

VendTek Systems Inc.

Management's Discussion and Analysis of Financial Condition and Results of Operations September 20, 2006

For the Nine Month Period Ended July 31, 2006

The following MD&A has been prepared to help investors understand the financial performance of the Corporation and provides information that management believes is relevant to an assessment and understanding of the Corporation's risks, opportunities and performance measures. Management has prepared this document in conjunction with its broader responsibilities for the accuracy and reliability of the financial statements and the development and maintenance of appropriate internal controls in its effort to ensure that the financial information is complete and reliable.

This discussion should be read in conjunction with the audited consolidated financial statements including the notes thereto, included in this annual report. Except for statements of historical fact contained herein, the information presented constitutes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievement of VendTek to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements. Actual results may differ materially from those indicated by these forward-looking statements as a result of risks and uncertainties impacting VendTek's business. Although VendTek has attempted to identify important factors that could cause actual results to differ materially, there may be other factors that cause results not to be anticipated, estimated or intended. All amounts presented in this MD&A are in accordance with Canadian generally accepted accounting principles ("GAAP") and presented in Canadian dollars unless otherwise specifically noted. References herein to "VendTek", "the Corporation", "the Company", "we" and "our" mean VendTek Systems Inc.

Additional information relating to the Company is available on SEDAR at www.sedar.com.

Overview

VendTek Systems Inc. strives to provide its customers with innovative products, exceptional service and superior technical expertise while endeavouring to enhance value to our shareholders.

VendTek develops and licenses automated transaction system software and supporting technologies that improve the efficiency of product delivery, reduce costs to clients and offer superior safety measures. VendTek's business focuses primarily in the prepaid telecom and financial services industries. VendTek markets its products and services directly and through its wholly-owned subsidiaries; Now Prepay Corp. (Canada), VendTek Systems Technologies (Beijing) Co., Ltd. and VendTek Systems Asia Pacific (Singapore) Pte. Ltd.

The Company's foremost product is its proprietary e-Fresh™ software which consists of a suite of server applications and corresponding client modules. The e-Fresh™ software is used to create a distribution system which can be used to sell services on proprietary or non-proprietary hardware thereby creating an e-Fresh™ network.

As part of the Company's strategy to develop recurring sources of revenues from the e-Fresh™ software, the Company has developed its own electronic distribution business across Canada under the Now Prepay™ brand and the Now Prepay Corp. subsidiary. Now Prepay is using e-Fresh to distribute cellular and long distance products. Now Prepay Corp. sells its own branded long distance products: Now#1 and Connect Now. The Now Prepay business is generating rapidly growing recurring revenues from the sale of these prepaid services through the e-Fresh™ network it has created. Now Prepay is currently generating the majority of VendTek's revenues.

VendTek's e-Fresh™ products provide infrastructure to service providers, retailers and retail distributors allowing them to distribute electronic products and services with increased efficiency. By licensing to its customers, the Company is developing sources of recurring license revenues from a global and growing market. Recurring revenues result from a fee being paid to VendTek each time a transaction occurs on one of the system terminals.

The e-Fresh™ software utilizes POS terminals and other electronic terminals as clients which connect to a central server and provide secure electronic distribution for prepaid goods and services to consumers in real time. Third party kiosks, bank machines, POS terminals, PC computers, and web browsers are all potentially suitable distribution points. Compared to the traditional method of delivering prepaid services using cards or plastic vouchers, distributing services electronically allows substantial savings through reduced printing and packaging costs, physical distribution costs and shrinkage (theft), as well as the elimination of inventory holding costs at the retail distribution level.

VendTek Systems Technologies (Beijing) is incorporated in China for developing e-Fresh™ licensed customers and providing low cost software development and support. This company's objective is to generate recurring license revenues from the world's largest prepaid and cellular markets. VendTek's Chinese operations include sales and marketing, customer support and engineering. With three years of operating history, VendTek is continuing to build business with its primary customer in China and evaluating potential opportunities.

VendTek Asia Pacific, incorporated and located in Singapore, is developing the e-Fresh™ market in South East Asia.

