

# AUDIOTECH HEALTHCARE CORPORATION

## MANAGEMENT DISCUSSION AND ANALYSIS

For the 3 Month Ended December 31, 2008  
(First Quarter of Fiscal 2009)

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Directors and Officers of the Corporation as at  
December 31, 2008, and February 25, 2009

**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*

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 not performed a review of these financial statements. These consolidated financial statements have been certified by management.

## 1.1 Date of This Report

Date of Report: February 25, 2009

## 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

	2008	2007	2006
Canadian Revenues	\$ 900,968	\$ 728,926	\$ 645,406
U.S. Revenues	378,677	295,417	292,509
<b>a). Total Revenues</b>	<b>\$ 1,279,645</b>	<b>\$ 1,024,343</b>	<b>\$ 937,915</b>
<b>Operating Cash Flow*</b>	<b>106,101</b>	<b>(18,838)</b>	<b>49,905</b>
<b>b,c). Net Earnings **</b>	<b>66,994</b>	<b>(54,200)</b>	<b>17,000</b>
<b>EPS (basic &amp; fully-diluted)</b>	<b>0.005</b>	<b>(0.004)</b>	<b>0.0013</b>
<b>d). Total Assets</b>	<b>\$ 2,071,944</b>	<b>\$ 2,756,461</b>	<b>\$ 2,781,819</b>
<b>e). Total Long-Term Liabilities</b>	<b>1,193,374</b>	<b>1,208,964</b>	<b>\$ 774,724</b>
<b>f). Cash Dividends per Share</b>	<b>NIL</b>	<b>NIL</b>	<b>NIL</b>

### Statement of Income – Annual Data (Audited) - Years Ended September 30

	2008**	2007**	2006**	2005**	2004**
Canadian Revenues	\$ 3,049,903	\$ 2,793,104	\$ 2,549,453	\$ 2,566,952	\$ 2,299,029
U.S. Revenues	1,377,315	1,309,288	1,002,555	1,244,648	1,330,895
<b>a). Total Revenues</b>	<b>\$ 4,427,218</b>	<b>\$ 4,102,392</b>	<b>\$ 3,552,008</b>	<b>\$ 3,811,600</b>	<b>\$ 3,629,924</b>
<b>Operating Cash Flow*</b>	<b>(151,520)</b>	<b>285,300</b>	<b>230,908</b>	<b>182,349</b>	<b>286,100</b>
<b>b,c). Net Earnings (Loss) **</b>	<b>(1,272,334)</b>	<b>87,937</b>	<b>101,804</b>	<b>78,559</b>	<b>153,647</b>
<b>EPS (basic &amp; fully-diluted)</b>	<b>(0.095)</b>	<b>0.007</b>	<b>0.008</b>	<b>0.006</b>	<b>0.012</b>
<b>d). Total Assets</b>	<b>\$ 2,028,511</b>	<b>\$ 2,899,293</b>	<b>\$2,683,075</b>	<b>\$ 2,587,126</b>	<b>\$ 2,526,933</b>
<b>e). Total Long-Term Liabilities</b>	<b>1,188,971</b>	<b>1,218,199</b>	<b>\$742,242</b>	<b>\$ 1,158,227</b>	<b>\$ 984,149</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, future taxes, and accounting gains (or losses) related to the sale of capital assets. 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. In management's opinion, operating cash flow accurately reflects the amount of cash generated by the business operations of the company that is available for reinvestment, to fund debt repayment, or to fund changes in non-cash working capital items, or in the event that operating cash flow is negative, it reflects the amount of capital that was needed to be funded from new debt or equity sources, or from working capital to sustain operations during the period. Operating cash flow is

also commonly used in business valuation models to determine acquisition values in a consolidating market, thus management believes that it is relevant to consider operating cash flow when evaluating the performance of the company. A reconciliation of net earnings to operating cash flow is provided below.

