

# AUGUSTA INDUSTRIES INC.

## Management's Discussion and Analysis September 30, 2017

**Marcon**  
International Inc.

A wholly owned subsidiary of  
Augusta Industries Inc.

**FOX\*TEK**

A wholly owned subsidiary of  
Augusta Industries Inc.

**Augusta Industries Inc.**

Management's Discussion and Analysis

September 30, 2017

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The following Management's Discussion and Analysis ("MD&A") relates to the financial condition and results of operations of Augusta Industries Inc. as at and for the nine months ended September 30, 2017 with comparatives. It should be read in conjunction with the interim condensed consolidated financial statements as at and for the nine months ended September 30, 2017. Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com), or on TSX Venture Exchange website at [www.tmx.com](http://www.tmx.com), and on our website at [www.fox-tek.com](http://www.fox-tek.com). Information contained in or otherwise accessible through our website doesn't form a part of this MD&A, and is not incorporated into this MD&A by references.

References to "we", "our", "Augusta", or "the Company" means Augusta Industries Inc. and its subsidiaries, unless the context requires otherwise.

**BASIS OF PRESENTATION**

Unless otherwise noted, all financial information has been prepared in accordance with International Financial Reporting Standards ("IFRS").

The interim condensed consolidated financial statements ("interim consolidated statements") include the accounts of the Company and its wholly-owned subsidiaries, Fiber Optic System Technology (Canada) Inc., PinPoint Fox-Tek Inc., Fox-Tek Canada Inc. ("Fox-Tek"), Marcon International Inc. ("Marcon"), Marcon International (USA) Inc. and Marcon International (UK) Ltd. All inter-company accounts and transactions have been eliminated.

All financial information is reported in Canadian dollars and is expressed in thousands except for per share amounts which are expressed in dollars.

The MD&A was approved for issue by the Board of Directors on November 29, 2017.

**FORWARD-LOOKING STATEMENTS**

This MD&A contains certain forward-looking statements, except for historical information, and reflect the Company's present assumptions regarding future events. These statements involve known and unknown risks, uncertainties, and other factors that may cause the Company's actual results, levels of activity, performance, and/or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by these forward-looking statements.

Certain statements contained in this document constitute "forward-looking statements". When used in this document, the words "may", "would", "could", "will", "intend", "plan", "propose", "anticipate", "believe", "forecast", "estimate", "expect" and similar expressions used by any of the Company's management, are intended to identify forward-looking statements. Such statements reflect the Company's internal projections, expectations, future growth, performance and business prospects and opportunities and are based on information currently available to the Company. Since they relate to the Company's current views with respect to future events, they are subject to certain risks, uncertainties and assumptions. Many factors could cause the Company's actual results, performance or achievements to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. The Company does not intend, and does not assume any obligation, to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future results, events or developments except as required by applicable securities legislation, regulations or policies.

## **OVERVIEW OF BUSINESS**

### **Corporate Overview**

Augusta Industries Inc. ("Augusta") was incorporated on October 13, 1999 under the laws of the State of Delaware.

Marcon International Inc. ("Marcon") was incorporated under the laws of the Province of Ontario on April 28, 2010. On August 1, 2010, Marcon entered into an asset purchase agreement with Knoxbridge Corp. ("Knoxbridge"), whereby Knoxbridge transferred certain net assets, to Marcon in exchange for shares and debt. Augusta's significant shareholder is Knoxbridge who owns 30.6% (December 31, 2016 – 37.4%) of the voting shares of the Company.

The Company has offices in Mississauga, Ontario and Calgary, Alberta; Augusta is traded on the TSX Venture Exchange ("TSXV") under the symbol "AAO".

### **Going Concern**

The interim consolidated statements have been prepared on a going concern basis. The going concern basis of presentation assumes that the Company will continue operations for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of operations.

The Company has incurred a net loss of \$431 for the nine months ended September 30, 2017 (nine months ended September 30, 2016 – net income of \$74) and has an accumulated deficit of \$8,082 (December 31, 2016 – \$7,651) from inception.

The challenges of securing requisite funding beyond September 30, 2018 and the cumulative operating losses indicate the existence of a material uncertainty that may cast significant doubt upon the Company's ability to continue as a going concern. These interim consolidated statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts nor to the amounts or classification of liabilities that might be necessary should the Company be unable to continue as a going concern. Such adjustments could be material.

### **Principal Business**

Fox-Tek is engaged in the development, design, manufacture and supply of systems using fiber optic sensors, related monitoring instruments, and software. Clients buy and operate systems and Fox-Tek handles the installation and reporting of information on an outsourcing basis. Fox-Tek provides support engineering services related to planning, training, on-site installation, and data interpretation and reporting. Fox-Tek's target market includes the monitoring, communication, alarming and prediction of safe/unsafe conditions in structures and facilities.

Fox-Tek's main products are patented non-intrusive asset health monitoring sensor systems for the oil and gas market to help operators track the thinning of pipelines and refinery vessels due to corrosion/erosion, strain due to bending/buckling, and process pressure and temperature.

Fox-Tek's FT fiber optic sensor monitoring systems ("FT systems") allow cost-effective, 24/7 remote monitoring capabilities to improve scheduled maintenance operations, avoid unnecessary shutdowns, and prevent accidents and leaks. The FT system uses non-intrusive fiber optic sensors to monitor strain due to settling, movement or

buckling of a variety of civil structures, such as bending, buckling, elongation or compression of pipelines. Movement of soil or foundation footing can also be monitored. Measurements can be made at multiple locations up to 2,000 meters apart.

FT systems are highly sensitive and easy to operate: portable or dedicated FT monitors make continuous or periodic measurements by interrogating multiple permanently mounted sensors. Digital data facilitates semi-automated analysis and prompt reporting. Remote telemetry, long robust lead cables, and maintenance-free sensors enable early warning, or confirmation of effective mitigation solutions such as rebuilding slopes or grades. The non-electrical sensors are very robust and inherently immune to electromagnetic interference. FT sensors can be field-bonded to steel, concrete, composite / FRP structures located underwater, below grade or imbedded during a pour. They safely and efficiently monitor:

- Steel structure degradation due to corrosion;
- Concrete column compression and swelling due to corrosion;
- Composite girder / deck bending strains;
- Frame stability / buckling;
- Piling & anchor movement caused by ground heaving or seismic activity;
- Foundation settling;
- Dam subsidence;
- Tunnel wall and building fascia buckling;
- Storage tank floor / wall integrity

FT systems can be used in a wide array of engineered structures, and for any root cause of stress or degradation. FT sensor measurements combined with standard structural modeling and finite element analysis provide information to optimize maintenance, or institute prevention measures such as load control.

Fox-Tek's Electric Field Mapping ("EFM") System is a continuous, non-intrusive wall thickness monitoring system for pipelines and process piping with a number of breakthrough features:

1. Welded-on or spring-loaded sensor array
2. Rated for direct burial applications
3. Remote telemetry
4. Immediate reporting of alarms
5. Streamlined, objective data processing

Fox-Tek's Data Management and Analysis Tool ("DMAT") platform which was launched in 2011 is the database management and analysis tool for providing analysis and interpretation of the collected data. Data from all channels of FT Monitors, or EFM Monitors is collected and processed into easily understood tabular or graphical formats. It is anticipated that the DMAT Platform will provide additional value to pipeline operators and other stakeholders by allowing such users to easily manage multiple FT systems.

Fox-Tek has been able to enhance the DMAT Platform user interface to facilitate the consistent presentation of data across multiple sites and improve the tools for location comparison and data reporting. In addition, the DMAT Platform now contains an alarm-on-event capability which the customer can customize according to their specific needs and thresholds.

Fox-Tek's Fiber Bragg Grating ("FBG") sensor system is an advanced fiber optic system consisting of many point strain sensors on one sensor string with high dynamic bandwidth. The FBG sensors measure the average local strain using Fox-Tek's FTG-3500 instrument. The system is suitable for static or low to medium frequency

monitoring applications such as continuous in-situ structural health monitoring.

As an all-fiber optic sensor, FBG sensors possess some unique advantages, compared to conventional electrical sensors. They are immune to electromagnetic interference, and being light powered, they are intrinsically safe, making them ideal for deployment in hazardous or flammable environments.

The sensor itself is made from conventional single-mode optical fiber, with a diameter of 250 microns. This small diameter allows the sensor to be embedded inside the structure being monitored with minimal intrusive effect. The sensors are also available in various ruggedized packaged configurations, for easy installations.

