

# **CRS Electronics Inc.**

## **Management Discussion and Analysis**

**Second Quarter Report  
Ended June 30, 2011**

August 24, 2011

The following is Management's Discussion and Analysis ("MD&A") of the financial condition of CRS Electronics Inc. (the "Company" or "CRS") and the financial performance for the three and six month period ended June 30, 2011. This quarterly report, prepared as of August 24, 2011, represents our second interim reporting under IFRS and should be should be read in conjunction with the unaudited condensed interim financial statements of CRS for the three and six months ended June 30, 2011 and the unaudited condensed interim financial statements for the three months ended March 31, 2011 prepared in accordance with IAS 34, *Interim financial reporting*, and IFRS 1, *First-time adoption of IFRS*, as issued by the IASB as well as the audited financial statements for the year ended December 31, 2010 and the related management's discussion and analysis (the "Annual MD&A") contained in the 2010 Annual Report prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP), which differ in certain respects from IFRS.

The comparative figures presented in the condensed interim financial statements as at December 31, 2010 and for the three and six month period ended June 30, 2010 have been restated to comply with IFRS. Figures referenced in this MD&A from periods prior to and including December 31, 2009 are in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). For details on the most significant adjustments to the statements of equity, income, and comprehensive income, see note 18 – Impact of adopting IFRS, to the condensed interim financial statements for the periods ending June 30, 2011 and March 31, 2011, as well as CRS's filings with Canadian securities regulatory authorities that are available at [www.sedar.com](http://www.sedar.com).

All amounts are in United States (U.S.) dollars unless otherwise noted (tabular amounts are in thousands of U.S. dollars) and prepared in accordance with IAS 34, *Interim financial reporting*, and IFRS 1, *First-time adoption of IFRS*, as issued by the IASB.

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

## **Forward-Looking Information**

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

similar import, are intended to identify any forward-looking statements. The forward-looking statements made in this MD&A describe our expectations as at August 24, 2011.

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

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

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

## **Overview**

For over 12 years, CRS has been a developer and manufacturer of light emitting diode ("LED") light products. As a manufacturer of LED light boards for its own school bus warning lights and under contract for other light applications, CRS realized that the improvement in LEDs created an opportunity for CRS to supply LED based indoor and outdoor lighting. Throughout 2007 to 2010 inclusive, CRS expended a significant amount of time and capital to develop an LED streetlight engine, the LED MR16 halogen bulb replacement and an LED PAR series of interior lights for the commercial market sector.

CRS is currently focused on the expansion of its LED MR16 and LED PAR lights to the North American interior light replacement market at a retail level. LED lighting products save energy, have attractive economic benefits and are eco-friendly. CRS' LED MR16 was tested by the Department of Energy in the United States ("DOE") under the Commercially Available LED Product Evaluation and Reporting ("CALiPER") Program and received the highest ranking in several of the features tested. Market penetration by LED lights in both the indoor and outdoor general lighting market is less than 1%. Over the next few years, management believes that LED lighting products will gain market share. CRS

continues to supply LED bus lights and LED light circuit boards for use in a variety of products such as LED road signs, accent lighting, tower warning lights, and vehicle warning lights to name a few.

In addition to measures based on International Financial Reporting Standards ("IFRS") in this MD&A, we use the term earnings before interest, taxes, depreciation and amortization ("EBITDA"). EBITDA is not in accordance with IFRS. This non-GAAP measure is derived from the financial statements but does not have a standardized meaning prescribed by IFRS; therefore, others using this term may calculate it differently.

## **Highlights for the Quarter**

CRS continues to execute on its strategic and operational initiatives:

*On April 28, 2011 the Company closed a brokered private placement equity financing issuing 9,379,156 units at a price of CAD \$0.55 per unit for gross proceeds of CAD \$5,158,535. Proceeds will be used to support the Company's ramp up for the Energizer product line.*

*The new "50W Equivalent" MR16 was launched at Lightfair in May and was an instant success. Inquiries from major commercial customers were received and a number of pilot runs were scheduled for Q3 of 2011.*

## **Business Objectives and Milestones**

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

### **FISCAL 2011**

#### ***Sales Objectives***

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

CRS' first sales objective is to launch its retail strategy under the Energizer Licensing agreement. This objective incorporates a) the creation of 2-3 select partnerships with top brand retail stores for distribution of the lamps, b) the successful launch a North American marketing campaign in Q3 of 2011, followed by c) a product roll out into select top brand retail chain stores. The target sales volume during the 2011 roll out is \$2 million with significantly higher sales anticipated in 2012 (the first full year of product roll out).

