

## MANAGEMENT'S DISCUSSION AND ANALYSIS

*The following is management's discussion and analysis of operations and financial position ("MD&A") and should be read in conjunction with the audited consolidated financial statements for the year ended July 31, 2011 and the audited consolidated financial statements and MD&A for the year ended July 31, 2010 included in our 2010 Annual Report to Shareholders. The audited consolidated financial statements for the year ended July 31, 2011 have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), and the audited consolidated financial statements for the year ended July 31, 2010 have been prepared in accordance with Canadian GAAP. When we use the terms "we", "us", "our", "Reko", or "Company", we are referring to Reko International Group Inc. and its subsidiaries.*

*This MD&A has been prepared by reference to the MD&A disclosure requirements established under National Instrument 51-102 "Continuous Disclosure Obligations" ("NI 51-102") of the Canadian Securities Administrators. Additional information regarding Reko International Group Inc., including copies of our continuous disclosure materials such as our annual information form, is available on our website at [www.rekointl.com](http://www.rekointl.com) or through the SEDAR website at [www.sedar.com](http://www.sedar.com).*

*In this MD&A, reference is made to gross profit and adjusted net income (loss), which is not measures of financial performance under Canadian GAAP. The Company calculates gross profit as sales less cost of sales (including depreciation and amortization). The Company calculates adjusted net income (loss) as net income (loss) plus business transformation expenses (including asset impairments recognized as part of the business transformation project). The Company included information concerning these measures because they are used by management as measures of performance, and management believes it is used by certain investors and analysts as a measure of the Company's financial performance. These measures are not necessarily comparable to similarly titled measures used by other companies.*

*All amounts in this MD&A are expressed in 000's of Canadian dollars, except per share data and where otherwise indicated.*

*This MD&A is current to October 11, 2011.*

### OVERVIEW

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Reko designs and manufactures a variety of engineered products and services for original equipment manufacturers ("OEMs") and their Tier 1 suppliers. These products include custom machining of very large castings and assemblies to high precision tolerances, specialty machines and lean cell factory automation, compression molds, hydroform dies, plastic injection molds, fixtures and gauges. Customers are typically OEMs or their Tier 1 suppliers and are predominantly in the automotive market. Divisions of Reko are generally invited to bid upon programmes comprised of a number of custom products used by the customer to produce a complete assembly or product.

For the automotive industry, the Company conceives, designs and builds innovation solutions to manufacturing challenges, including specialty machines for gas tank assembly lines, work cell solutions for compression molds, repair of CNC machines, plastic secondaries, as well as compression molds, hydroform dies, two shot molds and plastic injection molds. Reko has extensive experience and knowledge in mold design and material flow and the impact of pressure on segments of the mold/die. For the transportation and oil and gas industry, the Company machines customer supplied metal castings to customer indicated specifications.

Our design and manufacturing operations are carried on in two manufacturing plants located in Lakeshore, Ontario a suburb of the City of Windsor in Southwestern Ontario.

### BUSINESS TRANSFORMATION PROJECT

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The Company announced on April 28, 2011, a business transformation project that will enhance its competitive position in North America and build a solid foundation for future profitability. The project will place greater emphasis on its custom machining operations, reduce fixed costs and eliminate capacity in its plastic injection mold building operations. While the project reduces the Company's emphasis on building plastic injection molds, Reko will continue to build plastic injection molds.

The project resulted in the closure of 7 manufacturing plants at two industrial sites, elimination of a portion of the Company's machining capacity, related to plastic injection molds and involves an employee head count rationalization. The Company completed all of the steps associated with implementing the business transformation

project by July 31, 2011 and anticipates completing all non-strategic business asset divestitures associated with the plan by the end of its 2013 fiscal year. As a result of the project, the Company anticipates realizing \$7,500 annually in improvements to its overhead cost structure, comprised of \$4,000 related to fixed costs and \$3,500 related to labour costs and a reduction of in its annual debt service costs to \$2,300.

In order to implement the project, the Company will take \$7,100 in pre-tax charges over the next two fiscal years. Previously the Company announced \$7,500 in pre-tax charges. At July 31, 2011, the Company had paid \$581 related to its business transformation project. In the third quarter of 2011, the Company reported a \$3,400 charge related to the write-down of non-strategic business assets, which the Company recorded as an asset impairment, and a \$2,215 charge related to severance associated with adopting the plan, which the Company recorded as business transformation project expenses. In the current quarter, the Company revised its severance accrual and reported a recovery of \$425 related thereto. In addition, during the quarter, the Company recorded a charge of \$569 related to moving costs associated with implementing the project, all of which the Company recorded as business transformation project expenses. Over the next two years, the Company expects to incur \$1,600 of carrying costs associated with its real estate, while it is held for sale. Finally, the Company anticipates it will incur \$200 of asset restoration costs, which it will expense as part of the disposition costs of the real estate being held for sale.

As part of the business transformation project, the Company does not anticipate a write-down of its real estate. Based on current appraised values for the real estate, the Company anticipates recording an after-tax gain of between \$1,700 and \$2,400 on the sale of real estate. Portions of this gain will be recorded as income as each real estate asset is sold.

The Company anticipates generating \$10,600 in cash as it implements the project to be used to pay for the pre-tax charges. Of the total cash generated \$2,400 relates to the sale of non-strategic business assets, which the Company expects to realize on in the first quarter of 2012. Previously the Company indicated that the sale process was expected to generate \$1,300. The increase is based on actual proceeds realized subsequent to year-end. Another \$4,200 relates to the sale of real estate assets, which the Company expects to realize on over the next 27 months. The final \$4,000 relates to reductions in working capital associated with plastic injection mold builds, which the Company expects to realize on beginning in the first quarter of 2013.

## **INDUSTRY TRENDS AND RISKS**

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Historically, our success has been primarily dependent upon the levels of new model releases of cars and light trucks by North American OEMs and our ability to source moulding and automation programmes with them. OEM new model releases can be impacted by many factors, including general economic and political conditions, interest rates, energy and fuel prices, labour relation issues, regulatory requirements, infrastructure, legislative changes, environmental emissions and safety issues.

*Continued support of our lenders could have a material impact on our profitability, financial condition and continued sustainability*

The Company operates in a capital-intensive business, has significant financing requirements placed on it by its customers and its financial resources are less than the financial resources of our customer base. There can be no assurance that, if, as and when the Company seeks additional equity or debt financing, it will be able to obtain the additional financial resources required to successfully compete in its markets on favourable commercial terms or at all. Additional equity financings may result in dilution to existing shareholders.

*Our recent financial results may result in our customers assessing us as a high-risk supplier thereby jeopardizing our opportunities for new business, which could materially impact our profitability and financial condition*

We incurred significant operating losses in fiscal 2010 and 2011 as a result of the lack of commercial credit to support other companies' capital equipment purchases and the impacts of our business transformation project. As more of our customers perform supplier credit risk evaluations, on a more frequent basis, their assessment of Reko

could result in us being considered a high-risk supplier. Being categorized as a high-risk supplier could jeopardize our opportunities for new business awards.