Marcon is involved in the industrial supply of equipment and parts procuring for its clients, including the sale and distribution of Electrical, Mechanical and Instrumentation equipment. The equipment is purchased from various suppliers in Canada, the United States and Europe. Its clients are principally clients in the oil and gas industry, United States government agencies such as the Department of Defence, Department of the Interior, Department of Homeland Security and Department of Agriculture and in the Middle East. In addition to departments and agencies of the U.S. Government, Marcon's major clients include Saudi Arabia-Sabic Services (Refining and Petrochemical), Bahrain National Gas Co, Bahrain Petroleum, Qatar Petroleum, Qatar Gas, Qatar Petrochemical, Gulf of Suez Petroleum, Agiba Petroleum and Burullus Gas Co.

## **BUSINESS DEVELOPMENT**

The Company is constantly working to improve its position in terms of intellectual property and what it offers to its customers. In the first half of 2017, the Company continues to focus on improvements to its technology in markets with the highest perceived potential payoff, particularly oil and gas sectors.

Notable events include the following:

### **Fox-Tek Segment**

Fox-Tek continues to support its independent sales agents and distributors primarily outside of North America with the intent of utilizing their local contacts and established relationships within the oil and gas industry to expedite the distribution of Fox-Tek's products in the local jurisdictions. Fox-Tek has also streamlined its production process to meet the higher demand of our systems. In addition, we have an ongoing goal of significant reductions in overhead expenses, to provide greater potential towards corporate profitability.

The Company will continue to work closely with its existing clients to ensure their needs are met in order to strengthen and preserve the relationship in addition to developing new relationships with new clients.

After a very successful first introductory trip to India, FOX-TEK has provide a number of technical proposals and bids on a number of different projects – based on a number of our technologies. One of the more interested oil companies has requested a bid for 2 large EFM systems to be placed on vessels within a refinery. The Company is also working on introducing our leak detection technology for long distance applications I India.

The Company has initiated talks Ontario Centres of Excellence (OCE) to supplement a number of high quality personnel (HQP) within the organization. This includes having a Post Doctorate Fellow to come in and provide a full assessment on our data analysis techniques and to look at ways to better manage our large database of data.

Through OCE, FOX-TEK with the McMaster University's Centre of Opportunity, will be developing an innovative constant current source. This will be used across all of our EFM products, providing our existing and new clients with a better quality of analysis – with the use of a high precision constant current source.

The Company has been working to fulfill its obligations toward the Engineering and field services to meet the requirements of the contract announced on July 10th 2017 with one of our largest and long standing clients in North America.

The Company is still working closely with The Trans Africa Pipeline project ("T.A.P.") to provide non-intrusive sensing equipment which will verify the integrity of the pipeline composite at key locations. In addition to the non-intrusive sensing equipment, Fox-Tek will provide optical based sensing technology which would allow T.A.P. to monitor the right of way zones from possible third-party intrusions.

The company is in the process of registering with Petrobras as a supplier of corrosion detection monitoring systems, optical strain/pressure/temperature sensors & leak detection technology.

The Company is working with FiBos on two separate applications to monitor pressure in injectors. These injectors are critical to the plant operations since failures of these could lead to slowdowns or shutdowns of operations

#### Sales of EFM Corrosion Monitoring Systems

Company has successfully completed 3 site surveys for one of our largest and long standing clients in North America and negotiating a contract with the client to convert of the competitor's technology to Fox-Tek's EFM technology.

The Company has been working closely with engineering firms and major oil and gas companies in the Middle East, England, in addition to all the major Canadian companies. There have been increased interest the Company's products from a number of overseas markets including India and the UK. The Company entered into a contract in 2016 with a company in the U.K. for the supply of a custom built EFM system for a laboratory. This system was shipped out in the first quarter of 2017 and installed in the second quarter of 2017. The Company is confident this could lead to future orders for more portable and mobile systems that could be used for periodic monitoring for less critical applications.

The Company is also negotiating a contract for sale of another EFM unit to another of our clients.

#### I) DMAT Platform

The Company continues to enhance the DMAT platform (Data Management and Analysis Tool). Response from customers utilizing the DMAT service has been very positive. For DMAT, the revenue stream is guaranteed when a customer acquires the hardware. The Company has successfully negotiated new contracts with several clients, for Engineering services and Data Analysis, for the 2017 fiscal year and beyond.

## 2) Leak Detection Technology

Fox-Tek's leak detection technology has the potential of becoming a disrupting technology within the oil and gas sector due to its ability to detect minute amounts of volatile organic compounds present in hydrocarbon leaks. Due to the nature of the technology, it will likely have fewer false alerts unlike a number of competing technologies.

1. The Company has provided quotation for a system to detect oil on water in a drainage culvert.
2. The Company has been invited to be part of an onsite technical review for the use of our technology to monitor leaks in a pipe, within a tank farm. A budgetary/technical proposal was provided to the client. The pipe is estimated to be about 500 meters long.
3. FOX-TEK's leak detection technology is in the process of being evaluated by a large consortium consisting of a number of oil & gas companies.
4. FOX-TEK is working closely with CANMET to put a program together to validate it's leak detection technology. The Company is also working together with CANMET on the development of a new sensor technology to be used as a way to determine the damage of time on pipeline coatings.

The list below gives a range of projects that the Company is pro-actively working on and does not include bids to third parties that fall under confidentiality agreements.

- a) Leak detection system package to a number of our clients in North America.
- b) Signed an NDA with a Government body to evaluate and explore Confidential information relating to pipeline leak detection technology in order take the next step towards formalizing a collaborative working
- c) Corrosion monitoring systems package to one of our largest long standing clients in North America. Survey of the locations is underway as part of the contractor signed and announced July 10 2017. Corrosion monitoring systems package for the East West Pipeline Project JPSI-I in Saudi Arabia.
- d) Corrosion monitoring systems package for a UAE firm working on a Dubai Petroleum project.
- e) A package for a non-intrusive pressure monitoring systems for a tank farm in the United States.
- f) A package for a non-intrusive pressure monitoring systems for the Power Generation Industry
- g) A technical and commercial bid for the Yibal Kuff Project (YKP) in Oman.

## Marcon Segment

Marcon provides procurement and support services to existing and new projects worldwide in the energy sector. Initially Marcon had focused on providing services in the energy sector but moved on to government contracts and government services. Marcon has two subsidiaries, Marcon USA and Marcon UK, to help enhance and support its logistic and sales operations. Over the years it has established a good reputation and has been a consistent performer for its clients in the government as well as the international oil and gas industry.

Marcon International has built an impressive pipeline of quotes in 2017 and are witnessing increased bidding activity in 2017. Majority of the larger bids and quotes for Marcon International are time consuming both in preparation of the bidding process and with the client and the end users. Marcon has successfully signed numerous deals year to date and will continue to do so and update the public through periodic press releases. The backlog order as of the date of this MD&A is \$1,988. The backlogs include four orders valued at \$680, \$604, \$284 and \$155.

## SELECTED FINANCIAL AND OPERATING RESULTS

### Statement of Financial Position

As at September 30, 2017, the Company has a working capital of \$84 (December 31, 2016 – \$126). As at September 30, 2017, the Company had total assets of \$1,180 (December 31, 2016 – \$1,168). Total assets increased by \$12 during nine months ended September 30, 2017 as cash and cash equivalents increased by \$192 largely due to an additional loan from BDC while prepaid expenses and other assets decreased by \$148.

As at September 30, 2017, the Company had total liabilities of \$1,275 as compared to \$1,031 as at December 31, 2016 – an increase of \$244. This was largely due to \$200 increase in long term debt from BDC. Deferred revenue increased by \$71 as some of the customers have been invoiced in advance. Accounts payable and accrued liabilities fell by \$30.

There were no changes to the share capital during the nine months ended September 30, 2017.

### Summary of Consolidated Quarterly Results

The following is a summary of results on a quarterly basis.

