



**ADEPTRON TECHNOLOGIES CORPORATION**

**ANNUAL REPORT 2007**

**TSX – 'ATQ'**

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## MESSAGE FROM THE PRESIDENT AND CEO

Year 2007

As indicated by the quarterly financial statements published throughout the year and the annual financial statements contained in this Annual Report, the year 2007 contained several difficult challenges for Adeptron. These challenges included a significant reduction in the revenue of Adeptron's former largest revenue-contributing customer, the inexorable rise of the Canadian dollar against its US counterpart, and the slower than anticipated appearance of revenue from new customer business. The resulting effects of these items are set out in the financial statements and management's discussion and analysis of financial results.

Despite the disappointing year end results in 2007, there were a number of events and accomplishments in 2007 that will not show their true and positive effect until 2008 and will likely become most evident in the second quarter of 2008 and beyond.

On May 31, 2007, the Company acquired Pacific Circuit Assembly, Inc. ("PCA") in San Jose, California. This represents Adeptron's first manufacturing location outside of Canada and, very importantly, is in the significant technology market of California. The Company is using this location as a key part of its strategy to penetrate the California and greater US markets. At this time, PCA has been integrated into Adeptron's business operating model, including being on the same information technology platform for enterprise resource planning ("ERP") and materials requirements planning ("MRP"). PCA delivers full turnkey EMS services and is supported therein by the supply chain unit in our Markham facility. With the customer activity currently being experienced at this site, the Company expects that PCA's 2008 revenue will greatly exceed its 2007 revenue. For the Company, an additional benefit of operating in the United States is that there is a virtual complete matching of US dollar based revenue and expenses, thus there is not the same erosion of margin faced by Canadian operations as the US dollar weakens against its Canadian counterpart.

At the end of 2007, the Company employed approximately 280 employees in its three sites compared to 315 in its two sites at the end of 2006. (The two Canadian sites at the end of 2007 had 225 employees or 90 less than at the end of 2006.) This development is expected to lead to a large improvement in the amount of revenue and associated "manufacturing value add" delivered per employee in 2008 compared to 2007 and obviously represents a significant cost reduction. This future benefit, however, came at the price of increased restructuring expense that was reflected in the 2007 year-end results.

This reduction of workforce, without imperiling the manufacturing throughput capability, is to a large extent attributable to the Company's refurbishment and plant reorganization of its 96 Steelcase Road West, Markham facility conducted throughout much of 2007. This initiative allowed the consolidation of all its Markham operations into this plant and the closure of its previously operated 41 Steelcase Road West facility. The consolidation allowed the elimination of redundant processes and the improvement of workflow. Consequently, the Company was able to sublet the unused facility effective February 1, 2008 until the expiry of the lease in 2011. This adds to the cost reductions to be experienced in 2008 compared to 2007. This also required, however, that the restructuring costs related to the closure of operations in this facility, and preparing it for a new subtenant, be reflected in the 2007 year-end results.

During 2007 and early 2008, the Company has modified some of its internal operating systems with a view to flattening the organization and driving responsibility and accountability deeper into

the organization. This includes the development of “customer focused” teams that have the team membership to deal with the vast majority of customer’s requirements. This has led to an improvement in customer service and meant that the workforce reduction discussed above included the elimination of a number of mid-level and senior managerial salaries.

As was recently announced, the Company is working towards the completion of a proposed financing transaction that would result in a significant injection of equity into the Company. It is anticipated that this equity infusion, when completed, the resulting interest expense reduction, the benefits of the cost reduction measures described above, and new customer activity that is anticipated to become evident in the second quarter of this year, will all collectively allow the Company to improve its financial position. With that accomplished, Adeptron will be able to focus its efforts on growth through organic activities and M&A activity.

I am deeply indebted to all those on the Adeptron team who continue to work diligently and do not get distracted by the momentary difficulties we continue to overcome. I appreciate the efforts of our employees, directors and all other stakeholders of Adeptron who continue to support the Company as it looks forward to what should be a memorable year in 2008 for many positive reasons.

Signed

*“F. Michael Marti”*

F. Michael Marti  
President and Chief Executive Officer

## MANAGEMENT'S DISCUSSION AND ANALYSIS

For the year ended December 31, 2007:

*The following discussion of the financial condition and results of operations of Adeptron Technologies Corporation ("Adeptron" or the "Company") should be read in conjunction with the Company's Financial Statements for the Year-ended December 31, 2007. All dollar amounts are expressed in Canadian dollars unless otherwise indicated.*

*Certain statements contained in the following Management's Discussion and Analysis, and elsewhere in Adeptron's Annual Report, including, without limitation, statements containing the words believes, anticipates, estimates, expects, and words of similar import, constitute forward-looking statements within the meaning of applicable laws and regulations. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties which could cause actual results to differ materially from those anticipated in these forward-looking statements. These risks and uncertainties include, but are not limited to: foreign currency fluctuations; variability of quarterly and annual operating results; intense competitive pressures; fluctuations in global industry conditions; narrow margins; risks related to human resources recruiting and retention; vulnerability of management information systems; indebtedness of the Company; product-related risks; sales concentration risks; risks related to the availability of future financing; component shortages and sublease-related credit risks. These and other risks and uncertainties and factors are discussed in the Company's filings with applicable Canadian securities regulators, including the Company's Annual Information Form dated March 31, 2008 and other documents filed by the Company with Canadian securities regulators from time to time. Additional information related to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).*

*We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. You should read this Annual Report and Management's Discussion and Analysis with the understanding that Adeptron's actual future results may be materially different from what we expect. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.*

### **Date**

This Management's Discussion and Analysis ("MD&A") is dated as of March 28, 2008.

### **Overview and Business of the Company**

Adeptron was formed by amalgamation on January 1, 2003 under the *Business Corporations Act* (Alberta). The Company changed its name from Electronics Manufacturing Group Inc. ("EMG") to Adeptron Technologies Corporation on December 31, 2002. The Company has a wholly-owned subsidiary Adeptron, USA Inc., a Delaware company that owns all of the issued and outstanding shares of Pacific Circuits Assembly, Inc., ("PCA"), the California operating Company.

Adeptron's head office is located in Markham, Ontario, a suburb of Toronto. The Company operates out of leased facilities in Markham, Ontario comprising approximately 43,000 square feet, a 56,000 square foot leased facility in Ottawa, Ontario and a 20,000 square foot leased facility in San Jose, California, USA.

Adeptron provides its customers with an array of electronics manufacturing services ("EMS") in relation to third party electronic products and assemblies and derives all of its sales from the provision of these services. Adeptron services the North American electronics industry with a focus on low and medium volume, high complexity, commercial and industrial electronic products. Adeptron produces electronic assemblies under both turnkey and labour-only build contracts for customers whose products and end users represent a wide variety of markets.

The Company also provides many additional services related to the printed circuit board assembly process either on a stand-alone basis or as value-added services to its customers. In all aspects of its EMS business including raw materials procurement, flexible supply arrangements and design-related services, Adeptron continuously strives to achieve cost reductions and optimal quality outcomes for its customers.

### Significant Transactions

On May 31, 2007 the Company, through its wholly-owned subsidiary, Adeptron USA, Inc., acquired all of the outstanding shares of PCA. Based in San Jose, California, PCA provides full electronics manufacturing services, which include both surface mount and pin through-hole board assembly along with test and system-build capabilities.

Purchase consideration consisted of \$1,300,000 in cash paid on closing, \$802,000 in notes payable, and 903,520 common shares of the Company. The notes payable bear interest at 5% per annum and are repayable in equal annual instalments over a three year period. The notes payable were recorded at a fair value of \$734,000 using a discount rate of 10% and are being accreted using the effective interest rate method to the principal amount, which is denominated in US dollars. The fair value of share consideration was based on the market price of the Company's common shares over a short period before and after the announcement of the acquisition. In addition, the Company incurred \$280,000 in acquisition costs related to this transaction.

The acquisition of PCA has been accounted for using the purchase method and accordingly, the results of operations have been included in these consolidated financial statements from the date of acquisition. The consideration paid has been allocated to the net assets acquired based on their respective fair values and the excess has been recorded as goodwill as follows:

(in thousands)	\$
<b>Net assets acquired:</b>	
Current assets, excluding cash acquired	468
Property, plant & equipment	1,181
Intangible assets	364
Goodwill	1,224
Future income taxes	(538)
Accounts payable and accrued liabilities	(236)
	2,463
Cash acquired	68
<b>Fair value of net assets acquired</b>	<b>2,531</b>

In 2006, Adeptron concluded two significant financing transactions in the third quarter of 2006.

On September 21, 2006, the Company completed a private placement financing consisting of a subordinated debenture and common share purchase warrants for aggregate gross proceeds of \$5.0 million. As part of the private placement, the Company issued 6,851,000 common share purchase warrants, each of which entitles the holder thereof to purchase one common share of the Company for \$0.20 per common share for a period of 5 years. The subordinated debenture has a principal amount of \$5.0 million, a term of 66 months and carries interest at 12% per annum, payable monthly. Beginning on November 1, 2008, the Company will make principal repayments of \$35,000 per month for 42 months with the remaining outstanding principal due at the end of the 66-month term. The debenture is collateralized by a second ranking general security agreement covering substantially all of the Company's assets.

The subordinated debenture agreement contains various covenants that the Company must comply with, including financial covenants related to the ratio of current assets to current liabilities, debt coverage, interest coverage and debt to equity. During November 2007, the Company entered into a forbearance agreement with its subordinated lender in which the lender has agreed to waive its right to enforce the security it holds in the assets of the Company. The agreement will remain in effect until the earlier of September 30, 2008 or the occurrence of a further event of default, as defined in the original debenture agreement or in the forbearance agreement. In particular, the forbearance agreement contains additional financial targets that must be met over the term of the agreement.

In consideration for the forbearance agreement, the Company will pay to the lender a finance fee of \$50,000 per quarter that the forbearance agreement is in effect. As at December 31, 2007, this fee has been added to the outstanding principal balance of the debenture.

As at December 31, 2007, the Company did not comply with the additional financial targets under the forbearance agreement. As a result the Company was in a default position and has classified the subordinated debenture as a current liability in the 2007 consolidated balance sheet.

Also on September 21, 2006, the Company entered into a three-year credit agreement with a senior lender that provides the Company with a senior lending facility in the aggregate amount of up to \$6,750,000. The total senior lending facility is comprised of a \$6.0 million revolving credit facility and a \$750,000 term loan facility. The senior lending facility is collateralized by a first ranking general security agreement covering substantially all of the Company's assets.

Under the revolving credit facility, the Company can borrow by way of Canadian dollar prime rate loans or U.S. dollar base rate loans. In addition, the revolving credit facility allows for the issuance of letters of credit and has a foreign exchange trading component. The maximum availability under the revolving credit facility is based on certain terms and conditions, including, but not limited to, the levels of accounts receivable and inventory and is established on an ongoing basis. Borrowings under this facility are subject to interest at the bank's prime rate plus 1% for Canadian dollar loans and U.S. base rate plus 0.5% for U.S. dollar loans and the interest is payable monthly.

The term loan is repayable over 36 months in equal monthly instalments commencing on November 1, 2006. The term loan is subject to interest on the outstanding balance at the bank's prime rate plus 1.5% and interest is payable monthly.

The credit agreement contains various covenants that the Company must comply with including financial covenants related to minimum levels of net assets and interest coverage and maximum levels of capital spending.

As at December 31, 2007, the Company did not comply with the financial covenants and has therefore classified the balance remaining on the term loan facility as a current liability on the 2007 consolidated balance sheet.

On February 25, 2008, the Company announced that it had entered into a letter of intent in respect of a proposed private placement transaction whereby the Company will issue common shares at \$0.10 per share for gross proceeds of \$6 million. The Company has set May 7, 2008 as the date for a special meeting of shareholders at which time the shareholders will be asked to approve the proposed transaction. The proceeds of the proposed transaction are intended to repay the principal and accrued interest thereon to its subordinated debenture-holder. The remainder of the proceeds of the proposed transaction is intended to replenish working capital. During the last half of 2007, the Company engaged in various restructuring activities with the expectation that management expects to reduce future operating costs and increase future positive cash flows.

The Company believes that the combination of the proceeds of the proposed equity transaction, repayment of the subordinated debenture and elimination of the associated interest expense, and, the expected expense and cash savings of the restructuring activities, will allow it to continue its banking relationship with its current senior lender. As a result, the Company believes that it will be able to meet its short-term cash flow requirements. However, the outcome of all of the actions and events described above cannot be predicted at this time, hence the Company's ability to continue as a going concern is uncertain.

### **Overall Performance**

The Company's financial performance in 2007 deteriorated in comparison to the prior year. In 2007, sales decreased by 12.4% to \$38.4 million from \$43.8 million in 2006. This represented the Company's first decline in annual sales growth after three consecutive years of double-digit percentage growth in sales.

The Company's net loss of \$6.90 million was a deterioration in comparison to the prior year's net income of \$1.61 million. The write-off of goodwill previously associated with the Canadian reporting unit in the amount of approximately \$5.53 million, a non-cash item, accounted for the majority of this loss.

EBITDA<sup>(1)</sup> for 2007, and excluding the non-cash write-off of goodwill, was \$780,000 compared to approximately \$3.3 million in 2006. The Company recorded depreciation and amortization expense of \$867,000 in 2007. The Company also recorded \$318,000 in non-cash interest expense and \$124,000 in non-cash stock based compensation expense in 2007. Excluding changes in non-cash working capital balances, the Company lost approximately \$150,000 in cash from operating activities in 2007 compared to generating \$2.53 million in 2006.

