

# KREE TECH INTERNATIONAL CORPORATION

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### General

The following analysis deals with the financial situation and the results of operations of Kree Tech International Corporation ("KREE" or "the Corporation"). It has been prepared by KREE's management and should be read in conjunction with the information presented in KREE's unaudited interim consolidated financial statements for the second quarter ended October 31, 2005 along with the management's discussion and analysis for the year ended April 30, 2005 as well as the related annual audited consolidated financial statements.

The Corporation's unaudited interim financial statements for the second quarter ended October 31, 2005 were prepared according to Generally Accepted Accounting Principles (« GAAP ») in Canada, and have not been reviewed by the Corporation's auditors. The accounting principles and procedures used for these financial statements are the same as those used to prepare the Corporation's latest annual financial statements, except as otherwise stated. However, they do not include all the information and disclosure that must be presented in the annual financial statements. All financial information contained herein is expressed in Canadian dollars.

### Overview

Headquartered in St. Hubert, Quebec, Kree Tech International Corporation is an established and recognized developer of superior pressure-sensitive products for the health care industry. For over a decade, Kree has developed innovative and cost-efficient medical tape products including printed vinyl, coated plastic and fabric substrates, and bulk finished goods. Kree has also developed proprietary coating formulations giving its medical bandages greater effectiveness and versatility. These and other innovations have resulted in Kree becoming a key supplier to a number of branded and private label companies. Kree is registered under a number of quality management programs including ISO 9001-2000 as well as FDA certification required for medical device manufacturing.

During the second quarter ended October 31, 2005, KREE increased its sales by approximately \$232,000 compared to the same period last year. In addition, the Corporation received \$130,000 in proceeds through the exercise of 650,000 stock options.

### Selected Quarterly Financial Data

<u>(\$000's except per share amounts) (unaudited)</u>	<u>Fiscal 2006</u>			<u>Fiscal 2005</u>			<u>Fiscal 2004</u>	
	<u>Q2</u>	<u>Q1</u>	<u>Q4</u>	<u>Q3</u>	<u>Q2</u>	<u>Q1</u>	<u>Q4</u>	<u>Q3</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
<u>Net sales</u>	<u>1,240</u>	<u>1,397</u>	<u>1,536</u>	<u>995</u>	<u>1,008</u>	<u>1,490</u>	<u>1,207</u>	<u>1,509</u>
<u>Net earnings (loss)</u>	<u>(12)</u>	<u>(44)</u>	<u>(19)</u>	<u>(5)</u>	<u>(109)</u>	<u>104</u>	<u>11</u>	<u>59</u>
<u>Earnings (loss) per share (basic and diluted)</u>	<u>(0.0005)</u>	<u>(0.0021)</u>	<u>(0.0013)</u>	<u>(0.0006)</u>	<u>(0.0146)</u>	<u>0.0139</u>	<u>0.0015</u>	<u>0.0079</u>

### Net Sales

Total net sales for the second quarter ended October 31, 2005, increased by approximately \$232,000, or 23.0%, to \$1,239,900, compared with \$1,007,958 for the second quarter ended October 31, 2004. As KREE records

approximately 80% of its sales in US dollars, the impact of the decline in the value of the US dollar versus the Canadian dollar was approximately \$80,000 or 6.5% of net sales. Therefore, had the exchange rate been consistent throughout Q2 2005 and Q2 2006, KREE's management estimates that the normalized net sales would have increased by 31.0% in the second quarter ended October 31, 2005 compared to the same period one year earlier. This increase is primarily due to the fact that the second quarter ended October 31, 2004 was abnormally slow. In fact, at the same period last year, KREE's senior management was heavily involved in the reverse takeover of Kree Tech International Corporation (formerly known as "Cogivar Corporation") by Kree Technologies Inc., and the public issuance that took place in March 2005 to finance the growth of KREE. Therefore, fewer efforts were invested one year ago in the operations and the development of the Corporation.

During the six-month period ended October 31, 2005, net sales were at \$2,636,435, which is approximately \$139,000 or 5.5% higher compared to the same period one year earlier. Without the negative impact of the exchange rate, management estimates that this increase in net sales would have been around 12.8%. This too is attributed to the slowdown experienced in Q2 2005.