\*\* there were no material extraordinary or unusual items, gains or losses on discontinued operations, etc. for any of the reporting periods except as otherwise disclosed in this MD&A.

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:

During the year ended quarter ended September 30, 2008, a one-time provision for the impairment of goodwill in the amount of \$942,775 was recorded. This event is discussed further later in this MD&A.

See section 1.5 below for a discussion of the impact of the U.S. / Canadian dollar exchange rate on the company's financial results over the above-noted reporting periods.

Reconciliation of operating cash flow:

	3 Months ended December 31		
	2008	2007	2006
Net Income (Loss)	\$ 66,994	\$ (54,200)	\$ 17,000
Amortization of Plant & Equip.	39,107	35,362	25,943
Loss on Disposal of Assets	-	-	587
Amort. of Debenture Discount	-	-	6,375
Operating Cash Flow	106,101	(18,838)	49,905

  

	Years Ended September 30				
	2008	2007	2006	2005	2004
Net Income (Loss)	\$ (1,272,334)	\$ 87,937	\$ 101,804	\$ 78,559	\$ 153,647
Amortization of Capital Assets	161,297	127,800	107,529	92,217	83,691
Future Income Taxes	(1,300)	51,472	(14,243)	(35,929)	-
Writeoff of Goodwill Impairment	942,775	-	-	-	-
Loss on Assets Disposal	18,042	7,461	10,318	1,477	19,428
Amort. of Debenture Discount	-	10,630	25,500	46,025	29,334
Operating Cash Flow	(151,520)	285,300	230,908	182,349	286,100

## 1.4 Results of Operations

Audiotech is pleased to report record quarterly sales for the first quarter of fiscal 2009 and a return to profitability after a year of building in fiscal 2008.

Total revenues for the first quarter ended December 31, 2008, reached \$1,279,645, an increase of 25% over the same quarter in fiscal 2008. Revenues from the Canadian operations totaled \$900,968, an increase of 24% over the \$728,926 reported a year earlier. Sales from the U.S. clinics surged 28% to \$378,677. Revenue growth in Canada was driven by contributions from the new clinic in Penticton and internal growth at a number of other clinics. Similar to the fourth quarter of fiscal 2008, U.S. growth was driven by both a significant improvement in the U.S./Canadian dollar exchange rate and a small increase in business volume. The previously disclosed staff changes in the Kelowna clinic are beginning to produce results.

Gross margins exceeded the long-term historical average, reaching 69.9% during the first quarter of fiscal 2009 versus 66.7% during the first quarter of fiscal 2008. This level slightly exceeded projections, however, in management's opinion, the change in gross margins experienced during the quarter was within the expected range that would be anticipated with typical day-to-day minor variations in the mix of product sold as well as due to the maturing of some of the clinics opened during the past couple of years. Such day-to-day variations can occur as a result of special promotions of higher or lower-margin products, a variation in the ratio of private hearing aid sales vs. those subsidized by various healthcare programs. Additionally, newer clinic operations often exhibit lower gross margins than well established clinics due to their lower product volumes, as well as incentive programs and sales discounts offered to establish a position in a new marketplace. Over the past 5 years, the company has generally achieved steadily increasing gross margins as a result of the negotiation of bulk purchasing agreements with major hearing aid manufacturers. The greater number of new clinics operating during fiscal 2008 contributed to the

temporary decline in margins in fiscal 2008. The margins during the first quarter are returning to the fiscal 2006 and fiscal 2007 levels. Management expects gross margins to range from roughly 67 to 69% over the next 9 months.