*A slower than anticipated economic recovery or deterioration of economic conditions could have a material adverse effect on our profitability and financial condition.*

While the global economy is currently experiencing a gradual recovery, the global capital equipment market has just begun to stabilize and improve. As a result, considerable uncertainty remains as to the breadth and depth of a global economic and industry recovery, including the timing of a return to more normal market conditions. A slower than anticipated recovery or a deterioration of economic conditions, including a global or continent specific double dip recession, could have a material adverse effect on our profitability and financial condition.

*The bankruptcy of any of our major customers, and the potential corresponding disruption of the automotive supply chain, could have a material adverse effect on our profitability and financial condition.*

The short-term viability of several of our automotive customers appears to have improved as a result of restructuring actions in the past few years, as well as direct government financial intervention in the automotive industry in 2009. However, there can be no assurance that these restructuring actions will be successful in ensuring such automotive companies' long-term viability, nor can there be any assurance that government financial assistance will be made available at levels necessary to prevent automobile manufacturer failures in the future. The bankruptcy of any of our major customers could have a material adverse effect on our profitability and financial condition. Additionally, since automobile manufacturers rely on a highly interdependent network of suppliers, a bankruptcy could materially disrupt operations and the financial condition of one or more of our Tier 1 customers, which could have a material adverse effect on our profitability or financial condition.

*Our short-term and long-term profitability could be adversely affected by the costs associated with our business transformation project*

On April 28, 2011, we announced the implementation of our business transformation project. The physical relocation portion of the project was completed on July 31, 2011. The project is expected to have a pre-tax cost of \$7.1 million offset by a \$2 million gain on sale of real estate. In addition, the project is anticipated to generate \$10.6 million of cash and result in a reduced annual debt service cost of \$2.3 million. There can be no assurances that the Company will complete the business transformation project during the timeline identified or within the budget established for the project. There can be no assurances that the Company will sell the excess real estate made available by the project within the timeframes identified, which may have a material impact on both the proceeds from the sale and the carrying costs associated with the real estate. There can be no assurances that the working capital reduction associated with the project will be achieved or that it will be achieved within the timeframe suggested.

*Current outsourcing and in-sourcing trends could materially impact our profitability and financial condition*

As global market conditions weakened in the last 3 years, demand for our customers' products also weakened. During periods of weakened demand, our customers traditionally revisit outsourcing decisions as a method of maintaining their employment levels. As a result of this and other factors, some of our customers decided to bring work in-house that in the recent past would have been performed by Reko. Depending upon the depth and breadth of the current economic recovery, Reko may continue to experience significant reduction in outsourced work orders.

*Our inability to diversify our sales could have an adverse effect on our profitability and financial condition*

Although we supply molds, gauges, fixtures and factory automation to all of the leading automobile manufacturers, a significant majority of our sales are to three such customers. While we have diversified our customer base somewhat in recent years and continue to attempt to further diversify, particularly to increase our business with European and Asian based automobile manufacturers, there is no assurance we will be successful. Our inability to successfully grow our sales to non-traditional customers could have an adverse effect on our profitability and financial condition.

*We may not be able to successfully compete against suppliers with operations in developing markets, which could have an adverse effect on our profitability and financial condition*

Many of our customers have sought, and will likely continue to seek to take advantage of lower operating costs in China, India, Brazil, Indonesia, Russia and other developing markets. While we continue to expand our manufacturing sources, with a view to taking advantage of these lower cost countries, we cannot guarantee that we will be able to fully realize such opportunities. The inability to quickly adjust our manufacturing sources to take advantage of opportunities in these markets could harm our ability to compete with our suppliers operating in or from such markets, which could have an adverse effect on our profitability and financial condition.

*Significant long-term fluctuations in relative currency values could have an adverse effect on our profitability and financial condition*

Although, our financial results are reported in Canadian dollars, a significant portion of our sales are realized in U.S. dollars. Our profitability is affected by movements in the U.S. dollar against the Canadian dollar. As a result of our hedging program, foreign currency transactions are not fully impacted by movements in exchange rates. Our hedging program is designed to hedge our accounting risk (the risk associated with our foreign exchange balances on our balance sheet at any point in time) but does not hedge our economic risk (the risk associated with all of our foreign exchange balances and potential balances regardless of whether those balances and potential balances are on our balance sheet at any one particular time). Despite these measures, significant long-term fluctuations in relative currency values could have an adverse effect on our profitability and financial condition and any sustained change could adversely impact our competitiveness.

*The continuation or intensification of pricing pressures and pressure to absorb additional costs could have an adverse effect on our profitability*

We face significant pricing pressure, as well as pressure to absorb costs related to tooling design and machine design, as well as other items previously paid for directly by automobile manufacturers. These pressures are expected to continue, even as the industry recovers from the global recession and profitability returns to our customers. The continuation or intensification of these pricing pressures and pressure to absorb additional costs could have an adverse effect on our profitability and financial condition.

*The consequences of the automotive industry's dependence on consumer spending and general economic conditions could materially impact our profitability and financial condition*

The global automotive industry is cyclical and largely tied to general economic conditions. The recent economic downturn and economic recovery resulted in significant reductions in consumer spending which severely impacted our OEM and Tier 1 customers. As our customers revisit their business models and make design changes to existing models and new vehicle introductions, the market for tooling and factory automation may decline.

*The financial viability of our supply base could materially impact our profitability and financial condition*

The global economic conditions have weakened the financial stability of our supplier base. While our exposure to individual entities in our supply chain is largely limited to steel suppliers and mold grainers, both of which tend to be mandated by our customers, we are still exposed to multiple relatively small niche market players whose declining financial viability may present challenges for securing the necessary inputs to our build process.

*The increasing pressure from our customers to launch new awards without adequate design support could materially impact our profitability and financial condition*

As the automotive industry rushed to restructure its operations, our OEM and Tier 1 customers substantially reduced the design support offered to new vehicle launches. Without an adequate level of support, the quality of information provided to tool builders to begin their work dropped significantly. In addition, tool builders' ability to manipulate poor quality information is limited as the appropriate resources to approve the manipulations are not available from

the OEM or Tier 1. This introduced significant inefficiencies to the process and impaired the ability of the tool builder to manufacture molds at the same profitability as in the past.

*The increasing pressure from our customers to absorb their traditional overhead costs, including program management and design feasibility, could materially impact our profitability and financial condition*

As the automotive industry rushed to restructure its operations, services typically provided by our Tier 1 customers in the areas of program management and design feasibility were abandoned to meet internal financial targets. As this layer of oversight and engineering disappeared from our customers, Reko was expected to fill the void. To date, Reko has been able to meet this challenge using internal resources. However as additional cuts are made at our Tier 1 customers, increased pressure to fill this void may result in the need for Reko to increase its overhead to fulfill this role.