### **Gross Margin**

KREE's gross profit increased from 23.2% in Q2 2005 to 34.8% in Q2 2006. The decline in the exchange rate has less impact at the gross profit level since the decline in net sales, due to this factor, is partially offset by a similar decline in cost of sales. Since the cost of sales is comprised of a certain portion of fixed costs, the low level of revenues achieved in Q2 2005 led to the reduced 23.2 % gross margin realized last year. Similarly, for the six-month period ended October 31, 2005, the gross margin was at 30.8% compared to 28.0% for the same period ended October 31, 2004.

### **Selling Expenses**

Selling expenses slightly decreased by \$3,000 from \$122,601 in Q2 2005 to \$119,224 in Q2 2006. The decline in the US dollar versus the Canadian dollar had a slight impact on the salaries and compensation figures in the selling expenses. However this decline was offset by an increase in commissions payable on sales of product.

For the six months ended October 31, 2005, the selling expenses were \$273,382 compared to \$265,656 for the same period last year; an increase of \$8,000. This increase is due to some non-recurring moving expenses incurred in Q1 2006 caused by the transition of a portion of our sales force from our Plattsburgh plant to our new Florida facility.

### **Administrative Expenses**

KREE's administrative expenses increased by approximately \$86,000 to \$331,126 in the second quarter ended October 31, 2005 compared to the second quarter ended October 31, 2004. They also rose by approximately \$152,000 to \$597,784 for the first six months of fiscal 2006 compared to the same period of fiscal 2005. These increases are explained by new expenses related to being a public Corporation; as well as costs related to setting up our new Florida facility. The increases are partially offset by a decrease in professional fees incurred in the first six months of fiscal 2006 compared to the first six months of fiscal 2005.

### **Financing Expenses**

Financing expenses decreased by more than \$7,000 to \$9,105 in Q2 2006 compared to Q2 2005 due to a decrease in KREE's debts. For the six month period ended Oct 31, 2005, the Corporation's financing expenses were at \$20,462 compared to \$25,610 for the same period one year before, which represents a decrease of only \$5,000. This is due to the fact that interest on a prior year tax refund was collected in Q1 2005; this refund partially offset the decrease in interest expense realized throughout the first semester of fiscal year 2006.

### **Net Loss**

The fluctuation of the US dollar's negative impact on sales, and the increases in administrative and selling expenses described above resulted in KREE posting an after tax loss of \$56,000 (\$0.0026 per share) for the semester ended October 31, 2005 compared to an after tax loss of \$5,000 (\$0.0007 per share) for the equivalent period in the previous fiscal year. However, due to the significant increase in sales and the improvement of the gross margin in Q2 2006 compared to Q2 2005 the net loss was significantly lower in Q2 2006 (\$12,000 or 0.0005 per share) compared to Q2 2005 (\$109,000 or 0.0146 per share).

### **Cash Flow**

Funds used by operating activities before changes in non-cash working capital items was \$18,812 during the second quarter ended October 31, 2005 compared to \$99,105 for the same period last year, an improvement of \$80,293. This was mainly due to the net loss being \$11,591 for the second quarter period ended October 31, 2005, compared to \$108,702 for the same period last year, an improvement of \$97,111.

On the other hand, funds used by operating activities before changes in non-cash working capital items was \$88,092 during the semester ended October 31, 2005 compared to an inflow of \$24,952 for the same period last year, a decrease of \$113,044. This was mainly because the net loss of \$55,605 for the semester ended October 31, 2005 was comprised of a future income tax recovery of \$71,124, compared to the net loss of \$5,057 for the same period last year which only included \$7,760 of future income tax expenses. When combined, these two items led to an aggregate difference of approximately \$129,000 in cash flow between these two periods.

The acquisition of equipment for our new Florida facility required an investment of \$131,221 in the second quarter of fiscal 2006. This represents an increase in investment activities of \$73,817 compared to the second quarter of fiscal 2005 where no similar acquisitions were made. For the same reason, \$307,951 was spent during the six-month period ended October 31, 2005 compared to \$94,641 in the corresponding semester ended October 31, 2004.

The cash flow from financing activities increased from \$6,806 in the second quarter of fiscal 2005 to \$57,482 in the second quarter of fiscal 2006, mainly due to a cash infusion of \$130,000 received following the exercise of 650,000 stock options. These proceeds were partially offset by the repayment of debts.

Similarly, the semester ended October 31, 2005 provided cash proceeds of \$29,185 related to the exercise of stock options. In the same period last year it was an increase in the Corporation's bank credit facility of \$150,000 that provided funds of \$59,228 from financing activities.