Historical Gross Margins:

Current Qtr.	Fiscal 2008	Fiscal 2007	Fiscal 2006	Fiscal 2005	Fiscal 2004	5 Yr. Avg.
69.9%	66.1%	69.2%	68.9%	65.4%	63.9%	66.7%

Direct clinic costs during the quarter rose 9.3% as compared to the same period in fiscal 2008. This increase can be attributed to staff costs related to the clinic expansions and new clinics openings that were undertaken during fiscal 2008. Indicative of the early improvements in productivity of the certain clinics previously identified as underperforming, direct clinic costs as a percentage of sales decreased from 63.3% in the first quarter of fiscal 2008 to 55.4% during the quarter, a slight improvement from the 56.5% in the third quarter of fiscal 2008, and 56.7% during the fourth quarter of fiscal 2008, despite the additional overhead costs in Penticton. Management anticipates direct costs to continue to decline slightly as a percentage of sales during the remainder fiscal 2009 as the newer clinics begin to contribute more significant revenues, as newly trained staff are able to contribute to growth, and as a result of a leaner cost structure at the younger clinics now that the start-up costs have been absorbed. Direct clinic costs during the quarter included certain non-recurring costs associated with staff changes at the Kelowna clinic.

General and administrative expenses totaled \$118,337 for the quarter, up slightly from the \$111,912 reported during the same period last year. However, G&A expenses declined from 10.9% of sales to just 9.2% of sales. These costs were in line with expectations and include a provision towards the fiscal 2009 audit fees, reflected in professional fees, that was not included in the prior year. A small increase in interest costs was offset by a small decline in administrative overhead costs at the head office and a foreign exchange gain.

Income taxes for the quarter were entirely offset by the application of prior period loss carry forwards.

As a result of the strong revenue growth and ongoing improvements within the newer clinic operations, the company is pleased to report net earnings of \$66,994 or \$0.005 per share for the first quarter of fiscal 2009. This compares to a loss of \$54,200 or \$0.004 per share in the same quarter in fiscal 2008. Operating cash flow also increased correspondingly from negative \$18,838 during the first quarter of fiscal 2008 to positive \$106,101 in the current reporting period.

As a result of a \$44,135 cumulative translation adjustment resulting from the appreciation of the U.S. dollar during the quarter, comprehensive income for the period was \$111,129 compared to a loss of \$53,081 in first quarter of fiscal 2008.

Both the Canadian and the U.S. clinic operations produced positive operating cash flow during the quarter, however, the majority of the operating cash flow was derived from the Canadian operations. Management has undertaken an enhancement program aimed at improving margins, revenue growth, and cost rationalization at the U.S. clinics to further improve profitability. Management expects a positive contribution from these efforts in upcoming quarters.

The first quarter financial results were slightly ahead of management's expectations. The company remains confident that the investments made in fiscal 2007 and 2008 to expand various clinics and open new locations will produce expanding profitability during the remainder of fiscal 2009 as targeted production levels at the new operations are achieved and as prudent cost reductions are completed. Management also remains confident that these investments have helped secure Audiotech as a dominant regional clinic operator in British Columbia, particularly outside of the Vancouver area, and that this positioning will result in a higher corporate valuation in the event that Audiotech is acquired by another entity in the current market consolidation cycle.

Management intends to focus on creating further operational efficiencies and improving the results from existing clinics during fiscal 2009 to ensure further earnings growth.

Details of all expenses can be found in the unaudited financial statements for the 3 month period ended December 31, 2008.

## 1.5 Summary Quarterly Results

Revenues and net income for the last 8 fiscal quarters were as follows:

	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
	12-31-08	09-30-08	06-30-08	03-31-08	12-31-07	09-30-07	06-30-07	03-31-07
Revenues	1,279,645	1,213,212	1,180,297	1,009,366	\$1,024,343	\$1,056,647	\$1,038,884	\$1,068,946
Net Income	66,994	(1,051,558)*	(43,879)	(122,697)	(54,200)	(32,060)	38,948	64,049
/ Share Basic	0.005	(0.079)	(0.003)	(0.009)	(0.004)	0.0024	0.0029	0.0048
/ Share FD	0.005	(0.079)	(0.003)	(0.009)	(0.004)	0.0023	0.0028	0.0048

\* During the quarter ended September 30, 2008, a one-time non-cash provision for the impairment of goodwill in the amount of \$942,775 was recorded.