*Changes in consumer demand for specific vehicles could materially impact our profitability and financial condition*

The global automotive industry is cyclical and consumer demand for automobiles is sensitive to changes in economic and political conditions, including interest rates, energy prices, employment levels and international conflicts, including acts of terrorism. Automotive production and more importantly for Reko, the frequency of automotive model changes, is affected by consumer demand and may be affected by macro economic factors. As a result of these and other factors, some of our customers are currently experiencing, and/or may experience in the future, reduced consumer demand for all or a portion of their vehicles, leading to reduced product offerings.

*The consequences of shifting market shares among vehicle or automobile manufacturers could materially impact our profitability and financial condition*

Although we supply tooling, secondary automation and manufacturing work cells to almost all of the leading automotive manufacturers, a significant majority of our sales are to the Detroit 3. We are attempting to further diversify our customer base, particularly to increase our business with Asian-based and European-based automotive manufacturers. In the short-term, we remain constrained to our exposure with the Detroit 3.

*The consequences of a decrease in the world's energy reduction programs could materially impact our profitability and financial condition*

Certain of our activities are tied to machining of energy efficient locomotive engines. An adverse change in the current worldwide economic demand for energy efficient locomotive engines could result in reduction in the demand for our machining operations.

*Our failure to identify and develop new technologies and to successfully apply such technologies to create new products could have a material adverse effect on our profitability and financial condition*

Like our Tier 1 customers, we continue to invest in technology and innovation. Our ability to anticipate changes in technology and to successfully develop and introduce new and enhanced products on a timely basis using such technologies will be a significant factor in our ability to remain competitive. If there is a shift away from the use of such technologies, our costs may not be fully recovered. In addition, if other technologies in which our investment is not as great or our expertise is not as fully developed emerge as the industry-leading technologies, we may be placed at a competitive disadvantage, which could have a material adverse effect on our profitability and financial condition.

*The failure of one or more major financial institutions could affect the amount of credit available to us or subject us to counterparty risk in connection with derivative transactions, which could significantly impact our financial condition*

Turmoil in the financial sector has had a significant effect on the global economy over the last number of years. The failure of a major financial institution around the globe could lead to further disruptions in capital and credit markets

and could adversely affect our and our customers' ability to access needed liquidity for working capital. In addition, in the event of a failure of a financial institution in which we invest our cash reserves, that is a counter party in a derivative transaction, or a lender to us, we face the risk that our cash reserves or liquidity available to us may be significantly reduced. All of these risks could have a significant impact on our financial condition.

*Our dependence upon key personnel could materially impact our profitability and financial condition*

The success of Reko is dependent on our design engineers, control engineers, machinists and our management team. The experience and talents of these individuals is a significant factor in the Company's continued growth and success. The loss of one or more of these individuals without adequate replacement could have a material adverse effect on the Company's operations and business prospects.

*Our inability to utilize tax losses could materially impact our profitability and financial condition*

We incurred tax losses in both Canada and the United States, which we may not be able to fully or partially offset against future income in those countries. In the case of the United States, we may not be able to utilize these losses at all if we cannot generate profits in the United States.

*We could record impairment charges in the future, which could materially impact our profitability and financial condition*

Annually, we must test our capital assets, future income taxes and any other long-lived assets for impairment whenever indicators of impairment exist. The bankruptcy of a significant customer could be an indicator of impairment. In addition, to the extent that forward-looking assumptions regarding the impact of improvement plans on current operations, outsourcing and other new business opportunities are not met, impairment charges could occur.

*Our failure to successfully identify, complete, and integrate acquisitions could materially impact profitability and financial condition*

While we have not completed an acquisition in a number of years, we may do so in the future. In those product areas in which we identified acquisitions as critical to our business strategy, we may not be able to identify suitable acquisition targets or successfully acquire any suitable targets, which we identify. Additionally, we may not be able to successfully integrate or achieve anticipated synergies from those acquisitions, which we do complete.

*Significant changes in law, government regulations or accounting regulations could materially impact our profitability and financial condition*

A significant change in the current regulatory environment in our principal markets could impact future profitability. In particular, our profitability could be adversely impacted by significant changes in the tariffs and duties imposed on our products. In addition, we could be affected by changes in tax or other laws, which impose additional costs on automobile manufacturers or consumers, or more stringent fuel economy requirements on manufacturers, of sport-utility vehicles, light trucks and other vehicles from which we derive some of our sales.

*Environmental laws and regulations could materially impact our profitability and financial condition*

We are subject to a wide range of environmental laws and regulations relating to air emissions, wastewater discharge, waste management and storage of hazardous substances. We are also subject to environmental laws requiring investigation and clean up of environmental contamination. Estimating environmental clean-up liabilities is complex and heavily dependent on the nature and extent of historical information and physical data relating to the contaminated sites, the complexity of contamination, the uncertainty of which remedy to apply, and the outcome of discussions with regulatory authorities relating to the contamination. In addition, these environmental laws and regulations are complex, change frequently and have tended to become more stringent and expensive over time. Therefore, we may not have been, and in the future may not be, in complete compliance with all such laws and

regulations, and we may incur material costs or liabilities as a result of such laws and regulations significantly in excess of amounts we have reserved.

*Potential volatility of Reko's share prices could materially impact the financial returns earned by our shareholders*

The market price of the Company's common shares has been, and will likely continue to be, subject to fluctuations in response to a variety of factors, many of which are beyond the Company's control. These fluctuations may be exaggerated if the trading volume of the common shares remains low. In addition, due to the evolving nature of its business, the market price of the common shares may fall dramatically in response to a variety of factors, including quarter-to-quarter variations in operating profits, announcements of technological or competitive developments by the Company or its competitors, large short-term fluctuations in foreign exchange rates, acquisitions or entry into strategic alliances by the Company or its competitors, the industry or its customer's industry and general market and economic conditions.

*Interest of the majority and minority shareholders may be in conflict with the interests of the Company*

As of the date of this MD&A, The Reko Family Corporation owns directly or indirectly 54.8% of the outstanding shares of the Company. As such, The Reko Family Corporation will be able to elect or remove the directors of the Company and to exercise control in certain respects over the Company's affairs.

## **CONTINUING OPERATIONS AND LIQUIDITY RISKS**

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The Company has experienced reduced revenues and significant operating losses in both the current and the previous year caused primarily by the temporary decline in capital equipment markets occurring concurrent with the global recession and from structural changes in the automotive industry which eventually led to General Motors and Chrysler's bankruptcies. In addition, the Company is currently working with its primary lender under reduced financial covenants and in the third quarter announced a business transformation project that involves disposing of surplus assets with a net book value of \$3,328. The financial losses pose challenges to the Company's continued operations and its ability to meet its obligations as they fall due. Management is actively addressing this condition, as discussed in the following paragraphs.

