



Inventronics Limited

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

*Designing and Manufacturing  
Custom Metal Enclosures*

**3rd** Quarter Report  
for the period ending September 30, 2004

## Management's Discussion & Analysis – Q3 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 September 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 78% of the Corporation's 2004 year to date sales.

### **Comparison of the nine month periods and quarters ended September 30, 2004 and 2003**

#### **Sales**

Inventronics' sales for the three months ended September 30, 2004 were \$3,695,000 compared to \$3,457,000 for the same period last year. This brings sales for the nine months ended September 30, 2004 and 2003 to \$10,396,000 and \$10,269,000, respectively. Sales into markets other than the Corporation's principal market, telecommunications infrastructure, were \$962,000 compared to \$632,000 in the same period last year. Sales to non-telecommunications customers are continuing to increase as targeted marketing efforts successfully introduce the Corporation's service capabilities to a broader array of customers.

#### **Costs and Expenses**

The rising cost of raw materials coupled with the devaluation of the US-dollar has had a negative impact on margins. Cost of sales as a proportion of sales for the third quarter increased to 88%, compared to 84% for the same period last year. Sheet metal costs have increased more than 50% since the beginning of 2004, but are now showing signs of stabilizing. Approximately 70% of all sales are denominated in US dollars and, as a result, the continued rise of the Canadian dollar relative to its US counterpart is reducing margins compared to last year. Efforts to recover lost margins through revised product pricing to customers are proving successful and continuing.

### **Costs and Expenses - continued**

The Corporation's 2004 third-quarter EBITDA, not a measure defined by GAAP, of \$181,000 declined slightly compared to the \$188,000, before restructuring costs, achieved in the same period last year. The 2004 year to date EBITDA totals \$558,000, which is nearly double that of last year. The improved fixed cost structure achieved through restructuring actions taken in 2003 have been the main contributor to the increased EBITDA in spite of increased metal costs and exchange losses.

Interest costs increased to \$244,000 in the third quarter from \$211,000 in the same period of 2003. Debt service costs related to the Corporation's subordinated promissory notes amounted to \$176,000 for the quarter. All 2004 subordinated promissory note interest amounting to \$465,000 has been added to long-term debt and is payable at maturity.

### **Net Loss**

The net loss of \$267,000, or 4 cents per share, for the three months ended September 30, 2004 is significantly less than the net loss of \$475,000, or 7 cents per share, in the prior year. Substantial sheet metal cost increases and the rising Canadian dollar are expected to negatively impact earnings for the foreseeable future.

### **Liquidity and Capital Resources**

Inventronics' working capital position was \$150,000 at September 30, 2004 compared to \$205,000 at the end of the second quarter of 2004. The Corporation had a committed operating facility of \$1.25-million, which had a balance of \$1.0-million drawn against it. The \$1.0-million reducing term facility is available should it be required to support the contingent liability related to a former subsidiary (see Note 4). At September 30, 2004, the Corporation obtained waivers of default from its lenders in respect to certain financial covenants.

### **Subsequent Event**

Subsequent to the end of third quarter, on October 29, 2004, the Corporation agreed to forgive its loan receivable from Eurocraft Enclosures Limited, a former wholly owned subsidiary, in exchange for the cancellation of the letter of credit and guarantee issued by Inventronics in support of Eurocraft's long-term debt obligation to its bank. This transaction eliminates the contingent liability and will result in a write-off of the loan receivable in the amount of \$746 plus costs in the fourth quarter of 2004.

### **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 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

(\$'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)
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>June 30/04</u>	<u>Mar 31/04</u>	<u>Dec 31/03</u>	<u>Sept 30/03</u>
Sales	\$3,437	\$3,264	\$3,682	\$3,457
EBITDA before restructuring costs	226	151	149	188
Net loss	(198)	(269)	(273)	(475)
Basic and diluted loss per share	(3)¢	(4)¢	(4)¢	(7)¢

	<u>June 30/03</u>	<u>Mar 31/03</u>	<u>Dec 31/02</u>	<u>Sept 30/02</u>
Sales	\$3,531	\$3,281	\$ 4,522	\$ 6,464
EBITDA before restructuring costs & discontinued operations	155	(43)	110	103
Net loss	(266)	(491)	(676)	(2,508)
Basic and diluted loss per share	(4)¢	(7)¢	(10)¢	(36)¢

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 September 30, 2004	As at December 31, 2003
<b>ASSETS</b>		
<b>Current</b>		
Accounts receivable	\$ 2,098	\$ 1,616
Inventories	1,388	1,239
Prepaid expenses	102	52
	<u>3,588</u>	<u>2,907</u>
Capital assets	6,990	7,473
Other assets <i>[note 4]</i>	981	1,014
	<u>\$ 11,559</u>	<u>\$ 11,394</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Bank operating line <i>[note 3]</i>	\$ 1,151	\$ 588
Accounts payable and accrued charges	1,682	1,409
Current portion of capital lease obligations	605	576
	<u>3,438</u>	<u>2,573</u>
Capital lease obligations	473	928
Subordinated promissory notes	4,338	3,873
Other deferred liabilities	52	55
	<u>8,301</u>	<u>7,429</u>
Contingent liability and guarantee <i>[note 4]</i>		
<b>Shareholders' equity</b>		
Share capital <i>[note 6]</i>	14,474	14,447
Deficit	(11,216)	(10,482)
	<u>3,258</u>	<u>3,965</u>
	<u>\$ 11,559</u>	<u>\$ 11,394</u>