During the second quarter CRS has continued discussions with key partners in North America and commenced supply negotiations. These negotiations will continue as retailers firm up their stocking requirements in the coming months. In May, CRS locked up an agreement with a major North American mass merchant to carry the full Energizer line of LED lamps in all of their stores commencing January 2012. This launch will be supported with a full DRTV program and in-store merchandizing displays. Meetings with two more major mass merchants are being set up for August and September 2011.

## **2. Commercial LED Sales**

CRS's second sales objective is to achieve \$ 3 million in sales through its existing sales and distribution channels. The sales target includes a mix of the existing high output LED MR16, the new lower cost LED MR16, and the PAR series of lamps (20, 30 and 38).

Sales for the six months ending June 30, 2011 are \$299,100 representing 10.0% of the annual target. The product mix during this quarter represents MR 16 lamps only. Sales are expected to ramp during the second half of the year with many additional product offerings, more competitive pricing, and improved performance.

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

CRS continues to commit itself to its partners in these sectors and to developing new LED applications. While these market sectors have been through difficult economic times and continue to be constrained by budget cut-backs, CRS is targeting sales of \$1.6 million in the current year.

Sales for the six months ending June 30, 2011 are \$855,600 representing 53.5% of the annual target. Bus light business contributes \$601,200 or 37.6% of the annual target, and contract manufacturing provides revenues of \$254,400 or 15.9%.

### ***Product Development Objectives and Milestones***

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

CRS expects continued demand for a lower cost offering for customers who do not feel that they require the high colour accuracy and rendering index provided by CRS's premier MR16 model. The first major objective in the area of product development is to finalize development on the low cost LED MR16, GU10, PAR16, PAR20, PAR30, and PAR38 models while maintaining CRS's high standard of lighting quality. The target completion date is in the third quarter of 2011 for most of these models.

Development work on these and future models are running concurrently and are on track at the end of the second quarter. After further market research, it was determined that the PAR 16 had limited appeal but

the A19 lamp and the candelabra lamp should be added to the product line. A combination of outsourcing review and internal product development review is being engaged.

## **2. Expand versatility of LED interior lamp**

While researching its entry into the retail sector CRS's marketing group encountered strong consumer confidence with the Energy Star certification for selection of sound, energy efficient products. Additionally the market encompasses a much larger array of fixtures with product colour requirements outside of the standard black ICE brand LED product. The second major objective is to achieve Energy Star approval for the full CRS product line and to broaden the LED MR16, GU10, and PAR lamp series appeal. The objective is to be met by the fourth quarter of 2011.

Results from our investigation into colour requirements in the marketplace have been received and our team is evaluating manufacturing alternatives. Timelines for Energy Star approval have been set with milestones focused within the fourth quarter of 2011. Energy Star approval requires more than four months of testing, meaning models will be submitted for testing during the third quarter.

### ***Production Objectives and Milestones***

#### **1. Expand production capacity**

CRS expects that the Energizer brand products will surpass the existing capacity of \$12,000,000 to \$15,000,000 as we enter 2012. Accordingly, a second assembly line and enhanced SMT equipment is planned to double this capacity by the 4<sup>th</sup> quarter of 2011.

Equipment needs have been itemized and the layout for the second assembly line has been completed. Equipment has been sourced, quoted, and lead times have been established to ensure a timely launch.

#### **2. Automate packaging process**

The second major objective in the area of manufacturing is the automation of product packing to enable an in-line process that packs and skids finished goods at the point of assembly completion.

Product packaging alternatives have been investigated to ensure the best balance between efficient assembly and CRS's commitment to ecological friendly packaging. The packaging design was completed in July embracing environmentally friendly materials. The supplier is being selected in August. Automation alternatives are currently being reviewed for high speed manufacturing.

## **Outlook**

CRS continues to see significant opportunities for increased sales growth. The most dramatic change in year over year revenues is expected to occur with the introduction of the Company's new line of LED replacement lamps under both Energizer and ICE brands.

Incentive plans offered by governments and utilities in both Canada and the United States align LED pricing closer to traditional bulbs, overcoming a major resistance to purchase. CRS' ICE LED lights offer compelling energy savings, lower operating costs, and help commercial users meet reduced environmental impact targets.

CRS anticipates its retail suite of superior LED lighting products, marketed under the Energizer brand name, will drive sales as consumers embrace the long life and eco-friendly nature of LED lighting.

## **Performance of CRS**

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

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

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

The Company is aiming to achieve gross profit percentages (defined as revenues less cost of sales and plant expenses as a percentage of revenues) of approximately 25.0% on an annual basis. Maintaining a consistent contribution margin will be an indicator of how well the Company is managing its production costs and customer contract negotiations.