*Operating losses*

The Company needs to further reduce and eliminate its operating losses. The Company's ability to do this may be impacted by the speed of the current economic recovery, increased competitiveness and pricing pressure in the plastic injection mold industry, its ability to manage its cost structure based on changing market and economic conditions and the success of its business transformation project.

The Company is addressing its operating losses through: (i) increased sales in the capital equipment market, tied to the economic recovery; (ii) targeted entrances into new markets, such as aerospace, with greater sales opportunities and higher margins; (iii) changes in its product mix, moving away from heavily competitive low margin sales categories and into less competitive higher margin categories; and, (iv) an improved cost structure developed through the targeted restructurings completed in the last three years and its business transformation project.

*Continued support of its primary lender*

The Company needs to maintain the continued support of its primary lender, through the lender's willingness to accept reduced financial covenants while the Company addresses its operating losses. The primary lender's decision to continue its support may be impacted by their view of the speed, with which the Company improves its operating results and the lender's view of the markets in which the Company operates.

To address the continued support of its primary lender, the Company has built and will continue to build a proactive and open relationship with the lender, involving timely and frequent dialogue and a strategy of analyzing the Company based on rolling six month intervals as opposed to more traditional one year intervals.

Prior to April 2010, a debt service coverage ratio existed with the Company's primary lender. The debt service coverage ratio covenant was calculated as follows: EBITDA less cash taxes (for the previous 52 weeks) divided by the sum of interest expense and repayments of long-term debt (based on the upcoming 52 weeks). Effective April 2010, the Company's primary lender removed this quarterly debt service coverage covenant and replaced it with a monthly EBITDA target, established based on rolling six month analyses. As at July 31, 2011, the Company's monthly EBITDA target is established for the months of August, September and October 2011. Subsequent to year-end, the primary lender established the monthly EBITDA target for November, December and January 2012.

#### *Renewal of the mortgage*

During the last quarter of the year, the Company renewed its mortgage. The Company's renewed mortgage is amortized over 10 years, with a 2 year term and bears interest at 580 basis points above the 90 day bankers' acceptance rate.

#### *Business transformation project*

During the third quarter of the year, the Company announced a business transformation project that will substantially reduce the Company's manufacturing capacity associated with building plastic injection molds, a change in strategic direction for the Company to reduce its reliance on low margin business opportunities. The project will ultimately cost the Company \$7,075, of which \$5,759 has already been recognized in these consolidated financial statements. Part of the capacity reduction involves disposing of real estate, with a current net book value of \$1,978 and machinery and equipment, with a current net book value of \$1,350 after recognition, in the third quarter of the year, of the impairment of \$3,400 on these assets.

Further information related to liquidity risks is provided in Note 19 of our audited consolidated financial statements.

While the Company believes that the necessary steps are being taken with respect to eliminating its operating losses, and that the business transformation project will be successful, the outcome of these matters cannot be predicated at this time. However, the ongoing support of Reko's primary lender is crucial to the future of the Company.

## **UNUSUAL ITEMS**

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### **CHANGE IN INCOME TAX VALUATION ALLOWANCES**

Currently, Reko maintains three income tax loss carry-forward balances: U.S. net operating losses; Canadian non-capital losses; and, Canadian SR&ED tax credits. Each quarter, Reko reviews and considers the expected net realizable value of its loss carry-forward balances. As Reko's view of the expected net realizable value of its loss carry-forward balances change, it adjusts the valuation allowance associated with each loss carry-forward balance.

Consistent with our practices since the third quarter 2010, we did not record an income tax recovery on our non-capital losses in the current quarter. However, Reko subsequently determined that while its valuation allowance on all of its tax loss carry-forwards, both the non-capital losses and SR&ED tax credits, was appropriately stated, the allocation of the valuation allowance between the tax carry-forward accounts was inappropriate. Accordingly, Reko increased the valuation allowance associated with its SR&ED tax credits and decreased the valuation allowance associated with its Canadian non-capital losses in the amount of \$1,350 for the year. Further, Reko increased the valuation allowance associated with its U.S. non-capital losses and decreased the valuation allowance associated with its Canadian non-capital losses in the amount of \$1,500 for the year.

As a result of this change in allocation of valuation allowance, the increase in the valuation allowance associated with its SR&ED tax credits caused an increase in the cost of sales during the year of \$1,350 and a corresponding increase in taxes recoverable of \$1,350.



#### AVERAGE FOREIGN EXCHANGE/FINANCIAL AND OTHER INSTRUMENTS

Reko is exposed to the impacts of changes in the foreign exchange rate between Canadian and United States (“U.S.”) dollars. More specifically, approximately 90% of the Company’s sales and 20% of its costs are incurred in U.S. dollars. In addition, the Company maintains a significant asset on its balance sheet which represents unutilized non-capital losses available to reduce future taxable income in the U.S. and it operates a sales office in the U.S., where it maintains working capital and capital assets and holds a 50% membership interest in an Alabama Limited Liability Company, where it maintains an out-sourcing business and working capital.

In order to minimize our exposure to the impacts of changes in the foreign exchange rate, the Company maintains a forward foreign exchange hedging programme (“Programme”). Reko’s Programme is based on maintaining our net exposure to the U.S. dollar (total U.S. exposure less forward foreign exchange contracts) between positive and negative \$2,000. This Programme is designed to minimize the Company’s exposure to foreign exchange risks over the mid-term. As a consequence of this mid-term exposure protection, the Company is subject to short-term paper gains and losses on its net exposure to the U.S. dollar, most particularly during periods when our net exposure to the U.S. dollar is outside of our target exposure. During periods of rapid fluctuation in the foreign exchange rate between the Canadian dollar and the U.S. dollar, regardless of our net exposure to the U.S. dollar, the Company can generate significant gains or losses, which will materially impact financial results. These significant gains or losses are entirely related to mark-to-market accounting rules and represent the product of our net exposure to the U.S. dollar and the change during any given month of the value of the U.S. dollar in relation to the Canadian dollar.

During each of the last four quarters, the maximum amount of the Company’s month-end exposure to the U.S. dollar has been:

Fiscal Period	Total U.S. exposure before hedging programme	Forward foreign exchange contracts booked	Net exposure to the U.S. dollar
Q4 – 2011	\$15,658	\$16,000	\$ (342)
Q3 – 2011	\$19,334	\$23,000	\$(3,666)
Q2 – 2011	\$25,320	\$25,000	\$ 320
Q1 - 2011	\$26,516	\$28,400	\$(1,884)

As a result of the Company’s purchase of forward foreign exchange contracts (“FFECs”), the Company is subject to changes in foreign exchange rates that may not be consistent with changes in the current quoted foreign exchange rates. More specifically, the Company’s foreign exchange risk is split such that its net exposure to the U.S. dollar, as detailed above, is subject to change in market foreign exchange rates on a monthly basis and the remainder of its U.S. dollar exposure is subject to foreign exchange risks based on the specific foreign exchange rate contained in its FFECs. The table below presents a comparison between actual foreign exchange rates and Reko’s effective rate on its booked FFECs.

