

# **CRS Electronics Inc.**

## **Management Discussion and Analysis**

**Second Quarter Report  
For the period ended June 30, 2012**

August 29, 2012

The following information prepared as of August 29, 2012 is Management's Discussion and Analysis ("MD&A") of the financial condition and performance of CRS Electronics Inc. (the "Company" or "CRS") for the three and six months ended June 30, 2012 and should be read in conjunction with the unaudited condensed interim financial statements for the three and six months ended June 30, 2012 which have been prepared in accordance with International Financial Reporting Standards.

All amounts are in United States (U.S.) dollars unless otherwise noted (tabular amounts are in thousands of U.S. dollars).

This MD&A is the responsibility of management. The Board of Directors carries out its responsibility for the review of this disclosure principally through its audit committee comprised of a majority of independent directors. The audit committee reviews and prior to its publication, approves, pursuant to the authority delegated to it by the Board of Directors, this disclosure.

## **Forward-Looking Information**

The statements made in this MD&A, particularly those in the "Outlook" section that are not historical facts contain forward-looking information that involves risk and uncertainties. All statements, other than statements of historical facts, which address CRS's expectations, should be considered forward-looking statements. Such statements are based on management's exercise of business judgment as well as assumptions made by management and with information currently available to management. When used in this document, the words "may", "will", "anticipate", "believe", "estimate", "expect", "intend" and words of similar import, are intended to identify any forward-looking statements. The forward-looking statements made in this MD&A describe our expectations as at August 29, 2012.

You should not place undue reliance on these forward-looking statements. These statements reflect our current view of future events and are subject to certain risks and uncertainties as contained in the Company's filings with Canadian securities regulatory authorities. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, our actual results could differ materially from those anticipated in these forward-looking statements. Management undertakes no obligation to reflect events or circumstances after the date hereof, or to reflect the occurrence of any unanticipated events. Although the Company believes that their expectations are based on reasonable assumptions, the Company can give no assurance that our forward-looking statements will materialize. Subject to applicable laws, the Company assumes no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or any other reason.

The material assumptions that were applied in making the forward looking statements in this MD&A include: execution of the Company's existing plans and development programs for its product line, either of which may change due to changes in the views of the Company or if new information arises which makes it prudent to change such plans or programs; and the accuracy of current interpretation of market study results.

For a description of material factors that could cause our actual results to differ materially from the forward-looking statements in this MD&A, please see the "Risk and Uncertainties" section.

## **Overview**

For over 12 years, CRS has been a developer and manufacturer of light emitting diode ("LED") light products. As a manufacturer of LED light boards for its own school bus warning lights and under contract for other light applications, CRS realized that the improvement in LEDs created an opportunity for CRS to supply LED based indoor and outdoor lighting. Throughout 2007 to 2011 inclusive, CRS expended a significant amount of time and capital to develop an LED streetlight engine, the LED MR16 halogen bulb replacement and an LED PAR series of interior lights for the commercial market sector.

CRS is currently focused on the expansion of its LED MR16 and LED PAR lights to the North American interior light replacement market at a retail level. LED lighting products save energy, have attractive economic benefits and are eco-friendly. CRS' LED MR16 was tested by the Department of Energy in the United States ("DOE") under the Commercially Available LED Product Evaluation and Reporting ("CALiPER") Program and received the highest ranking in several of the features tested. Market penetration by LED lights in both the indoor and outdoor general lighting market is less than 3%. Over the next few years, management believes that LED lighting products will gain market share.

## **Outlook – Fiscal 2012**

For Fiscal 2012 the Company will be focusing on increasing revenues by adding additional retail partners and achieving Energy Star certification to support our commercial efforts. Additional work being undertaken on reducing product costing is also expected to support these initiatives.

## **Business Objectives and Milestones**

CRS' overall business objective is to gain market share in the LED general illumination market to provide an economic return to its shareholders.

