

# AUDIOTECH HEALTHCARE CORPORATION

## MANAGEMENT DISCUSSION AND ANALYSIS

For the 3 Months Ended December 31, 2006  
(First Quarter of Fiscal 2007)

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Directors and Officers of the Corporation as at December 31, 2006 and February 28, 2007

**Directors:**

Oswaldo (Ozzie) Iadarola\*  
Glen Martin\*\*  
Grant Robertson\*\*  
Daniel Allen  
Dr. Gerald Mill

\* member of the audit committee

\*\* independent member of the audit committee

**Officers:**

Oswaldo (Ozzie) Iadarola, *President & Chief Executive Officer*  
Darryl Walker, *Secretary, Chief Financial Officer*  
Daniel Allen, *Vice-President & Chief Operations Manager Canada*  
Dr. Gerald Mill, *Chief Operations Manager - Idaho*

The intention of Management's Discussion and Analysis (MD&A) is for Audiotech to present management's analysis of the results of its operations, current financial position, and future prospects. The MD&A complements and supplements the financial statements that have been prepared according to Canadian generally accepted accounting principles (GAAP). Management's discussion and analysis of Audiotech's operating results for the period should be read in conjunction with the company's consolidated financial statements for the same period, which can be found on SEDAR ([www.sedar.com](http://www.sedar.com)) or at the company's website at [www.audiotech.org](http://www.audiotech.org).

Given the objectives of the MD&A, certain information presented is of a forward-looking nature. Such forward looking information involves substantial known and unknown risks and uncertainties. Most of these are beyond Audiotech's control and include: the impact of general economic conditions, changes in industry conditions, the availability of qualified personnel, stock market volatility, and access to capital from internal and external sources. The reader is cautioned that assumptions used in the preparation of such information, while considered reasonable by Audiotech at the time, may prove to be incorrect. Audiotech's actual results could differ materially from those expressed in, or implied by, such forward looking information.

The Company's external auditors have performed a review of these financial statements (see Auditor's Report). These consolidated financial statements have also been certified by management.

## 1.1 Date of This Report

February 28, 2007.

## 1.2 Overall Performance

Audiotech owns and operates a network of hearing healthcare clinics located in Western Canada and the Pacific-Northwest United States. Since becoming a public company in 1997, the company has grown through acquisitions and the successful start-up of full-fledged and satellite clinics.

Please refer to section 1.4 below for further discussion of operating results during the quarter and a comparison to prior periods.

## 1.3 Selected Quarterly and Annual Information

### Statement of Income – Quarterly Data (Unaudited)

	3 Months ended December 31				
	2006	2005	2004	2003	2002
Canadian Revenues	\$ 645,406	\$ 567,878	\$ 651,653	\$ 442,832	\$ 422,369
U.S. Revenues	292,509	233,152	362,063	334,237	368,578
<b>a). Total Revenues</b>	<b>\$ 937,815</b>	<b>\$ 801,030</b>	<b>\$ 1,013,716</b>	<b>\$ 777,069</b>	<b>\$ 790,947</b>
<b>Operating Cash Flow*</b>	<b>49,905</b>	<b>34,436</b>	<b>37,804</b>	<b>23,251</b>	<b>(1,305)</b>
<b>b,c). Net Earnings ***</b>	<b>17,000</b>	<b>4,147</b>	<b>3,712</b>	<b>8,673</b>	<b>(20,929)</b>
<b>EPS (basic &amp; fully-diluted)</b>	<b>0.0013</b>	<b>0.0003</b>	<b>0.0003</b>	<b>0.0007</b>	<b>(0.0016)</b>
<b>d). Total Assets</b>	<b>\$ 2,781,819</b>	<b>\$ 2,511,477</b>	<b>\$ 2,542,238</b>	<b>\$ 1,895,532</b>	<b>\$ 1,966,092</b>
<b>e). Total Long-Term Liabilities</b>	<b>\$ 774,724</b>	<b>\$ 1,123,549</b>	<b>\$ 1,158,227</b>	<b>\$ 340,057</b>	<b>361,722</b>
<b>f). Cash Dividends per Share</b>	<b>NIL</b>	<b>NIL</b>	<b>NIL</b>	<b>NIL</b>	<b>NIL</b>