	For the three months ended July 31,				For the year ended July 31,			
	2011		2010		2011		2010	
	Actual	Reko effective	Actual	Reko effective	Actual	Reko effective	Actual	Reko effective
U.S. Dollar equals Canadian Dollar	0.9676	1.0323	1.0393	1.0655	0.9950	1.0422	1.0489	1.1032

The Company’s FFECs represent agreements with an intermediary to trade a specific amount of U.S. dollars for Canadian dollars at a specific rate on a specific date. Currently, the date is between one and two years after the date on which the FFEC is booked. The specific rate entered into is not necessarily indicative of what either the

intermediary or Reko believes the foreign exchange rate will be on the date the settlement of the trade occurs, rather than a rate set by the intermediary which Reko can either accept or reject.

During the fourth quarter, the Company recorded a pre-tax loss of approximately \$55 related to the fair value of its U.S. dollar exposures, as compared to a pre-tax loss of \$100 in the prior year's fourth quarter. For the year ended July 31, 2011 the Company recorded a pre-tax gain of \$469, as compared to a pre-tax gain of \$268 in the prior year. These foreign exchange gains or losses are reported as part of our sales.

At the end of the year, we held FFECs of \$16,000 compared to \$24,800 at the end of the prior year. During fiscal 2011, on average we held FFECs of \$23,500, compared to \$25,600 during the prior year.

The following table outlines the level of FFECs presently maintained and the average effective rate of these contracts:

<b>Fiscal Period</b>	<b>Contract value booked (000's)</b>	<b>Effective average rate</b>
Q4 – 2011	\$16,000	1.0300
Q1 – 2012	\$10,000	1.0328
Q2 – 2012	\$4,000	1.0515
Q3 - 2012	\$500	1.0454

The Company notes that at current levels of FFECs and U.S. dollar denominated assets and liabilities, an increase in the value of the U.S. dollar against the Canadian dollar results in the Company recording losses and an increase in the value of the Canadian dollar against the U.S. dollar results in financial gains for the Company.

Foreign currency transactions are recorded at rates in effect at the time of the transaction. Forward exchange contracts are recorded at month-end at their fair value, with unrealized holding gains and losses recorded in sales.

Additional information with respect to financial instruments is provided in Note 1 and Note 17 to Reko's audited financial statements, which by this reference are hereby incorporated herein.

#### **RECONCILIATION OF NON-GAAP MEASURES**

The reconciliation of gross profit (loss) to sales in accordance with GAAP is provided in the following table:

	<b>2011</b>	<b>2010</b>
Sales	\$ 41,078	\$ 40,151
Less: Cost of sales	35,231	36,040
Amortization	3,487	5,058
	\$ 2,360	\$ (947)

The reconciliation of adjusted net loss to net loss in accordance with GAAP is provided in the following table:

	<b>2011</b>	<b>2010</b>
Net loss	\$ (9,945)	\$ (7,469)
Plus: Business transformation expenses	2,359	--
Asset impairment	3,400	--
	\$ (4,186)	\$ (7,469)

## **RESULTS OF OPERATIONS**

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### *Sales*

Sales for the year ended July 31, 2011 increased \$927, or 2.3%, to \$41,078 compared to \$40,151 in fiscal 2010.

The increase in sales was largely related to:

- Increases in the amount earned per hour by our facilities, largely caused by improving conditions in the general economy;
- Increases in the volume of work processed for the capital equipment market; and,
- Changes in the fair value of foreign exchange future contracts, as described above.

Items offsetting the decrease in sales discussed above include:

- Decreased sales volume related to our work on projects that were out-sourced to low cost countries; and,
- Decreased sales volume on work performed in the plastic injection molded interior parts portion of the automotive industry.

### *Gross profit*

The gross profit for the year ended July 31, 2011 increased \$3,307 to \$2,360 or 5.7% of sales, compared to a gross loss of \$947, or 2.4% of sales, in the previous fiscal year.

The increase in gross profit was largely related to:

- Improved ability to cover our fixed overhead costs, as a result of increased sales levels;
- Reduced labour costs associated with prior year's restructuring;
- Productivity and efficiency improvements implemented in the previous year.

These factors were partially offset by:

- The re-allocation of the valuation allowance associated with our SR&ED tax credits, discussed above.

Absent the re-allocation of valuation allowances, Reko would have reported gross profit of \$3,710, or 9.0% of sales.

### *Selling and administration*

Selling and administration expenses ("S,G&A") decreased by \$121, or 2.0%, to \$5,869, or 14.3% of sales for the year ended July 31, 2011, compared to \$5,990, or 14.9% of sales for the same period in the prior year. The decrease in S,G&A was produced by savings achieved as a result of:

- Reductions in wages and benefits as a result of implementation of our business transformation project;

- Reductions in bad debts during the year; and,
- Reductions in the costs of commissioned sales representatives, as a result of a change in our sales mix.

These factors were partially offset by:

- Increased insurance costs, related to accounts receivable insurance, as the credit worthiness of our customers increased sufficiently to allow us to insure their balances; and,
- Increased costs of bank fees and professional fees associated with our lenders.

#### *Adjusted net income (loss)*

The adjusted net loss for the year was \$4,186, or \$0.65 per share, compared to a net loss of \$7,469, or \$1.16 per share in the prior year.

#### *Earnings overview*

The net loss for the year was \$9,945, or \$1.55 per share, compared to a net loss of \$7,469, or \$1.16 per share, in the prior year.

### **LIQUIDITY AND CAPITAL RESOURCES**

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Cash flow from operations increased \$6,041 from cash used in operations of \$8 in the prior year to proceeds from operations of \$6,033 in the current year.

The increase in cash flow from operations is primarily a result of:

- Reductions in our investment in work in progress, as a result of reduced sales levels at our facilities where we finance our work in progress; and,
- Increases in accounts payable at year-end.

This factor was partially offset by:

- Increases in the value of our non-hedging financial derivatives.

During the year, the Company renewed its mortgage payable for an additional two year term. The renewed mortgage did not generate funds nor did it utilize any funds from the Company's operating line of credit.

During the prior year, a capital lease on a machining centre came up for renewal and the Company did not refinance the capital lease in advance of its due date. Accordingly, on February 25, 2010, the Company made the required balloon payment of \$675 on the capital lease through our operating line of credit.

#### *Financial covenants*

The Company met its financial covenants at the end of the fourth quarter of 2011. During the fourth quarter, the Company requested that its secondary term lender permanently waive its sole financial covenant for fiscal 2011, to which our secondary term lender agreed.

The Company believes it has sufficient operating room with respect to its financial covenants for the next fiscal year and does not anticipate being in breach of any of its financial covenants during this period.

### *Capital assets and investment spending*

For the year ended July 31, 2011, the Company invested \$894 in capital assets. Approximately \$705 of this amount relates to our business transformation project. The remainder of this spending is considered maintenance capital expenditures intended to refurbish or replace assets consumed in the normal course of business.