Consistent with prior years, the strengthening of the Canadian dollar ("CDN\$") relative to the US dollar ("US\$") during 2007 had a negative effect on the Company's sales and gross profit. This negative foreign exchange trend reduced the Company's sales and gross profit, when compared to the sales and gross profit that Adeptron would have achieved had the 2006 exchange rate prevailed in 2007. This exacerbated the revenue loss experienced as a result of

the Company's former largest revenue-contributing customer moving a very significant portion of their outsourcing requirements to China.

In order to mitigate the adverse effect of the strengthening CDN\$ relative to the US\$, the Company continues to denominate as many of its expenses as possible in US\$ to drive the expenses lower when converted to CDN\$. However, management's primary emphasis in its approach to managing the effect of the \$US trend on Adeptron has been and continues to be on generating long-term sales growth. Adeptron's objective continues to be to develop significant customer relationships that are enduring and have meaningful sales growth potential. Having a core business offering that offers compelling value to existing and prospective customers is crucial to achieving this result and to this end, the Adeptron team remains committed to its goal of ongoing operational improvement initiated several years ago. In addition, the acquisition of PCA provides a situation in which revenues and expenses are matched in \$US and the Company's exposure to foreign currency exchange rate movements for PCA are greatly reduced compared to the operations carried out in Canada.

The Company had deferred income tax assets of approximately \$6.7 million at 2007 year-end, which are offset by a valuation allowance of approximately \$7 million resulting in a future tax liability of approximately \$300,000. This compares to deferred income tax assets of \$7.2 million at 2006 year-end, which were offset with an equivalent valuation allowance.

**Selected Consolidated Financial Information**  
**(as at and for the years ended December 31 and in thousands of dollars, except per share information and gross profit percentages)**

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Sales	\$38,406	\$43,832	\$38,202
Gross profit	\$5,598	\$7,733	\$5,274
Gross profit %	14.6	17.6	13.8
Income (loss) before the following items:	\$(674)	\$1,614	\$(411)
Goodwill impairment	\$(5,531)	—	—
Restructuring expense	\$(651)	—	—
Net income (loss)	\$(6,856)	\$1,614	\$(411)
Basic and diluted income (loss) per share <sup>(1)</sup>	\$(0.19)	\$0.05	(\$0.01)
Current assets	\$10,921	\$11,859	\$12,008
Total assets	\$15,820	\$20,158	\$19,770
Current liabilities	\$13,187	\$7,031	\$14,068
Long term liabilities <sup>(2)</sup>	\$955	\$4,830	\$240

Notes:

- (1) In 2005 and 2007, diluted loss per share equals basic loss per share, as the effect of options and warrants is anti-dilutive. In 2006, as a result of rounding, diluted and basic income per share are shown to be the same.
- (2) Does not include current portion of long term debt.

*2007: Year of Restructuring, Rebuilding and Expansion into the USA*

In 2007, the Company executed on a plan to restructure its operations to reduce operating costs, improve processes and systems, rebuild revenue being lost from its former largest revenue-contributing customer, and expand into the USA. Consequently, the Markham and Ottawa operations that started 2007 with 315 employees ended 2007 with 225 employees. Combined with the last restructuring steps taken in the first quarter of 2008, the number of senior management positions decreased by five. During 2007, the Company extensively renovated the larger of its two Markham sites and then consolidated all the operations carried out in the smaller Markham facility into the larger one. In February 2008, subsequent to the 2007 year-end, the Company was able to sublet the smaller Markham facility for the duration of the head lease on that facility. The Company expects to experience significant cost savings beginning with 2008 and extending into the future. As a result of these restructuring activities, 2007 was charged with \$651,000 in restructuring expenses covering staff severance and moving expenses related to the vacating of the sublet facility.

As described above, the Company acquired PCA in San Jose, California on May 31, 2007 and is using this location as the platform to launch its penetration into the California and the greater USA market. In addition, this acquisition provides a situation in which revenues and expenses are matched in \$US and the Company's exposure to foreign currency exchange rate movements for PCA are greatly reduced compared to the operations carried out in Canada.

Late in 2007 the Company was able to bring new customers on stream that are expected to contribute to a marked improvement in the revenue and bottom line results of the Company in 2008.

As explained elsewhere in this document, the Company did not comply with certain financial covenants related to the credit agreement with its senior lender and also its subordinated debenture lender. As a result, the Company's ability to continue as a going concern is uncertain and is dependent upon its ability to generate sufficient future cash flow and obtain sufficient financing to fund its business to the point that it achieves profitable operations.

On February 25, 2008, the Company announced that it had entered into a letter of intent in respect of a proposed private placement transaction whereby the Company will issue common shares at \$0.10 per share for gross proceeds of \$6 million. The Company has called and special meeting of shareholders on May 7, 2008 at which time the shareholders will be asked to approve the proposed transaction. The proceeds of the proposed transaction are intended to repay the outstanding principal and accrued interest thereon to the subordinated debenture-holder. The remainder of the proceeds of the proposed transaction is intended to replenish working capital. During the last half of 2007, the Company engaged in various restructuring activities with the expectation that management expects to reduce future operating costs and increase future positive cash flows.

The Company believes that the combination of the proceeds of the proposed equity transaction, repayment of the subordinated debenture and elimination of the associated interest expense, and, the expected expense and cash savings of the restructuring activities, will allow it to continue its banking relationship with its current senior lender. As a result, the Company believes that it will be able to meet its short-term cash flow requirements. However, the outcome of all of the actions and events described above cannot be predicted at this time.

The financial statements as at December 31, 2007 do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying financial statements.

#### *2006: Record annual profit, revitalization of balance sheet*

In 2006, the Company continued the trend in profitability that it began in the fourth quarter of 2005. The Company recorded net income in each quarter of 2006 and generated a record annual profit of approximately \$1.6 million.

The Company was also able to significantly strengthen its balance sheet during 2006. Cashflow from operating activities increased to approximately \$1.2 million in 2006 from a cash usage of \$240,000 in 2005. This had a direct impact on the balance sheet as it improved the Company's working capital position throughout the year. In addition, the Company concluded two significant financing transactions in the latter part of 2006. The private placement debenture transaction provided the necessary funding required to settle the subordinated notes liability reflected in current liabilities. In effect, the Company refinanced the short-term debt with long-term debt, thus, improving the Company's working capital position. The second financing transaction involved a \$6.0 million revolving credit facility that has provided the Company with greater borrowing availability than it previously had with its former senior lender.

#### *2005: Improved Operating Results and Fourth Quarter Profitability*

2005 proved to be a turnaround year for the Company from an operating results perspective. As in 2004, the Company continued to grow top line sales, in this case, by 14% over the prior year, even though the strengthening of the CDN\$ relative to the US\$ during 2005 was having a negative effect on overall sales.

More importantly, the Company made significant improvements in its gross profit and gross profit percentage in 2005. Gross profit percentage increased to 13.8% in 2005 from 8.5% in 2004 while gross profit increased by \$2.5 million, or over 85%, to \$5.3 million in 2005. Furthermore, even with sales increasing in 2005, the Company was able to lower selling, general and administrative expenses in 2005 compared to 2004.

The net result of the sales growth, improved gross profit and reductions in selling, general and administrative expenses was a significant improvement in the Company's operating performance. The net loss for 2005 was \$411,000 compared to a net loss of \$3.2 million in 2004. The Company's results improved progressively in each quarter culminating in a net income of \$153,000 in the fourth quarter of 2005.

## **Results of Operations**

### *Sales*

Sales for the year ended December 31, 2007 were \$38.4 million compared to \$43.8 million for the year ended December 31, 2006, representing a decrease of \$5.4 million, or 12%. This decrease is primarily attributable to two factors. As previously announced, the Company's former largest revenue-contributing customer moved a significant portfolio of its outsourcing requirements to China and this resulted in approximately \$9.9 million less sales in 2007 from

this customer than in 2006. The second factor, explained more fully below, is the continued strengthening of the Canadian dollar relative to the US dollar.

In 2007, approximately 69% of the Company's sales were derived from USA-based and domestic-based customers with sales denominated in US\$. Since US\$ sales are converted to CDN\$ using the appropriate exchange rate on the date of the transaction, fluctuations in exchange rates between the CDN\$ and US\$ have a direct impact on the Company's reported sales and gross profit. The continued strengthening of the CDN\$ in 2007 when compared to the prior year, had a negative effect on the Company's sales and, consequently, gross profits. The US\$ to CDN\$ exchange rate at December 29, 2006 (last business day of the year) was 1.1653 and declined to \$0.9881, or 15.2%, by December 31, 2007. This continued the trend of declining annual average exchange rates that began in 2002. If the effect of the change in currency rates were removed, the decrease in sales in 2007 in comparison to 2006 would have been significantly reduced.

#### *Cost of Goods Sold and Gross Profit*

Cost of goods sold for the year ended December 31, 2007 was \$32.8 million compared to \$36.1 million for the year ended December 31, 2006, a decrease of \$3.3 million, or 9.1%, from 2006. The decrease in cost of goods sold in 2007 in comparison to the prior year can be primarily attributed to the lower total material and labour costs directly associated with lower sales. However, the decrease in cost of goods sold of 9.1% was proportionately less than the decrease in total sales of 12%.

Gross profit for the year ended December 31, 2007 was \$5.6 million compared to gross profit of \$7.7 million for the year ended December 31, 2006, a decrease of \$2.1 million, or 27%. Gross profit, expressed as a percentage of sales for the year ended December 31, 2007, was 14.5% compared to 17.6% for the year ended December 31, 2006. The decrease in gross profit dollars and percentage in 2007 in comparison to 2006, is attributable to two main factors. These factors are the decrease in sales during 2007 in comparison to 2006 and the unfavourable effect of foreign currency exchange rates.

Depreciation of \$782,000 has been allocated between cost of goods sold and other expenses in 2007 compared to \$503,000 in 2006. The depreciation on manufacturing assets that have been employed to generate the sales reported for the year is allocated to cost of goods sold and the depreciation on non-manufacturing assets that have been employed in selling, general and administrative areas of the business is not included in gross profit.

Depreciation of \$679,000 has been allocated to cost of goods sold in 2007, compared to \$426,000 in 2006, an increase of \$253,000. The remainder of the depreciation has been charged to expenses below the gross profit line. This increase is primarily due to the amount and nature of capital assets acquired in 2007.

During 2007, the Company spent approximately \$902,000 to acquire capital assets compared to \$536,000 in 2006. The increase in capital spending was primarily due to the renovation of the Markham facility, including significantly increasing the amount of electricity supplied to the facility, so as to allow the consolidation of Markham's operations into one building from the previous two. The increase in capital spending in 2006 resulted in an increase in depreciation expense charged to cost of sales compared to the prior year.

Adeptron's management does not expect an increase in capital expenditures in 2008 over the levels incurred in 2007 unless a new customer project can financially justify such a purchase or significant future operational efficiencies can be realized through such expenditures.

#### *Selling, General and Administrative Expense*

Selling, general and administrative ("SG&A") expenses for the year ended December 31, 2007 were \$4.8 million, a decrease of approximately \$0.2 million, or 4%, from \$5.0 million for the prior year. The decrease is not attributable to any one or more significant factors but is the net result of a variety of expenses included in this category that individually increased or decreased in immaterial amounts.

#### *Interest on Subordinated Notes*

Interest on subordinated notes for the year ended December 31, 2007 was \$NIL compared to \$302,000 for the year ended December 31, 2006. This is due to the fact that the subordinated notes liability was fully repaid at the end of the third quarter in 2006 and as a result, the Company did not incur any further interest on this debt in the fourth quarter.

#### *Interest on Subordinated Debenture*

As described in the section "Significant Transactions", on September 21, 2006, the Company completed a private placement financing that included the issuance of a subordinated debenture. As described in that section, the Company has classified the subordinated debenture as a current liability on December 31, 2007 consolidated balance sheet. In 2007, interest expense relating to the Company's subordinated debenture was \$819,000 compared to \$235,000 in 2006, or an increase of \$584,000. The increase is entirely attributable to the subordinated debenture being outstanding for the entire year in 2007 compared to only a little more than three months in 2006.

#### *Interest on bank operating loan*

As described in the section "Significant Transactions", on September 21, 2006, the Company entered into a three-year credit agreement with a senior lender that provides the Company with a senior lending facility which includes a \$6.0 million revolving credit facility. Interest on bank operating loan is the interest and associated loan fees paid on the revolving credit facility. Under the revolving credit facility, the effective interest rate for the year was 7.2%. Interest on bank operating loan for the year ended December 31, 2007 was \$294,000 compared to \$390,000 for the year ended December 31, 2006, a decrease of \$96,000 or 25%. Included in interest expense is approximately \$88,000 relating to the amortization of deferred financing costs. The decrease is due to lower borrowing levels and lower interest rates in 2007 in comparison to 2006.

#### *Interest on term loan facility*

As described in the section "Significant Transactions", on September 21, 2006, the Company entered into a three-year credit agreement with a senior lender that provides the Company with a senior lending facility which includes a \$750,000 term loan facility. As described in that section, the Company has classified the term loan facility as a current liability on the 2007 consolidated balance sheet. The effective interest rate for the year on the term loan facility was

7.6%. Interest on term loan facility for the year 2007 was \$56,000 in comparison to \$15,000 for the year ended December 31, 2006.