### ***Sales Objectives***

#### **1. Retail LED Sales**

CRS' objective continues to be the expansion of its product line under the Energizer Licensing agreement. This objective incorporates a) the creation of 2-3 select partnerships with top brand retail stores for distribution of the lamps, b) the successful launch a North American marketing campaign, followed by c) a product roll out into select top brand retail chain stores. With a major Canadian retail partnership in place, our sales and marketing team are focused on major US retailers.

#### **2. Commercial LED Sales**

Our objective is to expand sales in the commercial replacement market. To achieve this target we plan to a) augment the existing LED lights will be offered by CRS (MR16, PAR 20, PAR 30 and PAR 38) to provide both premium and economy product lines to our electrical distributors and b) create strong partnerships in the new construction, replacement lamp and retrofit industries.

#### **3. Bus light business and contract LED light board manufacturing**

CRS continues support our partners in these market segments. Over many years CRS has developed strong partnerships and the product lines deliver consistent gross margins. CRS plans to work with our partners to maintain its current sales volumes.

### ***Product Development Objectives***

#### **1. Product cost reduction**

CRS expects continued demand for lower cost offerings for customers. The Company has been engaged with various offshore companies and is considering various outsourcing and product development changes to reduce the price points of our products while maintaining CRS' high standards.

## 2. Product Development

Market research has shown that Energy Star rating have strong consumer recognition and provide confidence for selection of sound, energy efficient products. On both domestically produced and imported products this approval is being aggressively pursued. CRS will work jointly with its strategic partners to provide performance specifications that are at the 'head of the class' for retail and professional series commercial lights.

## **Performance of CRS**

### ***Key performance indicators***

The key performance indicators for CRS are revenue growth, gross profit, EBITDA, net income, and increasing patent protection on intellectual property.

The success of the Company to expand will be measured by revenue growth. Revenue growth will be dependent on the Company being able to increase its sales staff and expand production capacity to meet the anticipated demand for its products.

The Company targeted gross margin percentages (defined as revenues less cost of sales and plant expenses as a percentage of revenues) of approximately 25.0% on an annual basis. Maintaining a consistent gross margin will be an indicator of how well the Company is managing its production costs and customer contract negotiations. The Company is looking at various product development and outsourcing alternatives to increase gross margin.

Management believes that EBITDA is a measure of how efficiently and effectively the business is running. The Company is entering a period of rapid expansion and growth. Therefore selling and general administration costs have increased over the last eighteen months. To maintain an acceptable EBITDA, management will need to balance the increase in selling and general administration costs and revenue growth. Net income is also viewed as an important measure for determining the value created for shareholders.

**Measurement**

Below in “Quarterly Results” and “Results of Operations” are two tables the Company uses to assess performance. “Quarterly Results” presents the Company’s results for the last eight quarters, followed by a comparison of the Company’s fiscal year to the prior year.