### *Cash resources/working capital requirements*

As at July 31, 2011, Reko had borrowed \$9,311 on its revolving line of credit, net of its cash on hand at year-end, compared to \$12,920 at April 30, 2011 and \$12,989 at July 31, 2010. The revolver borrowings decreased by approximately \$3,609 in the quarter and decreased approximately \$3,678 for the year. We expect borrowings to display a decreasing trend over the next four quarters, initially in the first quarter related to additional asset sales related to our business transformation project and secondarily, late in the fourth quarter related to reduced investment in projects, consistent with our capacity reduction as it relates to our business transformation project.

Reko has a \$20,000 revolver available to it; however, based on our current lender defined margining capabilities, our borrowings are limited to \$14,085, of which approximately \$4,774 was unused and available at the end of the year. Under the terms of our credit facilities, Reko must achieve certain financial covenants including a maximum Total Debt to Tangible Net Worth, a minimum Current Ratio and a minimum Debt Service Coverage Ratio. At the present time, our primary lender has agreed to temporarily waive the minimum Debt Service Coverage Ratio. In its place, our primary lender has instituted a minimum monthly EBITDA target. As previously discussed, Reko is confident about its ability to meet these financial covenants over the next fiscal year.

### *Contractual obligations and off-balance sheet financing*

Contractual obligations	Payments due by period				
	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Long-term debt	\$12,084	\$1,637	\$10,447	\$--	--
Capital lease obligations	254	254	--	--	--
Operating leases	--	--	--	--	--
Purchase obligations	--	--	--	--	--
Other long-term obligations	--	--	--	--	--
<b>Total contractual obligations</b>	<b>\$12,338</b>	<b>\$1,891</b>	<b>\$10,447</b>	<b>\$--</b>	<b>--</b>

Except as disclosed elsewhere in this MD&A, there have been no material changes with respect to the contractual obligations of the Company during the year.

Reko does not maintain any off-balance sheet financing.

### *Share capital*

The Company had 6,420,920 common shares outstanding at July 31, 2011. During the year, no options were granted and no options were exercised.

*Outstanding share data*

<b>Designation of security</b>	<b>Number outstanding</b>	<b>Maximum number issuable if convertible, exercisable or exchangeable for common shares</b>
Common Shares	6,420,920	
Stock options issued	74,000	
Stock options exercisable	74,000	
Total (maximum) number of common shares		6,494,720

**CRITICAL ACCOUNTING ESTIMATES**

The Company's discussion and analysis of its results of operations and financial position is based upon the consolidated financial statements, which have been prepared in accordance with Canadian GAAP. The preparation of the consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities. On an ongoing basis, management evaluates these estimates. However, actual results differ from these estimates under different assumptions or conditions.

Management believes the following critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements of the Company. Management has discussed the development and selection of the following critical accounting policies with the Audit Committee of the Board of Directors and the Audit Committee has reviewed its disclosure relating to critical accounting estimates in this MD&A.

*Allowances for doubtful accounts receivable*

In order for management to establish appropriate allowances for doubtful accounts receivable, estimates are made with regard to economic conditions, potential recoverability through our accounts receivable insurer, and the probability of default by individual customers. The failure to estimate correctly could result in bad debts being either higher or lower than the determined provision as of the date of the balance sheet.

*Revenue recognition and tooling and machinery contracts*

Revenue from tooling and machinery contracts is recognized on the percentage of completion basis. The percentage of completion basis recognizes revenue and cost of sales on a progressive basis throughout the completion of the tooling or machinery.

Tooling and machinery contracts are generally fixed; however, price changes, change orders and program cancellation may affect the ultimate amount of revenue recorded with respect to a contract. Contract costs are estimated at the time of signing the contract and are reviewed at each reporting date. Adjustments to the original estimates of total contract costs are often required as work progresses under the contract. When the current estimates of total contract revenue and total contract costs indicate a loss, a provision for the entire loss on the contract is made. Factors that are considered in arriving at the forecasted profit or loss on a contract include, amongst other items, cost overruns, non-reimbursable costs, change orders and potential price changes.

### *Impairment of long-lived assets*

Management evaluates capital assets for impairment whenever indicators of impairment exist. Indicators of impairment include prolonged operating losses or a decision to dispose of, or otherwise change the use of, an existing capital asset. If the sum of the future cash flows expected to result from the asset, undiscounted and without interest charges, is less than the reported value of the asset, asset impairment must be recognized in the financial statements. The amount of impairment to be recognized is calculated by subtracting the fair value of the asset from the reported value of the asset.

Management believes that accounting estimates related to capital assets are ‘critical accounting estimates’ because: (i) they are subject to significant measurement uncertainty and are susceptible to change as management is required to make forward-looking assumptions regarding their impact on current operations; and (ii) any resulting impairment loss could have a material impact on the consolidated net income and on the amount of assets reported on the Company’s consolidated balance sheet.

### *Future income taxes and SR&ED tax credits*

Future tax assets in respect of loss carry forwards and scientific research and experimental design credits relate primarily to legal entities in Canada and the United States. The Company evaluates the realization of its future tax assets by assessing the valuation allowance and by adjusting the amount of such allowance, if necessary. The facts used to assess the likelihood of realization are a forecast of future taxable income and available tax planning strategies that could be implemented to realize the future tax assets. The Company has, and continues to use, tax planning strategies to realize future tax assets in order to avoid the potential loss of benefits.

## **CONTROLS AND PROCEDURES**

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Management is responsible for implementing, maintaining and testing the operating effectiveness of adequate systems of disclosure controls and procedures. There are inherent limitations to the effectiveness of any system of disclosure including the possibility of human error and circumvention or overriding of the controls and procedures. Accordingly, even effective controls and procedures can only provide reasonable assurance of achieving their corporate objectives.

Our management used the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework to evaluate the effectiveness of internal controls over financial reporting. We carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures during fiscal 2011, and concluded that Reko’s controls and procedures are operating effectively to ensure that the information required to be disclosed is accumulated and communicated to management including the Chief Executive Officer and the Chief Financial Officer. A similar evaluation was performed in fiscal 2010.

Based on these evaluations, the Chief Executive Officer and the Chief Financial Officer concluded that Reko’s disclosure controls and procedures and internal controls over financial reporting do not include any material weaknesses and that they were effective in recording, processing, summarizing and reporting information required to be disclosed within the time period specified in the Canadian Securities Administrators (CSA) rules.

## **QUARTERLY RESULTS**

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The following table sets out certain unaudited financial information for each of the eight fiscal quarters up to and including the fourth quarter of fiscal 2011, ended July 31, 2011. The information has been derived from the Company’s unaudited consolidated financial statements, which in management’s opinion, have been prepared on a basis consistent with the audited consolidated financial statements contained elsewhere in this Annual Report and include all adjustments necessary for a fair presentation of the information presented. Past performance is not a guarantee of future performance and this information is not necessarily indicative of results for any future period.