#### *Interest on notes payable*

As described in the section "Significant Transactions", on May 31, 2007, the Company acquired all of the issued and outstanding shares of PCA. The purchase consideration included, amongst other things, \$802,000 in notes payable. The notes payable bear interest at 5% per annum and are repayable in equal annual instalments over a three-year period. The notes payable were recorded at a fair value using a discount rate of 10% and amounting to \$734,000 and are being accreted using the effective interest method to the principal amount, which is denominated in US dollars. Interest on notes payable in 2007, for the seven months that the notes payable were outstanding, was \$41,000. There was no such expense in 2006, as the liability did not exist.

#### *Depreciation*

Depreciation and amortization on non-manufacturing Company assets for the year ended December 31, 2007 was \$103,000 compared to \$77,000 for the year ended December 31, 2006. Depreciation of manufacturing assets is included in cost of goods sold and is discussed above in "Results of Operations – Cost of Goods Sold and Gross Profit".

Management expects the charge for depreciation and amortization on non-manufacturing Company assets in 2008 to be similar to that charged in 2007.

#### *Change in fair value of embedded derivative*

As a result of a change in accounting policy described in the section "Accounting Developments – Changes in Accounting Policies Including Initial Adoption", the Company incurred an expense related to the change in the asset and liability value of an embedded derivative contained in certain foreign currency denominated sale and purchase contracts. An expense in the amount of \$139,000 was recognized for the year ended December 31, 2007, in comparison to nil for 2006 when the accounting policy was not yet in effect.

#### *Business Restructuring*

The Company restructured its operations resulting in the closing of a manufacturing facility in Markham, Ontario and the consolidation of these operations into its main facility also in Markham, Ontario. The restructuring resulted in staff reductions and consolidation of office and manufacturing space.

The 2007 restructuring expense was \$651,000. Of this amount, \$490,000 remains as an obligation consisting of (i) an estimated \$274,000 relating to net facility lease costs with no additional economic benefits that will be paid out over the remaining lease period which extends to 2011, and (ii) \$216,000 relating to severance and moving costs. The long-term portion of the restructuring obligation is \$168,000 and is recorded in other long-term liabilities, and the current portion is recorded in accounts payable and accrued liabilities. Disposals in 2007 of property, plant and equipment comprising of leasehold improvements associated with the Markham restructuring had a cost of \$113,000 and accumulated amortization of \$84,000. The net book value of \$29,000 was written off.

### *Income Tax Provision*

For the fiscal year 2007, the Company recorded a provision for current income tax expense of \$66,000 and a future tax recovery of \$161,000 resulting in a net recovery for the year amounting to \$95,000. For the fiscal year 2006, the Company did not record any income tax provision in its financial statements. At December 31, 2007, the Company has approximately \$15.9 million of non-capital loss carryforwards available to apply against income of future periods.

### *Balance Sheet*

Cash at December 31, 2007 was \$114,000 compared to \$234,000 at December 31, 2006.

The Company is a net borrower against its revolving credit facility with its senior lender. It therefore minimises the amount of cash in its account at any time. The Company keeps cash in deposit and checking accounts in California related to the operations in San Jose. At the end of 2006 the Company still maintained bank accounts for cheque clearing activities with its former senior lender. This practice came to an end during 2007 and allowed the Company to lower its cash on hand compared to the prior year-end.

Working capital deficit, defined as current assets less current liabilities, as at December 31, 2007, was approximately \$2.27 million compared to positive working capital of \$4.83 million at December 31, 2006, or a decrease of \$7.10 million. This decrease in working capital is primarily explained by the following. In 2007 the Company paid \$1.3 million cash and incurred an additional \$280,000 of acquisition costs upon the purchase of the San Jose operations, purchased approximately \$900,000 of capital assets, and repaid \$250,000 of its term loan with its senior lender. In addition, as a result of the Company's default on certain financial covenants with its senior lender and its subordinated debenture lender, it has classified the subordinated debenture, amounting to \$3.99 million, and the term loan facility, amounting to \$459,000, as current on the consolidated balance sheet at December 31, 2007.

Accounts receivable at 2007 year-end were approximately \$6.3 million, compared to the 2006 year-end balance of approximately \$6.8 million, or a decrease of \$500,000. Sales in the fourth quarter of 2007 were \$9.9 million compared to fourth quarter 2006 sales of \$10.9 million. The accounts receivable decrease is explained by the revenue change in the fourth quarter of the two years and the timing of invoicing and cash collections within the respective quarters.

Inventory at 2007 year-end was approximately \$3.9 million compared to the 2006 year-end balance of \$4.5 million. The Company is expecting sales in the first quarter of 2008 to be marginally lower than the comparable quarter of 2007. This expectation combined with a continuing concerted drive to increase the inventory turnover rate resulted in the lower inventory at the end of 2007.

Accounts payable and accrued liabilities at 2007 year-end were approximately \$5.9 million compared to approximately \$6.1 million at 2006 year-end, a decrease of \$200,000. The decrease in accounts payable and accrued liabilities is due primarily to the reduction in inventory explained above.

As described in the section "Significant Transactions", on September 21, 2006, the Company completed a private placement financing that included the issuance of a subordinated debenture. As described above in the section, Results of Operations – Interest on Subordinated Debenture, the subordinated debenture is classified as a current liability on the 2007

consolidated balance sheet. The subordinated debenture is stated as at December 31, 2007, at its fair value of approximately \$3.99 million. The net book value of financing costs of approximately \$395,000 has been recorded as a reduction of the carrying value of the subordinated debenture and accreted interest of \$206,000 has been recorded as an increase in the carrying value of the subordinated debenture. As at December 31, 2006, the subordinated debenture was stated at its fair value of \$4.2 million including accreted interest of \$28,000 and classified as long-term debt. Prior to January 1, 2007 long-term debt deferred financing costs were recorded in the consolidated balance sheets as other assets and were amortized over the term of the debt on a straight-line basis. Therefore the net book value of financing costs of approximately \$395,000 was not recorded as a reduction of the carrying value of the subordinated debenture.

As described in the section "Significant Transactions", on September 21, 2006, the Company entered into a three-year credit agreement with a senior lender that provides the Company with a senior lending facility which includes a \$750,000 term loan facility. As described in that section, the Company has classified the term loan facility as a current liability on the 2007 consolidated balance sheet. As at December 31, 2007 the term loan facility liability was \$459,000. As at December 31, 2006 the term loan facility balance was \$708,000 and of this amount \$250,000 was classified as current and the remainder of \$458,000 was classified as long-term debt. The Company repaid \$249,000 of the principal amount of this liability in 2007.

The purchase consideration for the acquisition of PCA included, amongst other things, \$802,000 in notes payable. The notes payable bear interest at 5% per annum and are repayable in equal annual instalments over a three-year period. The notes payable were recorded at a fair value using a discount rate of 10% and amounting to \$734,000 and are being accreted using the effective interest method to the principal amount, which is denominated in US dollars. As at December 31, 2007, the outstanding balance was \$696,000, of which \$247,000 is shown as current portion of notes payable leaving \$449,000 in long-term debt.

Other long-term liabilities of \$168,000 covers the long-term portion of the restructuring obligation for the subsidization of a Calgary sub-lease which will be paid out through to December 31, 2011, and a Markham sub-lease which will be paid out through March 31, 2011. The current portion of other long-term liabilities is \$322,000 covering subsidization of the Calgary and Markham sub-leases and severance and moving costs. As at December 31, 2007 and 2006, respectively, the current portion of other long-term liabilities is recorded in accounts payable and accrued liabilities. The comparative balances at December 31, 2006 year-end were \$166,000 in other long-term liabilities and \$68,000 being the current portion of other long-term liabilities.

Future income taxes at 2007 year-end are approximately \$350,000. Future tax assets involving non-capital losses (\$4.6 million), property, plant and equipment (\$1.55 million), non-deductible reserves (\$560,000), share issue costs (\$50,000) and a reduction for intangibles (\$110,000) result in a net future tax assets of approximately \$6.65 million. These assets are offset by a valuation allowance of approximately \$7 million, resulting in the future income taxes stated above at the 2007 year-end.

In November 2006, the Company completed a private placement with a newly appointed director of the Company. Simultaneously, the Company entered into a consulting arrangement with this director. The private placement was for aggregate gross proceeds of \$200,000 on the issuance of 1,000,000 units and share issue costs related to the private placement were \$12,000. Each unit includes one common share and one-half common share purchase warrant and the net proceeds were recorded as share capital. The fair value of the units exceeded the

gross proceeds by approximately \$49,000. In 2006 this amount was recorded as stock-based compensation in the statements of operations and deficit and warrants on the balance sheet.

**Summary of Quarterly Results**  
(in thousands of dollars, except per share information and gross profit percentages)

	2007				2006			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
<b>Sales</b>	\$9,917	\$8,180	\$10,149	\$10,160	\$10,852	\$10,609	\$11,655	\$10,716
<b>Gross profit</b>	\$1,448	\$857	\$1,571	\$1,724	\$1,970	\$1,935	\$1,995	\$1,833
<b>Gross profit %</b>	14.6	10.5	15.5	17.0	18.2	18.2	17.1	17.1
<b>Income (loss) before the following items:</b>	\$(194)	\$(652)	\$10	\$163	\$307	\$506	\$489	\$312
<b>Goodwill impairment</b>	\$(5,531)	—	—	—	—	—	—	—
<b>Restructuring</b>	\$(202)	\$(450)	—	—	—	—	—	—
<b>Net income (loss)</b>	\$(5,927)	\$(1,102)	\$10	\$163	\$307	\$506	\$489	\$312
<b>EBITDA<sup>(1)</sup></b>	\$211	\$(514)	\$481	\$602	\$889	\$894	\$857	\$700
<b>Basic &amp; diluted income (loss) per share</b>	\$(0.16)	\$(0.03)	\$0.00	\$0.00	\$0.01	\$0.01	\$0.01	\$0.01

Adeptron's results of operations for the most recent eight fiscal quarters are primarily affected by the volume of sales but are also influenced by other factors such as fluctuating foreign exchange rates between the CDN\$ and US\$ and the mix of sales between various customers and the provision of turnkey and labour-only services. The Company has not been able to determine any specific seasonality or other cyclical influences that affect the predictability of its sales and results of operations. Instead, the Company's performance is more closely tied to the general economic conditions prevailing in the electronics products sector.

The Company entered 2006 with expectations of continued sales growth on an annual basis. Quarterly sales continued to increase sequentially in the first two quarters of 2006 while quarterly net income increased sequentially through the first three quarters of 2006. In addition, each quarter in 2006 showed increases in sales, improvements in gross profit and higher earnings than its corresponding quarter in 2005.

The Company was informed in the first quarter of 2007 to expect a significant reduction in the amount of orders for 2007 from its previous largest sales-contributing customer. At the same time the Company expected increases in the amount of orders for 2007 from other existing customers, including its previous second largest sales-contributing customer. Also, the Company expected the amount of orders in 2007 from labour-only customers to be higher than in 2006 and further mitigate the effect on gross profit margin exerted by the previously mentioned reduction in orders from its previous largest customer. In addition, the Company expected to see the benefit in the latter half of 2007 of new customer relationships developed in 2006. The Company's sales are dependent upon the level of orders from its existing customers and the introduction of new customers. The level of orders from the Company's existing customers fluctuate from month to month based on a variety of factors unique to each customer. The amount, size and delivery dates of orders from the various existing and new customers did

not materialize to the extent expected. As well, as explained elsewhere in this document, the Company's sales were adversely affected by the strengthening Canadian dollar. The Company was not able to fully make up the sales lost by the announced reduction from the previous largest revenue-contributing customer.

As part of the Company's continuing bolstering of its value proposition, it has hired or engaged certain key personnel that will enhance the Company's ability to attract prospective customers and will lead to greater operational efficiencies as 2008 progresses. The Company has strengthened its business development capability for 2008 and anticipates continued expansion of its sales capabilities during the year. These investments will assist the frontline business development personnel in accomplishing their task of developing new long-term customer relationships and growing the Company's sales.

## **Liquidity**

The Company's operating activities, before changes in non-cash working capital balances, used approximately \$148,000 in cash in 2007 compared to generating approximately \$2.5 million in 2006. Including changes in non-cash working capital items; cash generated in 2007 was approximately \$700,000 compared to cash generated of \$1.2 million in 2006. The deterioration in cash provided by operating activities, before and after changes in non-cash working capital balances, is due to the significant decrease in the Company's operating results in 2007 compared to 2006.

Cash provided by changes in non-cash working capital balances in 2007 was approximately \$870,000. This compares to cash used to support changes in non-cash working balances of approximately \$1.3 million in 2006. In 2007, decreases in accounts receivable and inventories of approximately \$820,000 and \$690,000 respectively, after giving effect to adjustments due to the adoption of new accounting standards, foreign currency adjustments and the acquisition of PCA during the year, provided a combined \$1.51 million of cash. Similarly, after giving effect to adjustments due to the adoption of new accounting standards, foreign currency adjustments and the acquisition of PCA during the year, an increase in prepaid expenses and deposits of approximately \$120,000 combined with a decrease in accounts payable of approximately \$520,000 resulted in the use of \$640,000 of cash.

In 2007, the Company's financing activities provided approximately \$1.58 million in cash in comparison to using \$450,000 in the same period of 2006. This was primarily the result of increasing the utilization of the bank operating loan by \$1.9 million offset by repayment of principal of the term loan facility in the amount of \$249,000 and recognizing approximately \$80,000 in financing costs. As at December 31, 2007, the bank operating loan balance is \$2.6 million compared to the 2006 year-end 2005 balance of approximately \$700,000.