Revenues and Expenses

Current revenues are substantially derived from the e-Fresh™ based businesses and consist primarily of:

- virtual prepaid voucher sales revenues derived from the Now Prepay network.
- license fees from VendTek Systems China and VendTek's other customers.
- professional service fees.

It is the Company's aim to increase sales through continued deployment of e-Fresh™ software to point-of-sale terminals through the Now Prepay network, increase the product base available to those clients and develop new international markets for the e-Fresh™ system.

Growth Strategy

Management is planning to continue growing revenues through its existing customers and through the development of new licensed customers in international markets.

Significant Accounting Policies

VendTek's financial statements are prepared in accordance with Canadian GAAP.

Revenue Recognition and Cost of Goods

VendTek's revenues are primarily generated from the resale of prepaid cellular and long distance telephone time. We recognize revenues when all of the following criteria are met:

- evidence of an agreement exists,
- delivery has occurred or services have been rendered,

- the price is fixed or determinable,
- collection is reasonably guaranteed.

Our revenue is primarily derived from the sale of prepaid telephone time for most of which the Company incurs substantial inventory risk but does not provide the related telephone service. The sale of these products is recognized on a gross basis at the date of sale to the consumer when title to the card transfers.

The Company purchases some phone time products for resale on consignment and revenues from these sales are recognized on a net basis. The full obligation to the phone service provider is fixed and determinable and we have no significant continuing obligations.

Impairment of Long-lived Assets

The Company monitors the recoverability of long-lived assets based on factors such as current market value, future asset utilization, business climate and future undiscounted cashflows expected to result from the use of related assets. VendTek's policy is to record an impairment loss in the period when it is determined that the carrying amount of the asset may not be recoverable. The impairment loss is calculated as the amount by which the carrying amount of the assets exceeds the undiscounted estimate of future cash flows from the asset.

Stock-Based Compensation

Effective January 1, 2002, the Company applied the fair value based method of accounting prescribed by CICA Handbook Section 3870; Stock-based Compensation and Other Stock based Payments, only to employee stock appreciation rights, and applied the settlement method of accounting to employee stock options. Under the settlement method, any consideration paid by employees on the exercise of stock options or purchase of stock is credited to share capital and no compensation expense was recognized.

The CICA Accounting Standards Board amended CICA Handbook Section 3870 – Stock-based Compensation and Other Stock-based Payments – to require entities to account for employee stock options using the fair value based method, beginning January 1, 2004. Under the fair value based method, compensation cost is measured at fair value at the date of grant and expensed over the award's vesting period. In accordance with one of the transitional options permitted under amended Section 3870, the Company has retroactively applied the fair value based method to all employee stock options granted or repriced on or after January 1, 2002.

Critical Estimates

The preparation of these consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and related notes to the financial statements. Significant financial statement items, which involve the use of estimates, include the allowance for doubtful accounts, inventory valuation and the useful life of property, plant and equipment including intangible assets. Actual results could differ from those estimates.

Selected Annual Information

Selected annual financial information derived from the audited consolidated financial statements for the most recently completed financial years is set forth below and is prepared in accordance with the generally accepted accounting principles in Canada:

For the years ended October 31:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
	\$000	\$000	\$000
Total assets	2,457	1,799	1,192
Total long-term liabilities	8	486	486
Revenue	38,354	21,742	11,369
Net loss	366	1,308	1,429
Net loss per share ¹	(0.01)	(0.04)	(0.06)

Summary of Quarterly Results

Quarter Ended	Revenue	Earnings (Loss)	Earnings (Loss) per share ¹
	\$	\$	\$
July 31, 2006	14,899,228	320,033	0.01
April 30, 2006	13,468,110	105,688	0.00
January 31, 2006	12,824,090	93,846	0.00
October 31, 2005	11,750,060	(65,492) ²	(0.01)
July 31, 2005	10,718,345	77,265	(0.00)
April 30, 2005	8,315,722	(194,392)	(0.01)
January 31, 2005	7,569,908	(182,882)	(0.01)
October 31, 2004	7,480,669	(560,218)	(0.01)

¹ The Company has recorded a loss, or where there has been income the earnings per share has been nil, in each quarter and since the exercise of warrants and options would reduce loss per share, basic and diluted earnings per share are the same.