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

**Measurement**

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

**Quarterly Results**

Unaudited

|  | Fiscal 2011 |           | Fiscal 2010            |           |           |           | Fiscal 2009            |           |
|--|-------------|-----------|------------------------|-----------|-----------|-----------|------------------------|-----------|
|  | Q2          | Q1        | Q4                     | Q3        | Q2        | Q1        | Q4                     | Q3        |
|  | IFRS        |           | Previous Canadian GAAP |           |           |           | Previous Canadian GAAP |           |
| <i>In Thousands of dollars</i>                         | USD         | USD       | CAD                    | CAD       | CAD       | CAD       | CAD                    | CAD       |
| Sales  | \$614.9     | \$540.7   | \$905.9                | \$704.4   | \$881.3   | \$653.8   | \$572.1                | \$878.7   |
| Gross profit   | (\$18)      | \$19.5    | \$118.7                | \$190.5   | \$228.3   | \$134.2   | \$101.4                | \$227.5   |
| <i>Gross profit %</i>                                  | (2.9)%      | 3.6%      | 13.1%                  | 27.0%     | 25.9%     | 20.5%     | 17.7%                  | 25.9%     |
| Select expenses  |             |           |                        |           |           |           |                        |           |
| Selling and marketing                                  | 264.7       | 108.7     | 93.9                   | 97.8      | 208.5     | 114.0     | 136.7                  | 191.2     |
| General and administrative                             | 479.7       | 407.9     | 443.1                  | 306.1     | 419.4     | 252.6     | 275.2                  | 263.6     |
| Engineering and research                               | 85.7        | 80.2      | 55.1                   | (13.6)    | 13.2      | 1.4       | 28.3                   | 4.8       |
| Foreign exchange (gain) loss                           | 2.6         | 4.0       | 17.3                   | 14.5      | (2.7)     | (1.1)     | 0.9                    | 9.4       |
| Total expenses   | 832.8       | 600.8     | 609.4                  | 404.8     | 638.4     | 366.9     | 441.1                  | 469.0     |
| Income (loss) from operations                          | (850.8)     | (581.3)   | (490.7)                | (214.3)   | (410.1)   | (232.7)   | (339.7)                | (241.5)   |
| Add back: Depreciation and amortization                | 74.5        | 73.9      | 110.3                  | 58.3      | 41.5      | 28.9      | 25.5                   | 30.6      |
| EBITDA   | (776.3)     | (507.4)   | (380.4)                | (156.0)   | (368.6)   | (203.8)   | (314.2)                | (210.9)   |
| Finance costs  | (10.8)      | (16.6)    | (10.2)                 | (16.9)    | (7.7)     | (7.8)     | (11.5)                 | (14.9)    |
| Refundable tax credit income (expense)                 | 12.4        | 28.3      | (7.2)                  | 4.3       | 13.8      | 3.8       | (6.5)                  | (4.0)     |
| Depreciation of capital equipment                      | (54.6)      | (52.7)    | (61.9)                 | (55.2)    | (40.3)    | (27.9)    | (16.9)                 | (26.9)    |
| Amortization of product development costs              | (28.7)      | (28.9)    | (65.7)                 | (11.0)    | (8.8)     | (6.5)     | (16.5)                 | (9.2)     |
| Gain (loss) on sale of capital assets                  | —           | —         | (5.0)                  | (3.0)     | —         | 1.9       | —                      | —         |
| Change in warrant liability                            | 277.1       | 62.8      | —                      | —         | —         | —         | —                      | —         |
| Foreign exchange (loss) gain and valuation adjustments | 12.6        | (2.2)     | —                      | —         | —         | —         | —                      | —         |
| Income taxes recovery                                  | —           | —         | —                      | —         | —         | —         | 4.7                    | —         |
| Net (loss) income                                      | (\$568.3)   | (\$516.7) | (\$530.4)              | (\$237.8) | (\$411.6) | (\$240.3) | (\$360.9)              | (\$265.9) |
| Loss per share   | (\$0.01)    | (\$0.02)  | (\$0.02)               | (\$0.01)  | (\$0.01)  | (\$0.01)  | (\$0.01)               | (\$0.01)  |

## Results of Operations

The following table sets out the Company's results for the six months ended June 30, 2011 compared with the same period last year.