|                                                                               | Q4<br>2015        | Q1<br>2016      | Q2<br>2016        | Q3<br>2016        | Q4<br>2016        | Q1<br>2017        | Q2<br>2017        | Q3<br>2017        |
|-------------------------------------------------------------------------------|-------------------|-----------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Sales                                                                         | \$ 425            | \$ 1,011        | \$ 807            | \$ 1,479          | \$ 1,299          | \$ 879            | \$ 696            | \$ 650            |
| Cost of sales                                                                 | (316)             | (550)           | (576)             | (1,293)           | (1,151)           | (679)             | (452)             | (515)             |
| <b>Grossprofit</b>                                                            | <b>\$ 109</b>     | <b>\$ 461</b>   | <b>\$ 231</b>     | <b>\$ 186</b>     | <b>\$ 148</b>     | <b>\$ 200</b>     | <b>\$ 244</b>     | <b>\$ 135</b>     |
|                                                                               | 25.6%             | 45.6%           | 28.6%             | 12.6%             | 11.4%             | 22.8%             | 35.1%             | 20.8%             |
| <b>Expenses</b>                                                               |                   |                 |                   |                   |                   |                   |                   |                   |
| Research and development                                                      | (44)              | (36)            | (38)              | (39)              | (42)              | (37)              | (35)              | (39)              |
| Selling                                                                       | (16)              | (8)             | (12)              | (8)               | (6)               | (7)               | (12)              | (6)               |
| General and administrative                                                    | (248)             | (235)           | (213)             | (208)             | (174)             | (233)             | (224)             | (206)             |
| <b>Total operating expenses</b>                                               | <b>(308)</b>      | <b>(279)</b>    | <b>(263)</b>      | <b>(255)</b>      | <b>(222)</b>      | <b>(277)</b>      | <b>(271)</b>      | <b>(251)</b>      |
| <b>Income/(loss) from operations</b>                                          | <b>(199)</b>      | <b>182</b>      | <b>(32)</b>       | <b>(69)</b>       | <b>(74)</b>       | <b>(77)</b>       | <b>(27)</b>       | <b>(116)</b>      |
| Finance costs                                                                 | (8)               | (4)             | (4)               | (5)               | (5)               | (3)               | (4)               | (4)               |
| Stock based compensation                                                      | -                 | -               | -                 | -                 | -                 | (101)             | (64)              | (47)              |
| Gain(loss) on sale of investment                                              | (90)              | -               | -                 | -                 | -                 | -                 | -                 | -                 |
| Unrealized (loss)gain on investment                                           | 90                | -               | -                 | -                 | -                 | -                 | -                 | -                 |
| Foreign exchange gain(loss)                                                   | (13)              | 13              | -                 | -                 | 4                 | -                 | 10                | 7                 |
| <b>Net income/(loss) for the period before tax</b>                            | <b>(220)</b>      | <b>191</b>      | <b>(36)</b>       | <b>(74)</b>       | <b>(75)</b>       | <b>(181)</b>      | <b>(85)</b>       | <b>(160)</b>      |
| Income tax expense                                                            | -                 | (6)             | -                 | -                 | (15)              | -                 | -                 | (5)               |
| <b>Net income/(loss) for the period</b>                                       | <b>(220)</b>      | <b>185</b>      | <b>(36)</b>       | <b>(74)</b>       | <b>(90)</b>       | <b>(181)</b>      | <b>(85)</b>       | <b>(165)</b>      |
| Other comprehensive income (loss)                                             | 14                | (7)             | -                 | (5)               | 14                | (1)               | (6)               | (6)               |
| <b>Total comprehensive income/(loss) for the period</b>                       | <b>(206)</b>      | <b>178</b>      | <b>(36)</b>       | <b>(79)</b>       | <b>(76)</b>       | <b>(182)</b>      | <b>(91)</b>       | <b>(171)</b>      |
| <b>Basic and diluted income/(loss) per share</b>                              | <b>\$ (0.001)</b> | <b>\$ 0.001</b> | <b>\$ (0.000)</b> | <b>\$ (0.000)</b> | <b>\$ (0.001)</b> | <b>\$ (0.001)</b> | <b>\$ (0.001)</b> | <b>\$ (0.001)</b> |
| <b>Basic and diluted weighted average number of common shares outstanding</b> | <b>237,058</b>    | <b>254,115</b>  | <b>254,115</b>    | <b>254,115</b>    | <b>256,115</b>    | <b>256,115</b>    | <b>256,115</b>    | <b>256,115</b>    |

## Results of Operations

|                                                         | Three months ended September 30, |                | Nine months ended September 30, |                |
|---------------------------------------------------------|----------------------------------|----------------|---------------------------------|----------------|
|                                                         | 2017                             | 2016           | 2017                            | 2016           |
| Sales                                                   | \$ 650                           | \$ 1,479       | \$ 2,225                        | \$ 3,297       |
| Cost of sales                                           | (515)                            | (1,293)        | (1,646)                         | (2,419)        |
| <b>Gross profit</b>                                     | <b>135</b>                       | <b>186</b>     | <b>579</b>                      | <b>878</b>     |
| <b>Expenses</b>                                         |                                  |                |                                 |                |
| Research and development                                | (39)                             | (39)           | (111)                           | (113)          |
| Selling                                                 | (6)                              | (8)            | (25)                            | (28)           |
| General and administrative                              | (206)                            | (208)          | (663)                           | (656)          |
| <b>Total expenses</b>                                   | <b>(251)</b>                     | <b>(255)</b>   | <b>(799)</b>                    | <b>(797)</b>   |
| <b>(Loss) income before the undernoted</b>              | <b>(116)</b>                     | <b>(69)</b>    | <b>(220)</b>                    | <b>81</b>      |
| Finance costs                                           | (4)                              | (5)            | (11)                            | (13)           |
| Stock based compensation                                | (47)                             | -              | (212)                           | -              |
| Foreign exchange gain                                   | 7                                | -              | 17                              | 12             |
| <b>Net (loss) income for the period before tax</b>      | <b>(160)</b>                     | <b>(74)</b>    | <b>(426)</b>                    | <b>80</b>      |
| Income tax expense                                      | (5)                              | -              | (5)                             | (6)            |
| <b>Net (loss) income for the period after tax</b>       | <b>(165)</b>                     | <b>(74)</b>    | <b>(431)</b>                    | <b>74</b>      |
| Other comprehensive loss                                | (6)                              | (5)            | (13)                            | (5)            |
| <b>Total comprehensive (loss) income for the period</b> | <b>\$ (171)</b>                  | <b>\$ (79)</b> | <b>\$ (444)</b>                 | <b>\$ 69</b>   |
| <b>(Loss) income per common share based on</b>          |                                  |                |                                 |                |
| <b>Net (loss) income for the period</b>                 |                                  |                |                                 |                |
| Basic and diluted                                       | \$ (0.001)                       | \$ (0.000)     | \$ (0.00)                       | \$ 0.00        |
| <b>Basic and diluted weighted average number</b>        |                                  |                |                                 |                |
| <b>of common shares outstanding</b>                     | <b>256,115</b>                   | <b>254,115</b> | <b>256,115</b>                  | <b>254,115</b> |

Sales and cost of sales were \$2,225 and \$1,646 respectively for the nine months ended September 30, 2017 (nine months ended September 30, 2016 - \$3,297 and \$2,419). The sales in the nine months ended September 30, 2017 were \$1,072 lower than the corresponding period of 2016 primarily due to a decrease in Fox-Tek sales by \$317 and Marcon sales by \$755 compared to prior year period. The gross margin was 26.0% in the nine months ended September 30, 2017 similar to 26.6% in 2016.

The trend for increased Marcon orders has continued through 2017 and also Marcon has seen a very significant jump in its volume of orders to date – the backlog order as of the date of this MD&A is \$1,988. The backlogs include four orders valued at \$680, \$604, \$284 and \$155. Two of these orders worth \$759 are expected to be delivered by end of December 2017. Additionally, Marcon entered into an agreement with Enerdynamic to undertake sales and marketing efforts on its behalf and this has generated revenue of \$125.

In the first half of 2017, Fox-Tek has shipped out 1 EFM system to a new customer and installed 2 units out of the 5 that were delivered in 2016. Fox-Tek has also negotiated with its customers to upgrade their field systems. This has led to additional revenue from implementing the upgrade and DMAT revenue has gone up. This work commenced in the first quarter of 2017 and has continued to beginning of the fourth quarter of 2017.

The Company is continually making efforts to reduce expenses in order to become cash flow positive over the next year. Total operating expenses for the nine months ended September 30, 2017 were \$799 similar to \$797 in the same period last year. All costs have remained generally at last year's levels. Finance costs of \$11 (2016 - \$13) include accrued interest expense of \$3 (2016 - accrued interest and accretion expense \$5) for the outstanding debentures, and interest of \$8 on long term loans (2016 - \$8).

On January 30, 2017, the Company granted 11,500 stock options to directors, officers and consultants of the Company exercisable at a price of \$0.10 per share and expiring on January 30, 2022. The options vest in three equal yearly tranches with the first instalment vesting on January 30, 2017 with the remaining options vesting on the one and two year anniversaries of the initial release. The fair value at date of grant was \$0.032 per option granted. The fair value of the options was calculated using the Black-Scholes option pricing model with the following assumptions: expected life of 5 years, a risk-free rate of 1.14%, expected dividend yield of 0% and an expected volatility of 134%. The expected volatility is based on the historical volatility of the Company's share price over the life of the options. The Company has not paid any cash dividends historically and has no plans to pay cash dividends in the foreseeable future. The risk-free interest rate is based on the yield of Canadian Benchmark Bonds with equivalent terms. The expected option life in years represents the period of time that the options are expected to be outstanding based on historical warrants issued. For the nine months ended September 30, 2017, included in the consolidated statements of (loss) income and comprehensive (loss) income is stock-based compensation of \$212 (nine months ended September 30, 2016 - nil) relating to the stock options granted to directors, officers and consultants of the Company.