### Statement of Income – Annual Data (Audited)

	Years Ended September 30				
	2006**	2005**	2004**	2003**	2002**
Canadian Revenues	\$ 2,549,453	\$ 2,566,952	\$ 2,299,029	\$ 1,737,167	\$ 1,855,175
U.S. Revenues	1,002,555	1,244,648	1,330,895	1,430,299	1,133,985
<b>a). Total Revenues</b>	<b>\$ 3,552,008</b>	<b>\$ 3,811,600</b>	<b>\$ 3,629,914</b>	<b>\$ 3,167,466</b>	<b>\$ 2,989,160</b>
<b>Operating Cash Flow*</b>	<b>230,908</b>	<b>182,349</b>	<b>286,100</b>	<b>(19,974)</b>	<b>62,283</b>
<b>b,c). Net Earnings **</b>	<b>101,804</b>	<b>78,559</b>	<b>153,647</b>	<b>(105,366)</b>	<b>(47,438)</b>
<b>EPS (basic &amp; fully-diluted)</b>	<b>0.008</b>	<b>0.006</b>	<b>0.012</b>	<b>(0.008)</b>	<b>(0.004)</b>
<b>d). Total Assets</b>	<b>\$2,683,075</b>	<b>\$ 2,587,126</b>	<b>\$ 2,526,933</b>	<b>\$ 1,966,092</b>	<b>\$ 2,199,099</b>
<b>e). Total Long-Term Liabilities</b>	<b>\$742,241</b>	<b>\$ 1,158,227</b>	<b>\$ 984,149</b>	<b>\$ 361,722</b>	<b>\$ 821,450</b>
<b>f). Cash Dividends per Share</b>	<b>NIL</b>	<b>NIL</b>	<b>NIL</b>	<b>NIL</b>	<b>NIL</b>

\* Operating cash flow is a non-GAAP measure that includes net earnings and non-cash expenses such as amortization. While management believes this number to be an important measure of corporate activity used in the industry in which the company operates, it cannot be assured that operating cash flow, as reported, is directly comparable to operating cash flow as reported by peer companies in the industry since there is no universally accepted means of its calculation. Audiotech's calculation of operating cash flow is done in the manner believed to be consistent with the most accepted means of calculation in the industry and the accounting profession as a whole.

\*\* there were no material extraordinary or unusual items, gains or losses on discontinued operations, etc. for any of the reporting periods.

There have been no material changes outside the general course of business that account for the fluctuation or changes in the financial results reported from period to period in the chart above, except as follows:

As mentioned in previous filings, the company has been affected by the increase in value of the Canadian dollar relative to the U.S. dollar over the past three years. The effect of the strength of the Canadian dollar has been to reduce reported revenues (in Canadian dollars) from the corporation's U.S.-based operations upon consolidation. Since September 30, 2006, the U.S. dollar has appreciated versus the Canadian dollar. Accordingly, reported revenues from Audiotech's U.S. based operations as reported in Canadian dollars have improved during the current reporting period and are expected to continue to improve throughout fiscal 2007.

## 1.4 Results of Operations

Total revenues for the first quarter ended December 31, 2006, were \$937,915, an increase of 17.1% over the same quarter a year ago, and up from the \$811,789 in sales reported during the previous quarter. Revenue growth was achieved in both the Canadian and U.S. clinic operations. Revenues from the company's Canadian operations totaled \$645,406, while the U.S. operations contributed revenues of \$292,509, representing growth of 13.7% and 25.5% respectively. During November 2006, the company opened a new clinic in Victoria, BC. The current reporting period reflects the initial start-up contribution of this facility, however, it was not until February 2007 that this clinic started to contribute meaningful revenues. U.S. revenue growth was aided by the reversal of a long-term trend that saw the U.S. dollar depreciate substantially over the past several years.

Gross margins slightly exceeded expectations, rising from 68.9% of sales during the fourth quarter of fiscal 2006 to 70.2% for the 3 month period ended December 31, 2006. Gross margins were 68.3% during the comparative quarter a year earlier. Management remains confident that the factors that have contributed to the strong gross margins reported by the company over the past six quarters will continue into the foreseeable future.

As a result of the opening of the Victoria clinic and the relocation the NW Calgary clinic during the quarter, most direct clinic expense categories saw modest increases during the quarter compared to previous reporting periods. Included in these expenses are certain on-time costs associated with these initiatives. As the Victoria clinic begins to contribute more meaningful revenues during the second and third quarters of fiscal 2007, it is expected that direct costs as a percentage of sales should begin to decline. Direct clinic operating costs for the quarter were \$508,093 compared to \$425,335 during the first quarter of fiscal 2006. This represents an increase of 19.5%. The most notable increase in direct clinic expenses was in the category of selling expenses which included initial start-up marketing for the new facility in Victoria, and marketing directed at ensuring client retention after the clinic relocation in Calgary.