Unit sales, product mix, and product pricing account for the greatest variation in quarterly sales and income. There have been no extraordinary or unusual events or items related to unit sales, product mix, and product pricing outside of what would be expected in normal day-to-day operations (inflation, the opening of new clinics, etc.) that impacted reported revenues and income during the past 8 quarters other than the variation in the US dollar / Canadian dollar exchange rate which impacts the results of the company's U.S. clinic operations which earn revenues in U.S. dollars. The results of the U.S. operations are converted into Canadian dollars upon the completion of the consolidated financial statements. Over the past several years, the Canadian dollar has appreciated considerable, thereby negatively impacted the revenues reported from the U.S. operations upon consolidation. However, during the first quarter of fiscal 2009, this trend exhibited a marked reversal, thereby having a positive impact on reported U.S. revenues as compared to reporting periods in fiscal 2008. The average US\$/CDN\$ exchange rate as per the Bank of Canada for each month since the beginning of the second quarter of fiscal 2007 is presented in the following chart (based on daily closing rates).

### 1US\$ - X\$CDN

Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
12-31-08	09-30-08	06-30-08	03-31-08	12-31-07	09-30-07	06-30-07	03-31-07
2008-10: 1.185	2008-07: 1.013	2008-04: 1.014	2008-01: 1.011	2007-10: 0.975	2007-07: 1.051	2007-04: 1.134	2007-01: 1.176
2008-11: 1.218	2008-08: 1.054	2008-05: 0.999	2008-02: 1.000	2007-11: 0.968	2007-08: 1.059	2007-05: 1.095	2007-02: 1.171
2008-12: 1.235	2008-09: 1.058	2008-06: 1.017	2008-03: 1.002	2007-12: 1.003	2007-09: 1.025	2007-06: 1.066	2007-03: 1.169
Avg.: 1.213	Avg.: 1.042	Avg.: 1.010	Avg.: 1.004	Avg.: 0.982	Avg.: 1.045	Avg.: 1.098	Avg.: 1.172

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. During fiscal 2007 and the first and second quarters of fiscal 2008 in particular, the Canadian dollar appreciated sharply against the U.S. dollar. The negative impact in the revenues of the U.S. operations (as reported in Canadian dollars) due to the appreciation of the Canadian dollar during this period was largely offset by increases business volume due to the opening of the Regional Hearing & Balance Center in Idaho Falls in 2005, and an increase in revenues from the company's Canadian operations as a result of the opening of several new clinics and the relocation and expansion of existing clinics noted below. As discussed above, there was a marked shift in the U.S. / Canadian dollar exchange rate during the first quarter of fiscal 2009. This trend has continued into the second quarter of fiscal 2009 and is expected to positively impact financial results from the U.S. operations during the remainder of fiscal 2009.

November 2006 – relocation of clinic in NW Calgary to larger facility

November 2006 – opened new clinic in Victoria, BC

October 2007 – opened new clinic in Kelowna, BC

October 2007 – relocation and expansion of clinic in Prince George, BC

August 2008 – closed underperforming clinic in Victoria, BC

August 2008 – opened clinic in Penticton, BC

The company's sales do not have any seasonal influences other than as noted below. It should be noted that these seasonal influences are minor and are not normally expected to have a material impact on the comparison of quarterly operating results.

Hearing aid sales in the month of December are typically slower than an average month due to the distraction of patients during the Christmas / holiday shopping season. Accordingly, there is a minor impact on the reported sales revenues of the company during the first quarter of most fiscal years (quarter ended December 31<sup>st</sup>). In some instances, the impact of this phenomena is delayed until January and the second quarter as the quantity of hearing assessments performed in one month has a corresponding impact not only on the current month's sales, but on the following month's sales as well.