² Includes non-cash year-end adjusting entries all of which are recorded in the fourth quarter 2005: consigned inventory reversal (\$191,000), stock-based compensation expense (\$126,000).

Results of Operations

Comparison of the nine month period ended July 31, 2006 compared to the nine month period ended July 31, 2005.

Note: The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Now Prepay Corp., VendTek Systems Technologies (Beijing) Co. Ltd., VendTek Systems Asia Pacific (Singapore), and VendTek Industries Inc., which owns VendTek International Inc. (an inactive U.S. company)

Revenues

For the nine month period ended July 31, 2006, revenues were \$41,191,000, an increase of \$14,587,000, or 55%, over the \$26,604,000 in revenues for the nine month period ended July 31, 2005. The increase is primarily the result of continued growth of VendTek's subsidiary Now Prepay Corp. The ongoing installation of POS terminals across Canada for the sale of virtual prepaid telecommunications vouchers and the increase in products available for sale via electronic methods provides increased sales revenues.

Our largest customer accounted for 18% of total revenues in the first three quarters of 2006 compared to 28% for the same period of 2005. We are actively seeking to expand our customer base for prepaid products.

Revenues are mostly comprised of prepaid PIN revenue, which totalled \$40,940,000 in the first nine months of 2006 compared to \$26,524,000 in the same period of 2005, an increase of 54%. License and engineering revenues increased by \$128,000 to \$138,000 year-to-date compared to \$10,000 for the same period of 2005. This increase was due to specialized engineering services being required by a customer as well as software licenses issued for a new customer. Systems and parts sales of \$114,000 in the first nine months of 2006, compared to \$70,000 in the same period of 2005, are up by 63% as a result of increased parts orders from VendTek's legacy vending machine customers and increased server sales.

The consolidated gross profit for the nine months ended July 31, 2006, increased by approximately 147% to \$2,531,000 compared to \$1,025,000 for the nine months ended July 31, 2005. The high revenues and profits generated by Now Prepay accounted for the majority of the consolidated gross profits.

Cost of Goods

VendTek's operating expenses are broken down into the four following categories: operational costs, general and administrative, engineering, and sales and marketing. Operational costs ("Cost of Goods") consist primarily of personnel and related expenses associated with ongoing operations and support of VendTek's services. General and administrative fees ("G&A") consist of personnel and related costs associated with VendTek's administrative and finance functions, as well as professional fees and other general corporate expenses. Product development expenses ("Engineering" or "PDG") consist of engineering personnel costs related to VendTek's technology development and maintenance. Sales and marketing costs consist of personnel and related costs associated with the ongoing sales and marketing functions, as well as fulfillment, advertising, trade shows and other promotional expenses.

Cost of Goods was \$38,660,000, or 94% of revenues for the nine months ended July 31, 2006, compared to \$25,579,000, or 96% of revenues for the nine months ended July 31, 2005. The low margin is indicative of the virtual prepaid telecommunications industry in which Now Prepay conducts its business. However, increased sales volumes and supplier discount options are expected to continue to improve the margin.

Our Cost of Goods consists of payments to carriers who provide cellular and long distance telephone time and various services associated with production and shipping of products, site commissions and personnel. The increase in Cost of Goods of \$13,081,000, or 51%, for the nine months ended July 31, 2006 compared to the same period in 2005 is due to the increase in revenues.