During the nine months ended September 30, 2017, the Company recognized \$20 (2016 - \$17) Ontario Investment Tax Credit, which has been deducted from research and development expenses. Investment tax credits for the fiscal year are dependent upon qualification of each individual project under stringent technical criteria and amounts may vary upon further review by the Canada Revenue Agency. Adjustments to the claim, if any, will be accounted for in the year of assessment. Historically, the investment tax credits have been assessed as filed, accordingly the Company has accrued the refundable credit of \$16 for the nine months ended September 30, 2017 (nine months ended September 30, 2016 - \$17). As at September 30, 2017 and December 31, 2016, the tax credits receivable totaled \$16 and \$22, respectively. As at September 30, 2017, the Company received \$26 against the 2016 receivable.

### **The Third Second Quarter Results**

Sales and cost of sales in the three months ended September 30, 2017 were \$650 and \$515 (three months ended September 30, 2016 - \$1,479 and \$1,293).

Marcon sales for the third quarter of 2017 were \$564 compared to \$1,394 in the corresponding quarter of 2016. Fox-Tek's sales in the third quarter of this year was \$86 similar to \$85 in the corresponding quarter of 2016. The margin of 20.7% during the three months ended September 30, 2017 is more than 12.6% in the corresponding period of 2016 due to the relative changes in sales mix between Fox-Tek and Marcon segments.

Total operating expenses for the three months ended September 30, 2017 were \$251 compared to \$255 for the same period of the 2016. All expenses for the three months ended September 30, 2017 were very similar to the corresponding period of 2016.

## Gross profit analysis

For the eight quarters, the gross profit margin for the two cash generating units fluctuated within a range of 8% to 79%, which was mainly due to the fluctuation of the sales mix between Fox-Tek and Marcon - Fox-Tek has an average of about 70% gross profit margins and Marcon has an average of 15% gross profit margins. See following tables for gross profit margins in the two divisions.

### Gross profit for Marcon

|                       | <b>Q4</b>   | <b>Q1</b>   | <b>Q2</b>    | <b>Q3</b>    | <b>Q4</b>    | <b>Q1</b>   | <b>Q2</b>    | <b>Q3</b>   |
|-----------------------|-------------|-------------|--------------|--------------|--------------|-------------|--------------|-------------|
|                       | <b>2015</b> | <b>2016</b> | <b>2016</b>  | <b>2016</b>  | <b>2016</b>  | <b>2017</b> | <b>2017</b>  | <b>2017</b> |
| <b>Sales</b>          | \$329       | \$509       | \$701        | \$1,394      | \$1,208      | \$690       | \$596        | \$564       |
| <b>Cost of sales</b>  | 279         | 442         | 549          | 1275         | 1092         | 634         | 431          | 495         |
| <b>Gross profit</b>   | <b>\$50</b> | <b>\$67</b> | <b>\$152</b> | <b>\$119</b> | <b>\$116</b> | <b>\$56</b> | <b>\$165</b> | <b>\$69</b> |
| <b>Gross profit %</b> | <b>15%</b>  | <b>13%</b>  | <b>22%</b>   | <b>9%</b>    | <b>10%</b>   | <b>8%</b>   | <b>28%</b>   | <b>12%</b>  |

### Gross profit for Fox-Tek

|                       | <b>Q4</b>   | <b>Q1</b>    | <b>Q2</b>   | <b>Q3</b>   | <b>Q4</b>   | <b>Q1</b>    | <b>Q2</b>   | <b>Q3</b>   |
|-----------------------|-------------|--------------|-------------|-------------|-------------|--------------|-------------|-------------|
|                       | <b>2015</b> | <b>2016</b>  | <b>2016</b> | <b>2016</b> | <b>2016</b> | <b>2017</b>  | <b>2017</b> | <b>2017</b> |
| <b>Sales</b>          | \$96        | \$502        | \$106       | \$85        | \$91        | \$189        | \$101       | \$86        |
| <b>Cost of sales</b>  | 37          | 108          | 27          | 18          | 59          | 45           | 22          | 20          |
| <b>Gross profit</b>   | <b>\$59</b> | <b>\$394</b> | <b>\$79</b> | <b>\$67</b> | <b>\$32</b> | <b>\$144</b> | <b>\$79</b> | <b>\$66</b> |
| <b>Gross profit %</b> | <b>61%</b>  | <b>78%</b>   | <b>75%</b>  | <b>79%</b>  | <b>35%</b>  | <b>76%</b>   | <b>78%</b>  | <b>77%</b>  |

Marcon revenue for the second quarter of 2017 was lower than the corresponding quarter of 2016 by \$830 but the margin was higher at 12% compared to 9 % in the third quarter of 2016.

Fox-Tek recorded sales of \$86 in the third quarter of 2017 was almost same as the \$85 in the corresponding period of 2016. The gross margin for Fox-Tek this quarter of 77% was about the same level as 79% in the third quarter of 2016.

The Company's revenue continues to be difficult to forecast and is likely to fluctuate significantly from period to period. In addition, the Company's operating results do not follow any past trends. The factors affecting the Company's revenue and results of operations include:

- competitive conditions in the industrial sensing industry, including new products, product announcements and special pricing offered by competitors of the Company;

- market acceptance of the Company's products;
- ability to hire, train and retain sufficient sales and professional services staff;
- ability to complete its service obligations related to product sales in a timely manner;
- varying size, timing and contractual terms of product orders, which may delay the recognition of revenue;
- ability to maintain existing relationships and to create new relationships to assist with sales and marketing efforts;
- the length and variability of the sales cycles for the Company's products;
- strategic decisions by the Company or its competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments or changes in business strategy;
- general weakening of the oil and gas industry resulting in a decrease in the overall demand for the products and services offered by the Company or otherwise affecting its customers' capital investment levels in workforce management software;
- changes in the Company's pricing policies and the pricing policies of its competitors;
- timing of product development and new product initiatives; and
- changes in the mix of revenue attributable to substantially lower-margin service revenue as opposed to higher-margin product license revenue.

Since the Company's revenue will be dependent upon a relatively small number of transactions, even minor variations in the rate and timing of conversion of sales prospects into revenue could cause the Company to plan or budget inaccurately. Such variations could adversely affect the Company's financial results. Delays and reductions in the amount of, or cancellations of, customers' purchases would adversely affect the Company's revenue, results of operations and financial condition.

Historically, the Company's revenues and net results have not been affected by seasons. Seasonal fluctuations will become more significant as the weighting of sales to the oil and gas field increases, since business activity is generally greater in the winter for this sector.

### **Performance Indicators**

In order to evaluate the Company's performance and generate long-term value for its shareholders, the Company has identified the following financial and non-financial performance indicators:

- Distribution, sales, and long-term recurring revenues;
- Products and innovation;
- Short-term financial performance and cash flows;
- Strategic acquisitions and development of new projects.

### **SEGMENTED INFORMATION**

The Company's reportable segments are strategic business units that offer different services and/or products. They are managed separately because each segment requires different strategies and involves different aspects of management expertise. The accounting policies of the segments are the same as those described in the summary of significant accounting policies as disclosed in the consolidated financial statements for the year ended December 31, 2017 and 2016. The Company carries out its operations through wholly-owned entities. These entities are located in Canada and the United States.

**NINE MONTHS ENDED SEPTEMBER 30, 2017**

|                                                           | <b>Marcon<br/>Operations</b> | <b>Fox-Tek<br/>Operations</b> | <b>Corporate<br/>Operations</b> | <b>Company</b>  |
|-----------------------------------------------------------|------------------------------|-------------------------------|---------------------------------|-----------------|
| Sales                                                     | \$ 1,849                     | \$ 376                        | \$ -                            | \$ 2,225        |
| Cost of sales                                             | (1,558)                      | (88)                          | -                               | (1,646)         |
| <b>Gross profit</b>                                       | <b>291</b>                   | <b>288</b>                    | <b>-</b>                        | <b>579</b>      |
| <b>Expenses</b>                                           |                              |                               |                                 |                 |
| Research and development                                  | -                            | (111)                         | -                               | (111)           |
| Selling                                                   | -                            | (25)                          | -                               | (25)            |
| General and administrative                                | (258)                        | (127)                         | (278)                           | (663)           |
| <b>Total operating expenses</b>                           | <b>(258)</b>                 | <b>(263)</b>                  | <b>(278)</b>                    | <b>(799)</b>    |
| <b>(Loss) income before the undernoted</b>                | <b>33</b>                    | <b>25</b>                     | <b>(278)</b>                    | <b>(220)</b>    |
| Finance costs                                             | (2)                          | -                             | (9)                             | (11)            |
| Stock based compensation                                  | -                            | -                             | (212)                           | (212)           |
| Foreign exchange gain (loss)                              | 19                           | (2)                           | -                               | 17              |
| <b>Net income/(loss) for the period before income tax</b> | <b>50</b>                    | <b>23</b>                     | <b>(499)</b>                    | <b>(426)</b>    |
| Income tax expense                                        | (5)                          | -                             | -                               | (5)             |
| <b>Net income (loss) for the period</b>                   | <b>45</b>                    | <b>23</b>                     | <b>(499)</b>                    | <b>(431)</b>    |
| Other comprehensive loss                                  | (13)                         | -                             | -                               | (13)            |
| <b>Total comprehensive income (loss) for the period</b>   | <b>\$ 32</b>                 | <b>\$ 23</b>                  | <b>\$ (499)</b>                 | <b>\$ (444)</b> |

**As of September 30, 2017**

|                     |               |               |               |                 |
|---------------------|---------------|---------------|---------------|-----------------|
| Equipment           | \$ 6          | \$ 28         | \$ -          | \$ 34           |
| <b>Total assets</b> | <b>\$ 661</b> | <b>\$ 257</b> | <b>\$ 262</b> | <b>\$ 1,180</b> |

All of the Company's equipment is located in Canada. The Marcon sales revenue of \$1,849 excludes intercompany sales of \$19 to Fox-Tek for the nine months ended September 30, 2017. The intercompany sales have been eliminated in the interim consolidated statements.