Hearing assessments and aid sales in August of each year can be impacted by staff holidays and a similar distraction of patients as seen in December. The impact is generally very minor but can slightly reduce revenues during the company's fourth quarter ended September 30<sup>th</sup> of each year.

## 1.6 Liquidity

As at December 31, 2008, Audiotech had a cash balance of \$419,642.

Due to the upcoming maturity of certain long-term debt, the company had a small working capital deficit of \$15,704 as at December 31, 2008, as compared to \$85,220 at the beginning of the quarter. Management remains very confident that debt maturing within the next 12 months will be renewed under the same or similar terms. In the event that the Corporation faces an unexpected loss of certain investors, and is not successful in replacing them with new investors, it may draw from its existing \$1 million term loan facility with a major hearing aid manufacturer to restore its working capital to a positive position. As at December 31, 2008, only \$579,522 of this facility was drawn. Alternatively, the company may undertake a private placement with management and insiders, and/or private investors if required to maintain a healthy level of working capital.

Audiotech has used a number of sources of capital in the past to fund its operations and growth initiatives, including: cash flow generated by operations; the issuance of common shares; the receipt of proceeds upon the exercise of stock options by management & insiders; debt financing including the issuance of promissory notes and debentures to private investors; capital leases of clinical audiology equipment; and credit lines, term loans, and notes from major hearing aid suppliers. Due to management's strong relationships in the financial community, the Corporation has historically been very successful at securing new capital, and in renewing expiring notes and debentures or replacing expiring notes and debentures with new financing. Management maintains ongoing communication with its note and debenture holders to gauge the likelihood and expected cost (interest rate) of debt renewals. Additionally, major hearing aid manufacturers are becoming very active in the financing of hearing care providers who purchase their products, as a means of strengthening relationships with the vendors of their products to gain market share. Audiotech has historically established mutually-beneficial relationships with hearing aid manufacturers to finance its growth initiatives and will continue to do so where prudent.

The following long-term debt obligations mature during the remainder of fiscal 2009:

Term loan (US\$14,852), repayable in quarterly installments of US\$5,000 plus interest at prime plus 2%. Secured by promissory note of the Company subordinated to the security agreement on other debt, and a continuing guarantee. The balance as at December 31, 2008, was CDN\$18,090. Upon maturity, this loan will be repaid in full and will not be replaced or renewed.

Promissory notes (unsecured) in the amount of \$77,000, bearing interest at 8% per annum, paid monthly. Due March 2009. Management expects that the promissory notes will be renewed with the current or new investors for an additional term of 3 to 5 years, under a similar interest rate.

Promissory notes in the amount of \$74,525, repayable in monthly installments of \$1,450 including interest at 8% per annum, due June 2009. Management expects that the promissory notes will be renewed with the current or new investors for an additional term of 3 to 5 years, under a similar interest rate.

Unsecured promissory notes totaling \$200,000 bearing monthly interest payments at 8% per annum. Due August 2009. Management expects that the promissory notes will be renewed with the current or new investors for an additional term of 3 to 5 years, under a similar interest rate.

The maturing loan and promissory notes comprise the majority of the balance in the current portion of long-term debt. As this debt is repaid or renewed under long-term arrangements, management expects a corresponding increase in working capital.

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 4 & 5).

During the first quarter of fiscal 2009, a total of \$36,005 in long-term debt and \$11,527 in capital lease obligations were repaid using cash flow from operations and working capital.

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 changes in working capital accounts (accounts receivable, inventory, accounts payable, prepaid expenses, deferred revenue, and income taxes payable) during the quarter are in line with the expectations of management based on normal variations in these accounts that are anticipated with day-to-day operations.

Management is not aware of any trends or market conditions likely to have a material impact on liquidity or the company's capital position other than as disclosed in this MD&A.

## **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 (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 ordinary course of its business as it acquires, expands, and opens new clinics. A total of \$1,975 in capital purchases were made during the quarter and were financed from working capital. As the majority of the equipment at the company's operations has recently been upgraded, management forecasts that capital purchases to sustain existing operations over the remainder of fiscal 2009 will be well below historical levels.

