

## **RUGGEDCOM INC.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE FIRST QUARTER ENDED JUNE 30, 2007 Dated: August 8, 2007**

The following is management's discussion and analysis ("MD&A") of the consolidated results of operations and financial condition of RuggedCom Inc. ("RuggedCom" or the "Company") for the three month periods ended June 30, 2007 and June 30, 2006. This MD&A should be read in conjunction with the Company's consolidated interim financial statements for the three month periods ended June 30, 2007 and June 30, 2006 and the notes thereto, the audited annual consolidated financial statements for the fiscal years ended March 31, 2007 and March 31, 2006 and the notes thereto and the auditors report thereon which can be found on pages F1-F17 of the Company's prospectus dated June 14, 2007 (the "Prospectus") filed with Canadian securities regulators in all of the provinces of Canada and management's discussion and analysis of financial condition and results of operations for the year ended March 31, 2007 which can be found in the Prospectus under the heading "Discussion and Analysis of Financial Condition and Results of Operations" at pages 40 - 52.

All amounts in this MD&A are in Canadian dollars, except where otherwise noted. References to "dollars" or "\$" mean Canadian dollars and references to "US\$" and "US dollars" mean United States dollars. The Company's fiscal year commences April 1 of each year and ends on March 31 of the following year. The Company's current fiscal year, which will end on March 31, 2008, is referred to as the "current fiscal year," "fiscal 2008" or using similar words. The previous fiscal year, which ended on March 31, 2007, is referred to as "previous fiscal year," "fiscal 2007," or using similar words.

The content of this MD&A has been approved by the Board of Directors, on the recommendation of its Audit Committee. This MD&A is dated August 8, 2007 and is current to that date, unless otherwise stated.

Additional information relating to the Company is available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at [www.sedar.com](http://www.sedar.com).

### **NON-GAAP MEASURES**

The Company reports its financial results in accordance with Canadian generally accepted accounting principles ("GAAP"). However, this MD&A contains references to certain non-GAAP financial measures such as EBITDA, EBITDA Margin and certain financial information presented on a "constant currency basis". Non-GAAP financial measures are used by management to evaluate the performance of the Company. Non-GAAP financial measures do not have standardized meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other reporting issuers. Earnings before interest, taxes, depreciation and amortization ("EBITDA"), is a measure used by many investors to compare companies on the basis of their ability to generate cash from operations. "Constant currency basis" is a method of comparison which assumes the foreign exchange rate between the US dollar and the Canadian dollar remains constant between comparison periods. We believe that EBITDA, EBITDA Margin and presenting certain financial information on a constant currency basis in this MD&A is useful supplemental information as it provides an indication of the results generated by the Company's main business activities before taking into consideration how these activities are financed and taxed and also prior to taking into consideration asset depreciation and, where indicated, exchange rate fluctuations in the value of the US dollar compared to the Canadian dollar. We track EBITDA, EBITDA Margin and revenues on a constant currency basis because we believe it makes it easier for management and investors to compare the Company's performance with previous periods and with companies and industries that do not have the same capital structure or tax laws. Investors are cautioned that non-GAAP measures, such as those presented herein, should not be construed as an

alternative to net income or loss determined in accordance with GAAP as indicators of the Company's performance or to cash flows from operating and investing activities as measures of liquidity and cash flow.

### **CAUTION REGARDING FORWARD-LOOKING INFORMATION**

Certain statements in this MD&A, particularly statements regarding future economic performance and finances, plans, expectations and objectives of management, may constitute "forward looking" statements which reflect the Company's current views with respect to future events and financial performance. When used in this MD&A, such forward-looking statements use words such as "may", "will", "expect", "believe", "anticipate", "plan", "intend", "estimate", "project", "continue" and other similar terminology of a forward looking nature or negatives of those terms. These forward looking statements are based on certain assumptions by management, certain of which are set out herein. The forward looking statements appearing in this MD&A reflect current expectations regarding future events and operating performance and speak only as of the date of this MD&A.

Although management believes that the expectations reflected in such forward-looking statements are reasonable, all forward-looking statements address matters that involve known and unknown risks, uncertainties and other factors and should not be read as guarantees of future performance or results. Accordingly, there are or will be a number of significant factors which could cause the Company's actual results, performance or achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements, including, but not limited to risks associated with: growth management; reliance on key personnel; growth in key markets; dependence on the electric power industry; competition; reliance on third-party suppliers; manufacturing and reliance on contract manufacturers; reliance on channel partners; fluctuations in quarterly results; dependence on certain licensed intellectual property; infringement of intellectual property rights; use of open-source software; protection of the Company's intellectual property; rapid technological change; product defects and liability claims; currency fluctuations; international risk; regulation; health and safety; economic and geopolitical uncertainty; acquisitions; transfer pricing; other tax matters; fluctuating share price; no dividends; and future sales of common shares by current shareholders.

Additional risk factor discussion can be found in this MD&A, in the section entitled "Risk Factors" and in the Company's continuous disclosure filings, reports and other filings with securities commissions and regulatory authorities in Canada and filed under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com).

### **RUGGEDCOM INC.**

RuggedCom is a leading provider of rugged communications networking solutions designed for mission-critical applications in harsh environments. When used outside of benign office environments, communications networking equipment can be exposed to harmful conditions that impact network reliability, throughput, availability, security and data integrity. The Company's solutions are designed for use in harsh environments such as those found in electric power substations and "Smart Grids", intelligent transportation systems, industrial process control and military applications. RuggedCom's robust technology solutions include proprietary hardware (Ethernet switches, network routers, wireless devices, serial servers and media converters), software (proprietary embedded software and application software) and professional services.

RuggedCom's solutions facilitate the extension of Internet Protocol ("IP") based communications networks from benign office environments to harsh non-office environments. IP-based communications networks are faster, more flexible and offer greater functionality than the legacy, serial, low-speed

communications systems currently used in most harsh environments. The extension of IP-based communications networks enables the seamless flow of information between an enterprise's non-office environment and its office environment. Moreover, the implementation of a common networking technology and infrastructure across an entire enterprise improves overall efficiency, increases the ability to monitor and secure operational assets and reduces costs associated with installation, integration, maintenance, parts and training.

## **SELECTED CONSOLIDATED INTERIM FINANCIAL INFORMATION**

The following tables set out selected consolidated financial information for the three month periods ended June 30, 2007 and 2006, respectively. The information in these tables have been derived from the unaudited consolidated interim financial statements and accompanying notes for the three month periods ended June 30, 2007 and June 30, 2006 as well as the March 31, 2007 audited consolidated financial statements. Each investor should read the following information in conjunction with those statements and related notes. The interim financial information for the three months ended June 30, 2007 and 2006 has been prepared by management in accordance with GAAP in a manner consistent with its annual financial statements.

**Selected Consolidated Quarterly Financial Information****Three months ended  
June 30 (unaudited)****2007**      **2006**In thousands, except share amounts, data  
expressed as percentages and per share  
data

<b>Revenue</b> .....	\$ 8,784	\$ 6,818
Cost of goods sold.....	<u>3,985</u>	<u>3,319</u>
Gross margin .....	4,799	3,499
Gross margin %.....	54.6%	51.3%
<b>Operating expenses:</b>		
Research and development.....	768	547
Sales and marketing.....	1,904	1,354
General and administrative.....	1,353	643
Amortization.....	<u>216</u>	<u>124</u>
Total operating expenses.....	<u>4,241</u>	<u>2,668</u>
Interest .....	<u>121</u>	<u>164</u>
Income before income taxes.....	437	667
Provision for income taxes – current.....	275	
Recovery for income taxes – future.....	<u>(16)</u>	<u>        </u>
Net income .....	<u>178</u>	<u>667</u>
<b>Net Income Per Share:</b>		
Basic.....	\$ 0.03	\$ 0.13
Diluted .....	\$ 0.02	\$ 0.09
<b>Weighted Average Number of Common Shares Outstanding:</b>		
Basic.....	5,926,776	5,296,087
Diluted .....	7,215,243	9,180,369
<b>Other data:</b>		
<b>EBITDA</b> <sup>(1)</sup> .....	\$ 774	\$ 955
<b>EBITDA Margin %</b> <sup>(1)</sup> .....	8.8%	14.0%

Notes:

(1) See "Non-GAAP measures"

<b><u>Net Income to EBITDA Reconciliation</u></b>	<b>Three months ended June 30 (unaudited)</b>	
	<b>2007</b>	<b>2006</b>
	In thousands	
Net income .....	\$ 178	\$ 667
Interest .....	121	164
Taxes .....	259	-
Amortization .....	<u>216</u>	<u>124</u>
<b>EBIDTA <sup>(1)</sup></b> .....	<b><u>\$ 774</u></b>	<b><u>\$ 955</u></b>

Notes:

(1) See "Non-GAAP measures"

<b><u>Consolidated Balance Sheet Data</u></b>	<b>As at June 30</b>	<b>As at March 31</b>
	<b>2007 (unaudited)</b>	<b>2006</b>
	In thousands	
Cash and cash equivalents .....	\$38,168	\$ 3,829
Working capital <sup>(1)</sup> .....	40,622	7,124
Total assets .....	51,159	14,808
Total liabilities .....	8,055	11,377
Total shareholders' equity .....	43,104	3,431

Notes:

(1) Working capital is calculated as current assets less current liabilities

## **Financial Highlights**

- Completed initial public offering and secondary offering of common shares (the "IPO") June 21, 2007 raising gross proceeds of approximately \$40.0 million, of which the Company received the net amount of approximately \$34.3 million from the issue and sale of 2,808,175 common shares at \$13.00 per common share from treasury;
- Subsequent to quarter end, completed the exercise of the underwriters' over-allotment option (the "Over-Allotment Option" and, together with the IPO, the "Offering") in connection with the IPO raising gross proceeds of approximately \$6.0 million, of which the Company received net proceeds of approximately \$5.1 million from the issue and sale of 421,226 common shares at \$13.00 per common share from treasury.
- Achieved revenues of \$8.8 million, an increase of 28.8% over the same quarter a year ago.
- Customer purchase orders totaled \$9.5 million, a quarterly record.
- Gross margins up 3.3 percentage points year over year.
- Completed the quarter with 12 consecutive quarters of record revenue growth.
- Completed the quarter with 9 consecutive quarters of profitability.