**Quarterly Results**

	Fiscal 2012		Fiscal 2011		Fiscal 2010			
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
<i>In Thousands of dollars</i>	USD	USD	USD	USD	USD	USD	USD	USD
Sales	\$687.7	\$1,312.0	\$526.6	\$461.0	\$614.9	\$540.7	\$889.4	\$677.7
Gross profit	(\$277.3)	(\$357.6)	(\$384.1)	(\$179.6)	(\$18.0)	\$19.7	\$127.3	\$189.7
<i>Gross profit %</i>	(40.3%)	(27.3)%	(72.9)%	(39.0)%	(2.9)%	3.6%	14.3%	28.0%
Select expenses								
Selling and marketing	278.9	571.6	352.7	286.4	264.7	108.7	92.5	94.1
General and administrative	453.2	512.0	427.4	430.1	488.5	415.7	451.1	302.1
Engineering and research	106.4	112.8	175.8	194.0	85.7	80.2	23.8	(6.7)
Foreign exchange (gain) loss	(147.6)	30.1	(57.4)	152.9	(10)	6.3	21.3	(4.2)
Total expenses	690.9	1,226.5	898.5	1,063.4	828.9	610.9	588.7	385.3
Income (loss) from operations	(968.2)	(1,584.1)	(1,282.6)	(1,243.0)	(846.9)	(591.2)	(461.4)	(195.6)
Add back: Depreciation and amortization	112.3	111.8	125.1	89.9	83.3	81.6	117.9	63.8
EBITDA Loss	(855.9)	(1,472.3)	(1,157.5)	(1,153.1)	(763.6)	(509.6)	(343.5)	(131.8)
Finance costs	(34.3)	(23.2)	(18.9)	(13.6)	(10.8)	(16.6)	(10.1)	(16.3)
Refundable tax credit income (expense)	—	—	(41.3)	19.3	12.4	28.3	(6.9)	4.2
Depreciation of capital equipment	(75.7)	(76.1)	(65.1)	(58.9)	(52.3)	(50.5)	(50.8)	(49.6)
Amortization of intangibles	(28.7)	(28.0)	(29.9)	(31.0)	(31.0)	(31.1)	(67.4)	(14.1)
Amortization of patents and trademarks	(7.9)	(7.7)	(30.1)	—	—	—	—	—
Impairment of product development costs	—	—	(456.0)	—	—	—	(39.3)	—
Impairment of patents and trademarks	—	—	(258.2)	—	—	—	—	—
Gain (loss) on sale of equipment, furniture and fixtures	(5.3)	(0.3)	—	0.1	—	—	(4.8)	(2.9)
Change in warrant liability	26.3	462.1	13.3	1,078.7	277.0	62.8	8.3	125.3
Income taxes recovery	—	—	—	—	—	—	—	—
Net (loss) income	(\$981.5)	(\$1,145.5)	(\$2,043.7)	(\$158.5)	(\$568.3)	(\$516.7)	(\$ 514.5)	(\$85.2)
Loss per share	(0.02)	(0.03)	(0.05)	(0.00)	(0.02)	(0.02)	(0.02)	(0.00)

## Results of Operations

The following table sets out the Company's results for the six months ended June 30, 2012 compared with the prior period ended.

<i>In Thousands of U.S. dollars</i> <sup>(1)</sup>	<b>Six Months Ended June 30</b>		<b>Increase (Decrease)</b>	<b>% Increase (Decrease)</b>
	<b>2012</b>	<b>2011</b>		
Sales	1,999.7	1,154.7	845.0	73.2%
Gross profit	(634.9)	1.9	(636.8)	(33,516%)
<i>Gross profit percentage</i>	(31.7%)	0.2%		
Selling and marketing	850.4	371.9	478.5	128.7%
<i>As a % of sales</i>	42.5%	32.2%		
General and administrative	965.2	903.4	61.8	6.8%
<i>As a % of sales</i>	48.3%	78.2%		
Engineering and research	219.2	165.7		
Foreign exchange (gain) loss	(117.5)	(0.9)		
<i>Total operating expenses</i>	1,917.3	1,440.1		
<i>Income (loss) from operations</i>	(2,552.2)	(1,438.2)		
Add back amortization	224.1	157.1		
EBITDA Loss	(2,328.1)	(1,281.1)		
Finance costs	(57.6)	(27.5)		
Depreciation of capital equipment	(151.7)	(99.5)		
Amortization of product development	(56.8)	(57.6)		
Amortization of patents and trademarks	(15.6)	-		
Impairment of product development	-	-		
Impairment of patents and trademarks	-	-		
Gain (loss) on sale of equipment, furniture and fixtures	(5.6)	-		
Refundable tax credit income	-	40.9		
Change in warrant liability	488.4	339.8		
Net loss	(2,127.0)	(1,085.0)		

<sup>(1)</sup> Information for 2012 and 2011 is prepared in accordance with IFRS.

**Revenues**

Revenues for the three months ended June 30, 2012 increased 11.8% to \$687,700 from \$614,900 for the same period in 2011.

Revenue from bus light sales during the three months ended June 30, 2012 decreased 3.6% to \$307,500 from \$318,900 for the same period in 2011. Revenues from contract manufacturing for the three months ended June 30, 2012 decreased 48.1% to \$70,300 from \$135,400 in 2011.

Commercial LED revenue for the three months ended June 30, 2012 stemmed from LED MR16 sales that decreased 10.8% to \$143,200 from \$160,600 during the same period in 2011.