This all led KREE's cash balance to increase by \$33,000 in Q2, and by \$215,000 during the semester ended October 31, 2005 - to a balance of \$619,303. The second quarter and the six months ended October 31, 2004, respectively, showed an increase in cash of \$68,000 and \$46,000.

### **Assets**

The \$303,688 decrease in working capital from April 30, 2005 to October 31, 2005 is mainly attributable to the net decrease in cash incurred during the first semester of 2006 for an amount of \$215,116 (described in the section above), and a decrease of \$101,351 in accounts receivable to a balance of \$727,914 as of October 31, 2005. This decrease in receivables was due to the timing of the sales made in Q2 2006 compared to Q4 2005. No slow down in the operation was noted. Inventory levels as at October 31, 2005 (\$696,170) were relatively unchanged from year-end 2005 (\$728,031).

Machinery and equipment constitute the vast majority of KREE's long-term assets. Fixed assets increased by \$263,000 from \$978,000 in April 2005 to \$1,241,000 in October 2005. This increase was mainly attributable to the acquisition of fixed assets for the Florida plant.

## **Liabilities**

As at October 31, 2005, liabilities were \$1,398,443 compared with \$1,604,201 as at April 30, 2005; a decrease of \$205,759. The decrease is mainly due to the repayment of long-term debt and obligations under a capital lease. The decrease of \$55,741 in future income taxes, caused by the losses related to the Florida plant opening, also contributed to this reduced figure.

## **Equity**

Shareholders' equity increased by \$246,006 following the issuance of 650,000 Class "A" shares in relation to the exercise of stock options during Q2 2006.

## **Outlook**

Through vertical integration of its operations, KREE is pursuing its strategy of improved production efficiency, accelerated growth and maximized profitability. The Corporation is currently leveraging its relationships with smaller clients who are in the initial stages of building their business and are looking to outsource manufacturing. KREE also remains committed to exploring new growth opportunities within the Advanced Wound Care (AWC) market segment, which represents a substantial opportunity for the Corporation to use its development capacity and in-house expertise. KREE's new manufacturing facility in Florida is now ready for production and has started working on small projects. Our Florida team is in the process of finalizing its quality control systems in order to be ready to deliver higher volumes to its clients. KREE's new manufacturing facility in Florida is nearing full production capacity and is the primary vehicle through which the Corporation aims to penetrate the AWC market.

On November 22, 2005 the corporation has entered into a sale and leaseback transaction concerning the machinery and equipment built in Florida. By virtue of this agreement, KREE sold this asset, built at a cost of approximately US\$ 334,187 (CA\$ 393,372), for a total amount of US\$ 500,000 (CA\$ 588,550), and sign a 60 months Capital lease. With this financing KREE currently has sufficient funds to finance its operations.

## **Significant accounting policies**

The Corporation prepares its consolidated financial statements in conformity with Canadian GAAP, which require management to make estimates and assumptions that affect reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of net sales and expenses during the reported period. Significant estimates include the valuation of options and warrants, allowance for doubtful accounts, provision for obsolete inventory and valuation of certain accrued liabilities. Actual amounts could differ from those estimates, but would not involve, in the opinion of management, significant changes in reported amounts.

## **Outstanding Share Data**

Details of KREE's outstanding share data as of December 21, 2005 are as follows:

Class "A" Shares	21,955,957
Stock Options part of KREE's Stock Option Plan	340,000
Other Stock Options issued	221,310

As at December 21, 2005, 8,973,215 Class "A" shares were held in escrow and cannot be transferred, hypothecated, pledged or otherwise disposed of without the consent of regulatory authorities. These shares will be liberated in several steps over a maximum period of 36 months from March 23, 2005.

### **Forward-looking statements**

Certain statements in this management discussion and analysis and elsewhere in this report contain forward-looking statements which, by their nature, necessarily involve risks and uncertainties, including those discussed herein, that could cause actual results to significantly differ from those contemplated by these forward-looking statements. Such statements reflect the Corporation's current views with respect to future events, and are based on information currently available to the Corporation and on assumptions, which it considers reasonable. However, management cautions readers that the assumptions relative to the future events, several of which are beyond management's control, could prove to be incorrect, given that they are subject to certain risk and uncertainties. Management disclaims any intention or obligation to update or revise any forward-looking statements as a result of new information, future events or otherwise.

### **Additional Information**

Additional information relating to KREE can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

**Dated December 20, 2005**