Unaudited <sup>(1)</sup>

| <i>In Thousands of U.S. dollars</i>                    | <b>Six months ended<br/>June 30</b> |             | <b>Increase<br/>(Decrease)</b> | <b>%<br/>Increase<br/>(Decrease)</b> |
|--|-------------------------------------|-------------|--------------------------------|--------------------------------------|
|  | <b>2011</b>                         | <b>2010</b> |                                |                                      |
| Sales  | \$1,154.7                           | \$1,483.9   | (329.2)                        | (22.2)%                              |
| Gross profit   | 1.9                                 | 350.1       | (348.2)                        | (99.5)%                              |
| <i>Gross profit percentage</i>                         | 0.2%                                | 23.6%       |                                |                                      |
| Selling and marketing                                  | 371.9                               | 311.8       | 60.1                           | 19.3%                                |
| <i>As a % of sales</i>                                 | 32.2%                               | 21.0%       |                                |                                      |
| General and administrative                             | 886.8                               | 649.7       | 237.1                          | 36.5%                                |
| <i>As a % of sales</i>                                 | 76.8%                               | 43.8%       |                                |                                      |
| Engineering and research                               | 165.7                               | 14.1        | 151.6                          | 1075.2%                              |
|  | 14.4%                               | 1.0%        |                                |                                      |
| Foreign exchange (gain) loss                           | 6.7                                 | (3.7)       | 10.4                           | (281.1)%                             |
| <i>Total operating expenses</i>                        | 1,431.1                             | 971.9       | 459.2                          | 47.2%                                |
| <i>Income (loss) from operations</i>                   | (1,429.2)                           | (621.8)     |                                |                                      |
| Add back amortization                                  | 140.6                               | 67.9        |                                |                                      |
| EBITDA   | (\$1,288.6)                         | (\$553.9)   | (734.7)                        | (132.6)%                             |
| Finance costs  | (27.5)                              | (15.1)      |                                |                                      |
| Depreciation of capital equipment                      | (99.5)                              | (65.9)      |                                |                                      |
| Amortization of product development                    | (57.6)                              | (14.8)      |                                |                                      |
| Gain (loss) on sale of capital assets                  | —                                   | 1.8         |                                |                                      |
| Refundable tax credit income                           | 40.9                                | 17.1        |                                |                                      |
| Change in warrant liability                            | 339.8                               | 78.0        |                                |                                      |
| Foreign exchange (loss) gain and valuation adjustments | 7.6                                 | 38.5        |                                |                                      |
| Net loss   | (\$1,084.9)                         | (\$514.3)   | (570.6)                        | (110.9)%                             |

<sup>(1)</sup> Information for 2011 and 2010 is prepared in accordance with IFRS.

***Revenues***

Revenues for the three months ended June 30, 2011 decreased 28.3% to \$614,900 from \$857,200 for the same period in 2010. Revenue from bus light sales during the three months ended June 30, 2011 increased 10% to \$318,900 from \$289,900 for the same period in 2010. Revenues from contract manufacturing for the three months ended June 30, 2011 decreased 21.4% to \$135,400 from \$172,300 in 2010. Commercial LED revenue for the three months ended June 30, 2011 stemmed from LED MR16 sales that decreased 59.3% to \$160,600 from \$395,000 during the same period in 2010.

Revenues for the six months ended June 30, 2011 decreased 22.2% to \$1,154,700 from \$1,483,900 for the same period in 2010. Revenue from bus light sales during the six months ended June 30, 2011 decreased 10.7% to \$601,200 from \$673,600 for the same period in 2010. Revenues from contract manufacturing for the six months ended June 30, 2011 decreased 17.4% to \$254,400 from \$308,100 in 2010. Commercial LED revenue for the six months ended June 30, 2011 stemmed from LED MR16 sales that decreased 40.4% to \$299,100 from \$502,200 during the same period in 2010.

***Cost of Sales and Gross Profit***

The cost of sales is inclusive of direct material costs, plant labour, plant overheads, plant management salaries, amortization of plant and equipment and the amortization of product development costs. For the three months ended June 30, 2011, gross profit percentage was (2.9)% compared to 26.1% in the same period last year. The decrease is primarily attributed to low sales volumes in relation to increased fixed plant expenses and amortization charged to cost of sales.

For the six months ended June 30, 2011, gross profit percentage was 0.2% compared to 23.6% in the same period last year. The decrease is attributed to the same factors as noted above.

***Selling and marketing expenses***

For the three months ended June 30, 2011 selling and marketing expenses increased 30.6% to \$264,700 from \$202,800 for the same period in 2010. This increase reflects stock based compensation totalling \$31,600, in addition to increased staffing costs and marketing focus in the retail lighting sector in line with the Energizer roll out scheduled for the fourth quarter of 2011.

For the six months ended June 30, 2011 selling and marketing expenses increased 19.3% to \$371,900 from \$311,800 for the same period in 2010. This increase is attributed to the same factors as noted above.

***General and administrative expenses***

For the three months ended June 30, 2011 general and administrative expenses increased 17.6% to \$479,700 from \$408,000 for the same period in 2010. This increase reflects the stock based compensation of \$57,300 provided to the Company's management during the second quarter of 2011.