Retail LED revenue of \$166,700 for the three months ended June 30, 2012 stemmed from LED MR16, GU10, PAR 20, 30, 38, and A19 sales vs. nil in the same period in 2011.

Revenues for the six months ended June 30, 2012 increased 73.2% to \$1,999,700 from \$1,154,700 for the same period in 2011.

Revenue from bus light sales during the six months ended June 30, 2012 decreased 5.5% to \$568,200 from \$601,200 for the same period in 2011. Revenues from contract manufacturing for the six months ended June 30, 2012 decreased 51.8% to \$122,600 from \$254,400 in 2011.

Commercial LED revenue for the six months ended June 30, 2012 stemmed from LED MR16 sales that decreased 13.9% to \$257,600 from \$299,100 during the same period in 2011.

Retail LED revenue of \$1,051,300 for the six months ended June 30, 2012 stemmed from LED MR16, GU10, PAR 20, 30, 38, and A19 sales vs. nil in the same period in 2011.

**Cost of Sales and Gross Profit**

The cost of sales is inclusive of direct material costs, plant labour, plant overheads, plant management salaries, amortization of plant and equipment and the amortization of product development costs.

For the three months ended June 30, 2012, gross profit percentage was (40.3)% compared to (2.9)% in the same period last year. For the six months ended June 30, 2012, gross profit percentage was (31.7)% compared to 0.2% in the same period last year. The decrease is primarily attributed to two factors: 1) A large portion of the retail product shipped in early January was subject to continued cost overrun issues, and 2) the sales volume in relation to increased fixed plant expenses and amortization charged to cost of goods sold resulted in lower gross margins. Measures are being taken to mitigate these issues which could persist to impact the gross margin of orders placed in fiscal 2012.



***Selling and marketing expenses***

For the three months ended June 30, 2012 selling and marketing expenses increased 5.4% to \$278,900 from \$264,700 for the same period in 2011. This increase reflects the addition of the retail sales and marketing team and additional marketing costs focused in the retail lighting sector in conjunction with the retail launch.

For the six months ended June 30, 2012 selling and marketing expenses increased 128.7% to \$850,400 from \$371,900 for the same period in 2011. This increase reflects the addition of the retail sales and marketing team and \$208,500 marketing costs focused in the retail lighting sector in conjunction with the retail launch.

***General and administrative expenses***

For the three months ended June 30, 2012 general and administrative expenses decreased 7.2% to \$453,200 from \$488,500 for the same period in 2011. This decrease primarily reflects the change in stock based compensation awarded during the periods.

For the six months ended June 30, 2012 general and administrative expenses increased 6.8% to \$965,200 from \$903,400 for the same period in 2011. This increase primarily reflects the change in stock based compensation awarded during the periods.

***Engineering and Research***

Research costs are expensed in the year the costs are incurred. When a product is likely to be commercially viable in the form developed, the costs to complete the development are capitalized on the balance sheet. When commercial sales begin the development costs are amortized over the expected life of the product.

For the three months ended June 30, 2012 net research and development expenses increased to \$106,400 from \$85,700 for the same period in 2011. The Company has incurred significant costs during 2012 as the department began support of continuous improvement of existing lines in addition to active product development projects.

For the six months ended June 30, 2012 net research and development expenses increased to \$219,200 from \$165,700 for the same period in 2011. The Company has incurred significant costs during 2012 as the department began support of continuous improvement of existing lines in addition to active product development projects.

**Finance Costs**

Total finance costs for the three month period ended June 30, 2012 increased \$23,500 to \$34,300 vs. \$10,800 for the same period in 2011. Total finance costs for the six month period ended June 30, 2012 increased \$30,100 to \$57,600 vs. \$27,500 for the same period in 2011.

Finance costs are attributable to a mix of long and short term debt obligations as follows:

Interest on short-term debt obligations increased 160.3% to \$17,700 during the three months ended June 30, 2012 from \$6,800 during the same period in 2011. Interest on short-term debt obligations increased 99.2% to \$25,100 during the six months ended June 30, 2012 from \$12,600 during the same period in 2011. The increase in the expense for this quarter resulted from an increase in the average credit card debt and bank operating loans during the period.