## **OVERALL PERFORMANCE**

### **Revenue and Expenses**

#### ***Revenue***

The Company's revenue is derived principally from the sale of IP-based rugged communications networking solutions including Ethernet switches, network routers, wireless devices, serial servers and media converters. The Company currently generates an insignificant percentage of revenue from application software and professional services.

The Company markets and sells rugged communications networking solutions worldwide through offices in North America, Europe and Asia. The Company's sales channel structure is different in each of the Company's target markets, but the majority of sales are derived from its sales team.

The Company's sales team is comprised of 15 regional sales managers who are employees of RuggedCom and are supported by its field application engineers. The Company's regional sales managers also utilize a network of manufacturers' representatives and distributors, as well as channel partners, such as original equipment manufacturers, system integrators and consultants, each utilized to varying degrees based on the specific nature of target markets.

The Company's revenues have increased from both sales to new customers as well as sales of additional products and services to its existing customer base and it has broadened its geographic sales base. The sales cycle is typically characterized by extensive evaluation periods and in some cases bench trials and pilot deployments. Most of the Company's orders are made pursuant to purchase orders and the Company does not typically have long term supply contracts with our customers.

The Company monitors revenue performance in four main geographical areas, North America, Europe, the Middle East and Africa ("EMEA"), Asia-Pacific (including Australia) ("APAC") and Latin America. The Company also monitors revenue performance in four main market categories: Utilities, Transportation, Industrial and Military.

#### ***Cost of Goods Sold***

Cost of goods sold consists primarily of costs of manufacturing and assembly of products. A significant portion of these costs is represented by components and compensation costs for the manufacture and assembly of products. Cost of goods sold also includes related overhead, final assembly, quality assurance, inventory management and payments to local third-party subcontract manufacturers that perform outsourced manufacturing and assembly for the Company. Cost of goods sold also includes the cost of providing services to customers, primarily the cost of service-related personnel used for training and professional services.

#### ***Operating Expenses***

The Company's operating expenses consist of (i) research and development expenditures, (ii) sales and marketing expenses, (iii) general and administrative expenses and (iv) amortization.

Research and development expenses consist primarily of personnel and related costs associated with the Company's research and development efforts, including the development of new products, enhancements to existing products, quality assurance activities, software development, tools and equipment. The Company is entitled to certain scientific research and experimental development ("SR&ED") Canadian tax credits for qualifying research and development activities performed in Canada. Expenses are shown net of applicable SR&ED tax credits.

Sales and marketing expenses consist primarily of costs relating to personnel and to the Company's sales and marketing activities, including the salaries and commissions paid to the Company's sales force, commissions paid to independent industry sales representatives, advertising, trade shows and other promotional expenses.

General and administrative expenses are comprised primarily of costs relating to personnel and related costs associated with the administration of the Company's business, including, information technology, finance and customer support functions, legal and other professional fees, rental of office and manufacturing space, insurance and other corporate and overhead expenses.

Amortization of property, plant and equipment and intangible assets is recorded over the estimated useful lives of the assets on a straight-line basis. Intangible assets consist primarily of intellectual property including patents, and patents for which applications have been filed and trademarks.

## INTERIM PERIOD OPERATING RESULTS

### Revenue

The Company's reporting currency is Canadian dollars. A significant portion of the Company's sales are in US dollars and accordingly the Company's sales results are affected by fluctuations in the exchange rate of the US dollar. The Company believes that a more accurate picture of sales performance is provided by performing comparative analysis on a constant currency basis<sup>(1)</sup>, (See "Effect of Foreign Exchange on Sales" below). For the three month period ending June 30, 2007 ("Q1-F08") approximately 92% of the Company's sales revenues were in US\$.

### Highlights (for Q1-F08):

- Achieved sales revenues of \$8.8 million
  - 12th consecutive quarter of record revenues
  - Increase of 28.8% (32.4% on a constant currency basis) from same period prior year
- Achieved purchase orders totaling \$9.5 million
  - A Company record
  - Increase of 37.0% (40.2% on a constant currency basis) from same period prior year
- Added 77 new customers
  - Increase of 11.6% from same period prior year

Sales for Q1-F08 were \$8.8 million compared to \$6.8 million for the same period in the last fiscal year, representing an increase of 28.8% (32.4% on a constant currency basis). Sales revenues for Q1-F08 were also 9.2% (17.0% on a constant currency basis) above the previous three month period ending March 31, 2007 and represented the Company's 12th consecutive record quarter.

Customer purchase orders for Q1-F08 totaled \$9.5 million compared to a \$6.9 million for the same period last year, representing an increase of 37.0% (40.2% on a constant currency basis).

In general, sales for Q1-F08 were driven by the continued deployment of IP-based rugged communications networking solutions across all of the Company's target markets and regions to both existing and new customers.

<sup>(1)</sup> See "Non-GAAP Measures".

## Sales by Market

The increase in sales was driven primarily by sales growth in the electric power market which grew 24.3% (27.7% on a constant currency basis) over the same period in the prior fiscal year and comprised 61.9% of total Company sales for the Q1-F08 as compared to 64.1% over the same period in the prior fiscal year. In addition, Q1-F08 sales in the electric power market represented the Company's fifth consecutive record quarter when measured on a constant currency basis. Sales in the industrial process and military markets grew by 66.7% and 200.7%, respectively, (71.2% and 208.9% respectively on a constant currency basis) and accounted for 12.4% and 7.7%, respectively, of total sales for the quarter as compared to 9.5% and 3.3%, respectively, over the same period in the prior fiscal year. Sales in both the industrial process and military sectors also established new quarterly records (on a constant currency basis) for the highest dollar sales for any prior quarter in the Company's history, however, the Company's experience indicates that sales in both of these markets are susceptible to volatility on a quarter over quarter basis. Sales in the transportation sector accounted for 16.5% of sales for the quarter compared to 21.8% over the same period in the prior fiscal year however growth was relatively flat, showing a slight decline of 2.6% (0.0% on a constant currency basis) over the same period in the last fiscal year. The Company's experience indicates that sales by the Company in the transportation sector have quarterly volatility due to the project-based nature of sales within this sector.

(Unaudited) MARKET/SECTOR	Three months ended June 30 (as percentage of total)		Three months ended June 30 (\$ millions)		Change	Change (on a constant currency basis) <sup>(1)</sup>
	2007	2006	2007	2006	%	%
Electric Power (Utilities) .....	61.9%	64.1%	\$5.4	\$4.4	24.3%	27.7%
Transportation .....	16.5%	21.8%	1.5	1.5	-2.6%	0.0%
Industrial .....	12.4%	9.5%	1.1	0.6	66.7%	71.2%
Military .....	7.7%	3.3%	0.7	0.2	200.7%	208.9%
Other .....	<u>1.5%</u>	<u>1.2%</u>	<u>0.1</u>	<u>0.1</u>	<u>69.5%</u>	<u>74.1%</u>
	<u>100.0%</u>	<u>100.0%</u>	<u>\$8.8</u>	<u>\$6.8</u>	<u>28.8%</u>	<u>32.4%</u>

Notes:

(1) See "Non-GAAP Measures".

## Sales by Region

North American sales, which comprised 43.3% of the Company's Q1-F08 revenue compared to 51.9% over the same period in the prior fiscal year, grew by 7.5% (10.5% on a constant currency basis) over the same period in the prior fiscal year and were largely driven by the electric power and transportation sectors. Europe, Middle-East and Africa (EMEA) sales, which comprised 36.1% of the Company's Q1-F08 revenue compared to 32.0% over the same period in the prior fiscal year, grew by 45.2% (49.1% on a constant currency basis) over the same period in the prior fiscal year and were largely driven by the electric power sector. Asia-Pacific (APAC) sales, which comprised 13.1% of the Company's Q1-F08 revenue compared to 13.0% over the same period in the prior fiscal year, grew by 29.9% (33.5% on a constant currency basis) over the same period in the prior fiscal year, primarily driven by sales in the electric power sector and industrial process sectors. Latin America, which comprised 7.5% of the Company's Q1-F08 sales revenue compared to 3.1% over the same period in the prior fiscal year, showed a steep growth spike in Q1-F08 sales, growing by over 200%, primarily driven by sales in the electric power sector. However, it should be noted that the quarter-over-quarter sales numbers for Latin America are small in absolute dollar terms and consequently, an increase in sales revenues translates to a large

growth percentage. The Company expects future volatility in quarter-over-quarter results for Latin America.