For 2007, the Company's investing activities utilized approximately \$2.4 million in cash in comparison to approximately \$540,000 in 2006. The increase of \$1.9 million is due to approximately \$1.5 million that was used to fund the acquisition of PCA and approximately \$902,000 used to purchase property, plant and equipment.

At December 31, 2007, the Company had total long-term debt outstanding of approximately \$700,000, of which \$247,000 is shown as current portion of notes payable. This compares to total long-term debt outstanding of approximately \$5.1 million at the 2006 year-end and of which \$250,000 was shown as current portion of long-term debt. The difference is primarily explained

by the classifying of the subordinated debenture and the term loan facility as current liabilities on the consolidated balance sheet at December 31, 2007, as discussed previously.

The total amount of its other long-term liabilities at December 31, 2007 is \$168,000, virtually unchanged from \$166,000 at the 2006 year-end.

As at December 31, 2007, principal repayments contractual obligations including long-term debt, the contractual obligations for restructuring accrual and all Company operating lease future payments were as follows:

(\$ in thousands)	Total	2008	2009	2010	2011	2012	Beyond
<u>Contractual obligations:</u>							
Term loan	458	458	—	—	—	—	—
Subordinated debenture	3,989	3,989	—	—	—	—	—
Notes payable	696	247	225	224	—	—	—
Restructuring accrual	274	88	70	68	48	—	—
Operating leases	4,020	918	878	751	468	456	549
Total	9,437	5,700	1,173	1,043	516	456	549

## Capital Resources

Under the bank credit agreement entered into on September 21, 2006 with its current senior lender, the Company has a revolving credit facility of up to a maximum of \$6.0 million based on certain terms and conditions contained in a credit agreement that is secured by a general security agreement. The credit agreement contains various covenants that the Company must comply with, including financial covenants related to minimum levels of net assets and interest coverage, and maximum levels of capital spending. As at September 30, 2007, the Company did not comply with certain financial covenants contained in the credit agreement. Subsequent to September 30, 2007, the Company and the senior lender signed an amendment to the credit agreement which in effect waived the default conditions with respect to the financial covenants as at September 30, 2007. In addition, the amendment agreement revised the financial covenant calculations included in the original credit agreement on a prospective basis.

As at December 31, 2007, the Company did not comply with the financial covenants in the amended agreement.

On February 25, 2008, the Company announced that it had entered into a letter of intent in respect of a proposed private placement transaction whereby the Company will issue common shares at \$0.10 per share for gross proceeds of \$6 million. The Company has set May 7, 2008 as the date for a Special General Meeting of Adeptron shareholders at which time the shareholders will be asked to approve the proposed transaction. The proceeds of the proposed transaction are intended to repay the principal and accrued interest thereon to its subordinated debenture-holder. The remainder of the proceeds of the proposed transaction is intended to replenish working capital. During the last half of 2007, the Company engaged in various restructuring activities with the expectation that management expects to reduce future operating costs and increase future positive cash flows.

The Company believes that the combination of the proceeds of the proposed equity transaction, repayment of the subordinated debenture and elimination of the associated interest expense, and, the expected expense and cash savings of the restructuring activities, will allow it to continue its banking relationship with its current senior lender. As a result, the Company believes that it will be able to meet its short-term cash flow requirements. However, the outcome of all of the actions and events described above cannot be predicted at this time.

The Company is using this credit facility to finance working capital requirements and for other corporate purposes as required. The availability of credit under this new facility is established based on certain terms and conditions, including the amount of accounts receivable and inventory available to secure the Company's borrowings. As at December 31, 2007, the Company's operating loan balance of approximately \$2.6 million was well within its borrowing limit based on accounts receivable and inventory margining conditions in its agreement with this lender.

The Company believes that it will generate positive cashflow from operations and have sufficient availability under its new senior credit facility to fund working capital requirements over the next 12 months.

As at December 31, 2007, the Company estimates that it could significantly increase its 2007 level of sales of \$38.4 million, based on turnkey sales, without requiring significant investment in capital assets. The Company expects that if sales increases in the future it will lead to more optimal utilization of its automated surface mount lines, sophisticated test platforms and other equipment. The only expected significant capital expenditures in the normal course of business over the next fiscal year would be due to the execution of a supply contract with a customer providing sufficient sales and gross profit margin to cost justify the expenditures.

The Company cannot state with certainty that capital resources in the form of debt, including capital lease debt, or equity, in sufficient amount and on reasonable terms, will be available in the event that funding for capital expenditures should become necessary.

### **Related Party Transactions**

In 2006 the Company entered into a consulting agreement with a newly appointed director of the Company. During 2007 the Company paid consulting fees of \$65,000 to this director and in 2006 did not pay any fees in respect to this consulting agreement. Subsequent to December 31, 2007, that director has resigned from the board.

### **Fourth Quarter**

Sales for the fourth quarter of 2007 were approximately \$9.9 million, a decrease of approximately \$1.0 million, or 9%, from \$10.9 million in the corresponding quarter of the prior year. In comparison to the third quarter of 2007, sales increased by over \$1.7 million. The gross profit for the fourth quarter of 2007, expressed as a percentage of sales, was 14.6% compared to 18.2% in 2006. This decrease is largely due to lower sales in the current quarter providing less contribution margin to cover fixed expenses and the effect of the strengthening Canadian dollar against its US counterpart. Gross profit of 14.6% in the current quarter increased from 10.5% in the third quarter of the current year. This increase is primarily due to higher revenues generating a greater contribution margin to cover fixed expenses.

SG&A expenses in the fourth quarter of 2007 were approximately \$1.2 million, or approximately \$130,000 less than the corresponding quarter of 2006. This decrease reflects some of the benefits of the restructuring begun in the third quarter of 2007 and lower commissions expense

Interest on the subordinated debenture was \$252,000 in the fourth quarter of 2007 compared to \$197,000 in the corresponding quarter of 2006. The difference is primarily due to the \$50,000 forbearance fee charged by the subordinated debt lender beginning with the fourth quarter of 2007.

Interest on the term loan facility was \$6,000 in the fourth quarter of 2007 compared to \$14,000 in the same quarter of 2006.

Interest on notes payable in the fourth quarter of 2007 was \$17,000. The notes payable liability was incurred on May 31, 2007 as part of the consideration paid for the acquisition of PCA.

Interest on the bank operating loan was \$93,000 in the fourth quarter of 2007 compared to \$71,000 in the same quarter of 2006. The increase is due to higher borrowing levels in the current quarter compared to the same quarter in 2006.

EBITDA<sup>(1)</sup> for the fourth quarter of 2007, and excluding the non-cash write-off of goodwill, was approximately \$210,000 compared to approximately \$890,000 in the corresponding quarter of 2006. The fourth quarter loss in 2007 was approximately up \$5.93 million compared to net income of approximately \$307,000 in the fourth quarter of 2006. The write-off of goodwill previously associated with the Canadian reporting unit in the amount of approximately \$5.53 million, and being non-cash, accounted for the majority of this loss

In the fourth quarter of 2007 the Company recorded a restructuring charge of \$201,000. In the fourth quarter 2006 there was no such charge.

### **Outstanding Share Data**

Adeptron has one class of voting securities for which there are securities outstanding: common shares. As at the date hereof, there are 36,707,000 common shares issued and outstanding.

Adeptron also has stock options outstanding that have been granted pursuant to its stock option plan for directors, officers, employees and consultants. As at the date hereof, there are 2,851,000 such stock options outstanding, each exercisable for one common share, with various vesting and expiry dates and exercise prices ranging from \$0.10 to \$0.51. Accordingly, up to 2,851,000 common shares are issuable on exercise of the foregoing stock options.

Adeptron also has a total of 7,351,000 warrants outstanding, as at the date hereof, each entitling the holder to purchase one common share for a specified price. 6,851,000 warrants have an exercise price of \$0.20 and expire on September 20, 2011. 500,000 warrants were issued on November 21, 2006 and have an exercise price of: [i] \$0.30 for the period between the date of issuance and the second anniversary of issuance; [ii] \$0.40 for the period between the second and third anniversaries of issuance; and [iii] \$0.50 for the period between the third anniversary and expiry of the warrants. These warrants expire on November 20, 2010. Accordingly, up to 7,351,000 common shares are issuable on exercise of the foregoing warrants.

## **Disclosure procedures and controls**

The Company has designed disclosure controls and procedures to ensure that information required to be disclosed by the Company is accumulated and communicated to its management as appropriate to allow timely decisions regarding required disclosure. The Corporation's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of December 31, 2007 that the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the Company is made known to them by employees or third party consultants working for the Company. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures will provide a reasonable level of assurance and that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute assurance that the objectives of the control system are met.

## **Internal controls over financial reporting**

Management of the Company is responsible for designing internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with Canadian GAAP.

As a result of the Company's assessment of the design of its internal controls over financial reporting, discussed below, the Company's management has concluded that there is only a remote likelihood that a material misstatement would not be prevented or detected. Management and the board of directors work to mitigate the risk of a material misstatement in financial reporting, however, there can be no assurance that this risk can be reduced to less than a remote likelihood of a material misstatement.

On February 1, 2008 The Company's former Chief Financial Officer resigned from the Company and the Chief Executive Officer was appointed as the Interim Chief Financial Officer. The Chief Executive Officer is a Chartered Accountant. The Company added a Corporate Controller to the ranks of its accounting and finance department in July 2007. The Corporate Controller is working closely with the Chief Executive Officer and compensates greatly for the departure of the former Chief Financial Officer.

The Company has identified control deficiencies within its accounting and financial function and its financial information systems over segregation of duties. Specifically, certain duties are not properly segregated due to the small number of individuals employed in this area. However, management has concluded that considering the employees involved and the control procedures in place, including management and Audit Committee oversight, risks associated with such lack of segregation are not significant enough to justify the expense associated with adding a number of employees to clearly segregate duties. Management is aware that in-house expertise to deal with complex taxation, accounting and reporting issues may not be sufficient. The Company utilizes, and will continue to utilize, outside assistance and advice on new accounting pronouncements and complex accounting and reporting issues, which is common with companies of a similar size. Management is of the opinion that none of these control deficiencies has resulted in a misstatement to the financial statements. However, these deficiencies may be considered a material weakness resulting in a more than remote likelihood that a material misstatement of the Company's annual or interim financial statements would not

be prevented or detected. As the Company grows, management plans to expand the number of individuals involved in the accounting function. At the present time, the Chief Executive Officer and the Corporate Controller oversee all material transactions and related accounting records. In addition, the Audit Committee reviews the financial statements and key risks of the Company and queries management about significant transactions on a quarterly basis.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and expenses during the year. Note 3 to the 2007 audited Financial Statements discloses the significant accounting policies and methods used by Adeptron in the preparation of its financial statements. Estimates and assumptions are assessed regularly by Adeptron in light of historical results, information currently available and perceptions regarding future developments. Actual results may differ materially from these estimates and assumptions. The Company has identified the critical accounting policies affecting its Audited Financial Statements below. These policies are affected by the assumptions, judgements and estimates used by management in the preparation of these statements.

#### *Basis of consolidation*

Adeptron's consolidated financial statements include the assets, liabilities, and operating results of the Company and its wholly owned subsidiaries. All inter-company transactions and balances have been eliminated on consolidation.

#### *Foreign currency translation*

The assets and liabilities of Adeptron's self-sustaining operations, having a functional currency other than Canadian dollars, are translated into Canadian dollars using the exchange rates in effect at the consolidated balance sheet dates. Revenues and expenses are translated at the average rate during the periods. Exchange gains and losses arising from the translation of the Company's net equity investment in these operations are recognized as other comprehensive income and are included as a separate component of shareholders' equity.

#### *Revenue Recognition*

Adeptron's revenue is derived from the sale of electronics based assemblies and sub-assemblies that have been built to customer specifications. Revenue from product sales is recognized upon shipment, when title has passed to the customer, persuasive evidence of an arrangement exists, performance has occurred, specified test criteria have been met and the earnings process is complete. The Company has no further performance obligations other than its standard manufacturing warranty.

#### *Allowance for Doubtful Accounts*

Adeptron records an allowance for doubtful accounts related to accounts receivable considered by management to be impaired. The assessment of the potential or actual impairment of accounts receivable is performed on each individual customer account and reflects the Company's knowledge of the financial condition of the customer, historical payment patterns,

the ageing of the account, and any other information pertinent to the assessment. Material changes in any of the assessment parameters could affect the allowance for doubtful accounts and the provision for bad debts recorded in the statements of operations and deficit.

#### *Inventory Valuation*

Inventories comprise raw materials, work-in-process and finished goods, which are valued at the lower of cost or market value, on a first-in first-out basis. Cost for work-in-process and finished goods includes the cost of materials, principally electronic components, direct labour and an allocation of overheads. Market value for raw materials inventory is replacement cost, and for work-in-process and finished goods is net realizable value. In determining market value, the Company considers factors, such as shrinkage, the ageing and future demand of the inventory, past experience with specific customers and the ability to redistribute inventory to other programs or return inventory to suppliers. A change to these assumptions may affect the valuation of inventory and gross profits.

#### *Income Tax Valuation Allowance*

Adeptron records a valuation allowance against deferred income tax assets until management believes it is more likely than not that the deferred income tax asset will be realized. In light of the Company's history of losses prior to the current year, and the lack of certainty of future profitability, Adeptron has recorded a valuation allowance for the full amount of its deferred income tax assets. A material change to profitability could affect the estimated income tax valuation and related income tax expense.

#### *Goodwill*

Adeptron performs its goodwill impairment test annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Initially, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired. The second step is carried out if the carrying amount of a reporting unit exceeds its fair value. In this case, the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss. The exercise of determining fair values is subject to management's expectations of future results for such items as sales and expenses, cash flows and discount rates.