Net interest on long-term debt obligations increased 315.0% to \$16,600 during the three months ended June 30, 2012 from \$4,000 during the same period in 2011. Net interest on long-term debt obligations increased 118.1% to \$32,500 during the six months ended June 30, 2012 from \$14,900 during the same period in 2011. Net interest on long-term debt obligations are comprised of the following:

	<b>Three Months ended June 30</b>		<b>Six Months ended June 30</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Interest LTD	6,500	5,400	13,300	10,000
Accretion expense	11,300	8,800	22,500	15,300
Less:				
Interest revenue	(1,200)	(10,200)	(3,300)	(10,400)
<b>Net Interest on LTD:</b>	<b>16,600</b>	<b>4,000</b>	<b>32,500</b>	<b>14,900</b>

Interest costs are higher during 2012 due to higher average principal outstanding on long-term debt. This is primarily attributable to the finance of capital equipment that occurred in the second and third quarter of 2011. Accretion expense is related to the non-interest bearing loan from the S.O.D.P. These expenses are partially offset by interest revenues. The 2011 revenues were due to a 1 year redeemable term deposit purchased by the Company with proceeds from the private equity placement issuance of common shares on April 28, 2011. Interest on the term deposit compounds annually at a rate of 1.5%.

**Depreciation of property and equipment**

Depreciation increased 44.7% to \$75,700 during the three months ended June 30, 2012 from \$52,300 during the same period in 2011. Depreciation increased 52.5% to \$151,700 during the six months ended June 30, 2012 from \$99,500 during the same period in 2011. The increase is related primarily to additional production equipment put into operation in the third and fourth quarters of 2011.

***Amortization of Product Development Costs***

The amortization expense decreased \$2,300 to \$28,700 during the three months ended June 30, 2012 from \$31,000 during the same period in 2011. The amortization expense decreased \$800 to \$56,800 during the six months ended June 30, 2012 from \$57,600 during the same period in 2011.

***Amortization of Patents and Trademarks***

The amortization expense of \$7,900 during the three months ended June 30, 2012 vs. nil during the same period in 2011. The amortization expense of \$15,600 during the six months ended June 30, 2012 vs. nil during the same period in 2011.

***Scientific Research and Experimental Development Tax Credit (“SRED”)***

The tax credits that relate to the deferred development costs are recorded on the balance sheet as a reduction of deferred development expenses. The tax credits that relate to research are recorded as a reduction in expenses on the statement of operations. The amount recorded as reduction to expenses for the three months ended June 30, 2012 was nil compared to (\$12,400) in 2011. The amount recorded as reduction to expenses for the six months ended June 30, 2012 was nil compared to (\$40,900) in 2011.

***Foreign Exchange Losses***

The US dollar is the functional currency of the Company and is also the currency in which it presents these financial statements. The Company recognizes transactions in currencies other than the US dollar (foreign currencies) at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, it retranslates monetary items denominated in foreign currencies at the rates prevailing at that date. It does not retranslate non-monetary items measured in terms of historical cost in a foreign currency. It recognizes exchange differences on monetary items in profit or loss in the period in which they arise. For the three months ended June 30, 2012, CRS incurred a foreign currency gain of \$147,600 compared to a gain of \$10,000 in 2011. For the six months ended June 30, 2012, CRS incurred a foreign currency gain of \$117,500 compared to a gain of \$900 in 2011.

***Loss before Income Taxes, Depreciation and Amortization (“EBITDA”)***

The negative EBITDA loss for the three months ended June 30, 2012 was (\$855,900) compared to (\$763,600) for the same period in 2011. The increase in fixed overhead and administrative costs has reduced overall earnings by \$92,300 for the three months ended June 30, 2012 compared to 2011. The negative EBITDA loss for the six months ended June 30, 2012 was (\$2,328,100) compared to (\$1,281,100) for the same period in 2011. The increase in fixed overhead and administrative costs has reduced overall earnings by \$1,047,000 for the six months ended June 30, 2012 compared to 2011.