	<b>Oct/09</b>	<b>Jan/10</b>	<b>Apr/10</b>	<b>July/10</b>
Sales	\$9,255	\$8,794	\$9,329	\$12,773
Net loss	(1,177)	(1,867)	(2,269)	(2,156)
Loss per share: Basic	(0.18)	(0.29)	(0.36)	(0.33)
Diluted	(0.18)	(0.29)	(0.36)	(0.33)
	<b>Oct/10</b>	<b>Jan/11</b>	<b>Apr/11</b>	<b>July/11</b>
Sales	\$9,841	\$8,518	\$11,257	\$11,462
Net loss	(1,287)	(1,256)	(6,659)	(743)
Loss per share: Basic	(0.20)	(0.20)	(1.04)	(0.11)
Diluted	(0.20)	(0.20)	(1.04)	(0.11)

### **NORMAL COURSE ISSUER BID**

The Company does not currently have an open Normal Course Issuer Bid.

### **SELECTED ANNUAL CONSOLIDATED FINANCIAL DATA**

The following selected consolidated financial data has been derived from, and should be read in conjunction with the accompanying audited consolidated financial statements for the year ended July 31, 2011, which are prepared in accordance with Canadian GAAP.

	<b>2011</b>	<b>2010</b>	<b>2009</b>
<b>Income statement data</b>			
Sales	\$41,078	\$40,151	\$55,277
Net (loss) income for the year	(9,945)	(7,469)	199
(Loss) earnings per share – basic	(1.55)	(1.16)	0.03
(Loss) earnings per share – diluted	(1.55)	(1.16)	0.03
<b>Financial position data</b>			
Working capital	6,749	\$131	\$16,941
Working capital excluding mortgage bullet included in current liabilities	6,749	11,423	16,941
Total assets	57,630	73,401	83,500
Bank indebtedness, net of cash	9,311	12,989	9,416
Long-term debt due within one year	1,891	12,678	2,640
Long-term debt	10,447	1,925	15,181
Shareholders' equity	26,216	36,156	43,617



## **INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)**

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For Reko's financial year ended July 31, 2012, Reko will no longer report its financial results using Canadian GAAP, as a result of changes announced by The Canadian Institute of Chartered Accountants in March 2008. Instead it will report its financial results using IFRS. This change affects all entities that are considered publicly accountable entities. Reko is considered a publicly accountable entity due to its listing on the TSX Venture Exchange.

While not all GAAP and IFRS are different, one of the most significant changes deal with the overriding premise in GAAP that financial reporting is based on historical cost, while IFRS' overriding premise is fair value.

Due to the potential pervasiveness of the changes inherent in moving to IFRS, a significant amount of time was necessary for management to plan its implementation. Possible impacts, besides external financial reporting, included, but are not limited to: banking agreements, business processes, information systems, employee and management incentive programmes, and legal agreements.

During the past two years, management:

- Engaged internal resources to understand the new rules;
- Educated its primary accounting staff on the differences between GAAP and IFRS;
- Concentrated its efforts on those portions of IFRS that are different than GAAP;
- Identified those business processes that have the potential for amendment to properly transition to IFRS;
- Finalized its policy selections both on conversion and post conversion; and,
- Evaluated new financial statement disclosure.

### ***IFRS Accounting Changes***

The Company has identified the areas noted below as those most relevant to the Company or expected to have the most significant impact on the financial statements. These impacts have not been subject to audit at this time. Differences between IFRS and Canadian GAAP, in addition to those referred to below, may still be identified based on further detailed analysis by the Company and other changes in IFRS prior to the Company's first completed year under IFRS in 2012. As a result, accounting policy choices may change prior to our 2012 year-end financial statements.

### **IFRS 1 First-time adoption of IFRS ("IFRS 1")**

Upon transition, the Company is required to apply each IFRS on a retrospective basis. However, IFRS 1 has certain mandatory exceptions, as well as limited optional exemptions in specific areas for certain standards that do not require retrospective application of IFRS. The most relevant to the Company are as follows:

#### **Mandatory exceptions**

Estimates – Hindsight cannot be used to create or revise estimates. As a result, past estimates previously made by the Company under Canadian GAAP will not be revised for application of IFRS except where necessary to reflect any differences in accounting standards.

## **Optional exemptions**

Business combinations – The Company may elect to apply IFRS 3 *Business Combinations* (“IFRS 3”) prospectively from August 1, 2010 or to restate all past business combinations from a certain point forward in accordance with IFRS 3. The Company has elected to apply IFRS 3 prospectively from August 1, 2010 and, as a result, not restate any business combinations that occurred prior to August 1, 2010.

Capital assets – IFRS 1 contains optional exemptions from the retrospective restatement of cost accounted for in accordance with IFRS. The “fair value or revaluation as deemed cost” option exemption (also referred to as the “deemed cost exemption”) permits the carrying value of an item of capital assets to be measured at the date of transition based on a deemed value. If elected, then the deemed cost exemption may be based on any of the following: fair value, a previous GAAP revaluation based on cost, a depreciated cost measure broadly comparable to IFRS or an event driven valuation. The Company has elected to use an event driven valuation as its deemed cost to measure its real estate and depreciated cost as its deemed cost to measure its machinery and equipment, leasehold improvements and equipment under capital lease at the date of transition and to continue to use the cost model for measurement under IFRS thereafter.

Share-based payments – IFRS 2 *Share-based Payments* (“IFRS 2”) encourages its application to equity instruments that were granted on or before November 7, 2002 but IFRS 1 permits the application only to equity instruments granted after November 7, 2002 that had not vested by the transition date. The Company has elected to apply the exemption provided under IFRS 1 and will apply IFRS 2 to all equity instruments after November 7, 2002 that had not vested at August 1, 2010.

Borrowing costs – IAS 23 *Borrowing Costs* (“IAS 23”) requires that borrowing costs that relate to assets that take a substantial period of time to get ready for use be capitalized. A first-time adopter is permitted to apply the transitional requirements to IAS 23. To the extent that the adoption of IAS 23 upon transition is a change in accounting policy, which it is for the Company, these transitional requirements provide a first-time adopter relief from applying the standard retrospectively. Instead, IAS 23 is applied to qualifying assets for which the commencement date for capitalization is on or after the later of January 1, 2009 and the date of transition or any earlier date chosen by the first-time adopter. The Company has elected to apply the requirements of IAS 23 prospectively from August 1, 2010 but does not expect the change to have significant impact on the financial results of the Company.

## **IAS 12 Income taxes (“IAS 12”)**

### ***Accounting policy under IFRS***

The Company provides for income taxes using the liability method of tax allocation. Deferred tax is recognized on temporary differences between the carrying amount of assets or liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. The carrying amount of deferred tax assets are reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the asset is realized or the liability is settled based on tax rates enacted or substantively enacted at the end of the reporting period. Foreign exchange gains or losses on deferred tax assets or liabilities are recognized in unrealized foreign exchange loss (gain) on foreign tax losses.