<b>(Unaudited)</b> <b>REGION</b>	<b>Three months ended June 30</b> (as percentage of total)		<b>Three months ended June 30</b> (\$ millions)		<b>Change</b>	<b>Change</b> (on a constant currency basis) <sup>(1)</sup>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>%</b>	<b>%</b>
North America.....	43.3%	51.9%	\$3.8	\$3.5	7.5%	10.5%
Latin America.....	7.5%	3.1%	0.7	0.2	212.7%	221.2%
Asia Pacific.....	13.1%	13.0%	1.1	0.9	29.9%	33.5%
Europe, Middle East & Africa ...	<u>36.1%</u>	<u>32.0%</u>	<u>3.2</u>	<u>2.2</u>	45.2%	49.1%
	<u>100.0%</u>	<u>100.0%</u>	<u>\$8.8</u>	<u>\$6.8</u>	<u>28.8%</u>	<u>32.4%</u>

Notes:

(1) See "Non-GAAP Measures".

### Sales by Customer

The total number of customers who placed orders in Q1-F08 was 260 as compared to 229 for the same period in the previous financial year, an increase of 13.5%. In Q1-F08 the Company also added 77 new customers as compared to 69 for the same period in the previous fiscal year, representing an increase of 11.6%. The electric power sector contributed the largest number of new customers (31 out of the 77).

The Company's top ten customers accounted for 51.3% of revenues. The following table outlines the revenue generated from the Company's top two customers, each of which represented more than 10% of the Company's revenues for Q1-F08.

<b>Customers comprising greater than 10% of revenues for a given period</b>		
	<b>% of total revenues for Three months ended June 30th, 2007</b>	<b>% of total revenues for Three months ended June 30th, 2006</b>
Customer A	13.2%	9.2%
Customer B	12.6%	11.2%
Total	25.8%	20.4%

## Effect of Foreign Exchange on Sales <sup>(1)</sup>

The Company's reporting currency is Canadian dollars. A significant portion of the Company's sales are invoiced in US dollars and therefore the Company's reported operating results are exposed to fluctuations in US dollar exchange rates. For the Q1-F08, approximately 92% of the Company's revenues were invoiced in US\$. The tables below show the average monthly exchange rate for the period indicated.

<i>Table showing effect of US\$ exchange rate compared to same period the previous year.</i>				
<b>1 unit of foreign currency = Canadian dollars</b>	<b>Three months ended June 30<sup>th</sup>, 2007</b>	<b>Three months ended June 30<sup>th</sup>, 2006</b>	<b>Variance (\$)</b>	<b>Variance (%)</b>
U.S. Dollar	1.0938	1.1237	(0.0299)	(2.7%)

<i>Table showing effect of US\$ exchange rate compared to same period the previous quarter.</i>				
<b>1 unit of foreign currency = Canadian dollars</b>	<b>Three months ended June 30<sup>th</sup>, 2007</b>	<b>Three months ended March 31<sup>st</sup>, 2007</b>	<b>Variance (\$)</b>	<b>Variance (%)</b>
U.S. Dollar	1.0938	1.1716	(0.0778)	(6.6%)

Notes:

- (1) See "Non-GAAP measures"

As a result of the strengthening Canadian dollar during the quarter, every sale invoiced in US dollars became worth less in Canadian dollar terms.

The table below quantifies the effect on sales if the average monthly exchange rate for Q1-F08 had remained constant with the same period in the previous fiscal year:

<i>Table showing effect of US\$ exchange rate on sales compared to same period the previous year.</i>				
	<b>Sales for three months ended June 30<sup>th</sup>, 2007 (\$ in thousands)</b>	<b>Sales for three months ended June 30<sup>th</sup>, 2006 (\$ in thousands)</b>	<b>Variance (\$)</b>	<b>Variance (%)</b>
As reported	8,784	6,818	1,966	28.8%
Impact of foreign exchange (fx)	240	-	-	-
Adjusted for fx	9,024	6,818	2,206	32.4%

The table below quantifies the effect on sales if the average monthly exchange rate for Q1-F08 had remained constant with the previous quarter:

<i>Table showing effect of US\$ exchange rate on sales compared to the previous quarter.</i>				
	<b>Sales for three months ended June 30<sup>th</sup>, 2007 (\$ in thousands)</b>	<b>Sales for three months ended March 31<sup>st</sup>, 2007 (\$ in thousands)</b>	<b>Variance (\$)</b>	<b>Variance (%)</b>
As reported	8,784	8,041	743	9.2%
Impact of foreign exchange (fx)	625	-	-	-
Adjusted for fx	9,409	8,041	1,368	17.0%

## ***Gross Margin***

Gross margin for the Q1-F08 increased 37% to \$4.8 million, compared to \$3.5 million in the same period in the last fiscal year, and as a percentage of revenue, increased to 54.6% from 51.3% for the same period in the last fiscal year. This increase in margin percentage was due in part to product mix and sales in different markets which resulted in a lower cost of goods sold relative to revenue. Approximately 92% of the Company's revenue for Q1-F08 was invoiced in US dollars, so the increase in gross margin percentage would have been greater had the average monthly exchange rate for Q1-F08 remained constant with the same period in the previous fiscal year. The Company continues to seek to grow top line revenue and to reduce the cost of its products in order to reduce the risk of declining gross margins associated with the competitive environment.

## ***Operating Expenses***

The following table presents additional comparative data for the Company's operating expenses:

### **Expenses as a Percentage of Revenue**

	<b>Three months ended June 30 (unaudited)</b>	
	<b>2007</b>	<b>2006</b>
	<b>\$</b>	<b>\$</b>
<b>Revenue</b> .....	<u>8,784</u>	<u>6,818</u>
Research and development .....	768	547
<b>% of revenue</b> .....	<b>8.7%</b>	<b>8.0%</b>
Sales and marketing .....	1,904	1,354
<b>% of revenue</b> .....	<b>21.7%</b>	<b>19.9%</b>
General and administrative .....	1,353	643
<b>% of revenue</b> .....	<b>15.4%</b>	<b>9.4%</b>
Amortization .....	216	124
<b>% of revenue</b> .....	<b>2.5%</b>	<b>1.8%</b>
Total operating expenses .....	<u>4,241</u>	<u>2,668</u>
<b>% of revenue</b> .....	<b>48.3%</b>	<b>39.1%</b>

## ***Research and Development Expenses***

Research and development expenses for the Q1-F08 (including \$75,000 of accrued SR&ED tax credits) increased 40% to \$768,000, compared to \$547,000 for the same period in the previous fiscal year, representing 8.7% and 8.0% of total revenues for each period, respectively. Removing SR&ED credits accrued in Q1-F08, the Company's research and development expenditures were 9.6% of revenue. The increase in both dollar and percentage terms was mainly attributable to increased research and development personnel costs as head count in this area increased from 17 to 28 and to the development of new products and the enhancement of existing products.

## ***Sales and Marketing Expenses***

Sales and marketing expenses for Q1-F08 increased 41% to \$1.9 million, compared to \$1.4 million for the same period in the previous fiscal year, representing 21.7% and 19.9% of total revenues

for each period, respectively. The increase in dollar amount was partially attributable to an increase in the Company's sales personnel from 16 to 27 and an increase in their total compensation, a portion of which is performance based. The expansion of the Company's marketing group from two to five personnel also contributed to the increase. An increase in marketing activities, including higher levels of advertising, trade show and related promotional expenses, resulted in a 97% increase over the same period a year ago. The Company expects that selling and marketing expenses will increase in dollar amount in future periods as amounts paid out to its sales force and to industry sales representatives increase commensurate with the growth in the Company's sales, as overall marketing activities and efforts increase and as the Company continues to invest in marketing activities to promote its products.

### ***General and Administrative Expenses***

General and administrative expenses for Q1-F08 increased 110% to \$1.4 million, compared to \$0.6 million the same period in the last fiscal year, representing 15.4% and 9.4% of total revenues for each period, respectively. Approximately one half of the increase of \$0.8 million was attributable to increased personnel expenses as general and administrative staff increased from 10 to 19 personnel. This increase was needed to support the Company's staffing requirements in finance, administration and customer support due to the growth in the Company's business as well as the increased administrative demands associated with being a public company. An additional \$0.1 million of the increase was due to one-time professional fees and other costs regarding tax related work. Approximately \$0.1 million of the total \$1.6 million of professional fees incurred by the Company with regard to the Offering was allocated to the selling shareholders in the Offering, and thus charged to expense and not to equity as share issuance costs. The Company also incurred bad debt expense in the quarter of approximately \$0.1 million. During the quarter the strengthening Canadian dollar had a negative impact on the Company's revenue which was partially responsible for general and administrative expenses being higher than the historical percentage of revenue experienced by the Company. If this foreign exchange effect and the foregoing one time expense items are excluded, general and administrative expenses would have been 11.2% of revenue.