**Net losses**

As a result of the above activities, the net loss for the three months ended June 30, 2012 was (\$981,500), or (\$0.02) per share compared to a loss of (\$568,300), or (\$0.02) per share for the same period 2011. The \$413,200 negative change in net losses vs. 2011 have been moderated by a positive change in warrant liability totalling \$26,300 for the three months ended and year ended June 30, 2012. The net loss for the six months ended June 30, 2012 was (\$2,127,000), or (\$0.05) per share compared to a loss of (\$1,085,000), or (\$0.03) per share for the same period 2011. The \$1,042,000 negative change in net losses vs. 2011 have been moderated by a positive change in warrant liability totalling \$488,400 for the six months ended and year ended June 30, 2012.

**Liquidity and Capital Resources**

The following table summarizes the key financial ratios of the Company.

<i>(in U.S. dollars except for ratios)</i>	June 30 2012	June 30 2011
Current Ratio	6.6:1	5.4:1
Cash	\$6,903,341	\$3,822,339
Available operating line	\$280,379	\$215,105
Net Working Capital	\$7,359,300	\$4,562,005
Total Assets	\$10,005,651	\$7,202,545
Total Debt	\$2,690,312	\$3,597,865
Total Equity	\$7,315,339	\$3,604,680
Debt to Equity Ratio	0.37:1	0.99:1

In accordance with IAS, warrants issued for cash and denominated in CAD dollars are classified as a liability and stated at fair value on the statement date. Prior to adoption of IFRS warrants were classified as equity resulting in changes to the Company's debt to equity ratio. The value of warrants included in total debt obligations (above) is:

<i>(in U.S. dollars)</i>	June 30 2012	June 30 2011
Derivative liability – Warrants	\$862,024	1,924,878

Total funding received from with the Southern Ontario Development Corporation (SODP) CAD \$667,036. The contribution amount is repayable in 60 equal monthly payments commencing August 1, 2012. No interest is payable on the outstanding balance of the contribution amount.

Management closely monitors the Company's current cash position and the short-term and long-term cash requirements. The Company is in a volatile market place that could generate significant orders for their LED products. The Company may be required to obtain additional funding to take advantage of the market opportunities. If additional funding is required, an issuance of common stock or a commitment to issue common stock will most likely be a component of the funding.

**Cash Flows**

During the period ended June 30, 2012, CRS experienced negative cash flows used in operations of (\$1,905,300) compared to a negative cash flow of (\$1,276,900) for the same period in 2011. Reduction of accounts receivable and inventory partially offset higher losses. The Company invested \$130,000 in tooling and other capital equipment, development costs and patents in the six months ended June 30, 2012 compared to \$348,800 in the prior year. The Company's various financing activities generated \$8,003,400 in cash flow for the six months ended June 30, 2012 compared to \$5,108,100 in the same period last year. The increase during the second quarter of 2012 is mainly attributable to the June 8, 2012 private placement offering generating gross proceeds of CAD \$8,880,000

## Outstanding Share Data

As at June 30, 2012 and August 29, 2012 the Company had the following items issued and outstanding:

- Common shares: 71,123,982
- Stock options:

Range of exercise prices (CAD\$)		Number outstanding	Weighted- average remaining contractual life	Weighted- average exercise price (CAD\$)
<b>\$0.30</b>	<b>\$0.50</b>	1,441,624	34 months	\$0.32
<b>\$0.51</b>	<b>\$0.70</b>	748,333	36 months	\$0.58
Total		2,189,957	35 months	\$0.41

2,189,957 options are exercisable as at June 30, 2012. The weighted average exercise price of these options is CAD \$0.41.

- Charitable options:

March 27, 2008, charitable options to purchase 66,486 common shares were granted to an eligible charitable organization. These options are exercisable at CAD \$0.30 per share with an expiry date as of March 27, 2018.

- Agent options:

As compensation for services related to the April 28, 2012 offering, the Company issued a total of 530,022 non-transferable compensation options to the lead agents. Each option entitles the agent to subscribe for one common share unit at a price of CAD \$0.55 until October 28, 2012.