For the six months ended June 30, 2011 general and administrative expenses increased 36.5% to \$886,800 from \$649,700 for the same period in 2010. This increase reflects increased staffing costs and insurance fees. As well as \$40,500 in non-recurring expenditures for legal and investor relations related to the Company's OTC listing during the first quarter of 2011 and \$57,300 of stock based compensation provided to management during the second quarter of 2011.

***Engineering and Research***

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

For the three months ended June 30, 2011 net research and development expenses increased to \$85,700 from \$12,800 for the same period in 2010. For the six months ended June 30, 2011 net research and development expenses increased to \$165,700 from \$14,100 for the same period in 2010. The Company has incurred significant costs during 2011 as engineering staff levels increased, and the department began support of continuous improvement of existing lines in addition to active product development projects.

***Finance Costs***

Total finance costs for the three month period ended June 30, 2011 increased \$3,200 to \$10,800 vs. \$7,600 for the same period in 2010. Total finance costs for the six month period ended June 30, 2011 increased \$12,400 to \$27,500 vs. \$15,100 for the same period in 2010. Finance costs are attributable to a mix of long and short term debt obligations as follows:

Interest on short-term debt obligations decreased 4.2% to \$6,800 during the three months ended June 30, 2011 from \$7,100 during the same period in 2010. Additionally, interest on short-term debt obligations increased 0.8% to \$12,600 during the six months ended June 30, 2011 from \$12,500 during the same period in 2010. The decrease in the expense for the three months ended June 30, 2011 from 2010 resulted from a decrease in the average credit card debt and bank operating loans during the period.

**Finance costs, continued:**

Net interest on long-term debt obligations increased 700% to \$4,000 during the three months ended June 30, 2011 from \$500 during the same period in 2010. Year to date, net interest on long-term debt obligations increased 473% to \$14,900 during the six months ended June 30, 2011 from \$2,600 during the same period in 2010. Net interest on long-term debt obligations are comprised of the following:

|                             | Three months ended<br>June 30 |            | Six months ended<br>June 30 |              |
|-----------------------------|-------------------------------|------------|-----------------------------|--------------|
|                             | 2011                          | 2010       | 2011                        | 2010         |
| Interest LTD                | 5,400                         | 2,100      | 10,000                      | 4,300        |
| Accretion expense           | 8,800                         | -          | 15,300                      | -            |
| Less:                       |                               |            |                             |              |
| Interest revenue            | (10,200)                      | (1,600)    | (10,400)                    | (1,700)      |
| <b>Net Interest on LTD:</b> | <b>4,000</b>                  | <b>500</b> | <b>14,900</b>               | <b>2,600</b> |

Interest costs are higher during 2011 due to higher average principal outstanding on long-term debt. This is primarily attributable to the finance of capital equipment that occurred in the second quarter of 2010. Accretion expense is related to the non-interest bearing loan from the S.O.D.P. These expenses are partially offset by increased interest revenues. The increased revenues are due to a 1 year redeemable term deposit purchased by the Company with proceeds from the private equity placement issuance of common shares on April 28, 2011. Interest on the term deposit compounds annually at a rate of 1.5%.

***Depreciation of property and equipment***

Depreciation increased 39.3% to \$54,600 during the three months ended June 30, 2011 from \$39,200 during the same period in 2010. Additionally, depreciation increased 51.0% to \$99,500 during the six months ended June 30, 2011 from \$65,900 during the same period in 2010. The increase is related primarily to additional production equipment put into operation in the second quarter of 2010.

***Amortization of Product Development Costs***

The amortization expense increased \$20,100 to \$28,700 during the three months ended June 30, 2011 from \$8,600 during the same period in 2010. During the second quarter of 2011, the Company amortized \$28,700 related to LED MR16, the G2Max bus safety light and dimming technology. Overall the amortization expense increased \$42,800 to \$57,600 during the six months ended June 30, 2011 from \$14,800 during the same period in 2010. Year to date June 30, 2011, CRS invested a gross amount of \$87,900 in deferred development costs for the development of the PAR Series of indoor lights.

***Scientific Research and Experimental Development Tax Credit ("SRED")***

The tax credits that relate to the deferred development costs are recorded on the balance sheet as a reduction of deferred development expenses. The tax credits that relate to research are recorded as a reduction in expenses on the statement of operations. The amount recorded as reduction to expenses for the three months ended June 30, 2011 was \$12,400 compared to \$13,500 in 2010. The amount recorded as reduction to expenses for the six months ended June 30, 2011 was \$40,900 compared to \$17,100 in 2010. The \$23,800 increase during the six month period includes \$17,300 a positive adjustment with respect to the reassessment of the period ended May 19, 2009 after acceptance of Scientific Research and Experimental Development Tax Credits ("SRED") along with increases activities in 2011.