### ***Interest and Other Income***

The Company incurred \$121,000 of interest expense in Q1-F08 compared to \$164,000 in the same period last fiscal year. The Q1-F08 expense is a net of:

1. \$162,000 of interest expense related to the Class A preferred shares which were outstanding until June 21, 2007 when they automatically converted to common shares on the Company's completion of the IPO; and
2. \$41,000 of interest income earned on the Company's cash and cash equivalents balances

The Class A preferred shares were accounted for as a liability, in accordance with the accounting guidance on financial instruments. The Class A preferred shares had a mandatory redemption feature and contained rights to 8% cumulative dividends. The value of the conversion feature was allocated to contributed surplus and the liability was being accreted to the redemption amount of the loan. Upon conversion of the Class A preferred shares to common shares on completion of the IPO, the Company no longer records interest expense with regard to these securities, and the 8% cumulative dividends cease to accrue.

### ***Income Tax Expense***

The Company recorded a tax provision for Q1-F08 of \$259,000 which is calculated at an effective rate of 59.2%. The relatively large size of certain permanent differences (totaling \$271,000) relating to stock compensation expense (\$109,000) and accrued interest expense associated with the Class A preferred shares (\$162,000) relative to our net income before taxes of \$437,000 caused our effective tax

rate for Q1-FY08 to be significantly higher than the normal statutory rate of 36.1%. Upon completion of the Company's IPO, the Class A preferred shares automatically converted to common shares and the related interest expense ceased to be accrued. This reduces the total permanent differences the Company would otherwise have.

### ***Net Income***

Net income before taxes for Q1-F08 was \$437,000 compared to \$667,000 for the same period in the last fiscal year, representing 5.0% and 9.8%, respectively, of total revenues for each period. Net income before income taxes fell short of the Company's expectations for several reasons. Approximately 92% of the Company's first quarter revenue was invoiced in US dollars, so the strengthening Canadian dollar relative to the US dollar resulted in lower than expected revenues, translating into lower net income before taxes of approximately \$160,000, or about 1.8% of actual revenue. Certain one-time general and administrative expenses, as explained earlier, were responsible for approximately \$330,000, or about 3.8% of revenue, of the shortfall. If these variances are excluded, the Company's net income before taxes in Q1-F08 would have been approximately \$927,000, or 10.2% of revenue (on a constant currency basis).

Net income after taxes for Q1-FY08 was \$178,000 compared to \$667,000 for the same period in the last fiscal year, representing 2.0% and 9.8%, respectively, of total revenues for each period. In the first quarter of fiscal 2007, net income before taxes equaled net income after taxes due to the fact that the Company did not have any provision for income taxes in that period.

### **Outlook**

The Company expects that our annual revenues will continue to grow in each of our target markets from sales of existing and new products and services. The Company expects to increase total dollar gross margins, however, gross margin percentages may vary depending on the mix of products and services sold and our success in winning large customer orders. Research and development will continue to be a key focus as the Company invests in new product and service development and current product and service enhancements. Additional resources will be committed to sales and marketing with particular emphasis on further developing our distribution channels internationally.

## LIQUIDITY AND CAPITAL

	As at June 30, 2007 (unaudited)	As at March 31, 2007
	(In thousands, except Balance Sheet Ratios)	
<b>Key Balance Sheet Amounts and Ratios:</b>		
Cash and cash equivalents	\$38,168	\$3,829
Working capital	40,622	7,124
Long term assets	3,407	2,029
Long term liabilities <sup>(1)</sup>	925	5,722
Working capital ratio <sup>(2)</sup>	6.7	2.3
Days sales outstanding in accounts receivable <sup>(3)</sup>	45 days	47 days
Inventory turnover <sup>(4)</sup>	4.6 times	4.5 times

### Notes:

- (1) Long term liabilities at March 31, 2007 included \$4,844 related to the Class A preferred shares which were outstanding until June 21, 2007 when they automatically converted to common shares on the Company's completion of the IPO
- (2) Current assets divided by current liabilities.
- (3) Days sales in accounts receivable represents the number of days' worth of sales uncollected as at June 30. It is derived by calculating the number of days required to accumulate total cumulative daily sales equal to the current trade receivable balance
- (4) Inventory turnover is defined as the total cost of goods sold for the last 12 months period divided by the average inventory balance over that same 12 months.

### *Cash and Cash Equivalents*

Cash and cash equivalents include cash on hand, banks balances and short term investments that are readily convertible to cash

Investments in cash equivalents and marketable securities are governed by the Company's Cash Management & Investment Policy as approved by the Board of Directors. Excess funds are invested in accordance with sound investment management principles. The policy stipulates that investments will at all times be based on the requirements for safety, liquidity and yield in that order of importance.

As at June 30, 2007, the Company had \$38.2 million of cash and cash equivalents compared to \$3.8 million as at March 31, 2007. This increase is attributable to the Company's receipt of its portion of proceeds from the issue and sale of common shares in the IPO. See "Issuance of Equity Shares".

### *Working Capital*

Working capital is defined as current assets less current liabilities. The Company's working capital balance increased to \$40.6 million at June 30, 2007 compared to \$7.1 million at the end of the last fiscal year. The Company's working capital ratio (current assets divided by current liabilities) increased to 6.7:1 compared to 2.3:1 at March 31, 2007. The increase in the Company's working capital ratio is mainly attributable to net cash proceeds received by the Company in connection with the completion of the IPO.

The Company's accounts receivable balance increased \$0.2 million during the first quarter of fiscal 2008 to \$4.8 million from \$4.6 million in the prior quarter. Days sales outstanding in accounts receivable ("DSO") decreased to 45 days at June 30, 2007 from 47 days at the end of fiscal 2007 due to improved collection efforts. The Company's DSO could trend upward to the extent that the Company increases its revenue base in markets outside of North America as, in the Company's experience, international receivables tend to take longer to collect. The Company's allowance for doubtful accounts

increased from \$58,000 at the end of the previous quarter to \$173,000 as at June 30, 2007. (See “Critical Accounting Policies and Estimates – Allowance for Doubtful Accounts.”)

Inventory balances increased by \$0.7 million to \$3.2 million at the end of the Q1-F08 from \$2.5 million in the prior quarter. This increase was partly due to the fact that material had been purchased in advance for sales which did not materialize in the quarter. Inventory levels also increased due to advance purchase of certain components to achieve unit cost reductions. Inventory turnover, calculated using the last 12 months' cost of sales and average inventory balances, increased slightly from 4.5 times at the end of fiscal 2007 to 4.6 times at the end of Q1-F08. The Company expects inventory turnover to increase as the Company continues to achieve cost productivity gains as a result of the growth in its business.

Accounts payable and accrued liabilities increased \$2.4 million to \$6.4 million at the end of the Q1-F08 from \$4.0 million in the prior quarter. Approximately half of this increase, \$1.1 million, was due to various legal, audit, tax, consulting and printing costs directly attributable to the IPO which remained unpaid as at the end of the quarter.

### ***Cash Provided by (used in) Operating Activities***

The Company generated \$0.4 million cash from operating activities in Q1-F08 as compared to \$0.7 million in the same period last fiscal year. The cash provided relates partly to \$0.6 million of non-cash items, offset by \$0.4 million cash used through the change in current non-cash working capital. The balance of \$0.2 million was provided through operating performance. In the same period in the last fiscal year the cash generated from operating activities of \$0.7 million was provided entirely through operating performance with \$0.4 million of non-cash items offsetting \$0.4 million cash used through the change in current non-cash working balances.

### ***Investing Activities***

Additions of capital assets were \$0.2 million for Q1-F08 compared with \$0.2 million for the same period in the last fiscal year. These additions represent continued investment by the Company in hardware, software and tooling as well as office and information technology infrastructure build. See “Capital Resources.”

### ***Financing Activities***

Financing activities generated \$34.1 million during Q1-F08. The Company completed the IPO on June 21, 2007. The Company offered a total of 3,080,000 shares at \$13.00 per common share, of which 2,808,175 were issued and sold from treasury and 271,825 were sold by the selling shareholders in a secondary offering. The Company received net proceeds of approximately \$34.3 million and the selling shareholders received net proceeds of an aggregate of approximately \$3.3 million, respectively, after underwriter fees of an aggregate of approximately \$2.4 million. The Company's share of the net proceeds from the issue and sale of common shares in the IPO will be used as disclosed in the Prospectus.

Upon completion of the IPO, the 10,813,734 outstanding Class A preferred shares automatically converted to common shares on a four for one basis, resulting in the issuance of 2,703,432 common shares. Upon the conversion, the total accreted value of the Class A preferred shares, including all cumulative dividends, was credited to capital stock

During the Q1-F08 the Company issued 189,930 common shares upon exercise of stock options for net proceeds of \$318,000.

On July 16, 2007, subsequent to the end of Q1-F08, the underwriters exercised an Over-Allotment Option granted to them in connection with the Company's IPO. The Over-Allotment Option entitled the underwriters to purchase an additional 462,000 common shares at \$13.00 per share, of which

421,226 shares were issued and sold by the Company from treasury for net proceeds of approximately \$5.1 million to the Company, and 40,774 shares were sold by the selling shareholders, for net proceeds of an aggregate of approximately \$0.5 million paid to the selling shareholders. The Company's share of the net proceeds from the issue and sale of common shares in the Over-Allotment Option will be used as disclosed in the Prospectus.