## Commitments and Contingencies

The Company has the following commitments outstanding as at June 30, 2012:

The Company signed an exclusive license agreement with Eveready Battery Company, Inc. (the “Exclusive Agreement”), a subsidiary of Energizer Holdings, Inc., for the Company to manufacture a suite of LED lighting products under the brand name Energizer. The term of the Exclusive Agreement is from January 1, 2011 to June 30, 2015. In accordance with the Exclusive Agreement, the minimum guaranteed royalty to be paid by the Company over the term thereof is as follows:

<u>Year</u>	<u>Minimum Guaranteed Royalty</u>
2011	\$ 20,000
2012	411,000
2013	592,500
2014	756,000
2015	836,000

The Company signed a service agreement with DBA Tenzing Managed IT Services, for the Company to establish offsite IT infrastructure and related management services. The services primarily relate to administration of the supplied infrastructure, network availability, data backup and archiving. The term of the agreement is from December 12, 2012 (deployment date) to December 11, 2014. In accordance with the Agreement, the service cost to be paid by the Company over the term thereof is as follows:

<u>Year</u>	<u>CAD \$ IT Hosting Fees</u>
2012	37,820
2013	37,820
2014	35,965

The Company signed a service agreement with Niagara Regional Broadband Network Limited, for the Company to establish high-speed fiber optic network bandwidth and related management services. The services primarily relate to the maintenance of the supplied fiber optic network and network availability. The term of the agreement is from April 1, 2011 (deployment date) to March 31, 2016. In accordance with the Agreement, the service cost to be paid by the Company over the term thereof is as follows:

<u>Year</u>	<u>CAD \$ IT Hosting Fees</u>
2012	8,700
2013	8,700
2014	8,700
2015	8,700
2016	2,175

The Company has participated in a distribution program that induces participation in a nationwide campaign providing the right to return unsold product after 90 days on the shelf. These rights are extinguished if subsequent reorders are placed. The Company does not possess enough information to reasonably estimate potential returns under this program at date of publication.

## **Transactions with Related Parties**

Key management includes the Chief Executive Officer and the Chief Operating Officer. The compensation paid or payable to key management for services is as follows:

	<b>June 30 2012</b>	<b>June 30 2011</b>
Wages and benefits	179,209	184,492
Stock based compensation	-	-
	<u>179,209</u>	<u>184,492</u>

## **Off-Balance Sheet Arrangement**

The Company does not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations or financial condition of CRS including, without limitation, such considerations as liquidity and capital resources that have not previously been discussed.

## **Proposed Transactions**

CRS is not a party to any proposed transactions, other than the financing initiatives being pursued as described elsewhere in this document, which may have an effect on the financial condition, results of operations or cash flows or proposed asset or business acquisition or disposition.

## **Critical Accounting Policies**

This MD&A should be read in conjunction with the Company's unaudited condensed interim financial statements for the three and six months ended June 30, 2012, and the audited annual financial statements for the year ended December 31, 2011. Those Financial Statements outline the accounting principles and policies used to prepare our financial statements. Accounting policies are critical if they rely on a substantial amount of judgment in their application or if they result from a choice between accounting alternatives and that choice has a material impact on reported results or financial position. There was no significant change to the critical accounting policies from the year ended December 31, 2011 during the six month period ended June 30, 2012.



## **Financial Instruments**

### **[a] Fair value**

The carrying values of cash and cash equivalents, accounts receivable, government incentives receivable, accounts payable and notes payable do not materially differ from their fair values given their short-term period to maturity. The fair values of bank indebtedness and debt obligations approximate carrying value as the instruments bear interest or are discounted at market rates.

### **[b] Credit risk**

The Company is exposed to credit risk in the event of non-performance by customers in paying outstanding trade accounts receivable. One customer represents 47.1% of accounts receivable at June 30, 2012 (29.2% at December 31, 2011). The Company has purchased insurance from the Export Development Corporation to compensate for this risk in addition to monitoring the status of accounts on a regular basis.