**NINE MONTHS ENDED SEPTEMBER 30, 2016**

|                                                           | <b>Marcon<br/>Operations</b> | <b>Fox-Tek<br/>Operations</b> | <b>Corporate<br/>Operations</b> | <b>Company</b> |
|-----------------------------------------------------------|------------------------------|-------------------------------|---------------------------------|----------------|
| Sales                                                     | \$ 2,604                     | \$ 693                        | \$ -                            | \$ 3,297       |
| Cost of sales                                             | (2,266)                      | (153)                         | -                               | (2,419)        |
| <b>Gross profit</b>                                       | <b>338</b>                   | <b>540</b>                    | <b>-</b>                        | <b>878</b>     |
| <b>Expenses</b>                                           |                              |                               |                                 |                |
| Research and development                                  | -                            | (113)                         | -                               | (113)          |
| Selling                                                   | -                            | (28)                          | -                               | (28)           |
| General and administrative                                | (249)                        | (133)                         | (274)                           | (656)          |
| <b>Total operating expenses</b>                           | <b>(249)</b>                 | <b>(274)</b>                  | <b>(274)</b>                    | <b>(797)</b>   |
| <b>(Loss) income before the undernoted</b>                | <b>89</b>                    | <b>266</b>                    | <b>(274)</b>                    | <b>81</b>      |
| Finance costs                                             | (2)                          | -                             | (11)                            | (13)           |
| Foreign exchange gain (loss)                              | 117                          | (15)                          | (90)                            | 12             |
| <b>Net income/(loss) for the period before income tax</b> | <b>204</b>                   | <b>251</b>                    | <b>(375)</b>                    | <b>80</b>      |
| Income tax expense                                        | (6)                          | -                             | -                               | (6)            |
| <b>Net income (loss) for the period</b>                   | <b>198</b>                   | <b>251</b>                    | <b>(375)</b>                    | <b>74</b>      |
| Other comprehensive loss                                  | -                            | -                             | (5)                             | (5)            |
| <b>Total comprehensive loss for the period</b>            | <b>\$ 198</b>                | <b>\$ 251</b>                 | <b>\$ (380)</b>                 | <b>\$ 69</b>   |

**As of September 30, 2016**

|                     |                 |               |              |                 |
|---------------------|-----------------|---------------|--------------|-----------------|
| Equipment           | \$ 9            | \$ 27         | \$ -         | \$ 46           |
| <b>Total assets</b> | <b>\$ 1,156</b> | <b>\$ 325</b> | <b>\$ 63</b> | <b>\$ 1,544</b> |

All of the Company's equipment is located in Canada. The Marcon sales revenue of \$2,604 excludes intercompany sales of \$13 to Fox-Tek for the six months ended September 30, 2016. The intercompany sales have been eliminated in the interim consolidated statements.

**THREE MONTHS ENDED SEPTEMBER 30, 2017**

|                                                           | <b>Marcon</b>     | <b>Fox-Tek</b>    | <b>Corporate</b>  |                 |
|-----------------------------------------------------------|-------------------|-------------------|-------------------|-----------------|
|                                                           | <b>Operations</b> | <b>Operations</b> | <b>Operations</b> | <b>Company</b>  |
| Sales                                                     | \$ 564            | \$ 86             | \$ -              | \$ 650          |
| Cost of sales                                             | (495)             | (20)              | -                 | (515)           |
| <b>Gross profit</b>                                       | <b>69</b>         | <b>66</b>         | <b>-</b>          | <b>135</b>      |
| <b>Expenses</b>                                           |                   |                   |                   |                 |
| Research and development                                  | -                 | (39)              | -                 | (39)            |
| Selling                                                   | -                 | (6)               | -                 | (6)             |
| General and administrative                                | (77)              | (38)              | (91)              | (206)           |
| <b>Total operating expenses</b>                           | <b>(77)</b>       | <b>(83)</b>       | <b>(91)</b>       | <b>(251)</b>    |
| <b>Income (loss) from operations</b>                      | <b>(8)</b>        | <b>(17)</b>       | <b>(91)</b>       | <b>(116)</b>    |
| Finance costs                                             | -                 | -                 | (4)               | (4)             |
| Stock based compensation                                  | -                 | -                 | (47)              | (47)            |
| Foreign exchange gain (loss)                              | 14                | (7)               | 0                 | 7               |
| <b>Net income/(loss) for the period before income tax</b> | <b>6</b>          | <b>(24)</b>       | <b>(142)</b>      | <b>(160)</b>    |
| Income tax expense                                        | (5)               | -                 | -                 | (5)             |
| <b>Net income (loss) for the period</b>                   | <b>1</b>          | <b>(24)</b>       | <b>(142)</b>      | <b>(165)</b>    |
| Other comprehensive loss                                  | -                 | -                 | (6)               | (6)             |
| <b>Total comprehensive income (loss) for the period</b>   | <b>\$ 1</b>       | <b>\$ (24)</b>    | <b>\$ (148)</b>   | <b>\$ (171)</b> |

**As of September 30, 2017**

|                     |               |               |               |                 |
|---------------------|---------------|---------------|---------------|-----------------|
| Equipment           | \$ 6          | \$ 28         | \$ -          | \$ 34           |
| <b>Total assets</b> | <b>\$ 661</b> | <b>\$ 257</b> | <b>\$ 262</b> | <b>\$ 1,180</b> |

All of the Company's equipment is located in Canada. The Marcon sales revenue of \$564 excludes intercompany sales of \$2 to Fox-Tek for the nine months ended September 30, 2017. The intercompany sales have been eliminated in the interim consolidated statements.

**THREE MONTHS ENDED SEPTEMBER 30, 2016**

|                                                           | <b>Marcon<br/>Operations</b> | <b>Fox-Tek<br/>Operations</b> | <b>Corporate<br/>Operations</b> | <b>Company</b> |
|-----------------------------------------------------------|------------------------------|-------------------------------|---------------------------------|----------------|
| Sales                                                     | \$ 1,394                     | \$ 85                         | \$ -                            | \$ 1,479       |
| Cost of sales                                             | (1,275)                      | (18)                          | -                               | (1,293)        |
| <b>Gross profit</b>                                       | <b>119</b>                   | <b>67</b>                     | <b>-</b>                        | <b>186</b>     |
| <b>Expenses</b>                                           |                              |                               |                                 |                |
| Research and development                                  | -                            | (39)                          | -                               | (39)           |
| Selling                                                   | -                            | (8)                           | -                               | (8)            |
| General and administrative                                | (79)                         | (39)                          | (90)                            | (208)          |
| <b>Total operating expenses</b>                           | <b>(79)</b>                  | <b>(86)</b>                   | <b>(90)</b>                     | <b>(255)</b>   |
| <b>Income (loss) from operations</b>                      | <b>40</b>                    | <b>(19)</b>                   | <b>(90)</b>                     | <b>(69)</b>    |
| Finance costs                                             | -                            | -                             | (5)                             | (5)            |
| Foreign exchange gain (loss)                              | (4)                          | 5                             | (1)                             | -              |
| <b>Net income/(loss) for the period before income tax</b> | <b>36</b>                    | <b>(14)</b>                   | <b>(97)</b>                     | <b>(74)</b>    |
| Other comprehensive loss                                  | (5)                          | -                             | -                               | (5)            |
| <b>Total comprehensive income (loss) for the period</b>   | <b>\$ 31</b>                 | <b>\$ (14)</b>                | <b>\$ (97)</b>                  | <b>\$ (79)</b> |

**As of September 30, 2016**

|                          |          |        |       |          |
|--------------------------|----------|--------|-------|----------|
| Equipment                | \$ 9     | \$ 37  | \$ -  | \$ 46    |
| Accumulated depreciation | \$ 1,150 | \$ 225 | \$ 60 | \$ 1,435 |

All of the Company's equipment is located in Canada. The Marcon sales revenue of \$1,394 excludes intercompany sales of \$nil to Fox-Tek for the three months ended September 30, 2016. The intercompany sales have been eliminated in the interim consolidated statements.