On an annual basis, management conducts a valuation of its goodwill to determine if there has been an impairment in the value of the goodwill carried on the balance sheet. The goodwill impairment test involves a two step approach. The first step identifies a potential impairment. As a result of the operating loss in fiscal 2008, the uncertainty in the projected earnings of a number of new clinics opened during the period, and the impact these had on the estimation of the future earning trends of the reporting units, the company's estimate of the present value of future cash flows determined that the carrying values of both of the company's reporting units exceeded their fair value. Accordingly, an impairment provision of \$942,775 was recorded during the fourth quarter of fiscal 2008, reflecting a write-down of goodwill for both the U.S. and Canadian segments in the amount of \$494,114 and \$448,661 respectively. The provision represented the company's initial estimate of the goodwill impairment given the aforementioned uncertainty. In light of the significant improvement in operating cash flow during the first quarter of fiscal 2009, management is currently assessing the implications on the completion of the second step of the impairment test. Any subsequent determination based on completion of the second step of the impairment test as additional information becomes available, will be reflected prospectively in a subsequent period.

## **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 9 of the consolidated financial statements for the period ended December 31, 2008, 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 \$846 was paid to MediaWave Communications Corp., an Internet services company controlled by a director of the corporation in connection with website design and hosting services, and commissions on revenues derived from HearingDepot.com and HearingCenterOnline.com.

A total of \$7,327 in rent and cost reimbursement for utilities and property taxes 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 been paid by the company to purchase similar products and services from third parties.

The company has the following ongoing relationships with and commitments to related parties:

**MediaWave Communications Corp.:** MediaWave provides ongoing services to the company for website hosting and website updating. Audiotech also pays a percentage of revenues derived from HearingDepot.com and HearingCenterOnline.com in the form of commissions to MediaWave on a monthly basis. The business relationship between Audiotech and MediaWave can be terminated by either party at any time, for any reason. Management and the Board of Directors reviews the terms of the business relationship, including compensation, on an ongoing and regular basis.

**Sherwood Real Estate Corp.:** The corporation pays a monthly fee of \$1,850 plus operating costs and property taxes for the lease of the real estate that houses the company's clinic in southwest Calgary. The six-year lease expires in April 2010 and may be renewed at the option of the company for an additional term of 6 years at the discretion of management and the Board of Directors.

## **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 and financings. 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 as a result of critical accounting estimates and actual results other than the possible future adjustment to the goodwill impairment recorded during the fourth quarter of 2008. See discussion related to goodwill in section 1.7 above.

## 1.13 Changes in Accounting Policies

In July 2006, the Accounting Standards Board ("AcSB") issued a replacement of The Canadian Institute of Chartered Accountants' Handbook ("CICA Handbook") Section 1506, Accounting Changes. The new standard allows for voluntary changes in accounting policy only when they result in the financial statements providing reliable and more relevant information, requires changes in accounting policy to be applied retrospectively unless doing so is impracticable, requires prior period errors to be corrected retrospectively and calls for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. The impact that the adoption of Section 1506 will have on the Company's results of operations and financial condition will depend on the nature of future accounting changes.

Effective October 1, 2008, the company adopted the following policies:

### General Standards of Financial Statement Presentation

In June 2007, the CICA amended Handbook Section 1400 – "General Standards of Financial Statement Presentation" to include requirements to assess an entity's ability to continue as a going concern and disclose any material uncertainties that cast doubt on its ability to continue as a going concern. The adoption of this Section is not expected to have an impact on the consolidated financial statements.

### CICA Section 3031 – Inventories

The Canadian Accounting Standards Board ("AcSB") issued CICA Handbook Section 3064 which replaces Section 3062 – "Goodwill and Other Intangible Assets", and Section 3450 – "Research and Development Costs". This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. Standards concerning goodwill remain unchanged from the standards included in the previous Section 3062. The section is not expected to have an impact on the Company's financial results.