As at December 31, 2007, management performed its annual goodwill impairment test in accordance with its accounting policies as described in Note 4 to the Financial Statements. Management considered a number of valuation methodologies including discounted future cash flows, recent acquisition and divestiture transactions, recent trading activity and capital market pricing of the Company's shares. Management also considered the a letter of intent in respect of a proposed private placement transaction whereby the Company will issue common shares at \$0.10 per share for gross proceeds of \$6 million. Management determined that there was no impairment to identifiable assets however management determined that the fair value of the Canadian reporting unit was less than the book value of that reporting unit. Management considers that such a deterioration in fair value was due to the strengthening Canadian dollar and a slow down in the economy having a negative impact on the reporting unit's cash flows.

Management engaged third party valuation specialists to assist in determining the fair value of this reporting unit's intangible assets and long-lived tangible assets. As a result, management

has determined that all of the goodwill amounting to \$5,531 relating to the Canadian reporting unit should be written off.

A summary of the changes to goodwill for the years ended December 31, 2007 and 2006 is as follows:

	2007	2006
	\$	\$
Balance, beginning of year	5,531	5,531
Acquisition of PCA [note 4]	1,224	—
Unrealized translation loss	(94)	—
Impairment	(5,531)	—
Balance, end of year	1,130	5,531

The Company has two reporting units at December 31, 2007 and had one reporting unit at December 31, 2006. Future goodwill impairment charges may result from future goodwill impairment tests.

#### *Long-Lived Assets*

The valuation of long-lived assets is based on the Company's expectations regarding the future cash flows to be generated by such assets. These cash flow expectations are affected by the Company's assumptions regarding specific customer and general industry conditions and the revenue streams of future periods correlating to the expected useful lives of such assets. Adepton recorded no long-lived asset impairment in 2007 and 2006. Material changes to these assumptions could affect the estimated useful lives or valuation of such assets resulting in changes to depreciation or the recording of impairment charges.

### **Accounting Developments – Changes in Accounting Policies Including Initial Adoption**

#### *Financial Instruments – Recognition and Measurement*

The Company adopted the Canadian Institute of Chartered Accountants (CICA) Handbook Sections 3855, "Financial Instruments – Recognition and Measurement"; 3861, "Financial Instruments – Disclosure and Presentation"; 3865, "Hedges" and 1531, "Comprehensive Income" on January 1, 2007. These standards reflect that fair value, not historical cost, is the appropriate way for measuring certain financial instruments. The adoption of the new standards resulted in changes in the accounting of financial instruments as well as the recognition of certain adjustments as described below. The comparative financial statements have not been restated.

The principal changes in the accounting for financial instruments and hedges are described below:

### *Comprehensive income (loss)*

Comprehensive income (loss) is comprised of the Company's net income (loss) and other comprehensive income (loss). In 2007 the Company had other comprehensive loss of \$136,000. The Company did not have any items that met the criteria for recognition as comprehensive income (loss) in the prior year.

### *Hedges and derivatives*

The new accounting rules require that hedging derivatives be recorded at fair value on the balance sheet. The Company does not engage in any formal hedging activities with third party providers. As a result, there is no impact of this change in accounting policy on the interim financial statements.

The Company has purchase and sales contracts denominated in a foreign currency, other than the functional currency of one of the substantial parties of the contract. The Company has determined that these contracts contain an embedded derivative. As a result of the change in accounting policy, the embedded foreign currency derivative must be bifurcated from the host purchase or sale contract and recorded on the balance sheet at fair value. As at December 31, 2007, the Company has recorded an asset of \$67,000 related to purchase contracts and a liability of \$183,000 related to sales contracts.

### *Effective interest method*

Prior to January 1, 2007, long-term debt deferred financing costs were recorded on the balance sheet as other assets and were amortized over the life of the debt on a straight-line basis. The new rules require that the effective interest method be used to amortize financing costs whereby the amount recognized as expense varies over the life of the debt based on the balance outstanding. In addition, the financing costs are recorded on the balance sheet as a reduction of the outstanding debt balance.

As at January 1, 2007, financing costs were adjusted to reflect what the balance would have been had the effective interest method been used from the inception date of the debt. In addition, other assets and long-term debt were adjusted to reflect the recording of the financing costs as a reduction of long-term debt rather than as other assets. The impact was a decrease in other assets of \$375,000, a decrease in long-term debt of \$384,000 and a decrease in the deficit of \$9,000.

### **EBITDA Reconciliation**

EBITDA reconciliation to GAAP income/(loss) for the three-month and twelve-month periods ended December 31, 2006 and 2005 are shown below (All numbers expressed in thousands):

	<u>3-Month Period</u> <u>December 31,</u> <u>2007</u>	<u>3-Month Period</u> <u>December 31,</u> <u>2006</u>	<u>12-Month Period</u> <u>December 31,</u> <u>2007</u>	<u>12-Month Period</u> <u>December 31,</u> <u>2006</u>
Net income/(loss) per GAAP	\$(5,927)	\$307	\$(6,856)	\$1,614
Add:				
Interest on term loan	6	14	56	15
Interest on subordinated	252	197	818	235

debt				
Interest on bank operating loan	93	71	294	390
Interest on notes payable	17	0	41	0
Interest on subordinated notes	0	0	0	302
Depreciation and amortization	265	163	867	604
Stock-based compensation	35	137	124	180
Goodwill impairment	5,531	0	5,531	0
Income tax recovery	(61)	0	(95)	0
EBITDA	\$211	\$889	\$780	\$3,340

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Note:

(1) EBITDA represents earnings before interest, tax, depreciation, amortization, goodwill impairment and stock-based compensation. EBITDA is not a recognized measure under Canadian generally accepted accounting principles. However, management believes that EBITDA is a useful supplemental measure to net income (loss), as it provides investors with an indication of cash earnings prior to debt service, capital expenditure, income tax and other non-cash items. Readers should be cautioned, however, that EBITDA should not be construed as an alternative to net income (loss) determined in accordance with generally accepted accounting principles as an indicator of the Company's performance or to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows. The Company's method of calculating EBITDA may differ from the methods by which other companies calculate EBITDA and, accordingly, the EBITDA used herein may not be comparable to measures used by other companies.

Consolidated Financial Statements

**Adeptron Technologies Corporation**  
December 31, 2007

## AUDITORS' REPORT

To the Shareholders of  
**Adeptron Technologies Corporation**

We have audited the consolidated balance sheets of **Adeptron Technologies Corporation** as at December 31, 2007 and 2006 and the consolidated statements of operations, changes in shareholders' equity and cash flows for the years then ended and the consolidated statement of comprehensive loss for the year ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada,  
March 26, 2008.

/s/ Ernst & Young LLP  
Chartered Accountants  
Licensed Public Accountants

## Adeptron Technologies Corporation

### CONSOLIDATED BALANCE SHEETS

[in thousands of dollars]  
[Going Concern - see note 2]

As at December 31

	2007	2006
	\$	\$
<b>ASSETS</b> [notes 10 and 12]		
<b>Current assets</b>		
Cash	114	234
Accounts receivable [note 20]	6,311	6,818
Inventories [note 6]	3,935	4,528
Prepaid expenses and deposits [note 3]	561	279
<b>Total current assets</b>	<b>10,921</b>	<b>11,859</b>
Property, plant and equipment [note 7]	3,207	2,015
Other assets [notes 3 and 8]	562	753
Goodwill [note 9]	1,130	5,531
	<b>15,820</b>	<b>20,158</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Bank operating loan [note 10]	2,612	712
Accounts payable and accrued liabilities [notes 3, 11 and 20]	5,880	6,069
Current portion of notes payable [note 5]	247	—
Current portion of term loan facility [note 10]	459	250
Subordinated debenture [note 12]	3,989	—
<b>Total current liabilities</b>	<b>13,187</b>	<b>7,031</b>
Future income taxes	338	—
Other long-term liabilities [note 11]	168	166
Notes payable [note 5]	449	—
Term loan facility [note 10]	—	458
Subordinated debenture [note 12]	—	4,206
<b>Total liabilities</b>	<b>14,142</b>	<b>11,861</b>
Commitments and contingency [note 16]		
<b>Shareholders' equity</b>		
Share capital [note 15]	35,532	35,315
Contributed surplus [note 15]	1,194	918
Warrants [notes 12 and 15]	793	945
Accumulated other comprehensive loss	(136)	—
Deficit [note 3]	(35,705)	(28,881)
<b>Total shareholders' equity</b>	<b>1,678</b>	<b>8,297</b>
	<b>15,820</b>	<b>20,158</b>

See accompanying notes

On behalf of the Board:

"F. Michael Marti"  
Director

"A.J. Robertson"  
Director

**Adeptron Technologies Corporation**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

[in thousands of dollars, except per share information]

Years ended December 31

	2007	2006
	\$	\$
<b>Sales</b> [notes 20 and 21]	<b>38,406</b>	43,832
Cost of goods sold	<b>32,808</b>	36,099
<b>Gross profit</b>	<b>5,598</b>	7,733
<b>Expenses</b> [note 20]		
Selling, general and administrative [note 15]	<b>4,821</b>	4,999
Interest expense [notes 10, 12, 13 and 14]	<b>1,210</b>	942
Change in fair value of embedded foreign currency derivative [note 3]	<b>139</b>	—
Restructuring [note 11]	<b>651</b>	—
Depreciation and amortization [notes 7 and 8]	<b>197</b>	178
Goodwill impairment [note 9]	<b>5,531</b>	—
	<b>12,549</b>	6,119
Income (loss) before income taxes	<b>(6,951)</b>	1,614
<b>Income tax (expense) recovery</b>		
Current	<b>(66)</b>	—
Future [note 5]	<b>161</b>	—
<b>Net income (loss) for the year</b>	<b>(6,856)</b>	1,614
<b>Income (loss) per share</b>		
Basic	<b>-0.19</b>	0.05
Diluted	<b>-0.19</b>	0.05
<b>Weighted average number of shares outstanding</b> [000's] [note 18]		
Basic	<b>36,334</b>	34,742
Diluted	<b>36,334</b>	35,213

See accompanying notes

**Adeptron Technologies Corporation**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS**

[in thousands of dollars]

Year ended December 31

	<u>2007</u>
	<u>\$</u>
<b>Net loss for the year</b>	<b>(6,856)</b>
<b>Other comprehensive loss</b>	
Change in foreign currency translation loss	
on self-sustaining foreign operations	<u>(136)</u>
<b>Comprehensive loss for the year</b>	<b><u>(6,992)</u></b>

*See accompanying notes*

**Adeptron Technologies Corporation**

**CONSOLIDATED STATEMENTS OF  
CHANGES IN SHAREHOLDERS' EQUITY**

[in thousands of dollars]

	Common shares #	Common shares \$	Contributed surplus \$	Warrants \$	Accumulated other comprehensive loss \$	Deficit \$	Total shareholders' equity \$
	[000's]						
<b>Balance, December 31, 2005</b>	34,613	35,058	787	112	—	(30,495)	5,462
Issuance on private placement [notes 15[b] and [c]]	1,000	188	—	793	—	—	981
Stock-based compensation [note 15[d]]	—	—	131	—	—	—	131
Modification of warrants [note 15[c]]	—	—	—	61	—	—	61
Exercise of warrants [notes 15[b] and [c]]	191	69	—	(21)	—	—	48
Net income for the year	—	—	—	—	—	1,614	1,614
<b>Balance, December 31, 2006</b>	35,804	35,315	918	945	—	(28,881)	8,297
Issuance of shares on acquisition [note 5]	903	217	—	—	—	—	217
Stock-based compensation [note 15[d]]	—	—	124	—	—	—	124
Expiration of warrants [note 15[c]]	—	—	152	(152)	—	—	—
Foreign currency translation loss on self-sustaining foreign operations [notes 4 and 5]	—	—	—	—	(136)	—	(136)
Cumulative impact of adopting new accounting requirements [note 3]	—	—	—	—	—	32	32
Net loss for the year	—	—	—	—	—	(6,856)	(6,856)
<b>Balance, December 31, 2007</b>	36,707	35,532	1,194	793	(136)	(35,705)	1,678

See accompanying notes

**Adeptron Technologies Corporation**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

[in thousands of dollars]

Years ended December 31

	<b>2007</b>	<b>2006</b>
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net income (loss) for the year	<b>(6,856)</b>	1,614
Add (deduct) items not involving cash:		
Depreciation and amortization	<b>867</b>	604
Non-cash interest expense	<b>318</b>	132
Future income tax recovery	<b>(161)</b>	—
Stock-based compensation <i>[note 15]</i>	<b>124</b>	180
Write-off of property, plant and equipment <i>[note 7]</i>	<b>29</b>	—
Goodwill impairment <i>[note 9]</i>	<b>5,531</b>	—
	<b>(148)</b>	2,530
Changes in non-cash working capital balances related to operations:		
Accounts receivable	<b>822</b>	(18)
Inventories	<b>686</b>	(66)
Prepaid expenses and deposits	<b>(118)</b>	144
Accounts payable and accrued liabilities	<b>(523)</b>	(848)
Interest payable on subordinated notes	—	(523)
<b>Cash provided by operating activities</b>	<b>719</b>	1,219
<b>FINANCING ACTIVITIES</b>		
Increase (decrease) in bank operating loan	<b>1,900</b>	(3,716)
Repayment of term loan facility	<b>(249)</b>	(42)
Costs of financing	<b>(78)</b>	(253)
Increase (decrease) in other long-term liabilities	<b>2</b>	(24)
Decrease in restricted cash	—	322
Issuance of subordinated debenture, net of issuance costs	—	4,533
Repayment of subordinated notes	—	(2,250)
Issuance of common shares and warrants, net of issuance costs	—	980
<b>Cash provided by (used in) financing activities</b>	<b>1,575</b>	(450)
<b>INVESTING ACTIVITIES</b>		
Acquisition <i>[note 5]</i>	<b>(1,512)</b>	—
Acquisition of property, plant and equipment	<b>(902)</b>	(536)
<b>Cash used in investing activities</b>	<b>(2,414)</b>	(536)
<b>Net increase (decrease) in cash during the year</b>	<b>(120)</b>	233
Cash, beginning of year	<b>234</b>	1
<b>Cash, end of year</b>	<b>114</b>	234
<b>Supplemental cash flow information</b>		
Interest paid	<b>916</b>	1,253

*See accompanying notes*

## **Adeptron Technologies Corporation**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2007

#### **1. DESCRIPTION OF THE BUSINESS**

Adeptron Technologies Corporation [the "Company"] is a public company traded on the Toronto Stock Exchange under the symbol ATQ and was formed under the Business Corporations Act (Alberta). The Company's principal business activities include providing a full range of electronics manufacturing services to the global electronics market. Substantially all of the Company's identifiable assets and sales are in Canada and the United States.

