

APPENDIX B

MD&A DEFICIENCIES

The quality of MD&A disclosure continues to be an area where we see deficiencies. MD&A is a narrative explanation through the eyes of management of how the issuer performed during the period covered by the financial statements, and what the issuer's financial condition and future prospects are. We often find boilerplate disclosure that does not change from period to period. Issuers frequently replicate disclosure from the financial statements without any analysis. Entity-specific disclosure provides investors with information that complements the financial statements so they are able to assess the current financial condition of the issuer and its future prospects. Under the requirements, the MD&A should:

- help current and prospective investors understand what the financial statements show and do not show;
- discuss important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future; and
- provide information about the quality, and potential variability, of the issuer's earnings and cash flow, to assist investors in determining whether past performance is indicative of future performance.

There are three important areas where we continue to see boilerplate disclosure in the MD&A: discussion of operations, liquidity, and general provisions. For each, we have provided examples of deficient disclosure contrasted against more robust entity-specific disclosure.

1. Discussion of Operations

Issuers are required to analyze their operations during the most recently completed financial year, including a comparison against the previously completed financial year. The analysis should discuss and quantify all material variances. Common deficiencies include: discussion of immaterial information without inclusion of information that may be material to investors; and insufficient analysis of why changes have occurred. Issuers are reminded that the MD&A should contain a balanced discussion of their operations. Issuers should quantify how volume and price changes affected revenue, and discuss why changes occurred. If other elements affected revenue, such as the introduction of a new product or new competitors, the MD&A should also address these factors. Issuers should not limit the operational analysis to revenue; if issuers experienced a change in their gross profit percentage, the MD&A should discuss the factors behind the change.

Example of Deficient Disclosure

Revenue increased from \$900,000 to \$1,080,000, a 20% increase. Gross profit increased from \$400,000 to \$408,000, a 2% increase.

Example of entity-specific disclosure

Revenue increased from \$900,000 to \$1,080,000, a 20% increase. Gross profit increased from \$400,000 to \$408,000, a 2% increase. Three factors caused revenue to increase by \$180,000:

- increased sales volume of Product X-\$60,000;
- decreased unit price of Product X-(\$30,000); and
- the introduction of a new product during the fourth quarter, Product Y-\$150,000.

In late 2011, we anticipated new competition entering our market, so we discounted our remaining Product X units to encourage their sale and to allow us to focus on its replacement, Product Y. Discounts on Product X caused the reduced gross profit percentage. We expect to continue discounting Product X in the first quarter, but expect our gross profit to improve as Product Y replaces Product X.

2. Liquidity

The MD&A should identify and discuss any known or expected fluctuations and trends in an issuer's liquidity, taking into account demands, commitments, events or uncertainties. Where applicable, the discussion should also include disclosure of any defaults or risk of defaults on debt covenants and how the issuer intends to cure the default or otherwise address the risk as set out in the example below. The disclosure relating to expected liquidity fluctuations is required for all issuers, but it is especially important when issuers have negative cash flows from operations, a negative working capital position or have breached or expect to breach their debt covenants.

Example of deficient disclosure

As at year-end, the Company had cash of \$100,000 and accounts receivable of \$50,000. Current assets amounted to \$150,000 with current liabilities of \$400,000 resulting in a working capital deficit of \$250,000. The Company believes that it has sufficient capital on hand to satisfy working capital requirements for the next 12 months.

Example of entity-specific disclosure

As of year-end, the Company's debt to equity ratio was in breach of a covenant in its loan agreement. Subsequent to year-end, the Company:

- renegotiated the covenants in the loan agreement to cure the default; and
- borrowed an additional \$300,000 to meet current and future working capital requirements.

New terms under the loan agreement restrict repayment of existing debt payable to related parties. We estimate that the Company will need \$500,000 over the next two years to complete its exploration project. In the short-term, the Company will rely on advances from shareholders and the exercise of options and share purchase warrants to fund exploration costs.

3. General Provisions

Issuers must endeavour to improve MD&A disclosure. In particular, many issuers operating in a specialized industry or high-tech sector do not sufficiently describe their operations, thereby restricting the usefulness of their MD&As. We would like to remind issuers of the requirements under Part 1(a) of Form 51-102F1, *Management's Discussion & Analysis*.

Example of deficient disclosure

Strategy

The Corporation (ABC) expects to generate revenue from its product candidates in the form of royalties. ABC sold its interest in its joint venture to its partner, XYZ Inc. (XYZ) on June 30, 2011. Following this transaction, ABC manages its relationship with its two major partners to maximize value from the products that will generate royalties on a going-forward basis. The main assets of ABC are the patent portfolio licensed to NMO Inc. and the royalty agreement with XYZ.

Example of entity-specific disclosure

Strategy

We have implemented a business strategy with intent to reacquire growth in revenue and improve our operations. We continue to invest in order to transform from a print directory business to a digital media and marketing solutions company.

Our strategy remains to leverage our multiplatform media and marketing solutions, to enhance services to our advertisers, build traffic to our network of properties and improve user experience. Our goal is to serve the advertising needs of small and medium enterprises across Canada, by providing the right services and tools to manage and grow their businesses.

We are focusing on key areas, such as:

- Improving our operations with increased focus on sales effectiveness, product fulfillment, billing and customer support;
- Provisioning of new services for our customers with the objective of offering an overall better customer experience and return on investment by driving more quality leads through calls, clicks, forms and emails;
- Improving our value proposition for the consumer by enhancing our content on our online and mobile properties;
- Creating partnerships in traffic and distribution to augment leads to our advertisers; and
- Branding and promotion to raise awareness on our product portfolio and accelerate our brand transformation.

We achieve profitability by maximizing our operating efficiency and constantly reviewing all of our operations with a view to ensuring we maintain a competitive cost structure. Improving our cost structure remains a key priority and will continue to be achieved through:

- Business process redesign;
- Cost containment initiatives; and
- Investment in technology to better support our operations and our transformation.

Our key priorities for 2012 are to:

- Execute our sales approach;
- Deliver superior customer value; and
- Lead our industry transformation.