### CICA Section 3064 - Goodwill and Intangible Assets

The Canadian Accounting Standards Board ("AcSB") issued CICA Handbook Section 3064 which replaces Section 3062 – "Goodwill and Other Intangible Assets", and Section 3450 – "Research and Development Costs". This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. Standards concerning goodwill remain unchanged from the standards included in the previous Section 3062. The section is not expected to have an impact on the Company's financial results.

The Canadian Institute of Chartered Accountants has the following new section to its handbook that is expected to be adopted by the company in the future.

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of October 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended September 30, 2011. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

## 1.14 Financial and Other Instruments

Under Section 3251, *Equity*, Section 3855, *Financial Instruments - Recognition and Measurement* and Section 3861, *Financial Instruments - Disclosure and Presentation*, all financial instruments are classified into one of the following five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale assets or other financial liabilities. All financial instruments, including derivatives, are included on the balance sheet and are measured at fair market value upon inception with the exception of certain related party transactions.

Subsequent measurement and recognition of change in the fair value of financial instruments depends on their initial classification. Held-for-trading financial investments are measured at fair value and all gains and losses are included in operations in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Loans and receivables, held to maturity investments and other financial liabilities are measured at amortized cost using the effective interest method. Gains and losses upon inception, de-recognition, impairment write-downs and foreign exchange translation adjustments are recognized immediately. Transaction costs related to financing are expensed in the period incurred.

As a result of the adoption of these new standards, the Company has classified its cash as held-for-trading, receivables as loans and receivables and its accounts payable, accrued liabilities, long term debt, and capital lease obligations as other liabilities, which are measured at amortized cost.

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.

#### *Foreign exchange risk*

The Company's exposure to foreign exchange risk associated with self-sustaining foreign operations is limited to its net investment in those operations. The Company does not use forward looking foreign exchange contracts.

Certain financial instruments of the Company include amounts translated from foreign currencies into Canadian dollars. Listed below are the relevant instruments and the amount of foreign currencies included in their balances (in US dollars):

Cash \$ 75,607

Accounts receivable \$150,823

Accounts payable \$124,309

U.S. Dollars were translated at \$1.2180 to \$1.00 Canadian as at December 31, 2008.

#### *Credit risk*

Credit risk refers to the risk that a party to a financial instrument defaults on its obligation and thus brings about a financial loss to the Company. Credit risks arise mainly from trade accounts receivables. Company's policy requires that trade accounts receivable become due when services are rendered. The Company continually analyzes and manages the accounts. The Company has had history of few bad debts. The bad debt provision is maintained at a level considered sufficient to cover all potential losses.

#### *Interest rate risk*

The Company has cash balances, interest-bearing debt and capital lease obligations. Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company's exposure to the risk in market interest rates relates to entering into fixed or variable interest rate borrowing arrangements as required. The existing debt and capital lease obligations are held at fixed interest rates. The Company is also exposed to interest rate fluctuations on its cash balances and cash equivalents.

#### *Liquidity risk*

Liquidity risk is defined as the risk that the Company would not be able to meet its financial obligations due to a lack of liquidity. It is managed through diverse financing sources to maintain flexibility and by closely planning operational needs. The Company prepares budgetary and treasury projections to insure that it will have the funds necessary to meet its obligations. A large part of the Company's needs are met by its cash flow from operations. To finance business expansion, the Company negotiates financing facilities to meet its obligations when due. See "1.6 - Liquidity" above for further discussion.

## **1.15 Other**

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

As at December 31, 2008, and February 25, 2009 (the date of this report), 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, 2008, and February 25, 2009 (the date of this report), 450,000 options with an exercise price of \$0.16 were outstanding. These options expire on May 18, 2009.

### ***Subsequent Events***

There have been no material subsequent events since December 31, 2008, as of the date of this report.

### ***Additional information***

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