#### **2. GOING CONCERN**

These consolidated financial statements have been prepared on a going concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future.

The Company has incurred significant cumulative net losses since inception and has negative working capital and an accumulated deficit as at December 31, 2007. Furthermore, as at December 31, 2007 the Company did not comply with certain financial covenants related to the credit agreement with its senior lender and also the subordinated debenture. As a result, the Company's ability to continue as a going concern is uncertain and is dependent upon its ability to generate sufficient future cash flow and obtain sufficient financing to fund its business to the point that it achieves profitable operations.

On February 25, 2008, the Company announced that it has entered into a letter of intent in respect of a proposed private placement transaction whereby the Company will issue common shares at \$0.10 per share for gross proceeds of \$6 million. The Company has set May 7, 2008 as the date for a Special General Meeting of the Company's shareholders at which time the shareholders will be asked to approve the proposed transaction. The proceeds of the proposed transaction are intended to repay the principal and accrued interest thereon to the subordinated debenture-holder. The remainder of the proceeds of the proposed transaction is intended to replenish working capital. During the last half of 2007, the Company engaged in various restructuring activities with the expectation that management expects to reduce future operating costs and increase future positive cash flows.

The Company believes that the combination of the new equity, repayment of the subordinated debenture and elimination of the associated interest expense, and, the expected expense and cash savings of the restructuring activities, will allow it to continue its banking relationship with its current senior lender. As a result, the Company believes that it will be able to meet its short-term cash flow requirements. However, the outcome of all of the actions and events described above cannot be predicted at this time.

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2007

These consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying consolidated financial statements.

#### 3. CHANGES IN ACCOUNTING POLICIES

The Company adopted The Canadian Institute of Chartered Accountants ["CICA"] Handbook Sections 3855, "Financial Instruments – Recognition and Measurement"; 3861, "Financial Instruments – Disclosure and Presentation"; 3865, "Hedges" and 1531, "Comprehensive Income" on January 1, 2007. These standards reflect that fair value, not historical cost, is the appropriate way for measuring certain financial instruments. The adoption of the new standards resulted in changes in the accounting of financial instruments as well as the recognition of certain adjustments as described below.

On January 1, 2007, the Company recorded the following adjustments to the consolidated balance sheets to adopt the new requirements:

	<b>As at January 1, 2007</b>
	\$
Prepaid expenses, deposits and other assets	93
Other assets	(375)
Accounts payable and accrued liabilities	70
Subordinated debenture	(384)
Deficit	32

The principal changes in the accounting for financial instruments and hedges are described below:

#### [a] Comprehensive income

Comprehensive income is comprised of the Company's net income and other comprehensive income. As a result of the acquisition completed by the Company on May 31, 2007 described in note 5 the Company recorded a loss of \$136 on translation of the Company's net equity investment in foreign operations for the year ended December 31, 2007. The unrealized loss is recorded as other comprehensive loss in the consolidated statement of comprehensive loss.

## **Adeptron Technologies Corporation**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2007

#### **[b] Hedges and derivatives**

The new accounting rules require that hedging derivatives be recorded at fair value in the consolidated balance sheets. The Company does not engage in any formal hedging activities with third-party providers. As a result, there is no impact of this change in accounting policy in the consolidated financial statements.

The Company has purchase and sales contracts denominated in a foreign currency, other than the functional currency of one of the substantial parties of the contract. The Company has determined that these contracts contain an embedded derivative. As a result of the change in accounting policy, the embedded foreign currency derivative must be bifurcated from the host purchase or sale contract and recorded in the consolidated balance sheets at fair value. As at December 31, 2007, the Company has recorded an asset of \$67 related to purchase contracts and a liability of \$183 related to sales contracts. For the year ended December 31, 2007, a charge of \$139 was recorded in the consolidated statements of operations related to the change in fair value of the embedded foreign currency derivative.

#### **[c] Effective interest method**

Prior to January 1, 2007, long-term debt deferred financing costs were recorded in the consolidated balance sheets as other assets and were amortized over the term of the debt on a straight-line basis. The new rules require that the effective interest method be used to amortize financing costs whereby the amount recognized as expense varies over the term of the debt based on the balance outstanding. In addition, the financing costs are recorded in the consolidated balance sheets as a reduction of the outstanding debt balance.

As at January 1, 2007, financing costs were adjusted to reflect what the balance would have been had the effective interest method been used from the inception date of the debt. In addition, other assets and long-term debt were adjusted to reflect the recording of the financing costs as a reduction of long-term debt rather than as other assets. The impact was a decrease in other assets of \$375, a decrease in subordinated debenture of \$384 and a decrease in deficit of \$9.

#### **4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

These financial statements have been prepared by management on the historical cost basis in accordance with Canadian generally accepted accounting principles ["GAAP"]. The significant accounting policies are summarized as follows:

## **Adeptron Technologies Corporation**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2007

#### **Basis of consolidation**

These consolidated financial statements include the accounts of Adeptron and its subsidiaries, Adeptron USA, Inc. and Pacific Circuit Assembly, Inc. ["PCA"]. All intercompany balances and transactions has been eliminated on consolidation.

#### **Use of estimates**

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the year. The most significant assumptions made by management in the preparation of the Company's consolidated financial statements include, but are not limited to, the allowance for doubtful accounts, inventory valuation, valuation allowances for income taxes, restructuring accruals, the useful lives and recoverability of property, plant and equipment, fair value of stock-based compensation and the valuation of goodwill. Actual results could differ from those estimates.

#### **Inventories**

Inventories comprise raw materials, work-in-process and finished goods, which are valued at the lower of cost or market value, on a first-in, first-out basis.

Cost for work-in-process and finished goods includes the cost of materials, principally electronic components, direct labour and an allocation of overhead.

Market value for raw materials inventory is replacement cost, and for work-in-process and finished goods is net realizable value. In determining market value, the Company considers factors, such as shrinkage, the aging and future demand of the inventory, past experience with specific customers and the ability to redistribute inventory to other programs or return inventory to suppliers.

## **Adeptron Technologies Corporation**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2007

#### **Property, plant and equipment**

Property, plant and equipment are recorded at cost less accumulated depreciation. Depreciation is calculated using the straight-line method, commencing when the assets become available for productive use, based on the following estimated useful lives:

Manufacturing equipment	5 to 10 years
Computer hardware and software	3 years
Furniture and office equipment	5 years
Vehicles	5 years
Leasehold improvements	Term of lease

The Company reviews the recoverability of property, plant and equipment annually or more frequently, if events or circumstances indicate that the carrying amount may not be recoverable. Recoverability is measured by comparing the carrying amounts of a group of assets to future undiscounted cash flows expected to be generated by that group of assets. When an asset is not recoverable, the impairment loss recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value.

#### **Goodwill**

Goodwill represents the excess of the purchase consideration over the fair value of the net tangible and intangible assets acquired at the date of acquisition.

Goodwill is not amortized and is tested for impairment annually. The impairment test is carried out in two steps.

In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is not required. The fair value of the reporting unit is principally based on management's estimates of future discounted cash flows.

The second step is carried out when the carrying amount of a reporting unit exceeds its fair value, in which case, the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as the value of goodwill is determined in a business combination described in the preceding paragraph, using the fair value of the reporting unit as if it was the purchase consideration. When the carrying amount of a reporting unit's goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess.

## **Adeptron Technologies Corporation**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2007

The Company is also required to evaluate goodwill for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Certain indicators of potential impairment that could impact the Company's reporting unit include, but are not limited to, the following: [a] a significant long-term adverse change in the global electronics business industry that is expected to cause a substantial decline in sales and/or gross margins and [b] a significant technological change that results in a substantially more cost-effective method of production and [c] the continued appreciation of the Canadian dollar relative to the U.S. dollar may result in reduced contributions.

As at December 31, 2007, the Company had two [2006 - one] reporting units.

#### **Other assets**

Other assets consist of up-front lease costs, customer relationships, customized software, and deferred financing costs.

Up-front lease costs represent lump-sum amounts paid on the initiation of operating leases and are amortized on a straight-line basis over the life of the related lease.

Deferred financing costs represent the costs incurred by the Company related to bank financing. The costs are being amortized over the expected term of the bank financing. In the event of early settlement of the bank financing, the unamortized balance of the respective deferred financing costs will be written off.

Customer relationships and customized software are carried at cost less accumulated amortization and are amortized on a straight-line basis over their economic life, which is estimated to be three years. The cost of these assets represents the fair value of these assets acquired as part of a business acquisition. Internal costs incurred on developing customer relationships are expensed as incurred. Management periodically reviews the carrying value of these assets whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, which is determined by comparing the carrying amount to the estimated undiscounted future net cash flows. The Company writes down the costs associated with these assets to their fair value when the value is determined to be impaired.

## **Adeptron Technologies Corporation**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2007

#### **Revenue recognition**

The Company recognizes revenue upon shipment, when title has passed to the customer, persuasive evidence of an arrangement exists, performance has occurred, specified test criteria have been met and the earnings process is complete. Revenue is derived from turnkey and consignment sales. Turnkey revenue involves the sale of electronics-based assemblies and sub-assemblies that have been built to customer specifications. Consignment revenue is generated by providing a manufacturing assembly service to customer-owned parts. The Company has no further performance obligations other than its standard manufacturing warranty.

#### **Income taxes**

The Company follows the liability method of accounting for income taxes. Under this method, the future tax assets or liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, as well as for the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized. Future tax assets and liabilities are measured using the substantively enacted tax rates and laws which are expected to be in effect when the differences are expected to reverse. The Company records a valuation allowance against the future income tax asset until management believes it is more likely than not that the future income tax asset will be realized.

#### **Stock-based compensation plan**

The Company has a stock-based compensation plan that is described in note 15[d].

Stock options are accounted for using the fair value method. The fair value of stock options granted is recognized on a straight-line basis over the applicable stock option vesting period as compensation expense included in selling, general and administrative expenses in the consolidated statements of operations and contributed surplus within shareholders' equity on the consolidated balance sheets. On the exercise of stock options, the total of the consideration received and the accumulated contributed surplus is credited to share capital.

Fair value is calculated using the Black-Scholes option pricing model with the assumptions described in note 15[d].

#### **Income (loss) per share**

Basic income (loss) per share is computed using the weighted average number of shares outstanding during the year. Diluted income (loss) per share is computed in accordance with the treasury stock method. Diluted income (loss) per share reflects the dilution that would occur if outstanding stock options and warrants were exercised or converted into common shares using the treasury stock method.

## **Adeptron Technologies Corporation**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2007

#### **Foreign currency translation**

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars using exchange rates in effect at the year end. Revenue and expenses are translated into Canadian dollars at the rates of exchange in effect on the dates of the transactions. Gains or losses arising from the translation of foreign currencies are included in the consolidated statements of operations.

The assets and liabilities of self sustaining foreign subsidiaries that are denominated in foreign currency are translated into Canadian dollars using exchange rates in effect at the year end. Revenue and expenses are translated into Canadian dollars at the rates of exchange in effect on the dates of the transactions. Gains or losses arising from the translation of self sustaining foreign subsidiaries are included in the shareholders' equity section of the consolidated balance sheet as accumulated other comprehensive income or loss.

#### **5. ACQUISITION**

On May 31, 2007, the Company acquired all of the issued and outstanding shares of PCA, a San Jose based electronics manufacturing service provider. Purchase consideration consisted of \$1,300 in cash paid on closing, \$802 in notes payable and 903,520 common shares of the Company. The notes payable bear interest at 5% per annum and are repayable in equal annual instalments over a three-year period. The notes payable were recorded at fair value using a discount rate of 10% and amounting to \$734 and are being accreted using the effective interest rate method to the principal amount, which is denominated in U.S. dollars. The carrying amount of the notes payable as at December 31, 2007, after adjusting for the accretion of interest, was \$696, of which \$247 is shown as current portion on the consolidated balance sheets. The fair value of share consideration was based on the market price of the Company's common shares over a short period before and after the announcement of the acquisition. The Company incurred \$280 in acquisition costs related to this transaction.