General and Administrative

The G&A expenses were \$1,491,000 or approximately 4% of revenues during the nine months ended July 31, 2006 compared with \$1,047,000 or 4% of revenues, during the nine months ended July 31, 2005. Salaries under G&A increased by 18% when the nine months ended July 31, 2006 is compared to the nine months ended July 31, 2005 due to management and administrative wage increases. Stock-based compensation is the non-cash based option expense which is allocated between salaries and director's fees and for the first three quarters of 2006 was \$222,000. Office, rent, computer expenses and banking fees are up from \$215,000 for the nine months ended July 31, 2005 to \$218,000 for the nine months ended July 31, 2006. Accounting and legal expenses increased by \$14,000, or 7%, to \$63,000 for the nine months ended July 31, 2006 compared to \$59,000 for the nine months ended July 31, 2005. Travel expenses increased to \$35,000, or 85%, in the nine months

ended July 31, 2006 compared to \$19,000 in the nine months ended July 31, 2005. This was due to increased travel in Asia.

Telecommunication costs increased in the first nine months of 2006 by \$33,000 (44%) to \$108,000 compared to \$75,000 in the same period in 2005. This is due to increased call volume associated with Now Prepay sales. Investor relation expenses year-to-date were \$48,000, an increase of \$26,000 (119%) when compared to the \$22,000 expense for the same period of 2005. This is the result of increased fees paid for on-going services.

Amortization expense increased to \$143,000 for the nine months ended July 31, 2006, compared to \$98,000 for the nine months ended July 31, 2005 (\$45,000 or 46%). The increase is due to increased acquisitions of point-of-sale terminals which are depreciated on a straight-line basis over three years.

Product Development

Engineering costs for the nine month period ending July 31, 2006 consist of personnel expenses of \$261,000, or approximately 0.63% of revenues, compared with \$200,000 or approximately 0.75% in the nine month period ending July 31, 2005. The increase of the expense is attributed to increased personnel and increased use of contract labour, although as a percentage of revenues, it declined.

Sales and Marketing

Sales and marketing expenses increased in the first nine months of 2006 by \$181,000 (233%) to \$259,000 compared to the \$78,000 expense for the first nine months of 2005. Expenses for the nine month period ended July 31, 2005 and 2006 were both less than 1% of revenues. The increase in expense is attributed to increased personnel (the nine month period ended July 2006 = \$107,000; the same period in 2005 = \$3,000) and increased travel (first nine months of 2006 = \$135,000; same period in 2005 = \$56,000). Advertising and trade show costs were \$18,000 in both periods.

Net Income

Net income for the nine months ended July 31, 2006 was \$520,000 compared to a net loss of (\$300,000) for the nine months ended July 31, 2005. This \$820,000 increase was due to the growth of virtual PIN telecommunication sales and supplier offered discounts and rebates. The earnings are offset by increased salaries and stock-based option expenses, telecommunication, office and amortization. The net income per share in the first three quarters of 2006 increased to \$0.01 compared to a loss in the same period of 2005 of (\$0.01).

In the first three quarters of fiscal 2006 the Company recognized the fair value of vested stock options resulting in an increase in the stock-based compensation expense to \$222,000 compared to \$10,000 for the same period in 2005. There are no other changes in results of operations and elements of income that are not related to ongoing business operations nor are there any seasonal aspects of the Company's business that affect its financial condition, results of operations or cash flows.

Revenues continue to grow every quarter. In 2006, third quarter revenues were 10% higher than second quarter revenues and 16% higher than first quarter revenues. Management expects this trend to continue and revenues surpassing fiscal year end 2005 are expected in fiscal 2006. With increased revenues increased costs are also expected. Telecommunication, office, amortization and personnel costs for fiscal 2006 are expected to be more than at year end 2005; however some of these expenses will be offset by supplier discounts and rebates and a reduction in rent and other expenses.

Liquidity and Capital Resources

As of July 31, 2006, VendTek had working capital of \$1,090,000 compared to a deficiency of \$948,000 as of October 31, 2005; an increase in capital of \$2,038,000. The majority is attributable to 96% of

warrants issued by the Company being exercised and generating \$1,335,000 in new capital. As well, employee options scheduled to expire were exercised generating another \$118,000.