### ***Current accounting policy under Canadian GAAP***

The Company provides for income taxes using the liability method of tax allocation, consistent with IFRS. The Company establishes a valuation allowance against future income tax assets, if based on available information, it is not more likely than not that some or all of the future income tax assets will be realized. Foreign exchange gains or

losses on deferred tax assets or liabilities are recognized in unrealized foreign exchange loss (gain) on foreign tax losses.

#### ***Opening retained earnings adjustment***

The Company is currently in the process of quantifying the impact to opening retained earnings on transition.

#### ***Impact to 2011 under IFRS***

The Company is currently in the process of quantifying the impact to the 2011 financial statements under IFRS.

### **IAS 16 Capital assets (“IAS 16”)**

#### ***Accounting policy under IFRS***

The Company will use the cost model such that capital assets are recorded at cost, net of accumulated amortization and accumulated impairment losses, if any. Where part of an item of capital assets is considered a component, it is amortized separately if it has a cost that is significant to the item as a whole and a significantly different useful life. Assets are amortized when available for use. Major inspection or overhaul costs are recognized in the carrying amount of capital assets if the recognition criteria are satisfied. All maintenance and repair costs, other than major inspection or overhaul costs are expensed to earnings as incurred.

#### ***Current accounting policy under Canadian GAAP***

Capital assets are recorded at historical cost, net of accumulated amortization and accumulated impairment losses, if any. Assets are amortized when put in use. All maintenance and repair costs are expensed as incurred.

#### ***IFRS 1 election***

IFRS 1 provides a choice between measuring capital assets at its fair value at the transition date or using a previous GAAP revaluation as deemed cost instead of applying IAS 16 retrospectively. The Company will elect to use fair value as deemed cost of its land and buildings and will apply IAS 16 retrospectively for the remainder of its capital assets.

#### ***Opening retained earnings adjustment***

The Company reviewed its capital assets to determine which capital assets required componentization and to be amortized over separate useful lives as well as whether there are any idle assets currently not being amortized. The Company estimates that it will have an increase to opening retained earnings and capital assets of approximately \$6,376 related to fair value adjustments on transition for land and building. The Company estimates that it will have a decrease to opening retained earnings and capital assets of approximately \$4,411 related to applying IAS 16 retrospectively on transition for the remainder of its capital assets.

#### ***Impact to 2011 under IFRS***

The Company estimates a decrease to amortization expense and an increase to capital assets and retained earnings of approximately \$594, primarily related to applying IAS 16 retrospectively on transition. The Company estimates that the impairment charge taken in the third quarter of 2011, of \$3,400, will increase to approximately \$4,681 as a result of the transition.

## **IAS 23 Borrowing costs**

### ***Accounting policy under IFRS***

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

### ***Current accounting policy under Canadian GAAP***

There is no requirement under Canadian GAAP to capitalize interest attributable to the acquisition, construction or production of assets.

### ***IFRS 1 election***

The Company will elect to apply the requirements of IAS 23 prospectively from August 1, 2010.

### ***Opening retained earnings adjustment***

There will be no impact on opening retained earnings.

### ***Impact to 2011 under IFRS***

The Company expects that there will be no impact to 2011 financial statements under IFRS.

## **IAS 37 Provisions (“IAS 37”)**

### ***Accounting policy under IFRS***

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Probable in this context means more likely than not.

### ***Current accounting policy under Canadian GAAP***

Canadian GAAP does not have a similar concept of provisions as defined under IFRS but does have equivalent concepts of contingent liabilities, contingent assets, restructuring accruals and asset retirement obligations. Under Canadian GAAP, the criterion for the recognition of a contingent liability in the financial statements is when the expected is “likely”, which is a higher threshold than “probable” under IFRS. Therefore, it is possible that there may be some contingent liabilities which would meet the recognition criteria under IFRS that were not recognized under Canadian GAAP.

### ***Opening retained earnings adjustment***

The Company does not expect to record any additional provisions on the transition to IFRS.

### ***Impact to 2011 under IFRS***

The Company does not expect there to be an impact to 2011 financial statements under IFRS.

## **IFRS 2 Share-based payment**

### ***Accounting policy under IFRS***

The fair value of the Company's stock options will be determined using a valuation model which incorporates the time value of money, expected time to maturity and expected rate of forfeiture. The fair value of the stock options will be determined using the Black-Scholes option pricing model. The fair value of stock options, determined at the grant date, will be expensed over the vesting period, based on the Company's estimate of stock options that will eventually vest. The Company's stock options vest in installments, each tranche will be considered a separate award with the compensation cost amortized accordingly.

### ***Current accounting policy under Canadian GAAP***

The Company currently uses the Black-Scholes option pricing model to determine the fair value of stock options. The fair value is amortized over the vesting period as an expense in the statement of earnings (loss) and as an increase to contributed surplus. Forfeitures are not reflected as part of the fair value calculation nor do they impact the amortization of the grant date fair value.

### ***IFRS 1 election***

The Company will utilize the election and will apply IFRS 2 to all equity instruments issued after November 7, 2002 that had not existed at August 1, 2010.

### ***Opening retained earnings adjustment***

The Company estimates the impact on opening retained earnings to be insignificant.

### ***Impact to 2011 under IFRS***

The Company estimates the impact on 2011 financial statements related to IFRS 2 to be insignificant.

## **Other areas of conversion to IFRS**

Based on conversion analysis to date, the Company does not expect the conversion to have a significant impact on information systems and internal controls over financial reporting for the Company and its subsidiaries.

The International Accounting Standards Board ("IASB") currently has activities underway which may change IFRS and such changes may impact the Company. The Company will assess any such changes as they are announced by the IASB.

*This MD&A contains forward-looking information and forward-looking statements within the meaning of applicable securities laws. We use words such as “anticipate”, “plan”, “may”, “will”, “should”, “expect”, “believe”, “estimate” and similar expressions to identify forward-looking information and statements. Such forward-looking information and statements are based on assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe to be relevant and appropriate in the circumstances. Readers are cautioned not to place undue reliance on forward-looking information and statements, as there can be no assurance that the assumptions, plans, intentions or expectations upon which such statements are based will occur. Forward-looking information and statements are subject to known and unknown risks, uncertainties, assumptions and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed, implied or anticipated by such information and statements. These risks are described in the Company’s MD&A and, from time to time, in other reports and filings made by the Company with securities regulators.*

*While the Company believes that the expectations expressed by such forward-looking information and statements are reasonable, there can be no assurance that such expectations and assumptions will prove to be correct. In evaluating forward-looking information and statements, readers should carefully consider the various factors, which could cause actual results or events to differ materially from those, indicated in the forward-looking information and statements. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the Company disclaims any obligations to update publicly or otherwise revise any such factors of any of the forward-looking information or statements contained herein to reflect subsequent information, events or developments, changes in risk factors or otherwise.*