General and administrative expenses totaled \$126,537 during the quarter which compares favorably with the average quarterly G&A expense for fiscal 2005 which was just over \$133,000. As expected, general and administrative costs declined as a percentage of sales from 14.5% during fiscal 2006 to 13.5% during the first quarter of fiscal 2007.

First quarter earnings were \$17,000 or \$0.0013 per share, up from \$4,147 or \$0.0003 a year earlier. It should be noted that the first quarter is typically the company's weakest from an earnings perspective due to a typical slow-down in patient visits during the Christmas holiday season. Before the deduction of the debenture discount, earnings were \$23,375 or \$0.0017 per share. Net operating cash flow was \$49,905, an increase of 44.9% over the cash flow reported for the same quarter in fiscal 2006.

Effective October 1, 2006, Audiotech's two principal Canadian operating subsidiaries were amalgamated. The amalgamation will afford the consolidated company greater tax planning opportunities and the ability to better utilize loss carryforwards in fiscal 2007 and beyond to reduce the consolidated corporate income tax liability. Accordingly, Audiotech expects a more favorable tax position in fiscal 2007 than was experienced in fiscal 2006, and no provision for income taxes has been applied during the first quarter.

During the quarter, a total of \$6,375 in amortization related to the debenture discount was recorded on the statement of income thereby reducing net earnings by the same amount (\$6,375 for the same quarter in fiscal 2006).

Management's profit outlook fiscal 2007 and beyond remains favorable. Management is also optimistic that it will be able to close one or more material acquisitions during the coming quarters to stimulate additional sales, cash flow, and earnings growth.

Details of all expenses can be found in the unaudited interim consolidated financial statements for the year ended September 30, 2006.

## 1.5 Summary Quarterly Results

Revenues and net income for the last nine fiscal quarters were as follows:

	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	12-31-06	09-30-06	06-30-06	03-31-06	12-31-05	09-30-05	06-30-05	03-31-05	12-31-04
Revenues	\$ 937,915	\$811,789	\$966,212	\$972,977	\$ 801,030	\$ 913,300	\$ 928,511	\$ 956,073	\$1,013,716
Net Income*	17,000	(106,496)	102,184	101,969	4,147	12,560	2,470	59,817	3,712
/ Share Basic	0.0013	(0.008)	0.0077	0.0076	0.0003	0.0009	0.0002	0.0044	0.0003
/ Share FD	0.0013	(0.008)	0.0074	0.0073	0.0003	0.0009	0.0002	0.0042	0.0003

\* there were no material extraordinary or unusual items, gains or losses on discontinued operations, etc. for any of the reporting periods.

## 1.6 Liquidity

As at December 31, 2006, Audiotech had a cash balance of \$391,837.

Working capital was negative \$88,968 as a result of the re-classification of certain long-term liabilities during the latter half of fiscal 2006 as short-term (current liabilities) as repayment of these liabilities is now scheduled within the next twelve months. These liabilities include convertible debentures totaling \$243,995 which bear interest of 10% per annum and mature in April 2007, as well as the 10% promissory notes which mature in June 2007. Management has been in discussions with its financial partners and fully expects that these instruments will be refinanced under long-term arrangements at more favorable interest rates when they come due. Accordingly, management is very confident that the company's working capital position is sufficient to meet its needs. Investments have and will continue to be made in new and additional equipment as new clinics are opened or upgraded. Such expenditures will be financed from existing working capital, capital leases, or through funding arrangements with key hearing aid suppliers as appropriate under the circumstances. The company may undertake an equity financing in the near future to accelerate the company's debt retirement goals and to reduce future interest costs.

Details of all long-term debt and capital lease obligations as well as debt repayments and other financial commitments due during the next 5 years are disclosed in the notes to the consolidated financial statements for the period (see Note 3, 4 & 10).

A total of \$37,718 in long-term debt obligations (including capital leases) were repaid during the quarter ended December 31, 2006. A total of \$50,000 in new debt financing was secured during the period, primarily to fund the opening of the Victoria operation and relocation of the NW Calgary clinic.