Historically, the Company has financed its operations through the sale of equity as well as through long-term debt, lease financing, an operating line of credit with a chartered Canadian bank, term loans from the Business Development Bank of Canada, related party debt, and cash flow from its operating activities including customer deposits and supplier credit. There are no legal or practical restrictions on the ability of subsidiaries to transfer funds to the company nor are there defaults or arrears or anticipated defaults or arrears on lease payments, interest or principle payments on debt. The Company's current contractual obligations are as follows:

	July 31, 2006 \$	October 31, 2005 \$
Convertible Debentures	-	493,200
Capital Leases - capital leases in respect of computer equipment mature at varying dates from 2005 to 2010 and bear interest at a weighted-average rate of 8.4%	8,254	10,134
	8,254	503,334
<u>Less: Current portion of long-term debt</u>	<u>(1,868)</u>	<u>(495,811)</u>
	<u>6,386</u>	<u>7,523</u>

Convertible Debentures

On November 29, 2001, the Company completed a convertible debenture financing. The Company received \$500,000 and issued \$500,000 of redeemable convertible debentures with a principal amount of \$1,000 each to one investor. A 7% cash finders' fee was paid. Costs of completing this transaction, totalling \$76,346, were deferred and were amortized to operations over the five-year term. The debentures attracted an interest at a rate of 9½% per annum. The debenture matured and was redeemed for \$500,000 on June 30, 2006. These debentures were convertible, at the option of the holder, into common shares at the following rates:

- i) July 1, 2004 to June 30, 2005 - \$4.00 per share
- ii) July 1, 2005 to June 30, 2006 - \$5.00 per share

The estimated equity value of the conversion feature of the debentures totalling \$34,000 was included as a separate component of shareholders' equity. The equity component was calculated as the difference between the gross proceeds received by the Company and the discounted cash flow of repayments based on an annual rate of 12%, which was consistent with similar borrowings available to the Company, without conversion features. The remaining portion of \$466,000 was classified as a long-term liability. The debt component was accreted to its face value at maturity over the term of the debt through a charge to interest expense.

As at July 31, 2006, the Company had 41,412,341 common shares issued and outstanding.

Summary of Options Granted

VendTek has a Stock Option Plan (the "Plan") whereby it may grant options to its directors, officers and employees. The terms and conditions of options granted under the Plan are determined solely by the Board of Directors. Options are generally granted with a term of five years and vest over eighteen months, with exercise prices equal to the fair value of the shares on the date of grant.

	Number of shares	Weighted average exercise price \$
Outstanding, October 31, 2005	4,410,900	0.20
Granted	50,000	0.30
Granted	100,000	0.35
Exercised	(437,900)	0.20
Outstanding, April 30, 2006	4,123,000	
Exercised	(150,000)	0.20
Outstanding, July 31, 2006	3,973,000	

Summary of Warrants

	Number of shares	Weighted average exercise price \$
Balance, October 31, 2005	6,939,314	0.20
Exercised	(6,672,945)	0.20
Expired	(266,369)	0.20
Balance at April 30, 2006	-	-

Related Party Transactions

During the nine month period ended July 31, 2006, the Company paid rent of \$36,937 (2005 - \$38,440) to a company in which a director has a minority interest. The Company's premises lease with the related company expired on October 31, 2001 and is currently on a month-to-month basis. This transaction was in the normal course of operations and, in management's opinion, undertaken with the same terms and conditions as a transaction with an unrelated third party.

Off-Balance Sheet Arrangements

VendTek does not have any off-balance sheet arrangements.

Forward-looking Statements

This Management's Discussion and Analysis contains certain forward-looking statements. All statements, other than statements of historical fact, included herein, including without limitation, statements regarding future plans and objectives of the Company are forward-looking statements that include various risks and uncertainties. There can be no assurance that such statements will prove accurate, and actual results and future events could differ materially from those anticipated in such statements. Important factors that could cause actual results to differ materially from the Company's expectations are disclosed in Company documents filed from time to time with the TSX Venture Exchange and other regulatory authorities.

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VendTek Systems Inc. is a publicly traded company listed on the Canadian TSX-Venture Exchange symbol VSI.