The Company also has a credit facility from a chartered financial institution as well as outstanding capital leases under which periodic payments are made. See "Contractual Obligations" and "Capital Resources."

### ***Outstanding Share Capital***

The Company's authorized share capital is comprised of an unlimited number of common shares of which there are 11,481,579 outstanding as of the date of this MD&A. This number includes the common shares issued and sold by the Company in connection with the underwriters' exercise of the Over-Allotment Option.

### ***Financial Instruments***

The fair value of accounts receivable, other receivables, accounts payable, accrued liabilities and obligations under capital leases approximates their carrying value due to the immediate or short-term maturity of these financial instruments.

The Company is subject to financial risk related to earnings and expenses that arises from fluctuations in foreign exchange rates. The Company does not currently enter into hedging arrangements or utilize derivative financial instruments to manage its exposure to foreign exchange rate fluctuations, but may do so in the future.

### **Contractual Obligations**

The majority of the Company's contractual obligations consists of current and long-term capital and operating lease obligations. The Company also accrues warranty costs regarding the five year warranty associated with the sale of its products. As at June 30, 2007 the Company had long-term liabilities of \$0.9 million. This compares to long-term liabilities of \$5.7 million as at March 31, 2007, of which \$4.8 million was comprised of the liability portion of the Company's Class A preferred shares. This liability ceased upon the automatic conversion of the Class A preferred shares to common shares upon completion of the Company's IPO.

### **Capital Resources**

Future capital expenditures will continue to be funded through a combination of internally generated cash flows and capital lease financing. Capital expenditures will continue to include a mix of computer hardware, software, test equipment, tooling, leasehold improvements and office furniture as the Company continues to invest in its office and IT infrastructure. The Company also has a credit facility from a chartered financial institution comprising a \$0.7 million revolving demand facility that is secured by certain of our assets. The facility is available for working capital requirements and general corporate purposes. As at June 30, 2007 there were no borrowings outstanding under the facility and the full amount available under the facility is available for future cash needs.

**Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements other than those disclosed under "Contractual Obligations" and "Financial Instruments".

**Transactions with Related Parties**

The Company did not enter into any transactions with related parties during Q1-FY08, fiscal 2007, 2006 and 2005.

## Selected Consolidated Quarterly Information

	Fiscal 2008	Fiscal 2007				Fiscal 2006			
	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30
	(In thousands, except share amounts, data expressed as percentages and per share data)								
	(Unaudited)								
Revenue .....	\$ 8,784	\$ 8,041	\$ 7,562	\$ 7,276	\$ 6,818	\$ 4,679	\$ 4,223	\$ 3,931	\$ 3,107
Cost of goods sold.....	<u>3,985</u>	<u>3,695</u>	<u>3,342</u>	<u>3,303</u>	<u>3,319</u>	<u>1,963</u>	<u>1,955</u>	<u>1,737</u>	<u>1,347</u>
Gross margin .....	4,799	4,346	4,220	3,973	3,499	2,716	2,268	2,194	1,760
Gross margin %.....	54.6%	54.0%	55.8%	54.6%	51.3%	58.0%	53.7%	55.8%	56.6%
<b>Operating expenses:</b>									
Research and development....	768	(583)	585	588	547	408	254	346	227
Sales and marketing.....	1,904	2,263	1,606	1,331	1,354	1,132	908	807	744
General and administrative....	1,353	1,024	679	740	643	460	385	316	319
Amortization .....	<u>216</u>	<u>202</u>	<u>178</u>	<u>142</u>	<u>124</u>	<u>98</u>	<u>98</u>	<u>87</u>	<u>77</u>
Total operating expenses .....	<u>4,241</u>	<u>2,906</u>	<u>3,048</u>	<u>2,801</u>	<u>2,668</u>	<u>2,098</u>	<u>1,645</u>	<u>1,556</u>	<u>1,367</u>
Interest .....	<u>121</u>	<u>149</u>	<u>160</u>	<u>168</u>	<u>164</u>	<u>137</u>	<u>139</u>	<u>143</u>	<u>142</u>
Income before income taxes....	437	1,291	1,012	1,004	667	481	484	495	251
Provision for income taxes – current .....	275	141	271	522					
Provision for income taxes- future.....	<u>(16)</u>	<u>(129)</u>							
Net income .....	<u>178</u>	<u>1,279</u>	<u>741</u>	<u>482</u>	<u>667</u>	<u>481</u>	<u>484</u>	<u>495</u>	<u>251</u>
<b>Net Income Per Share:</b>									
Basic .....	\$ 0.03	\$ 0.24	\$ 0.14	\$ 0.09	\$ 0.13	\$ 0.09	\$ 0.09	\$ 0.09	\$ 0.05
Diluted.....	\$ 0.02	\$ 0.16	\$ 0.10	\$ 0.07	\$ 0.09	\$ 0.07	\$ 0.07	\$ 0.07	\$ 0.04
<b>Weighted Average Number of Common Shares Outstanding</b>									
Basic .....	5,926,776	5,345,717	5,345,717	5,343,950	5,296,087	5,295,717	5,294,307	5,294,154	5,293,817
Diluted .....	7,215,243	9,223,222	9,207,833	9,180,021	9,180,369	9,054,738	9,044,523	9,029,687	9,018,564
<b>Other data:</b>									
EBITDA <sup>(1)</sup> .....	\$ 774	\$ 1,642	\$ 1,350	\$ 1,314	\$ 955	\$ 716	\$ 721	\$ 725	\$ 470
EBITDA Margin <sup>(1)</sup> % .....	8.8%	20.4%	17.9%	18.1%	14.0%	15.3%	17.1%	18.4%	15.1%

(1) See "Non-GAAP Measures".

## Net Income to EBITDA Reconciliation

	Fiscal 2008	Fiscal 2007				Fiscal 2006			
	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30
	(In thousands)								
	(Unaudited)								
Net income	178	\$1,279	\$ 741	\$ 482	\$667	\$481	\$484	\$495	\$251
Interest <sup>(1)</sup>	121	149	160	168	167	137	139	143	142
Taxes	259	12	271	522	--	--	--	--	--
Amortization	<u>216</u>	<u>202</u>	<u>178</u>	<u>142</u>	<u>124</u>	<u>98</u>	<u>98</u>	<u>87</u>	<u>77</u>
<b>EBITDA <sup>(2)</sup> <sup>(3)</sup></b>	<b><u>\$774</u></b>	<b><u>\$1,642</u></b>	<b><u>\$1,350</u></b>	<b><u>\$1,314</u></b>	<b><u>\$955</u></b>	<b><u>\$716</u></b>	<b><u>\$721</u></b>	<b><u>\$725</u></b>	<b><u>\$470</u></b>

Notes:

- Upon completion of the IPO, the Class A Shares were automatically convert to common shares and virtually all of the future interest expense ceased to accrue. See "Interim Period Operating Results – Interest and Other Income".
- See "Non-GAAP Measures".
- EBITDA includes SR&ED tax credits. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Comparison of Years Ended March 31, 2007 and 2006 – Research and Development Expenses" and "Management's Discussion and Analysis of Financial Condition and Results of Operations – Comparison of Years Ended March 31, 2006 and 2005 – Research and Development Expenses" in the Prospectus.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

### *Principles of Consolidation*

The Company incorporated a wholly-owned subsidiary, RuggedCom (USA) Inc., in fiscal 2007 and adopted the temporal method of consolidation for financial reporting. The Company's consolidated financial statements include the accounts of the Company and RuggedCom (USA) Inc.

### *Revenue Recognition*

The Company derives revenue from the sale of Ethernet-based networking products which includes embedded software and a license to use the software, post contract customer support, customer services and product warranties. Software is considered to be incidental to the product. Post contract customer support consists of on-site support. Services range from installation and training to basic consulting. Revenue is recognized when persuasive evidence of an arrangement exists, shipment has occurred, there are no significant remaining vendor obligations, collection of receivables is probable and the fee is fixed and determinable. From time to time, the Company's business agreements contain multiple elements, however to date revenue from multiple elements has not been significant. Accordingly, the Company is required to determine the appropriate accounting, including whether the deliverables specified in a multiple element arrangement should be treated as separate units of accounting for revenue recognition purposes, the fair value of these separate units of accounting and when to recognize revenue for each element. For arrangements involving multiple elements, the Company allocates revenue to each component of the arrangement using the residual value method, based on vendor-specific objective evidence of the fair value of the undelivered elements. These elements may include one or more of the following: advanced replacement, training, and installation.

The Company first allocates the arrangement fee, in a multiple-element transaction, to the undelivered elements based on the total fair value of those undelivered elements, as indicated by vendor-specific objective evidence. This portion of the arrangement fee is deferred. Then the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements. In some instances, a group of contracts or agreements with the same customer may be so closely related that they are, in effect, part of a single multiple element arrangement, and therefore, the Company would allocate the corresponding revenue among the various components, as described above.