## Revenue by Geographic Region

|              | Three months ended September 30, |                 | Nine months ended September 30, |                 |
|--------------|----------------------------------|-----------------|---------------------------------|-----------------|
|              | 2017                             | 2016            | 2017                            | 2016            |
| USA          | \$ 570                           | \$ 1,421        | \$ 1,713                        | \$ 2,538        |
| Canada       | 47                               | 45              | 322                             | 578             |
| Middle East  | 28                               | 9               | 118                             | 171             |
| Others       | 5                                | 4               | 72                              | 10              |
| <b>Total</b> | <b>\$ 650</b>                    | <b>\$ 1,479</b> | <b>\$ 2,225</b>                 | <b>\$ 3,297</b> |

## LIQUIDITY AND CASH RESOURCES

Net cash generated by operating activities was \$6 during the nine months ended September 30, 2017 as compared to cash used in operating activities of \$77 during the nine months ended September 30, 2016. The Company expensed \$212 as stock based compensation (2016 - \$nil) which does not involve cash. Trade and accounts receivable went down by \$22 as did prepaid expenses by \$148. Deferred revenue went up by \$71 while accounts payable and accrued liabilities went down by \$30.

Cash generated from financing activities was \$200 during the nine months ended September 30, 2017 (nine months ended September 30, 2016 – cash used in financing activities \$10) from a new loan from BDC.

For the nine months ended September 30, 2017, the Company had a net increase in cash and cash equivalents of \$192 (nine months ended September 30, 2016 – decrease of \$95). As a result, as at September 30, 2017, the Company had a cash and cash equivalents balance of \$275.

The Company is committed under operating lease agreements for the rental of its premises and a car lease. Minimum annual future lease payments are approximately as follows:

| Year | Lease Commitments |
|------|-------------------|
| 2017 | \$ 20             |
| 2018 | 71                |
| 2019 | 24                |
|      | <b>\$ 115</b>     |

Management will continue to work on maintaining an optimal inventory level and the timely collection of accounts receivable to minimize its working capital requirements.

The Company uses its capital to finance marketing expense, research and development activities, administrative charges, working capital and capital assets. Historically, the Company has financed activities through rounds of public and private financing and debt financing. The Company has a 12% debenture which matured on December 31, 2016 with a carrying amount of \$46 that is due on demand and long term debt of \$251 with an interest rate of 8.05%, repayable in monthly instalments of \$4.1 plus interest with effect from January 15, 2018, maturing on December 15, 2022. Only interest is payable of the long term loan until then.

## SHARE CAPITAL, WARRANTS, AND OPTIONS

Subsequent to September 30, 2017, the Company issued 181 common shares at a deemed value of \$0.05 per share to Agora Internet Relations Corp. ("Agora") to settle the Company's first instalment payment of \$9 for on-line marketing services. The Company has entered into an agreement with Agora pursuant to which Agora will provide marketing, advertising and related services to the company for a fee of \$40 plus applicable sales taxes to be paid by the issuance of common shares of the Company. The fee is payable in five instalments of \$8 each payable at the end of each three-month period. The price of the common shares to be issued as payment for each instalment will be set at the closing price of the common shares on the date which such instalment becomes payable.

Subsequent to September 30, 2017, 2,000 warrants exercisable at \$0.10 per share expired unexercised.

As at the date of this MD&A, the number of common shares of the Company outstanding and the number of common shares issuable pursuant to other outstanding securities of the Company are as follows:

|                                                | No. of shares<br>('000) |
|------------------------------------------------|-------------------------|
| Common shares outstanding                      | 256,296                 |
| Issuable on exercise of options                | 11,500                  |
| Issuable on exercise of warrants               | 30,140                  |
| <b>Fully diluted common shares outstanding</b> | <b>297,936</b>          |

Additional information about the Company's share capital can be found in note 8 of the notes to the interim consolidated statements for nine months ended September 30, 2017 and 2016.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.

## TRANSACTIONS WITH RELATED PARTIES

Related parties include the Board of Directors, Officers of the Company and enterprises that are controlled by these individuals as well as certain persons performing similar functions. The transactions with related parties were in the normal course of operations and were measured at fair value. Related party transactions not disclosed elsewhere in these interim consolidated statements are as follows:

- (a) As at September 30, 2017, \$4 (December 31, 2016 - \$4) is owing to a law firm in which a director, Jay Vieira, is a former partner.
- (b) Included in accounts payable and accrued liabilities as at September 30, 2017 is \$21 (December 31, 2016 - \$21) owing to the CEO and a company controlled by the CEO.
- (c) Included in the consolidated statements of (loss) income and comprehensive (loss) income for the nine months ended September 30, 2017 is \$126 (2016 - \$126) paid to a company controlled by the CEO for services rendered by the CEO (Note 12).
- (d) As at September 30, 2017, \$7 (December 31, 2016, \$1) is owing to officers of the Company.
- (e) During the nine months ended September 30, 2017, the Company granted 5,500 options to directors and officers of the Company at an exercise price of \$0.10 per share expiring on January 30, 2022. Included in

the statements of (loss) income and comprehensive (loss) income for the nine months ended September 30, 2017 is stock-based compensation expense of \$101 relating to options granted to related parties (Note 8(c)).

## **KEY MANAGEMENT PERSONNEL COMPENSATION**

During the nine months ended September 30, 2017, the Company recognized salaries and short term benefit expenses of \$359 (six months ended September 30, 2016 - \$359) for its key management personnel, including the CEO of the Company, CEO of Marcon, VP of Software Solutions, VP of Operations, and CFO of the Company.

## **CHANGES IN ACCOUNTING POLICIES**

The interim consolidated statements follow the same accounting policies and methods of computation as those described in Note 3 of the annual consolidated financial statements as at and for the year ended December 31, 2016, except those adopted on January 1, 2017 as follows:

- (a) IAS 7 – Statement of Cash Flows (“IAS 7”) was amended in January 2016 to clarify that disclosures shall be provided that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments are effective for annual periods beginning on or after January 1, 2017. The implementation of amendments to IAS 7 had no impact to the Company's interim consolidated statements for the nine months ended September 30, 2017.
- (b) IAS 12 – Income Taxes (“IAS 12”) was amended in January 2016 to clarify that, among other things, unrealized losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use; the carrying amount of an asset does not limit the estimation of probable future taxable profits; and estimates for future taxable profits exclude tax deduction resulting from the reversal of deductible temporary differences. The amendments are effective for annual periods beginning on or after January 1, 2017. The implementation of amendments to IAS 12 had no impact to the Company's interim consolidated statements for the nine months ended September 30, 2017.

## **Future accounting pronouncements**

IFRS accounting standards, interpretations and amendments to existing IFRS accounting standards that were not yet effective as at December 31, 2016, are described in Note 4 to the annual consolidated financial statements as at and for the year ended December 31, 2016. There have been no other changes to existing IFRS accounting standards and interpretations since December 31, 2016 that are expected to have a material effect on the Company's interim consolidated statements.

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of the financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts that are reported in the financial statements and accompanying note disclosures. Although these estimates and assumptions are based on management's best knowledge of current events, actual results may be different from the estimates.

Critical accounting estimates used in the preparation of the Company's interim financial statements include the Company's allowances for impairments of trade and other accounts receivables, impairment of inventory, valuation of convertible debenture conversion options and warrants, the valuation related to the Company's deferred tax assets ("DTA") and deferred tax liabilities ("DTL"). The key sources of estimation uncertainty at the financial reporting date, which have a significant risk of causing a material adjustment to the carrying amounts of assets within the next financial year, are discussed below.

### **Allowances for impairment of trade and other accounts receivables**

The Company's carrying value of trade and other receivables as at September 30, 2017 was approximately \$640 (December 31, 2016 – \$662), net of allowances for doubtful accounts of \$Nil (December 31, 2016 – \$Nil). The policy for allowances for impairment on accounts receivable of the Company is based on the evaluation of collectability and on management's judgment. A considerable amount of judgment is required in assessing the ultimate realization of these receivables, including the current creditworthiness and the past collection history. If the financial conditions of the debtors of the Company were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

### **Impairment of inventory**

Inventory is recorded at the lower of cost and net realizable value. The cost of inventory may not be recoverable if their selling prices have declined. The estimate of net realizable value is based on the most reliable information available at the time the estimates are made, of the amount the inventory is expected to realize. As at September 30, 2017, the carrying amount of inventory was \$115 (December 31, 2016 – \$111).