The acquisition of PCA has been accounted for using the purchase method and accordingly, the results of operations have been included in these consolidated financial statements from the date of acquisition. The consideration paid has been allocated to the net assets acquired on their respective fair values and the excess has been recorded as goodwill. The allocation of the purchase price was completed during the fourth quarter of 2007.

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2007

	\$
<b>Net assets acquired:</b>	
Current assets, excluding cash acquired	468
Property, plant and equipment	1,181
Intangible assets	364
Goodwill	1,224
Future income taxes	(538)
Accounts payable and accrued liabilities	(236)
	<u>2,463</u>
Cash acquired	68
<b>Fair value of net assets acquired</b>	<u><b>2,531</b></u>
	\$
<b>Purchase consideration consists of :</b>	
Cash	1,300
Notes payable	734
Common shares	217
Acquisition costs	280
<b>Total purchase consideration</b>	<u><b>2,531</b></u>

## 6. INVENTORIES

Inventories consist of the following:

	2007	2006
	\$	\$
Raw materials	2,765	2,835
Work-in-process	914	1,408
Finished goods	256	285
	<u><b>3,935</b></u>	<u><b>4,528</b></u>

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2007

#### 7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	2007		
	Cost \$	Accumulated depreciation \$	Net book value \$
Manufacturing equipment	12,369	9,953	2,416
Computer hardware and software	681	618	63
Furniture and office equipment	371	289	82
Vehicles	28	28	—
Leasehold improvements	950	304	646
	<b>14,399</b>	<b>11,192</b>	<b>3,207</b>

  

	2006		
	Cost \$	Accumulated depreciation \$	Net book value \$
Manufacturing equipment	11,090	9,355	1,735
Computer hardware and software	644	553	91
Furniture and office equipment	291	271	20
Vehicles	28	23	5
Leasehold improvements	461	297	164
	<b>12,514</b>	<b>10,499</b>	<b>2,015</b>

Depreciation of property, plant and equipment during the year ended December 31, 2007 amounted to \$782 [2006 - \$503], of which \$679 [2006 - \$426] is recorded in cost of goods sold.

During 2007, disposals of property, plant and equipment comprising leasehold improvements associated with the Markham restructuring had a cost of \$113 and accumulated depreciation of \$84. The net book value of \$29 was written off.

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2007

#### 8. OTHER ASSETS

Other assets consist of the following:

	2007	2006
	\$	\$
Up-front lease costs	121	141
Customer relationships <i>[note 5]</i>	247	7
Software <i>[note 5]</i>	24	—
Deferred financing costs <i>[note 10]</i>	170	605
	<u>562</u>	<u>753</u>

Up-front lease costs are net of accumulated amortization of \$78 [2006 – \$59], of which \$20 [2006 - \$20] was recorded as amortization expense in the consolidated statement of operations in 2007.

Customer relationships are net of accumulated amortization of \$295 [2006 – \$236], of which \$59 [2006 - \$81] was recorded as amortization expense in the consolidated statements of operations in 2007.

Software is net of accumulated amortization of \$6 [2006 - nil], all of which was recorded as amortization expense in the consolidated statement of operations in 2007.

Deferred financing costs are net of accumulated amortization of \$111 [2006 - \$43], of which \$88 [2006 - \$43] was recorded as interest expense in the consolidated statements of operations in 2007.

#### 9. GOODWILL

As at December 31, 2007, management performed its annual goodwill impairment test in accordance with its accounting policies *[note 4]*. Management considered a number of valuation methodologies including discounted future cash flows, recent acquisition and divestiture transactions, recent trading activity and capital market pricing of the Company's shares. Management also considered the Company's signed letter of intent in respect of a proposed private placement transaction whereby the Company will issue common shares at \$0.10 per share for gross proceeds of \$6 million. Management determined that there was no impairment to identifiable assets; however, management determined that the fair value of the Canadian reporting unit was less than the book value of that reporting unit. Management considers that such deterioration in fair value was due to the strengthening Canadian dollar and a slow-down in the economy having a negative impact on the reporting unit's cash flows.

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Management engaged third party valuation specialists to assist in determining the fair value of this reporting unit's intangible assets and long-lived tangible assets. As a result, management has determined that all of the goodwill amounting to \$5,531 relating to the Canadian reporting unit should be written off.

A summary of the changes to goodwill for the years ended December 31, 2007 and 2006 is as follows:

	2007	2006
	\$	\$
<b>Balance, beginning of year</b>	<b>5,531</b>	5,531
Acquisition of PCA <i>[note 5]</i>	<b>1,224</b>	—
Unrealized translation loss	<b>(94)</b>	—
Impairment	<b>(5,531)</b>	—
<b>Balance, end of year</b>	<b>1,130</b>	5,531

#### 10. BANK CREDIT AGREEMENT

On September 21, 2006, the Company entered into a three-year credit agreement with a senior lender that provides the Company with an aggregate senior lending facility in the amount of up to \$6,750. The total senior lending facility is comprised of a \$6,000 revolving credit facility and a \$750 term loan facility. The aggregate senior lending facility is collateralized by a first ranking general security agreement covering substantially all of the Company's assets.

The credit agreement contains various covenants that the Company must comply with, including financial covenants related to minimum levels of net assets and interest coverage, and maximum levels of capital spending.

The Company incurred financing costs of \$253 related to the credit agreement and these costs have been recorded on the consolidated balance sheets as deferred financing costs in other assets. These deferred financing costs will be amortized over the three-year term of the agreement and will be included in the consolidated statements of operations as interest expense.

## **Adeptron Technologies Corporation**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

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#### **[a] Revolving credit facility**

Under the revolving credit facility, the Company can borrow by way of Canadian dollar prime rate loans or U.S. dollar base rate loans. In addition, the revolving credit facility allows for the issuance of letters of credit and has a foreign exchange trading component. The maximum availability under the revolving credit facility is based on certain terms and conditions, including, but not limited to, the levels of accounts receivable and inventory, and is established on an ongoing basis. Borrowings under this facility are subject to interest at the bank's prime rate plus 1% for Canadian dollar loans and U.S. base rate plus 0.5% for U.S. dollar loans and is payable monthly.

As at December 31, 2007, the Company's bank operating loan balance of \$2,612 was within its borrowing limit based on the accounts receivable and inventory margining conditions in its agreement with its senior lender. Under the revolving credit facility, the effective interest rate for the year was 7.2%.

#### **[b] Term loan facility**

In addition, the Company borrowed \$750 under its term loan facility with its senior lender. The term loan is repayable over 36 months in equal monthly installments commencing on November 1, 2006. The term loan is subject to interest on the outstanding balance at the bank's prime rate plus 1.5% and interest is payable monthly. The effective interest rate for the year was 7.6%.

The credit agreement contains various covenants that the Company must comply with, including financial covenants related to minimum levels of net assets and interest coverage, and maximum levels of capital spending. As at December 31, 2007, the Company did not comply with the financial covenants and has therefore classified the balance remaining on the term loan facility as a current liability on the 2007 consolidated balance sheet.

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2007

#### 11. BUSINESS RESTRUCTURING

During the year ended December 31, 2001, the Company restructured its operations, resulting in the closing of its manufacturing facilities in Calgary, Alberta. During the year ended December 31, 2007, the Company restructured its operations by consolidating its facilities in Markham, Ontario. The restructuring resulted in staff reductions, consolidation of office and manufacturing space and the sale of non-core assets.

Restructuring accrual activity for the years ended December 31 is as follows:

	2007	2006
	\$	\$
Balance, beginning of year	234	296
New restructuring	651	—
Restructuring payments	(283)	—
Lease payments, net of sublease income	(112)	(62)
Balance, end of year	490	234
Less current portion	(322)	(68)
	<u>168</u>	<u>166</u>

The remaining obligations consist of two facility leases that will be paid out over the remaining lease period, net of sublease income, which extends through 2011.

During the year, the restructuring expense was \$651. Of this amount, \$490 remains as an obligation consisting of [i] an estimated \$274 relating to facility leases that will be paid out over the remaining lease period which extends to 2011, and [ii] \$216 relating to severance and moving costs. The long-term portion of the restructuring obligation is \$168 and is recorded in other long-term liabilities, and the current portion is recorded in accounts payable and accrued liabilities.

#### 12. SUBORDINATED DEBENTURE

On September 21, 2006, the Company completed a private placement financing consisting of a subordinated debenture and common share purchase warrants in the amount of \$5,000. As part of the private placement, the Company issued 6,851,000 common share purchase warrants, each of which entitles the holder thereof to purchase one common share of the Company for \$0.20 per common share for a period of five years. The subordinated debenture has a principal amount of \$5,000, a term of 66 months and carries interest at 12% per annum, payable monthly. In addition, beginning on November 1, 2008, the Company will make principal repayments of \$35 per month for 42 months with the remaining outstanding principal due at the end of the 66-month term. The subordinated debenture is collateralized by a second ranking general security agreement covering substantially all of the Company's assets.

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2007

The Company has allocated the \$5,000 gross proceeds received from the private placement to debt and equity based on the relative fair values of the common share purchase warrants and the subordinated debenture. The fair value of the common share purchase warrants was determined to be \$822 using an option-pricing model. The fair value allocated to the subordinated debenture was based on an effective interest rate of 17% and was determined to be \$4,178. In addition, the Company incurred financing costs of \$473 related to the private placement and these costs have been allocated on a pro-rata basis to debt and equity, amounting to \$395 and \$78, respectively. The amount related to the issuance of the subordinated debenture has been recorded in the consolidated balance sheets as a reduction to the carrying value of the subordinated debenture. These financing costs will be amortized using the effective interest rate method over the 66-month term of the subordinated debenture and will be included in the consolidated statements of operations as interest on long-term debt. The amount allocated to equity is included as a reduction in the warrant value within shareholders' equity. Interest expense on the subordinated debenture, including amortization of the financing costs, will be charged to income at the effective rate of 20%.

The carrying value for the debenture is as follows:

	2007	2006
	\$	\$
Principal of debenture	5,000	5,000
Amount allocated to warrants	(822)	(822)
Amount allocated to debenture	4,178	4,178
Financing costs	(395)	—
	3,783	4,178
Accreted interest	206	28
	<u>3,989</u>	<u>4,206</u>

The subordinated debenture agreement contains various covenants that the Company must comply with including financial covenants related to the ratio of current assets to current liabilities, debt coverage, interest coverage and debt to equity. During November 2007, the Company entered into a forbearance agreement with its subordinated lender in which the lender has agreed to waive its right to enforce the security it holds in the assets of the Company. The agreement will remain in effect until the earlier of September 30, 2008 or the occurrence of a further event of default, as defined in the original debenture agreement or in the forbearance agreement. In particular, the forbearance agreement contains additional financial targets that must be met over the term of the agreement.

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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In consideration for the forbearance agreement, the Company will pay to the lender a finance fee of \$50 per quarter that the forbearance agreement is in effect. As at December 31, 2007, this fee has been added to the outstanding principal balance of the debenture. As at December 31, 2007, 6,851,000 common share purchase warrants related to the private placement financing remain outstanding.

As at December 31, 2007, the Company did not comply with the additional financial targets under the forbearance agreement. As a result, the Company was in a default position and has classified the subordinated debenture as a current liability on the 2007 consolidated balance sheet.

#### 13. SUBORDINATED NOTES

During 2004, the Company issued subordinated notes with a principal amount of \$2,250. These notes were subordinated to the bank operating loan and accrued interest at a rate of 12% per annum. In September 2006, the Company paid \$3,014 to the note holders which represented full payment of the original principal and all interest accrued and unpaid up to September 29, 2006. As a result of this payment, the Company has no further debt obligation related to these subordinated notes.

#### 14. INTEREST EXPENSE

Interest expense is comprised of the following:

	2007	2006
	\$	\$
Subordinated debenture <i>[note 12]</i>	819	235
Term loan facility <i>[note 10]</i>	56	15
Notes payable <i>[note 5]</i>	41	—
Bank operating loan <i>[note 10]</i>	294	390
Subordinated notes <i>[note 13]</i>	—	302
	<b>1,210</b>	<b>942</b>

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2007

#### 15. SHARE CAPITAL

##### [a] Authorized

Unlimited non-voting preferred shares

Unlimited voting common shares without nominal or par value

##### [b] Common shares issued

On November 21, 2006, the Company completed a private placement with a newly appointed director of the Company. Simultaneously, the Company entered into a consulting arrangement with this director. The private placement was for aggregate gross proceeds of \$200 on the issuance of 1,000,000 units and share issue costs related to the private placement were \$12. Each unit includes one common share and one-half common share purchase warrant [see 15[c]].

The fair value of the units exceeded the gross proceeds by approximately \$49. This amount has been recorded as stock-based compensation in the consolidated statements of operations.

##### [c] Warrants

	Warrants	Amount
	#	\$
	[000's]	
<b>Balance, December 31, 2005</b>	2,097	112
Expired unexercised [i]	(557)	—
Modification of warrants [i]	—	61
Exercise of common share purchase warrants [i]	(191)	(21)
Issued on private placement, net of issuance costs [ii]	6,851	744
Issued on private placement, net of issuance costs [iii]	500	49
<b>Balance, December 31, 2006</b>	<u>8,700</u>	<u>945</u>
Expired unexercised [i]	<u>(1,349)</u>	<u>(152)</u>
<b>Balance, December 31, 2007</b>	<u>7,351</u>	<u>793</u>

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

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[i] Warrants outstanding at December 31, 2005 include 1,540,000 common purchase share warrants issued in relation to the subordinated notes [note 13] where each warrant was originally exercisable for one common share at a price of \$0.35 for a period of 24 months. During 2006, the Company modified the warrants whereby each warrant is exercisable for one common share at a price of \$0.25 and the warrants expired on August 31, 2007. During 2006, 191,000 warrants were exercised for cash proceeds of \$48. As at December 31, 2007, there are no [2006 - 1,349,000] warrants related to the issuance of the subordinated notes outstanding.