Revenue from engineering services or development agreements is recognized according to the specific terms and acceptance criteria as services are rendered.

Shipping and handling costs borne by the Company are recorded in costs of goods sold. Shipping and handling costs charged to customers are recorded as a reduction of costs of goods sold.

### *Allowance for Doubtful Accounts*

The Company's accounts receivable balance as at June 30, 2007 was \$4.8 million compared to \$4.6 million at March 31, 2007. The allowance for doubtful accounts was \$173,000 as at June 30, 2007 compared to \$58,000 as at March 31, 2007.

The allowance for doubtful accounts represents management's best estimate of potential losses that may be incurred if customers are unable to pay for products and services provided by the Company. Management regularly reviews its accounts receivable and makes an assessment as to the collectibility of each receivable. For those amounts deemed to be uncollectible, an allowance is recorded on a by-account basis.

## ***Inventory***

Inventories are recorded at the lower of cost and market value, cost being determined on an average cost basis. The cost of finished goods and work-in-process is comprised of material, labour and manufacturing overhead.

## ***Warranty Costs***

The Company's products are sold with a product warranty of five years and the Company accrues warranty expense as a percentage of revenues, based on historical experience. This represents management's best estimate of the future costs to be incurred to fulfill the Company's warranty obligations with regard to product still under warranty. Management regularly reviews historical warranty experience and makes periodic adjustments from time to time in the warranty accrual rate.

## ***Research and Development Costs***

Research and development costs are recorded before deduction of SR&ED tax credits. Research and development costs are charged to the consolidated statements of operations in the period in which they are incurred unless the criteria for deferral are met, including the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established once a working model has been produced and tested. To date, development costs incurred between the completion of a working model and the point where a product is released have been insignificant. Accordingly, all research and development costs have been charged to the consolidated statement of operations in the period in which they were incurred. The Company is entitled to certain Canadian SR&ED tax credits for qualifying research and development activities performed in Canada. In particular, the Company is entitled to Canadian federal SR&ED tax credits for qualifying SR&ED activities. The Company is also entitled to provincial (Ontario) SR&ED tax credits for qualifying research and development activities performed in the province of Ontario. SR&ED tax credits are recognized in the period as the related research and development expense is incurred. Upon completion of the Company's IPO, the Company ceased to qualify as a CCPC. Accordingly, SR&ED tax credits for the entire fiscal 2008 year are now earned at a lower rate and are not refundable in cash, however, they may be credited against Part I tax.

## ***Stock-Based Compensation***

The Company has a stock option plan for employees and directors. The board of directors established a stock option plan in August 2004 to attract, retain and motivate our employees, consultants, directors and officers and to advance the interests of the Company by providing these persons with the opportunity, through stock options, to acquire an ownership interest in the Company. In connection with the Company's IPO, the board of directors adopted an amended and restated stock option plan, which will become effective upon the completion of the IPO.

Effective April 1, 2005, the Company has adopted the revised CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments," which requires that a fair value basis of accounting be applied to all stock-based compensation payments. The Company accounts for all awards using the fair value method. The fair value of options is determined using a fair value pricing model with compensation expense charged to income over the vesting period with a corresponding credit to contributed surplus. Any consideration paid on the exercise of options or purchase of shares is credited to capital stock.

The determination of the fair value of the stock options requires management to make estimates as to the estimated life of the options and the expected volatility of the stock, among other inputs. A change in these factors could impact the compensation expense recorded in the statement of operations.

### ***Foreign Currency Translation***

Monetary assets and liabilities of domestic and integrated foreign operations denominated in foreign currencies are translated at year-end exchange rates. Non-monetary assets and liabilities of integrated foreign operations are translated at the historical rate relevant to the particular asset or liability. The exchange gains or losses resulting from translation are recorded in income. Revenue and expense items are translated at the average exchange rate of the year, except amortization, which is translated on the same basis as the related assets.

### ***Financial Instruments***

At the beginning of the first quarter of fiscal 2008 the Company had a compound financial instrument in the form of Class A Shares which were redeemable at the option of the holder, bore an 8% cumulative annual dividend, and were convertible into common shares. The Class A Shares were considered financial instruments as defined in CICA Handbook Section 3860 (CICA 3860) because the holder of such shares had the option to settle the shares in exchange for cash at a future date. Financial instruments that include both equity and debt components are considered compound financial instruments. Under CICA Handbook Section 3860, compound financial instruments are bifurcated, with the resulting debt and equity components accounted for separately. The debt portion was calculated as the present value of the required repayment (including dividends during the term) discounted at a rate approximating the market interest rate for similar debt without the conversion feature. The difference between the fair value of the debt portion and the required repayment was assigned to the equity component and reflected as contributed surplus. The debt component was being accreted to the value due at maturity over the term the financial instrument was outstanding, with the resulting charge recorded as interest expense. While interest was accrued for the debt component of the Class A Shares, no interest or dividend payments were ever declared or paid. Upon completion of the Company's IPO, the Class A Shares were automatically converted to common shares on a four-for-one basis.

### ***Future Income Taxes***

The Company accounts for income taxes using the asset and liability method. Under this method, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. These future tax assets and liabilities are measured using enacted or substantially enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. Future tax benefits are recognized to the extent that realization of such benefits is considered more likely than not. The effect of a change in income tax rates on future tax assets and liabilities is recognized in earnings in the period that includes the substantive enactment date.

## ACCOUNTING CHANGES

The Accounting Standards Board of the Canadian Institute of Chartered Accountants issued CICA Handbook Section 3855, "Financial Instruments — Recognition and Measurement," CICA Handbook Section 3865, "Hedges," CICA Handbook Section 1530, "Comprehensive Income," and CICA Handbook Section 3251, "Equity," which is being applied by the Company for its fiscal years beginning on April 1, 2007. CICA Handbook Section 3855 prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and the measurement of such amount. It also specifies how financial instrument gains and losses are to be presented. CICA Handbook Section 3865 is applicable for designated hedging relationships and builds on existing GAAP guidance by specifying how hedge accounting is applied and what disclosures are necessary when it is applied. CICA Handbook Section 1530 introduces new standards for the presentation and disclosure of components of comprehensive income. Comprehensive income is defined as the change in net assets of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in net assets during a period except those resulting from investments by owners and distributions to owners. CICA Handbook Section 3251 requirements are in addition to CICA Handbook Section 1530 and recommend separate presentation of the following components of equity: retained earnings; accumulated other comprehensive income; and the total for retained earnings and accumulated other comprehensive income, contributed surplus, share capital and reserves.

Under the new standards, policies followed for periods prior to the effective date generally are not reversed and therefore, the comparative figures have not been restated. The adoption of these new Handbook Sections had no material effect on the Company's financial results.

Under CICA Handbook Section 3855, "Financial Instruments — Recognition and Measurement," financial instruments must be classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income; held-to-maturity financial assets are measured at amortized cost with changes in fair value not being recognized. Upon adoption of these new standards, the Company designated some of its cash and cash equivalents as held-for trading, which are measured at fair value, and some as held-to-maturity, which are measured at amortized cost. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities which are measured at amortized cost.

On December 1, 2006 the CICA issued three new accounting standards: CICA Handbook Sections 1535, "Capital Disclosures," 3862, "Financial Instruments — Disclosures," and 3863, "Financial Instruments — Presentation." These new standards will be effective for the Company on April 1, 2008. CICA Handbook Section 1535 specifies the disclosure of:

- (a) an entity's objectives, policies and processes for managing capital;
- (b) quantitative data that the entity regards as capital;
- (c) whether the entity has complied with any capital requirements; and
- (d) if it has not complied, the consequences of such non-compliance.

The new CICA Handbook Sections 3862 and 3863 replace CICA Handbook Section 3861 "Financial Instruments — Disclosure and Presentation," revising and enhancing its disclosure requirements and carrying forward unchanged its presentation requirements. These new sections establish the requirements for presentation and disclosure of financial instruments and non-financial derivatives. The Company is in the process of evaluating the impact of the new accounting standards.

### **Risk and Uncertainties**

*The risks and uncertainties discussed below are not the only ones the Company faces. Additional risks and uncertainties not presently known to it or that the Company currently considers immaterial also may impair its business operations and cause the price of its common shares to decline. If any of the following risks actually occur, its business may be harmed and its financial condition and results of operations may suffer significantly.*

### **Growth Management**

The growth of the Company's operations places a strain on managerial, sales, financial and human resources personnel as well as its physical plant. The Company's ability to succeed will depend in large part upon its ability to manage future growth to successfully expand all aspects of its business in a timely and cost effective manner consistent with the sales growth the Company experiences.

### **Reliance on Key Personnel**

The Company depends on the services of its senior management and key professional, technical, sales, marketing and other specialized personnel to develop, market and support its solutions and develop the business. Most of its employees are not subject to non-competition restrictions that would prohibit them from leaving the Company to immediately join or form competitive businesses. The Company's success is highly dependent on its continuing ability to identify, hire, train, motivate and retain appropriate personnel. Competition for these personnel can be intense, and the Company cannot provide assurance that it will be able to attract or retain them. To do so, it may be necessary for the Company to materially increase the compensation it pays.