See accompanying notes

# Statements of Net Loss and Deficit

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\$ 000's (Unaudited)

	Three months ended		Nine months ended	
	Sept 30, 2004	Sept 30, 2003	Sept 30, 2004	Sept 30, 2003
<b>SALES</b>	<b>\$ 3,695</b>	<b>\$ 3,457</b>	<b>\$ 10,396</b>	<b>\$ 10,269</b>
<b>COSTS AND EXPENSES</b>				
Cost of sales	3,250	2,920	9,099	8,713
Selling and administration	264	349	739	1,256
Depreciation and amortization	189	211	580	702
Restructuring charges <i>[note 2]</i>	-	234	-	234
	<b>3,703</b>	<b>3,714</b>	<b>10,418</b>	<b>10,905</b>
<b>Operating loss</b>	<b>(8)</b>	<b>(257)</b>	<b>(22)</b>	<b>(636)</b>
Interest expense – Current	19	9	47	10
– Long term	225	202	650	577
Income taxes	15	7	15	9
<b>Net loss</b>	<b>\$ (267)</b>	<b>\$ (475)</b>	<b>\$ (734)</b>	<b>\$ (1,232)</b>
Deficit, beginning of the period	(10,949)	(9,734)	(10,482)	(8,977)
Deficit, end of the period	<b>\$ (11,216)</b>	<b>\$ (10,209)</b>	<b>\$ (11,216)</b>	<b>\$ (10,209)</b>
<b>Earnings (loss) per share</b> <i>[note 2]:</i>				
Basic and diluted	<b>(4) ¢</b>	<b>(7) ¢</b>	<b>(11) ¢</b>	<b>(18) ¢</b>

See accompanying notes

# Statements of Cash Flows

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**\$ 000's (Unaudited)**

	Three months ended		Nine months ended	
	Sept 30, 2004	Sept 30, 2003	Sept 30, 2004	Sept 30, 2003
<b>OPERATING ACTIVITIES</b>				
Net loss	\$ (267)	\$ (475)	\$ (734)	\$ (1,232)
Items not involving cash	387	336	1,145	907
	120	(139)	411	(325)
Changes in non-cash working capital balances	(125)	733	(450)	156
	(5)	594	(39)	(169)
<b>FINANCING ACTIVITIES</b>				
Repayment of capital lease obligations	(145)	(134)	(426)	(426)
	(145)	(134)	(426)	(426)
<b>INVESTING ACTIVITIES</b>				
Acquisition of capital assets	(21)	(91)	(102)	(193)
Funding of other asset <i>[note 3]</i>	-	(228)	-	(695)
Other	-	3	4	3
	(21)	(316)	(98)	(885)
Increase (decrease) in cash and cash equivalents	(171)	144	(563)	(1,480)
Cash and cash equivalents, beginning of the period	(980)	(564)	(588)	1,060
<b>Cash and cash equivalents, end of the period</b>	<b>\$ (1,151)</b>	<b>\$ (420)</b>	<b>\$ (1,151)</b>	<b>\$ (420)</b>
<b>Breakdown of cash and cash equivalents:</b>				
Bank operating line	\$ (1,040)	\$ (420)	\$ (1,040)	\$ (420)
Outstanding cheques	(111)	-	(111)	-
	\$ (1,151)	\$ (420)	\$ (1,151)	\$ (420)
<b>Supplemental disclosure of cash paid for:</b>				
Interest	\$ 44	\$ 86	\$ 130	\$ 415
Income taxes	\$ -	\$ 7	\$ -	\$ 23

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, 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 are calculated using the weighted average number of common shares outstanding, which totalled 6,912,164 at September 30, 2004 (September 30, 2003 - 6,875,726). For the nine months ended September 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**

At September 30, 2004, the Corporation had a committed operating facility of \$1.25-million with an interest rate of bank prime plus 3.0%. In addition, the Corporation had a reducing term facility of \$1.0 million with an interest rate of bank prime plus 4.0% should this facility be drawn. 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 September 30, 2004, the Corporation continued to have a letter of credit in the amount of £440 (CA\$1,007) 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 by agreement would be expected to 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\$69) per month. As each monthly principal payment is made, the Corporation's letter of credit obligation automatically reduces by an equivalent amount. At September 30, 2004, the Corporation has a long-term receivable discounted to a present value of \$746 reflected within Other Assets.

**5. SUBSEQUENT EVENT**

On October 29, 2004 the Corporation agreed to forgive its loan receivable referred to in Note 4 in exchange for the cancellation of the letter of credit and guarantee issued by the Corporation in support of Eurocraft's long-term debt obligation to its bank. This transaction eliminates the contingent liability and will result in a write-off of the loan receivable in the amount of \$746 plus costs in the fourth quarter of 2004. Having eliminated the contingent liability, the Corporation's bank credit facilities referred to in Note 3 were modified to eliminate the reducing term facility and convert the committed operating facility to a demand operating facility with an interest rate of bank prime plus 2.0%.

**6. 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 subordinated debt lenders agreement to provide the Corporation with an option to accrue cash interest on a monthly basis until December 31, 2004.

**7. COMPARATIVE FIGURES**

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