

# AUDIOTECH HEALTHCARE CORPORATION

## MANAGEMENT DISCUSSION AND ANALYSIS

For the 12 Months Ended September 30, 2006  
(Fourth Quarter of Fiscal 2006)

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Directors and Officers of the Corporation as at September 30, 2006 and January 29, 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

January 29, 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 September 30		
	2006	2005	2004
Canadian Revenues	\$ 595,246	\$ 656,837	\$ 720,178
U.S. Revenues	216,543	256,463	372,831
<b>a). Total Revenues</b>	<b>\$ 811,789</b>	<b>\$ 913,300</b>	<b>\$ 1,093,009</b>
<b>Operating Cash Flow*</b>	<b>(74,934)</b>	<b>11,058</b>	<b>156,109</b>
<b>b,c). Net Earnings **</b>	<b>(106,496)</b>	<b>12,560</b>	<b>108,812</b>
<b>EPS (basic &amp; fully-diluted)</b>	<b>(0.008)</b>	<b>0.001</b>	<b>0.008</b>
<b>d). Total Assets</b>	<b>\$ 2,683,075</b>	<b>\$ 2,587,126</b>	<b>\$ 2,526,933</b>
<b>e). Total Long-Term Liabilities</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>

### 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>\$742,242</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 are expected to improve.

## 1.4 Results of Operations

Total revenues for the fourth quarter of fiscal 2006 were \$811,789, compared to \$913,300 during the same quarter a year earlier. Management attributes a portion of this decrease in fourth quarter revenue to an unusual distribution of production staff vacation days (about 10% of the quarter) and considers it to be an anomaly. Revenues from the company's Canadian operations totaled \$595,246, while the U.S. operations contributed revenues of \$216,543. The reported revenues from Audiotech's U.S. operations continued to be negatively impacted by the strength of the Canadian dollar. As noted above, the U.S. dollar is now appreciating versus the Canadian dollar so reported revenues from the company's U.S. operations in fiscal 2007 are expected to strengthen. Total sales for the fiscal year ended September 30, 2006, were \$3,552,008.

As has been the case for the past year, Audiotech continued to post very strong gross profit margins during the fourth quarter. Gross margins for the fourth quarter and for the entire fiscal year were 68.9% of sales. This compares to 65.4% in fiscal 2005. Management remains confident that the factors that have contributed to the strong gross margins reported by the company over the past five quarters will continue into the foreseeable future.

Once again, other direct clinic costs (direct costs excluding materials and freight) during the quarter remained below the levels reported for the corresponding period last year. Direct clinic costs of \$430,573 during the quarter compare with \$498,675 during the quarter ended September 30, 2005, a reduction of 13.7%. Similarly, for the fiscal year, other direct clinic costs declined by 9.1% to \$1,736,943. Cost reductions for the fiscal year were experienced in several areas including clinic overheads, salaries, and selling expenses, following the trend set in earlier quarters.

Overall, for fiscal 2006, G&A expenses rose 3.6% due to a small increase in general expenses, professional fees, and administrative salaries and benefits. These increases were partially offset by a decline in interest costs. Management expects that general and administrative costs will decline as a percentage of sales in fiscal 2007.

Fourth quarter operating cash flow and earnings were below expectations largely due to a bigger than expected corporate income tax liability for the company's B.C. operating subsidiary, and a modest softening of revenues from both the Canadian and U.S. clinics during the quarter as noted above. Audiotech recorded a loss after taxes and amortization of the debenture discount of \$106,496 or \$0.008 per share for the quarter. Of this, \$65,345 pertains to corporate income taxes that relate to the entire fiscal year, not just the fourth quarter reporting period.

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.

Despite the unexpectedly high tax burden in fiscal 2006 and softer than anticipated fourth quarter revenues, the company reported net earnings of \$101,804 or \$0.008 per share for the year ended September 30, 2006, an increase of 29.6% over fiscal 2005. Net income before the amortization of the debenture discount totaled \$127,304, and operating cash flow reached \$230,908.

Both the Canadian and U.S. operations were profitable during fiscal 2006.

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 2005). For the year ended September 30, 2006, a total of \$25,500 in amortization of the debenture discount has been recorded versus \$46,025 during the fiscal 2005.

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:

	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
	09-30-06	06-30-06	03-31-06	12-31-05	09-30-05	06-30-05	03-31-05	12-31-04	09-30-04
Revenues	\$811,789	\$966,212	\$972,977	\$ 801,030	\$ 913,300	\$ 928,511	\$ 956,073	\$1,013,716	\$1,092,000
Net Income*	(106,496)	102,184	101,969	4,147	12,560	2,470	59,817	3,712	106,268
/ Share Basic	(0.008)	0.0077	0.0076	0.0003	0.0009	0.0002	0.0044	0.0003	0.008
/ Share FD	(0.008)	0.0074	0.0073	0.0003	0.0009	0.0002	0.0042	0.0003	0.008

\* 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 September 30, 2006, Audiotech had a cash balance of \$393,756.

Working capital was negative \$84,531 as a result of the re-classification of certain long-term liabilities as short-term (current liabilities) as the repayment of these liabilities is now scheduled within the next twelve months. This includes convertible debentures totaling \$250,370 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 \$20,568 in long-term debt obligations were repaid during the quarter ended September 30, 2006, bringing the total repaid to date in fiscal 2006 to \$166,282. A total of \$65,000 in new debt was secured during the year.

Total long term debt as at September 30, 2006, was \$1,196,801, a reduction of 7.2% from the long-term debt outstanding a year earlier. The current portion of long-term debt due within the next 12 months was \$467,033. 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 September 30, 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 \$69,212 in capital purchases were made during the fourth quarter of fiscal 2006 (\$141,173 for the year ended September 30, 2006). These purchases were financed from cash flow and working capital.

## **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 year ended September 30, 2006, entitled "Related Party Transactions," Audiotech had, in the normal course of business, several non-material transactions with related parties during the fiscal 2006:

A total of \$4,167 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 \$34,005 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 Fourth 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 or 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 August 29, 2006, or since the beginning of the current fiscal year.

## **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 September 30, 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.

425,000 escrowed shares were cancelled during the second quarter of fiscal 2006.

As at September 30, 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 September 30, 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).