***Foreign Exchange Losses***

The US dollar is the functional currency of the Company and is also the currency in which it presents these financial statements. The Company recognizes transactions in currencies other than the US dollar (foreign currencies) at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, it retranslates monetary items denominated in foreign currencies at the rates prevailing at that date. It does not retranslate non-monetary items measured in terms of historical cost in a foreign currency. It recognizes exchange differences on monetary items in profit or loss in the period in which they arise. For the three months ended June 30, 2011, CRS incurred a foreign currency loss of \$2,700 compared to a gain of \$2,700 in 2010. For the six months ended June 30, 2011, CRS incurred a foreign currency loss of \$6,700 compared to a gain of \$3,700 in 2010.

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

The negative EBITDA for the three months ended June 30, 2011 was (\$776,300) compared to (\$358,500) for the same period in 2010. The negative EBITDA for the six months ended June 30, 2011 was (\$1,288,600) compared to (\$553,900) for the same period in 2010. The decrease in revenues in 2011 combined with the increase in fixed overhead and administrative costs has reduced overall earnings by \$417,800 and \$734,700 respectively for the three and six months ended June 30, 2011 compared to 2010.

***Net losses***

As a result of the above activities, the net loss for the three months ended June 30, 2011 was (\$568,300), or (\$0.01) per share compared to a loss of (\$38,200), or \$0.00 per share for the same period 2010. The net loss for the six months ended June 30, 2011 was (\$1,084,900), or (\$0.03) per share compared to a loss of (\$514,300), or (\$0.02) for the same period 2010. The \$530,100 and \$570,600 negative changes respectively in net losses vs. 2010 have been moderated by a positive change in warrant liability totalling \$277,100 and \$339,800 respectively for the three and six months ended June 30, 2011.

## Liquidity and Capital Resources

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

| <i>(in U.S. dollars except for ratios)</i> | June 30<br>2011 | <i>December 31</i><br>2010 |
|--|-----------------|----------------------------|
| Current Ratio                              | 5.5:1           | 1.9:1                      |
| Cash                                       | \$3,822,339     | \$340,015                  |
| Available operating line                   | \$215,105       | \$38,052                   |
| Net Working Capital                        | \$4,562,005     | \$849,917                  |
| Total Assets                               | \$7,202,545     | \$3,226,254                |
| Total Debt                                 | \$3,597,865     | \$1,603,951                |
| Total Equity                               | \$3,604,680     | \$1,622,303                |
| Debt to Equity Ratio                       | 0.99:1          | 0.99:1                     |

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

| <i>(in U.S. dollars)</i>        | June 30<br>2011 | December 31<br>2010 |
|---------------------------------|-----------------|---------------------|
| Derivative liability – Warrants | \$1,924,878     | 315,080             |

Subsequent to the end of the period the Company received its 5<sup>th</sup> and final payment for CAD \$178,000 with the Southern Ontario Development Corporation (SODP). Total funding received is CAD \$667,036 increasing the amount repayable to SODP. The contribution amount is then repayable in 60 equal monthly payments commencing April 1, 2011. No interest is payable on the outstanding balance of the contribution amount.

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

The Company has the following commitments outstanding as at June 30, 2011:

The Company signed an exclusive license agreement with Eveready Battery Company, Inc. (the "Exclusive Agreement"), a subsidiary of Energizer Holdings, Inc., for the Company to manufacture a suite of LED lighting products under the brand name Energizer. The term of the Exclusive Agreement is from January 1, 2011 to December 31, 2015. In accordance with the Exclusive Agreement, the minimum guaranteed royalty to be paid by the Company over the term thereof is as follows:

| <u>Year</u> | <u>Minimum Guaranteed Royalty</u> |
|-------------|-----------------------------------|
| 2011        | \$157,000                         |
| 2012        | 274,000                           |
| 2013        | 539,000                           |
| 2014        | 688,000                           |
| 2015        | 760,000                           |

### **Cash Flows**

During the six month ended June 30, 2011, CRS experienced negative cash flows used in operations of (\$1,276,900) compared to a negative cash flow of (\$636,200) for the same period in 2010. Reduction of accounts receivable and increases in accounts payable partially offset higher losses. The Company invested \$348,800 in tooling and other capital equipment, development costs and patents in the six months ended June 30, 2011 compared to \$757,800 in the prior year. The Company's various financing activities generated \$5,108,100 in cash flows for the six month ended June 30, 2011 compared to \$524,700 in the same period last year. The increase during the second quarter of 2011 is mainly attributable to the April 28, 2011 private placement offering generating gross proceeds of CAD \$5,158,500.