### **Valuation of convertible debenture conversion options and warrants**

The conversion options require an estimation of the fair value of a similar liability that doesn't have an associated equity component by using a suitable discount rate at initial recognition and each extension date. The carrying amount of the conversion options is then determined by deducting the fair value of the financial liability from the fair value of the convertible debenture as a whole. The warrants attached with convertible debenture and warrants issued upon private placement financings require an estimation of the fair value at initial recognition and each extension date. Management uses the Black-Scholes option pricing model to estimate the fair value of options, warrants and conversion options, and the residual equity amount is then allocated to them based on their relative fair values.

On January 30, 2017, the Company granted 11,500 stock options to directors, officers and consultants of the Company exercisable at a price of \$0.10 per share and expiring on January 30, 2022. The fair value at date of grant was \$0.032 per option granted. The fair value of the options was calculated using the Black-Scholes option pricing model with the following assumptions: expected life of 5 years, a risk-free rate of 1.14%, expected dividend yield of 0% and an expected volatility of 134%. The expected volatility is based on the historical volatility of the Company's share price over the life of the options. The Company has not paid any cash dividends historically and has no plans to pay cash dividends in the foreseeable future. The risk-free interest rate is based on the yield of Canadian Benchmark Bonds with equivalent terms. The expected option life in years represents the period of time that the options are expected to be outstanding based on historical warrants issued.

For the nine months ended September 30, 2017, included in the consolidated statements of income (loss) and comprehensive (loss) is stock-based compensation of \$212 (nine months ended September 30, 2016 – nil) relating to the stock options granted to directors, officers and consultants of the Company.

## **Deferred tax assets**

Deferred tax is provided using the statement of financial position method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

DTL are recognized for all taxable temporary differences and DTA are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses. The Company does not record DTA to the extent that it considers it is not more likely than not that deductible temporary differences, the carry forward of unused tax credits and unused tax losses can be utilized.

Management determined, based upon expectations for future taxable income, that it believes that it is not more likely than not it will realize the tax benefits of the DTA during the next several years.

## **RISKS AND UNCERTAINTIES**

### **High Degree of Product Concentration**

Substantially all of the Company's currently anticipated revenues will be derived from a limited number of products and services. Consequently, the Company's performance will depend on establishing market acceptance of these products and services in a single market, as well as enhancing the performance of such products and services to meet the evolving needs of customers. The Company, like other entities involved in a rapidly evolving new industry, faces the risk that the Company's products and services may not prove to be commercially successful or may be rendered obsolete by further scientific and technological developments. There can be no assurances that the Company will establish and maintain a position at the forefront of emerging technological trends. Any reduction in anticipated future demand or anticipated future sales of these products or any increase in competition could have a material adverse effect on the Company's business prospects, operating results or financial condition.

### **Competition**

The Company has experienced, and expects to continue to experience, competition from a number of companies. The Company's competitors may announce new products, services or enhancements that better meet the needs of customers or changing industry standards. Increased competition may cause price reductions, reduced gross margins and loss of market share, any of which could have a material adverse effect on the Company's business, results of operations and financial condition.

Many of the competitors and potential competitors of the Company have significantly greater financial, technical, marketing and/or service resources than does the Company. Many of these companies also have a larger installed base of users, longer operating histories or greater name recognition than the Company. Customers of the Company are particularly concerned that their suppliers will continue to operate and provide upgrades and maintenance over a long-term period. The Company's smaller size and short operating history may be considered negatively by prospective customers. Even if competitors of the Company provide products with more limited system functionality than those of the Company, these products may incorporate other capabilities of interest to some customers and may be appealing due to a reduction in the number of different types of systems used to operate such customers' businesses. Further, competitors of the Company may be able to respond more quickly than the Company to changes in customer requirements and devote greater resources to the enhancement, promotion and sale of their products.

## **Market Uncertainty**

The Company's success depends to a significant degree on its ability to develop the market and gain acceptance for its products and services. There is no assurance that a significant market will develop for the Company's principal products and services. Implementation and adoption of its products have been slow to develop and may continue to be subject to delays. There can be no assurances that the additional commercial applications and markets for the Company's products will develop as currently contemplated.

The market for the Company's products is just beginning to develop and the Company's business plan will continue to require significant marketing efforts and working capital. To manage such development, the Company must continue to expand its existing resources and management information systems and must attract, train, and motivate qualified marketing, management, technical and administrative personnel. There can be no assurance that the Company will be able to achieve these goals.

The Company's success in the Marcon segment depends on and is exposed to the Middle East oil & gas market. The region has gone through some tremendous changes in the last year that have a slight impact on future sales and services in the region, and the United States Government Departments spending patterns in the operating expenditure side of procurement and contracting rather than the CAPEX side of the business and therefore most contracts signed with the Company fall under the maintenance repair and operations ("MRO").

## **Labour and Key Personnel**

The Company depends on the services of its engineers, technical employees, and key management personnel. The loss of one of these people could have a significant unfavorable impact on the Company, its operating results, and its financial position. The success of the Company is largely dependent upon its ability to identify, hire train, motivate, and retain highly skilled management employees, engineers, technical employees, and sales and marketing personnel. Competition for its employees can be intense, and the Company cannot ensure that it will be able to bring in and retain highly skilled technical and management personnel in the future. Its ability to bring in and retain management and technical personnel and the necessary sales and marketing employees could have unfavorable impact on its growth and future profitability. The Company may be obligated to increase the compensation paid to current or new employees, which could substantially increase operating expenses.

## **Growth Management and Market Development**

There is no guarantee that the Company can develop its market significantly, thus affecting its profitability. The Company expected growth might create significant pressure on management, operations, and technical resources. In order to manage its growth, Augusta may need to increase the size of its technical and operational staff and manage its personnel while maintaining many effective relationships with third parties.

## **Pricing Policies**

The competitive market in which Augusta operates could force it to reduce its prices. If its competitors offer large discounts on certain products and services in order to gain market shares or sell products and services, the Company may need to lower its prices and offer other favorable terms in order to compete successfully. Such changes could reduce profit margins and have an unfavorable impact on its operating results. Some of Augusta's competitors could offer products and services that compete with theirs for promotional purposes or as part of a long-term pricing strategy or offer price guarantees or product implementation. With time, these practices could limit the prices Augusta may charge for its products and services. If Augusta cannot offset these price reductions with a corresponding increase in sales volume or decreased expense, the decreased revenues from products and services could unfavorably affect its profit margins and operating results.

## **Product Failures and Mistakes**

Augusta products are complex and therefore may contain failures and mistakes that could be detected at any time in a product's life cycle. Failures and mistakes in its products could have a significant unfavorable impact on its reputation, open it up to significant costs, delay product launch dates, and harm its ability to sell its products in the future. The costs of correcting a failure or mistake in one of these products could be significant and could negatively affect its operating margins. Although Augusta expects to continue to test products to detect failure and mistakes and to work with its customers through its support and maintenance services in order to find and correct failure and mistakes, they could appear in its products in the future. Augusta is exposed to warranty expenses, product recalls and other claims, particularly if the products prove to be defective, which would harm business development and the Company's reputation. Augusta provides one year warranty for its products.

## **Technological Obsolescence**

Competitors and new companies could launch new products. In order to remain on the cutting edge of technology, Augusta may need to launch a new generation of fiber optic sensors and develop its related products and services. Whether it is competition from development companies and /or marketing of fiber optic sensors or a merger or acquisition of existing companies, competition within certain fiber optic sensor industry sectors offering solutions similar to what Augusta offers is vigorous and could increase. Some of Augusta's competitors have significantly greater financial, technical, distribution, and marketing resources than Augusta. Technological progress and product development could make Augusta products obsolete or reduce their value.

## **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

The Company's financial instruments include cash, investments at fair value through profit or loss, trade and other accounts receivable, bank indebtedness, accounts payable and accrued liabilities, advances, long-term debt, and convertible debentures.

The Company doesn't have any other instruments that will be settled by the delivery of non-financial assets.

### **The fair value of financial instruments**

The Company has estimated the fair value of its financial instruments as follows:

- Cash is carried at its stated value;
- The share prices quoted in the market approximates the fair value of the investments;

- The carrying value of trade and other accounts receivable, bank indebtedness, accounts payable and accrued liabilities, and advances approximate their fair values due to the short-term nature of these instruments;
- The convertible debentures include liability component, conversion option, and warrants. Both conversion option and warrants meet all the criteria for recognition as equity instruments under IAS 32, financial instruments presentation, and have been recognized as equity components. Management estimated the fair value of a similar liability that doesn't have associated equity components by using a discount rate of 18% at initial recognition and each extension date. The residual amount has been allocated to equity components. Management used the Black-Scholes option pricing model to estimate the fair value of conversion option and warrants, and the residual equity amount is then allocated to based on their relative fair values. At initial recognition date and each extension date, the convertible debentures have been segregated into conversion option, warrants and liability components. The equity components decreased the carry amount of convertible debenture liability and will be accreted into profit and loss using the effective interest method over the each extension terms of convertible debentures, and bring the carry amount of convertible debenture to their face amounts at maturity dates.
- Long term debt is carried at amortized cost. It has a fixed interest rate which is paid monthly.