Trade accounts receivable are past due when a customer fails to make a payment when contractually due. The Company specifically identifies customers with past due balance and provides for these accounts where appropriate. The following is an aging of trade accounts receivable:

	Current	30-60 days	60-90 days	Over 90 days	Total
June 30, 2012	239,187	142,449	60,154	10,464	452,254

### **[c] Interest rate risk**

The Company is exposed to interest rate risk on its short-term credit facilities and on a portion of its long-term debt, since the interest rate charged on these facilities fluctuates with the general level of interest rates. However, in management's opinion, this risk is not significant as the short term credit facilities do not represent a significant amount of financing.

**[d] Foreign currency risk**

The Company is exposed to currency risk because it makes purchases and sales transacted in Canadian currency. The following accounts were denominated in Canadian dollars:

	June 30	December 31
	2012	2011
Cash	6,925,554	577,856
Trade accounts receivable	207,367	326,073
Trade accounts payable	(373,345)	(733,788)
Short-term notes payable	(13,540)	(37,538)
Debt obligations	(624,890)	(699,586)

At June 30, 2012 a 10% change in the average exchange rate between U.S. dollars and Canadian dollars would have resulted in a USD \$612,155 change on reported net loss and comprehensive loss for the year.

**Accounting Standards Issued But Not Yet Applied**

Certain pronouncements were issued by the IASB or IFRIC that are mandatory for accounting periods beginning after January 1, 2011 or later periods.

The following new standards, amendments and interpretations, that have not been early-adopted in these financial statements, may have an effect on the Company's future results and financial position:

**Amendments to IFRS 7 “Financial Instruments: Disclosures”**

This amendment increases the disclosure required regarding the transfer of financial assets, especially if there is a disproportionate amount of transfer transactions that take place around the end of a reporting period. This amendment is effective for annual periods beginning on or after July 1, 2011. The Company is in the process of evaluating the impact of the new standard.

**IFRS 9 Financial Instruments**

IFRS 9 Financial Instruments is part of the IASB's wider project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard is effective for annual periods beginning on or after January 1, 2015. The Company is in the process of evaluating the impact of the new standard.

**IFRS 13 – Fair value measurement**

IFRS 13 Fair Value Measurement will improve consistency and reduce complexity by providing, for the first time, a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The standard is effective for annual periods beginning on or after January 1, 2013. The Company is in the process of evaluating the impact of the new standard.

The following new standards, amendments and interpretations, that have not been early-adopted in these financial statements, are not expected to have an effect on the Company's future results and financial position:

- IFRS 1 – Severe Hyperinflation (Effective for periods beginning on or after July 1, 2011)
- IAS 12 – Deferred Tax: Recovery of Underlying Assets (Amendments to IAS 12 (Effective for periods beginning on or after January 1, 2012)
- IAS 1 – Presentation of Other Comprehensive Income (Amendments to IAS 1 (Effective for periods beginning on or after July 1, 2012)
- IFRS 10 – Consolidated Financial Statements (Effective for periods beginning on or after January 1, 2013)
- IFRS 11 – Joint Arrangements (Effective for periods beginning on or after January 1, 2013)
- IFRS 12 – Disclosure of interests in other entities (Effective for periods beginning on or after January 1, 2013)

## **Subsequent Events**

In the third quarter the Company has commenced restructuring efforts to reduce losses. Preparations are under way to move production of our led lamps overseas and use the Canadian base as a distribution center for our led products as well as a catalogue of synergistic products sourced through our new investors.

## **Risk and Uncertainties**

CRS operates in the LED lighting market and is exposed to a variety of risk factors and uncertainties in the normal course of operations. The risks and uncertainties that could materially affect our business, financial condition and results of operations are described in our Annual Report for the fiscal year 2011 which has been filed with Canadian securities regulatory authorities and is available at [www.sedar.com](http://www.sedar.com) under the corporate name CRS Electronics Inc. The risks disclosed in our annual report are not necessarily the only risks and uncertainties we face. Additional risks and uncertainties not presently known to us, or that we currently believe to be immaterial, may also adversely affect our business.

There was no significant change to these risks and uncertainties during the period ended June 30, 2012 other than those described elsewhere in this MD&A.