### **Outstanding Share Data**

As at June 30, 2011 and August 24, 2011 the Company had the following items issued and outstanding:

#### **at June 30, 2011:**

- Common shares: 40,723,434
- Stock options:

| Range of exercise prices    | Number outstanding | Weighted-average remaining contractual life | Weighted-average exercise price |
|-----------------------------|--------------------|---|---------------------------------|
| <b>\$0.30</b> <b>\$0.50</b> | 789,124            | 29 months                                   | \$0.32                          |
| <b>\$0.51</b> <b>\$0.70</b> | 1,235,000          | 56 months                                   | \$0.60                          |
| <b>Total</b>                | <b>2,024,124</b>   | <b>45 months</b>                            | <b>\$0.49</b>                   |

- Charitable options:

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

- Agent options:

As compensation for services related to the April 28, 2011 offering, the Company issued a total of 530,022 non-transferable compensation options to the lead agent, each option entitles the agent to subscribe for one Unit at a price of \$0.55 until October 28, 2012.

**at August 24, 2011:**

- Common shares 40,723,434
- Stock options:

| Range of exercise prices | Number outstanding | Weighted-average remaining contractual life | Weighted-average exercise price |
|--------------------------|--------------------|---|---------------------------------|
| \$0.30                   | 789,124            | 29 months                                   | \$0.31                          |
| \$0.51                   | 1,235,000          | 56 months                                   | \$0.60                          |
| Total                    | 2,024,124          | 45 months                                   | \$0.49                          |

- Charitable options:

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

- Agent options:

As compensation for services related to the April 28, 2011 offering, the Company issued a total of 530,022 non-transferable compensation options to the lead agent, each option entitles the agent to subscribe for one Unit at a price of \$0.55 until October 28, 2012.

**Off-Balance Sheet Arrangement**

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

## **Transactions with Related Parties**

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

|                    | <b>June 30<br/>2011</b> | <b>June 30<br/>2010</b> |
|--------------------|-------------------------|-------------------------|
| Wages and benefits | 92,244                  | 61,530                  |

## **Proposed Transactions**

CRS is not a party to any proposed transaction other than those previously discussed, that may have an effect on the financial condition, results of operations or cash flows or proposed asset or business acquisition or disposition.

## **Subsequent Events**

a) Subsequent to the end of the period the Company received its 5<sup>th</sup> and final payment for CAD \$178,000 with the Southern Ontario Development Corporation (SODP). Total funding received is CAD \$667,036 which is repayable in 60 equal monthly payments commencing April 1, 2011. While no interest is payable on the outstanding balance, the loan is presented at fair value in U.S. Dollars.

## **Adoption of International Financial Reporting Standards (IFRS)**

The following reconciles the Company's Statement of Financial Position, Statements of Loss and Comprehensive Loss, and Statements of Equity as previously reported under Canadian GAAP

| <b>Statements of loss and comprehensive loss</b>   | <b>Three months ended<br/>June 30, 2010</b> | <b>Six months ended<br/>June 30, 2010</b> |
|--|---|---|
| As previously reported under Canadian GAAP   | (411,599)                                   | (652,488)                                 |
| Statement of Loss and Comprehensive loss -<br>Foreign exchange (loss) gain                   | 11,237                                      | 21,663                                    |
| Statement of Financial Positions - Foreign exchange<br>(loss) gain and valuation adjustments | 31,529                                      | 38,462                                    |
| Revaluation of warrant (loss) gain   | 330,593                                     | 78,030                                    |
| <b>As reported in accordance with IFRS</b>   | <b>(38,240)</b>                             | <b>(514,333)</b>                          |