### **Growth in Key Markets**

The overall market for rugged communications networking solutions has experienced significant growth in the past few years. There can be no assurance that the market for its solutions will continue to grow or grow as quickly as it currently anticipates, that firms in its target markets will adopt its solutions, or that it will be able to establish additional markets for its solutions.

### **Dependence on Electric Power Industry**

The Company currently derives almost two-thirds of its revenue from sales to the electric power market and it expects revenue from these sales to continue to account for a substantial portion of its revenue for the foreseeable future. The Company is highly dependent for its sales on the ongoing electric power market migration to IP-based communications networks throughout the non-office environment and there can be no assurance that the migration will continue. For example, as the electric power market is a regulated industry, the migration to IP-based networks could be adversely affected by legislative developments.

### **Competition**

The market for the Company's products is highly competitive. The Company has experienced, and expects to continue to experience, substantial competition from numerous competitors whom it expects to continue to improve their products and technologies. Competitors may announce and introduce

new products, services or enhancements that better meet the needs of end-users or changing industry standards, or achieve greater market acceptance due to pricing, sales channels or other factors. Competitors may be able to respond more quickly than RuggedCom to changes in end-user requirements and devote greater resources to the enhancement, promotion and sale of their products.

The Company competes with a wide range of competitors of varying sizes. New competitors or alliances among competitors could emerge. Many of the Company's competitors and potential competitors have significantly greater financial, technical, marketing or service resources than RuggedCom with which to pursue research and development, marketing and distribution of their products. Many of these competitors also have a larger installed base of products, have longer operating histories or have greater name recognition than RuggedCom.

Certain of RuggedCom's original equipment manufacturers have or could acquire the internal capabilities to manufacture their own solutions competitive to RuggedCom's rather than reselling the Company's products, which could result in a reduction in its sales.

While many of the Company's direct competitors today are relatively small, consolidation is taking place in the industry resulting in competitors who are larger and better capitalized and therefore have greater resources. In addition, if two or more of the Company's competitors were to merge or partner, the change in the competitive landscape could adversely affect the Company's ability to compete effectively.

If RuggedCom's competitors offer deep discounts or more favourable purchase terms on certain products or services, the Company may be required to lower prices or offer other favourable terms to compete successfully. Any changes would likely reduce its margins and could adversely affect its operating results, particularly if it is unable to affect the changes with a corresponding increase in the quantity of sales or through lower spending. In addition, its level of product gross margin may not be sustainable as it enters new geographic regions, adjusts its product mix or if it experiences increased warranty costs.

### ***Reliance on Third-Party Suppliers***

The Company relies on third-party suppliers, in some cases sole suppliers, to provide components, such as processor chips, necessary for the manufacture of its products. It depends on these suppliers to allocate to the Company a portion of their manufacturing capacity sufficient to meet its needs, to produce components of acceptable quality and to deliver those components to the Company on a timely basis at acceptable prices. The Company is not a major customer of any of its key suppliers and consequently they may be unwilling or unable to devote sufficient resources to meet the Company's requirements. Should a shortage of components occur (e.g. due to production interruption or a worldwide shortage of certain parts), a supplier may limit the number of components it may purchase. Additionally, a supplier may determine to cease production of components supplied to the Company. If it is unable to obtain sufficient allocations of these components in a timely manner, or a supplier ceases production of any if the components it relies on, production and shipment of products will be delayed. Reliance on third-party suppliers also reduces its control over production costs, delivery schedules, reliability and quality of materials.

### ***Manufacturing and Reliance on Contract Manufacturers***

The Company has one manufacturing and assembly facility which is located in Woodbridge, Ontario at which final assembly and testing of all of its products is completed. Should the operation of the facility be interrupted for a significant period of time for any reason, its ability to fulfill orders in a timely fashion will be significantly adversely affected.

If any of the Company's outsourced manufacturers are unable or unwilling to continue manufacturing its products in required volumes and quality levels, the Company will have to identify, qualify, select and implement acceptable alternative manufacturers, which could be time consuming and costly. In addition, an alternate source may not be available to the Company or may not be in the position to satisfy the Company's production requirements at commercially reasonable prices and quality. Therefore, any significant interruption in contract manufacturing would result in the Company being unable to deliver the affected products to meet its customer orders.

### ***Reliance on Third Party Channel Partners***

The Company is dependent upon its ability to establish and develop new relationships and to build on existing relationships with channel partners including manufacturer's representatives, distributors, original equipment manufacturers, systems integrators and consultants. It currently relies and expects to rely upon these relationships in the future to sell or facilitate the sale of a material portion of its solutions. These third parties may provide the Company with direct or indirect customer referrals, cooperate with the marketing of its products and integrating its products in end-users' systems and infrastructure or include the Company as a specified supplier in their projects. It cannot provide assurance that it will be successful in maintaining or advancing its relationships with them. In addition, it cannot provide assurance that those with whom it currently has relationships will act in a manner that will promote the success of its solutions.

Some channel partners also sell products and services of the Company's competitors.

Some of the Company's competitors have been acquired by certain original equipment manufacturers with whom it has relationships, which could result in products and services of its competitors being favoured by them.

### ***Fluctuations in Quarterly Results***

The Company's quarterly operating results have fluctuated in the past and may fluctuate significantly in the future depending on factors such as seasonality, demand for its products, the size and timing of orders, progress on implementation of projects, the number, timing and significance of new product announcements by the Company and its competitors, the ability to develop, introduce and market new and enhanced versions of products on a timely basis, the level of product and price competition, changes in operating expenses, changes in the sales incentive strategy, sales personnel changes and general economic factors, among others. A significant portion of the Company's expenses are based on expectations of future revenue and, therefore, is relatively fixed in the short-term. Accordingly, if revenue levels are below expectations, operating results are likely to be adversely affected.

The Company relies on individual purchase orders for product sales to customers and have no long-term customer supply contracts providing for specified sales. Because its quarterly revenue is dependent upon a relatively small number of transactions, even minor variations in the rate and timing of conversion of its sales prospects into revenue could cause the Company to plan or budget inaccurately, and those variations could adversely affect its financial results.

### ***Dependence on Certain Licensed Intellectual Property***

The Company licenses certain technologies used in its products from third parties, including as part of ROS. The termination of any of these licences, or the failure of the licensors to maintain or update their products adequately, could delay its ability to ship solutions while it seeks to implement alternative technology offered by other sources that may require significant unplanned investments. In addition, alternative technology may not be available, and even if it is available it may not be available on commercially reasonable terms. In the future, it may be necessary or desirable to obtain other third-party

technology licences relating to one or more of its solutions or relating to current or future technologies to enhance the Company's product offerings. There is a risk that the Company will not be able to obtain licensing rights to the needed technology on commercially reasonable terms, if at all.

### ***Infringement of Intellectual Property Rights***

While the Company believes that its products and other intellectual property do not infringe upon the proprietary rights of third parties, its commercial success depends, in part, upon the Company not infringing intellectual property rights of others. A number of the Company's competitors and other third parties have been issued patents and may have filed patent applications or may obtain additional patents and proprietary rights for technologies similar to those used in the Company's solutions. Some of these patents may grant very broad protection to the owners of the patents. The Company has not undertaken a review to determine whether any existing third party patents or the issuance of any third party patents would require the Company to alter its technology, obtain licenses or cease certain activities. The Company may become subject to claims by third parties that its technology infringes their intellectual property rights due to the growth of products in its target markets, the overlap in functionality of these products and the prevalence of products. The Company may become subject to these claims either directly or through indemnities against these claims that it routinely provides to its end-users, manufacturer's representatives, distributors, value added resellers, systems integrators and original equipment manufacturers.

Litigation may be necessary to determine the scope, enforceability and validity of third party proprietary rights or to establish the Company's proprietary rights. Some of its competitors have, or are affiliated with companies having, substantially greater resources than RuggedCom and these competitors may be able to sustain the costs of complex intellectual property litigation to a greater degree and for a longer period of time than RuggedCom. Regardless of their merit, any such claims could be time consuming to evaluate and defend; result in costly litigation; cause product shipment delays or stoppages; divert management's attention and focus away from the business; subject the Company to significant liabilities and equitable remedies, including injunctions; require the Company to enter into costly royalty or licensing agreements; and require the Company to modify or stop using infringing technology.

The Company may be prohibited from developing or commercializing certain technologies and products unless it obtains a licence from a third party. There can be no assurance that it will be able to obtain any such licence on commercially favourable terms, or at all. If it does not obtain such a licence, it could be required to cease the sale of certain of its solutions.

### ***Use of Open Source Software***

The Company uses certain open source software (such as Linux) in the development of certain of its software products, which are not maintained or supported by the original developers thereof. This open-source software was developed originally by third parties over whom the Company has no control. The Company has no assurances that the Linux operating system and the Company's related components do not infringe on the intellectual property rights of others and the Company could be exposed to infringement claims and liability in connection with the use of such open source software. The Company conducted no independent investigation to determine whether the sources of that software have the rights necessary to permit the Company to use this software free of claims of infringement by third parties. The Company could be required to replace certain components with internally developed or commercially licensed equivalents, which could delay product development plans, interfere with its ability to support its customers and/or require the Company to pay licensing fees. Certain open source software licences provide that any software that makes use of or incorporates components distributed under that licence will itself become subject to the same general distribution rights and other terms of that licence. As a result, there is a risk that third parties, including RuggedCom's competitors, could have the right to use and distribute certain elements of the Company's software products which is based on open-source software.