In addition, the Company's agent for the subordinated notes was issued common share purchase warrants entitling the agent to acquire up to a maximum of 557,000 common shares at a price of \$0.35 per share for a 24-month period. During 2006, these warrants expired unexercised.

[ii] As part of the private placement described in note 12, the Company issued 6,851,000 common share purchase warrants, each of which entitles the holder thereof to purchase one common share of the Company for \$0.20 per common share for a period of five years. The fair value of the common share purchase warrants was determined to be \$822 using an option-pricing model. The Company incurred financing costs related to the private placement and the pro-rata amount of these costs allocated to equity amounts to \$78.

[iii] As part of the private placement described in note 15[b], the Company issued 500,000 common share purchase warrants, each of which is exercisable into one common share for a period of 48 months at an exercise price of: [i] \$0.30 for the period between the date of issuance and the second anniversary of issuance; [ii] \$0.40 for the period between the second and third anniversaries of issuance; and [iii] \$0.50 for the period between the third anniversary and expiry of the warrants. The fair value of the common share purchase warrants was determined to be \$49 using an option-pricing model.

#### [d] Stock options

The Company has established a stock option plan for its directors, officers, employees and consultants, whereby options to a maximum of 4,800,000 common shares may be granted subject to certain terms and conditions. Stock options vest over a period of up to three years and expire at various dates through 2011.

**Adeptron Technologies Corporation**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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December 31, 2007

Changes in the number of options, with their weighted average exercise prices, are summarized below:

	2007		2006	
	Number of options [000's]	Weighted average exercise price \$	Number of options [000's]	Weighted average exercise price \$
<b>Outstanding, beginning of year</b>	3,240	0.34	2,434	0.43
Granted	890	0.18	1,270	0.28
Forfeited/expired	(1,279)	0.40	(464)	0.61
<b>Outstanding, end of year</b>	<b>2,851</b>	<b>0.27</b>	<b>3,240</b>	<b>0.34</b>
<b>Options exercisable, end of year</b>	<b>2,071</b>	<b>0.29</b>	<b>2,537</b>	<b>0.37</b>

The following table summarizes information about the stock options at December 31, 2007:

Range of exercise price \$	Options outstanding			Options exercisable		
	Number of options [000's]	Weighted average remaining contractual life [years]	Weighted average exercise price \$	Number of options [000's]	Weighted average exercise price \$	
0.00 - 0.19	690	4.2	0.13	465	0.14	
0.20 - 0.29	810	3.8	0.22	452	0.22	
0.30 - 0.39	890	3.9	0.32	693	0.32	
0.40 - 0.49	286	1.3	0.42	286	0.42	
0.50 - 0.59	175	1.3	0.51	175	0.51	
	<b>2,851</b>	<b>3.5</b>	<b>0.27</b>	<b>2,071</b>	<b>0.29</b>	

## Adeptron Technologies Corporation

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The estimated fair value of the options is amortized to expense over the options' vesting period on a straight-line basis, and was determined using the Black-Scholes option pricing model with the following assumptions:

	<u>2007</u>	<u>2006</u>
Risk-free interest rate	3.82%	3.9%
Volatility factor of the future expected market price of common shares	73%	82%
Weighted average expected life of the options	<u>3 years</u>	<u>3 years</u>

During the year, the Company recorded \$124 [2006 - \$131] of stock-based compensation expense. These amounts are included in selling, general and administrative expenses and contributed surplus. For options granted in 2007, the weighted average estimated fair value at the date of the grant was \$0.09 [2006 - \$0.15] per option.

#### 16. COMMITMENTS AND CONTINGENCY

As a result of the acquisition of PCA, the Company has a 26-month lease related to a manufacturing facility. The monthly lease payments are approximately \$15 per month, resulting in a remaining commitment of approximately \$292 at December 31, 2007.

In December 2006, the Company received an order from the Pay Equity Commission of Ontario [the "Commission"] requiring it to develop and implement a pay equity plan for its operations in Ontario. In addition, the order requires the Company to pay any retroactive pay equity adjustments, in accordance with Ontario pay equity legislation, that may be warranted as a result of the plan's implementation. The Company began a process that it believed would allow it to achieve compliance with the order before the end of 2007. However, during the third quarter of 2007, the Company determined that the process could not be completed by the end of 2007 and requested an extension to June 30, 2008. As a result of the request for an extension, the Commission filed an application with the Pay Equity Hearings Tribunal requesting that the tribunal issue an order that the Company comply with the original order issued by the Commission in December 2006. The Company is in the process of responding to the Pay Equity Hearings Tribunal. In the interim, the Company is continuing its internal process that will allow it to comply with the original order by June 30, 2008 or earlier. At this time, the Company is unable to determine the likelihood and amount, if any, of any potential retroactive pay equity adjustments.

## Adeptron Technologies Corporation

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Future minimum annual operating lease payments for office space and equipment are as follows:

	\$
2008	918
2009	878
2010	751
2011	468
2012	456
Thereafter	549
	<u>4,020</u>

Excluded from the amounts noted above is \$1,440 [2006 - \$1,335], representing certain lease costs for the years 2008 to 2011. Offsetting these commitments is \$1,171 [2006 - \$1,101] of sublease income that has been committed to the Company from sub-tenants. These amounts were recorded as part of the 2001 and 2007 restructuring charges and are included in restructuring accruals [note 11].

#### 17. INCOME TAXES

The income tax expense (recovery) differs from the amount obtained by applying the combined federal and provincial income tax rate to income (loss) before income taxes. The difference relates to the following items:

	2007 \$	2006 \$
Combined statutory income tax rate	<u>34.0%</u>	34.0%
Expected income tax expense (recovery)	(2,398)	548
Decrease in income tax expense (recovery) resulting from		
Benefit of tax losses not recognized (utilized)	353	(966)
Change in future tax rates	—	383
Permanent differences	1,922	63
Foreign tax rate differential	(15)	—
Other	43	(28)
<b>Future tax (recovery)</b>	<u>(95)</u>	—

**Adeptron Technologies Corporation**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2007

The components of the Company's net future tax assets at December 31, none of which has been recorded in these consolidated financial statements, are as follows:

	<b>2007</b>	<b>2006</b>
	\$	\$
<b>Future tax assets</b>		
Non-capital losses	<b>4,613</b>	5,009
Share issue costs	<b>46</b>	22
Intangible assets	<b>(109)</b>	—
Non-deductible reserves	<b>559</b>	474
Property, plant and equipment	<b>1,552</b>	1,725
	<b>6,661</b>	7,230
Valuation allowance	<b>(6,999)</b>	(7,230)
<b>Future tax liability</b>	<b>(338)</b>	—

The non-capital loss carryforwards expire as follows:

	\$
2008	10,814
2009	2,369
2014	695
2015	1,473
2027	555
	<b>15,906</b>

## Adeptron Technologies Corporation

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December 31, 2007

#### 18. INCOME (LOSS) PER SHARE

The dilutive effect of stock options and warrants on the weighted average number of shares outstanding in 2007 is as follows:

	2007	2006
	#	#
	[000's]	[000's]
Basic weighted average number of shares outstanding	36,334	34,742
Dilutive effect of stock options	—	80
Dilutive effect of warrants	—	391
<b>Diluted weighted average number of shares outstanding</b>	<b>36,334</b>	<b>35,213</b>

In 2007, all stock options and warrants were excluded from the calculation of diluted loss per share, as the effect of including them would have been anti-dilutive.

#### 19. RELATED PARTY TRANSACTIONS

During the year, the Company entered into a consulting agreement and completed a private placement [note 15[b]] with a newly appointed director of the Company. During the year, the Company paid \$65 [2006 - nil] in fees regarding this consulting agreement.

#### 20. FINANCIAL INSTRUMENTS

##### [a] Fair values

The carrying values of cash, accounts receivable, bank operating loan and accounts payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of these financial instruments.

The carrying value of long-term debt, comprised of the subordinated debenture, term loan and notes payable, approximates its fair value due to the fact that there have been minimal changes in prevailing interest rates and the long-term risk profile of the Company has not significantly changed.

##### [b] Credit risk

At December 31, 2007, the Company's two largest customer accounts receivable balances represented 22% [2006 - 46%] of the total accounts receivable balance.

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### [c] Foreign currency risk

The Company's activities that result in exposure to fluctuations in foreign currency exchange rates consist of the sale of products to customers invoiced in foreign currencies and the purchase of services, raw materials and property and equipment from suppliers invoiced in foreign currencies. The Company does not use derivative instruments to hedge its currency risk. Of the Company's accounts receivable and accounts payable at December 31, 2007, 65% [2006 - 67%] and 51% [2006 - 57%], respectively, are denominated in foreign currencies. During the year, approximately 69% [2006 - 66%] of sales and approximately 33% [2006 - 45%] of expenses were incurred in U.S. dollars.

#### 21. SEGMENTED INFORMATION

The Company operates in one business segment, which is the supply of electronics manufacturing services. The Company markets its services primarily in Canada and the United States.

Sales attributable to geographic location based on the location of the customer are as follows:

	2007 \$	2006 \$
Canada	25,085	35,024
United States	13,321	8,808
	<u>38,406</u>	<u>43,832</u>

For the year ended December 31, 2007, sales to the Company's two largest customers represent 29% [2006 - 47%] of the Company's total sales. The two customers represent 18% [2006 - 31%] and 11% [2006 - 16%] of total sales, respectively.

All of the Company's identifiable assets as at December 31, 2007 and 2006 are located in Canada and the United States as detailed below.

Current assets are located as follows:

	2007 \$	2006 \$
Canada	9,625	11,859
United States	1,296	—
	<u>10,921</u>	<u>11,859</u>

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Property, plant and equipment and other assets are located as follows:

	2007 \$	2006 \$
Canada	2,511	2,768
United States	1,258	—
	<u>3,769</u>	<u>2,768</u>

Goodwill is located as follows:

	2007 \$	2006 \$
Canada	—	5,531
United States	1,130	—
	<u>1,130</u>	<u>5,531</u>

## 22. NEW CANADIAN ACCOUNTING STANDARDS

The CICA has issued new accounting standards, Section 1400, "General Standards of Financial Statement Presentation"; Section 1535, "Capital Disclosures"; Section 3031, "Inventories"; Section 3862, "Financial Instruments – Disclosures"; and Section 3863, "Financial Instruments – Presentation", which are applicable to the Company's 2008 fiscal year.

[i] Section 1400, General Standards of Financial Statement Presentation

Section 1400, "General Standards of Financial Statement Presentation", was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The new requirements are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company will adopt the amendments to Section 1400 on January 1, 2008 and is currently evaluating the effects of adopting the new requirements of this standard.

[ii] Section 1535, Capital Disclosures

This new standard requires disclosure of the Company's objectives, policies and processes for managing capital; quantitative data about what the Company regards as capital; whether the Company has complied with any capital requirements; and, if the Company has not complied, the consequences of such non-compliance. The new accounting standard covers disclosure only and will have no effect on the financial results of the Company.

## Adeptron Technologies Corporation

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

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#### [iii] Section 3031, Inventories

The new standard provides more guidance on the measurement and disclosure requirements for inventories than the previous standard, Section 3030, "Inventories". Specifically, the new standard requires that inventories be measured at the lower of cost and net realizable value, and provides more guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. The Company is assessing the effect of the new standard and does not anticipate a material effect on its results.

#### [iv] Section 3862, Financial Instruments – Disclosures Section 3863, Financial Instruments – Presentation

These new standards replace Section 3861, "Financial Instruments - Disclosure and Presentation". Presentation requirements have not changed. Enhanced disclosure is required to assist users of the financial statements in evaluating the significance of financial instruments on the Company's financial position and performance, including qualitative and quantitative information about the Company's exposure to risks arising from financial instruments. The new accounting standards cover disclosure only and will have no effect on the financial results of the Company.

#### [v] Convergence with International Financial Reporting Standards

In 2006, Canada's Accounting Standards Board ratified a strategic plan that will result in Canadian generally accepted accounting principles ["GAAP"], as used by public companies, being evolved and converged with International Financial Reporting Standards ["IFRS"] over a transitional period to be complete by 2011. The Company will be required to report using the converged standards effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Canadian GAAP will be converged with IFRS through a combination of two methods: as current joint-convergence projects of the United States' Financial Accounting Standards Board and the International Accounting Standards Board are agreed upon, they will be adopted by Canada's Accounting Standards Board and may be introduced in Canada before the complete changeover to IFRS; and standards not subject to a joint-convergence project will be exposed in an omnibus manner for introduction at the time of the complete changeover to IFRS. As the International Accounting Standards Board currently, and expectedly, has projects underway that should result in new pronouncements that continue to evolve IFRS, and as this Canadian convergence initiative is in an early stage as of the date of these consolidated financial statements, it is premature to currently assess the impact of the Canadian initiative on the Company.

**Adeptron Technologies Corporation**

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**23. SUBSEQUENT EVENT**

On February 25, 2008, the Company announced that it has entered into a letter of intent in respect of a proposed private placement transaction whereby the Company will issue common shares at \$0.10 per share for gross proceeds of \$6 million. The Company has set May 7, 2008 as the date for a Special General Meeting of the Company's shareholders at which time the shareholders will be asked to approve the proposed transaction.

**24. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS**

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2007 consolidated financial statements.

