,060
Cash and cash equivalents, end of the period	\$ (980)	\$ (564)	\$ (980)	\$ (564)
Breakdown of cash and cash equivalents:				
Bank operating line	\$ (980)	\$ (564)	\$ (980)	\$ (564)
Supplemental disclosure of cash paid for:				
Interest	\$ 42	\$ 168	\$ 86	\$ 329
Income taxes	\$ -	\$ 16	\$ -	\$ 16

See accompanying notes

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 6,886,959 at June 30, 2004 (June 30, 2003 - 6,875,726). For the six months ended June 30, 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

In the second quarter ended June 30 2004, the Corporation extended its credit facilities to March 15, 2005; increased its committed operating facility to \$1.25-million from \$1.0-million; and established financial ratio covenants in accordance with forecast expectations. The interest rate charged on the committed facility was changed to bank prime plus 3.0% from bank prime plus 2.75% and the rate charged on the reducing term facility was changed to bank prime plus 4.0% from bank prime plus 3.0% should this facility be drawn. In addition to these credit facility amendments, the Corporation's subordinated debt lender agreed to provide the Corporation with an option to accrue cash interest on a monthly basis until December 31, 2004. At June 30, 2004, the Corporation received waivers of compliance from its lenders related to its debt to tangible net worth financial covenant contained in the credit facilities.

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 June 30, 2004, the Corporation continued to have a letter of credit in the amount of £530 (CA\$1,272) 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 June 30, 2004, the Corporation has a long-term receivable discounted to a present value of \$746 reflected within Other Assets.

5. SHARE CAPITAL

On May 21, 2004, the Corporation issued 100,000 common shares at a per share price of 27 cents to its subordinated debt lender in payment of renegotiation fees related to the debt arrangements described in Note 3.

6. COMPARATIVE FIGURES

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