### ***Protection of the Company's Intellectual Property***

The Company's success depends in part on its ability to protect its rights in its intellectual property. The Company relies on various intellectual property protections, including patents, copyright, trade-mark and trade secret laws and contractual provisions, to preserve its intellectual property rights. Despite these precautions, it may be possible for third parties to obtain and use RuggedCom's intellectual property without its authorization. Policing unauthorized use of intellectual property is difficult, and some foreign laws do not protect proprietary rights to the same extent as the laws of Canada and the United States. Furthermore, many key aspects of networking technology are governed by industry wide standards, which are freely available to all market entrants.

To protect the Company's intellectual property, it may become involved in litigation, which could result in substantial expenses, divert the attention of its management, cause significant delays and materially disrupt the conduct of its business.

### ***Rapid Technological Change***

The markets for the Company's products are characterized by rapidly changing technology, evolving industry standards and increasingly sophisticated customer requirements. The introduction by competitors of products embodying new technology and the emergence of new industry standards can render RuggedCom's existing products obsolete and unmarketable and can exert price pressures on existing products. It is critical to the Company's success that it be able to anticipate and react quickly to changes in technology or in industry standards and successfully develop and introduce new, enhanced and competitive products on a timely basis. The Company cannot give assurance that it will successfully develop new products or enhance and improve its existing products, that new products and enhanced and improved existing products will achieve market acceptance or that the introduction of new products or enhanced existing products by others will not render the Company's products obsolete. The process of developing new technology is complex and uncertain, and, if RuggedCom fails to accurately predict customers' changing needs and emerging technological trends, its business could be harmed. The Company must commit significant resources to developing new products before knowing whether its investments will result in products the market will accept. To remain competitive, the Company may be required to invest significantly greater resources than currently anticipated in research and development and product enhancement efforts, and result in increased operating expenses.

### ***Product Defects and Liability Claims***

The Company is subject to proceedings and claims that may arise in the ordinary conduct of the business, which could include product and service warranty claims, which could be substantial. The Company's products are highly complex and sophisticated, and could contain design defects or software errors that are difficult to detect and correct. The Company provides product warranties that typically run for five years. If its products fail to perform as warranted and it fails to resolve product quality or performance issues in a timely manner, sales may be lost and it may be forced to pay damages. In addition, because its products are sold and marketed in different countries, the products must function in and meet the requirements of many different environments and be compatible with different systems. Any failure to meet customer requirements could materially affect its business, results of operations and financial condition. The occurrence of product defects and the inability to correct errors could result in the delay or loss of market acceptance of its products, material warranty expense, diversion of engineering and other resources from its product development efforts, and the loss of credibility with its customers, manufacturer's representatives, distributors, value added resellers, systems integrators and original equipment manufacturers and end-users, any of which could have a material adverse effect on the Company's business, operating results and financial condition.

The Company does not currently maintain product liability insurance coverage. The Company has not experienced a material product liability claim to date; however, if that claim were to arise it would likely be substantial in light of the use of its products in mission critical applications. A successful product liability claim could result in significant monetary liability and could seriously disrupt or harm its business.

### ***Currency Fluctuations***

The Company enters into transactions in multiple currencies and are subject to gains and losses due to fluctuations between those currencies. A substantial portion of the Company's revenue is earned in US dollars, but a substantial portion of its operating expenses are incurred in Canadian dollars. Fluctuations in the exchange rate between the US dollar and other currencies, such as the Canadian dollar, may have a material adverse effect on the Company's business, financial condition and operating results. The Company intends to continue to expand operations internationally so it may be subject to additional gains and losses against additional currencies. The Company does not currently have a foreign exchange hedging program in place. However, in the future, it may establish a program to hedge a portion of its foreign currency exposure with the objective of minimizing the impact of adverse foreign currency exchange movements. However, even if it develops a hedging program, it may not hedge entirely the exposure related to any one foreign currency and it may not hedge its exposure at all with respect to certain foreign currencies.

### ***International Risk***

The Company's international operations are significant and it intends to continue to expand these international operations. RuggedCom's foreign operations face additional specific local risks, which may adversely affect the Company, including: changes in legal and regulatory requirements (including tariffs and other trade barriers); less favourable intellectual property laws; any loss of sales personnel in one of RuggedCom's small foreign offices that could result in a significant loss of sales in that foreign country; changes in local tax rates and other potentially adverse tax consequences (including the cost of repatriation of earnings); collectability of accounts in foreign jurisdictions; and burdens of complying with a wide variety of foreign laws, including changing import and export regulations.

The Company believes that its future growth depends in large part on its ability to increase its business in international markets. This will require significant management attention and financial resources, including capital to hire additional personnel and establish additional international facilities.

### ***Regulation***

Certain components of the Company's products may be subject to current or future regulation, including relating to environmental protection, for example, lead solder and wireless solutions. Regulatory agencies may make rulings or adopt new standards with which its solutions may need to be compliant. The timing and nature of these rulings or adoption of new standards may impact future sales to its customers, its ability to conform its solutions and/or to retain its market position.

In addition, the Company expects that in the future it may be required to comply with substance bans and product/component take-back requirements that would make the Company responsible for recycling and disposing of certain of its products/components that it has sold.

### ***Health and Safety***

In recent years there has been publicity regarding the potentially negative direct and indirect health and safety effects of electromagnetic emissions from wireless equipment sources, including allegations that these emissions may cause cancer. The Company's wireless communications products emit electromagnetic radiation. Health and safety issues related to its products may arise that could lead to

litigation or other actions against the Company or to regulation of certain of its product components. The Company may be required to modify its technology and may not be able to do so. It may also be required to pay damages that may reduce its profitability and adversely affect its financial condition. Even if these concerns prove to be baseless, the resulting negative publicity could affect the Company's ability to market certain of its products and, in turn, could harm its business and results of operations.

### ***Economic and Geopolitical Uncertainty***

The market for RuggedCom's solutions depends on economic and geopolitical conditions affecting the broader market. Economic conditions globally are beyond the Company's control. In addition, acts of terrorism and the outbreak of hostilities, disease, and armed conflicts between countries can create geopolitical uncertainties that may affect the global economy. Downturns in the economy or geopolitical uncertainties may cause end-users to delay or cancel projects, reduce their overall information technology budgets or reduce or cancel orders for the Company's solutions, which could have a material adverse effect on its business, results of operations and financial condition.

### ***Acquisitions***

The Company may engage in selective acquisitions. There is a risk that it will not be able to identify suitable acquisition candidates available for sale at reasonable prices. It is likely to face competition for acquisition candidates from other parties including those that have substantially greater available resources. Acquisitions may involve a number of other risks, including: diversion of management's attention; disruption to its ongoing business; failure to retain key acquired personnel; difficulties in integrating acquired operations, technologies, products or personnel; unanticipated expenses, events or circumstances; assumption of disclosed and undisclosed liabilities; and inappropriate valuation of the acquired in-process research and development. In addition, if the Company proceeds with an acquisition, its available cash may be used to complete the transaction, diminishing its liquidity and capital resources, or shares may be issued which could cause significant dilution to existing shareholders.

### ***Transfer Pricing***

The Company conducts business operations in various jurisdictions and through legal entities in Canada and the United States. RuggedCom and RuggedCom (USA) Inc., its United States subsidiary, provide solutions to, and may from time to time undertake certain significant transactions with, other currently existing or new subsidiaries in different jurisdictions. The tax laws of these jurisdictions, including Canada, have detailed transfer pricing rules which require that all transactions with non-resident related parties be priced using arm's length pricing principles and that contemporaneous documentation must exist to support that pricing. The taxation authorities in the jurisdictions where it carries on business could challenge RuggedCom's arm's length related party transfer pricing policies. International transfer pricing is a subjective area of taxation and generally involves a significant degree of judgement. If any of these taxation authorities were to successfully challenge the Company's transfer pricing policies, its income tax expense may be adversely affected and it could also be subjected to interest and penalty charges. Any such increase in its income tax expense and related interest and penalties could have a significant impact on its future earnings and future cash flows.

### ***Other Tax Matters***

Although management is of the view that all expenses and tax credits claimed by the Company, including research and development expenses and SR&ED tax credits, are reasonable and deductible and have been correctly determined, there can be no assurance that the Canadian taxation authorities will agree. If the Canadian taxation authorities successfully challenge such expenses or the correctness of such income tax credits claimed, the Company's operating results could be adversely affected. If the Canadian

taxation authorities reduce the tax credit either by reducing the rate of the grant or the eligibility of some research and development expenses in the future, its operating results will be adversely affected.

The majority of the Company's research and development activities are conducted at its headquarters in Woodbridge, Ontario. The Company participates in government programs with both the federal Government of Canada and the Government of Ontario that provide SR&ED tax credits based upon qualifying SR&ED expenditures. These expenditures primarily consist of the salaries of the persons conducting research and development activities. If these SR&ED tax credits are reduced or eliminated, the Company's business, financial condition and results of operations may be adversely affected.