### The classification and measurement base of financial instruments

The classification and measurement base for the Company's financial instruments as follows:

| Financial Instrument                     | Classification              | Measurement    |
|------------------------------------------|-----------------------------|----------------|
| Cash and cash equivalents                | Loans and receivables       | Amortized cost |
| Trade and other accounts receivable      | Loans and receivables       | Amortized cost |
| Accounts payable and accrued liabilities | Other financial liabilities | Amortized cost |
| Long term debt                           | Other financial liabilities | Amortized cost |
| Debentures                               | Other financial liabilities | Amortized cost |

## FINANCIAL RISK MANAGEMENT

The Company has exposure to counterparty credit risk, liquidity risk and market risk associated with its financial assets and liabilities. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board of Directors has established the Audit Committee which is responsible for developing and monitoring the Company's compliance with risk management policies and procedures. The Audit Committee regularly reports to the Board of Directors on its activities.

The Company's risk management program seeks to minimize potential adverse effects on the Company's financial performance and ultimately shareholder value. The Company manages its risks and risk exposures through a combination of insurance, a system of internal and disclosure controls, and sound business practices.

### Cash

Cash consists of bank balances and petty cash. Credit risk associated with cash and bank is minimized substantially by ensuring that these financial assets are invested in debt instruments of highly rated financial institutions. As at September 30, 2017, the Company held cash and bank balances of \$275 (December 31, 2016 - \$83).

### Trade and Other Accounts Receivable

**Augusta Industries Inc.**

Management's Discussion and Analysis

September 30, 2017

Accounts receivable consists primarily of trade accounts receivable from the sale of equipment, installation and reporting services. The Company's credit risk arises from the possibility that a counterparty which owes the Company money is unable or unwilling to meet its obligations in accordance with the terms and conditions in the contracts with the Company, which would result in a financial loss to the Company. This risk is mitigated through established credit management techniques, including monitoring counterparty creditworthiness, setting exposure limits and monitoring exposure against these customer credit limits.

The carrying amount of accounts receivable is reduced through the use of an allowance for doubtful accounts and the amount of the loss is recognized in the statement of loss in expenses. When a receivable balance is considered uncollectible, it is written off against the allowance for accounts receivable. Subsequent recoveries of amounts previously written off reduce general and administrative expenses in the statement of loss. Historically, trade credit losses have been minimal.

**Liquidity Risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due.

The following items are the contractual maturities of financial liabilities:

| <b>September 30, 2017</b>                | <b>Carrying<br/>amount</b> | <b>Contractual<br/>cash flows</b> | <b>0 to 12<br/>months</b> | <b>After 12<br/>months</b> |
|------------------------------------------|----------------------------|-----------------------------------|---------------------------|----------------------------|
| Accounts payable and accrued liabilities | \$ 847                     | \$ 847                            | \$ 847                    | \$ -                       |
| Debentures                               | 46                         | 46                                | 46                        | -                          |
| Income tax payable                       | 15                         | 15                                | 15                        | -                          |
| Non-cash liabilities                     | 116                        | 116                               | 116                       | -                          |
| Long term debt                           | 251                        | 251                               | 38                        | 213                        |
|                                          | <b>\$ 1,275</b>            | <b>\$ 1,275</b>                   | <b>\$ 1,062</b>           | <b>\$ 213</b>              |

| <b>December 31, 2016</b>                 | <b>Carrying<br/>amount</b> | <b>Contractual<br/>cash flows</b> | <b>0 to 12<br/>months</b> | <b>After 12<br/>months</b> |
|------------------------------------------|----------------------------|-----------------------------------|---------------------------|----------------------------|
| Accounts payable and accrued liabilities | \$ 877                     | \$ 877                            | \$ 877                    | \$ -                       |
| Debentures                               | 43                         | 43                                | 43                        | -                          |
| Income tax payable                       | 15                         | 15                                | 15                        | -                          |
| Non-cash liabilities                     | 45                         | 45                                | 45                        | -                          |
| Long term debt                           | 51                         | 51                                | 20                        | 31                         |
|                                          | <b>\$ 1,031</b>            | <b>\$ 1,031</b>                   | <b>\$ 1,000</b>           | <b>\$ 31</b>               |

## **Market Risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the fair value of recognized assets and liabilities or future cash flows or the Company's results of operations. To contend with changes in market prices, the Company constantly reviews its current and planned expenditures to ensure it has adequate resources to continue operations. The Company primarily sells goods in Canada and the United States and attempts to limit its exposure by transacting in the local currency and therefore limiting exposure to foreign exchange rates.

## **Foreign Exchange**

The Company operates primarily in Canada and the United States.

The presentation currency is Canadian dollars and the functional currency of the parent company is the Canadian dollars. As at September 30, 2017, the Company's US dollar net monetary assets totalled \$41 (December 31, 2016 – \$220). Accordingly a 5% change in the US dollar exchange rate as at September 30, 2017 on this amount would have resulted in an exchange gain or loss and therefore net income would have increased (decreased) by \$2 (December 31, 2016 - \$11).

## **Capital Management**

The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue new shares or debt. The Company considers its capital to include shareholders' deficit which amounts to \$95 (December 31, 2016 – equity of \$137).

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern, so that it can provide returns for shareholders and benefits for other stakeholders.

The Company is not subject to any capital requirements imposed by a lending institution or regulatory body, other than of the TSX Venture Exchange ("TSXV") which requires adequate working capital or financial resources of the greater of (i) \$50 and (ii) an amount required in order to maintain operations and cover general and administrative expenses for a period of 6 months. As of September 30, 2017, the Company is in compliant with the policies of the TSXV.

The Company has no commitments, other than options and warrants, to sell or otherwise issue common shares. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. The Company has not changed its approach to capital management during the period ended September 30, 2017.

## **Investor Relations**

During the three months ended September 30, 2017, the Company performed its own investor relations. The Company will continue to perform its own investor relations for the foreseeable future.

## **AMALGAMATION AGREEMENT**

The Company has entered into an amalgamation agreement dated September 27, 2017 (the "Agreement") with Sensor Technologies Inc. ("Sensor"). Pursuant to the Agreement, Sensor has agreed to purchase all of the issued and outstanding securities (the "Spin-Out Transaction") in the capital of Fox-Tek Canada Inc. ("Fox-Tek") for an aggregate purchase price of \$25 million (the "Purchase Price"). The Purchase Price will be satisfied through the issuance of an aggregate 50 million common shares (the "Sensor Shares") to the Corporation. It is the intention of the Corporation to distribute the Sensor Shares, on a pro rata basis, to its shareholders. The Spin-Out Transaction, is subject to shareholder and regulatory approval, including the acceptance for filing by the TSX Venture Exchange and the Superior Court of Ontario and there is no assurance that the transaction will eventually close.

## **SUBSEQUENT EVENTS**

- (a) Subsequent to September 30, 2017, the Company issued 181 common shares at a deemed value of \$0.05 per share to Agora Internet Relations Corp. ("Agora") to settle the Company's first instalment payment of \$9 for on-line marketing services. The Company has entered into an agreement with Agora pursuant to which Agora will provide marketing, advertising and related services to the company for a fee of \$40,000 plus applicable sales taxes to be paid by the issuance of common shares of the Company. The fee is payable in five installments of \$8,000 each payable at the end of each three-month period. The price of the common shares to be issued as payment for each installment will be set at the closing price of the common shares on the date which such installment becomes payable.
- (b) Subsequent to September 30, 2017, 2,000 warrants exercisable at \$0.10 per share expired unexercised.
- (c) Subsequent to September 30, 2017, the directors and officers of the Company, holding an aggregate of 83,454,264 common shares (the "Shares") in the capital of the Company, have entered into a lock-up agreement where they have agreed to vote the Shares in support of the spin-off of FOX-TEK Canada Inc.
- (d) Subsequent to September 30, 2017, the TSX Venture Exchange has been advised by the company that pursuant to a notice of intention to make a normal course issuer bid dated Nov. 14, 2017, it may repurchase for cancellation up to 17,340,061 common shares in its own capital stock. The purchases are to be made through the facilities of the TSX Venture Exchange during the period from Nov. 20, 2017, to Nov. 19, 2018. Purchases pursuant to the bid will be made by TD Securities on behalf of the company. There has been no purchases under the normal course issuer bid as at the date of the filing of these consolidated financial statements