Total long term debt as at December 31, 2006, was \$1,264,191 including obligations under capital leases. The current portion of long-term debt due within the next 12 months was \$489,467. This amount includes expiring debentures and promissory notes as discussed above that are expected to be refinanced upon maturity on terms more favorable to the company.

## 1.7 Capital Resources

The Corporation's capital assets consist of various hearing diagnostic equipment, computer and office equipment, leasehold improvements, and land and building as detailed in the notes to the consolidated financial statements for the period ended December 31, 2006 (see note 2), as well as the goodwill in acquired and developed clinics. The company intends to make additional investments in capital assets during the in the ordinary course of its business as it acquires, expands, and opens new clinics.

A total of \$66,306 in capital purchases, primarily related to the opening of the Victoria clinic and upgrades to the relocated NW Calgary clinic, were made during the first quarter of fiscal 2007. These purchases were financed from working capital and \$50,000 in new long-term debt financing.

## **1.8 Off Balance Sheet Arrangements**

There are no off-balance sheet arrangements to which the Company is committed.

## **1.9 Transactions with Related Parties**

As detailed in note 8 of the consolidated financial statements for the 3 months ended December 31, 2006, entitled "Related Party Transactions," Audiotech had, in the normal course of business, several non-material transactions with related parties during the quarter:

A total of \$839 was paid to MediaWave Communications Corp., an Internet services company controlled by a director of the corporation in connection with website maintenance and hosting services.

A total of \$7,512 in rent was paid to Sherwood Real Estate Corp., a company controlled by a director of the company during the period.

These transactions were in the normal course of operations and were measured at the exchange amount which is the amount of consideration established and agreed to by the related parties. Such consideration was no more than that would have otherwise been paid by the Corporation to purchase similar products and services from third parties.

## **1.10 First Quarter**

Please refer to sections 1.4 and 1.6 above.

## **1.11 Proposed Transactions**

At any given time, the Corporation is in active and ongoing negotiations with respect to various acquisition, merger, and joint venture opportunities as well as negotiations pertaining to the potential opening of new clinics. Management regards such negotiations as a part of its every day operations and accordingly, until a letter of intent is completed or it is deemed that there is a strong likelihood of a transaction proceeding, such negotiations are not generally announced. As of the date of this document, there are no pending proposed transactions of a material nature that have not been disclosed in this MD&A, however, negotiations are active and ongoing with respect to several potential transactions.

## **1.12 Critical Accounting Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions regarding the estimated rate of depreciation, estimated useful lives, and residual value of capital assets, as well as average exchange rates for an accounting period, 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 revenues and expenses during the year. Actual results could differ from those estimates. Management is not presently aware of any of material differences between the amounts reported and actual results.

## **1.13 Changes in Accounting Policies**

There have been no changes in accounting policies since the filing of the last Management Discussion & Analysis on January 29, 2007, or since the beginning of the current fiscal year.

However, it should be noted that effective October 1, 2006, Audiotech's two principal Canadian operating subsidiaries were amalgamated. The amalgamation will afford the consolidated company greater tax planning opportunities and the ability to better utilize loss carryforwards in fiscal 2007 and beyond to reduce the consolidated corporate income tax liability.

## **1.14 Financial and Other Instruments**

The carrying values of cash, term deposit, accounts receivable and accounts payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of these items.

The fair value of the Company's long-term debt approximates its carrying value as there is a market rate of interest attached to the repayment.

The majority of the Company's accounts receivable are due from customers in Canada with the remainder due from customers in the United States. The maximum credit risk associated with the Company's financial assets is the carrying value of those assets. The Company's exposure to foreign exchange risk associated with self-sustaining foreign operations is limited to its net investment in those operations.

## **1.15 Other**

### ***Disclosure of Outstanding Share Capital***

As at December 31, 2006, Audiotech had 13,229,825 common shares issued and outstanding with a book value of \$1,750,340. No common shares were issued during the quarter.

As at December 31, 2006, there were 650,000 options to acquire common shares outstanding with a weighted average exercise price of \$0.20 (range of \$.16 to \$0.28).

### ***Subsequent Events***

There have been no material events subsequent to December 31, 2006, and prior to the date of this report, that have not been disclosed in this MD&A.

### ***Additional information***

Additional information relating to the company is on SEDAR at [www.sedar.com](http://www.sedar.com).