## Adoption of IFRS, continued:

| Unaudited                                    | <b>June 30, 2010</b> |                  |                  |
|--|----------------------|------------------|------------------|
|  | <b>CDN GAAP</b>      | <b>IFRS Adj.</b> | <b>IFRS</b>      |
|  | <b>CDN \$</b>        |                  | <b>USD \$</b>    |
| <b>ASSETS</b>                                |                      |                  |                  |
| <b>Current Assets</b>                        |                      |                  |                  |
| Cash and cash equivalents                    | -                    | -                | -                |
| Accounts receivable                          | 830,383              | (50,404)         | 779,979          |
| Government incentives receivable             | 69,809               | (4,237)          | 65,572           |
| Inventory                                    | 883,349              | (53,619)         | 829,730          |
| Deposits and prepaid expenses                | 54,389               | (3,301)          | 51,088           |
|  | <u>1,837,930</u>     | <u>(111,562)</u> | <u>1,726,368</u> |
| <b>Long-term assets</b>                      |                      |                  |                  |
| Equipment, furniture and leaseholds          | 758,422              | (74,160)         | 684,262          |
| Patents and trademarks                       | 53,144               | (1,764)          | 51,380           |
| Intangible assets - development costs        | 645,219              | (44,360)         | 600,859          |
|  | <u>3,294,715</u>     | <u>(231,847)</u> | <u>3,062,868</u> |
| <b>LIABILITIES</b>                           |                      |                  |                  |
| <b>Current liabilities</b>                   |                      |                  |                  |
| Bank indebtedness                            | 65,674               | (3,986)          | 61,688           |
| Trade and other payables provisions          | 1,217,913            | (73,927)         | 1,143,986        |
| Notes payable                                | 34,742               | (2,109)          | 32,633           |
| Current portion of debt obligations          | 52,338               | (3,177)          | 49,161           |
| Current portion of finance lease obligations | 4,975                | (302)            | 4,673            |
|  | <u>1,375,642</u>     | <u>(83,501)</u>  | <u>1,292,141</u> |
| <b>Long-term liabilities</b>                 |                      |                  |                  |
| Debt obligations                             | 229,109              | (13,907)         | 215,202          |
| Finance lease obligations                    | 2,873                | (174)            | 2,699            |
| Derivative liability - Warrants              | -                    | 216,447          | 216,447          |
|  | <u>1,607,624</u>     | <u>118,864</u>   | <u>1,726,488</u> |
| <b>SHAREHOLDERS' EQUITY</b>                  |                      |                  |                  |
| Share capital                                | 2,889,132            | (337,022)        | 2,552,110        |
| Shares to be issued                          | 297,891              | (9,890)          | 288,001          |
| Contributed surplus                          | 173,897              | (24,828)         | 149,069          |
| Warrants                                     | 198,129              | (198,129)        | -                |
| (Deficit)                                    | (1,871,958)          | 219,158          | (1,652,800)      |
|  | <u>1,687,091</u>     | <u>(350,711)</u> | <u>1,336,380</u> |
|  | <u>3,294,715</u>     | <u>(231,847)</u> | <u>3,062,868</u> |

**Adoption of IFRS, continued:****Statement of Equity:**

|  | <b>June 30<br/>2010</b> |
|--|-------------------------|
| <b>Share Capital</b>                             |                         |
| As previously reported under Canadian GAAP       | 3,187,023               |
| Foreign exchange loss (gain)                     | (17,942)                |
| Prior period(s) foreign exchange loss (gain)     | (328,970)               |
| Transfer of exercised warrants                   | -                       |
| <b>As reported in accordance with IFRS</b>       | <b>2,840,111</b>        |
| <b>Other Paid in Capital</b>                     |                         |
| As previously reported under Canadian GAAP       | 173,897                 |
| Foreign exchange loss (gain)                     | 1,170                   |
| Prior period(s) foreign exchange loss (gain)     | (25,998)                |
| Transfer value of expired warrants               | -                       |
| <b>As reported in accordance with IFRS</b>       | <b>149,069</b>          |
| <b>Deficit</b>                                   |                         |
| As previously reported under Canadian GAAP       | (1,871,958)             |
| Foreign exchange loss (gain)                     | 141,128                 |
| Gain (loss) on warrant liability                 | 78,030                  |
| <b>As reported in accordance with IFRS</b>       | <b>(1,652,800)</b>      |
| <b>Canadian \$ Warrants as Equity</b>            |                         |
| As previously reported under Canadian GAAP (CAD) | 198,129                 |
| FVTPL revaluation loss (gain) (USD)              | (78,030)                |
| Loss (gain) on expiry of warrants (USD)          | -                       |
| Cumulative foreign exchange loss (gain)          | 96,348                  |
| Transfer to derivative liability (USD)           | (216,447)               |
| <b>As reported in accordance with IFRS</b>       | <b>-</b>                |
| <b>Total reported in accordance with IFRS</b>    | <b>1,336,380</b>        |

**Accounting standards issued but not yet effective**

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

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

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

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

### **IFRS 9 Financial Instruments**

IFRS 9 Financial Instruments is part of the IASB's wider project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard is effective for annual periods beginning on or after January 1, 2013. The Company is in the process of evaluating the impact of the new standard.

### **IFRS 13 – Fair value measurement**

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

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

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

## **Risk and Uncertainties**

CRS operates in the LED lighting market and is exposed to a variety of risk factors and uncertainties in the normal course of operations. The risks and uncertainties that could materially affect our business, financial condition and results of operations are described in our Annual Report for the fiscal year 2010 which has been filed with Canadian securities regulatory authorities and is available at [www.sedar.com](http://www.sedar.com) under the corporate name CRS Electronics Inc. The risks disclosed in our annual report are not necessarily the only risks and uncertainties we face. Additional risks and uncertainties not presently known to us, or that we currently believe to be immaterial, may also adversely affect our business.

There was no significant change to these risks and uncertainties during the six-month period ended June 30, 2011 other than those described elsewhere in this MD&A.