

## **VendTek Systems Inc.**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **For the Three and Nine Month Periods Ended July 31, 2011 and 2010**

*The following Management's Discussion & Analysis, dated September 29<sup>th</sup>, 2011 should be read in conjunction with the financial statements and notes to the consolidated financial statements for the three and nine months ended July 31, 2011. References herein to "VendTek", "the Company", "we" and "our" mean VendTek Systems Inc.*

*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.*

*Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).*

#### **Overview**

We strive to provide our customers with innovative products, exceptional service and superior technical expertise while endeavouring to enhance value to our shareholders.

The Company is principally a software application and services company. We develop, market and license automated transaction system software and supporting technologies that improve the efficiency of product delivery, reduce costs to clients and offer superior transaction security measures. Our business focuses primarily in the prepaid telecom and financial services industries. We market our products and services in Canada and the United States directly and through our Now Prepay™ division ("NPP") and in Brazil through our wholly owned subsidiary Now Prepay Servicos de Informatica Ltda. ("NPS").

Our principal product is our proprietary e-Fresh™ software which consists of a suite of server applications and corresponding end point device software. The e-Fresh™ software is used to create a distribution and transaction processing system which can be used to sell services on proprietary or non-proprietary hardware thereby creating an e-Fresh™ network. Our e-Fresh™ software creates a digital or electronic payment mechanism as a replacement for cash that allows the system to act as an electronic data warehouse in certain business transactions. Historically, the principal usage of e-Fresh has been the electronic distribution of prepaid telecommunications products in Canada. In recent years, we have licensed our software internationally to allow our partners to develop a local e-distribution network. The software has other potential applications in situations where businesses are looking to replace cash as a mechanism for payment (i.e. gift cards; prepaid credit cards; bill payment; international mobile top and micro-money transfer; prepaid utilities and prepaid cable TV).

The e-Fresh™ software utilizes point-of-sale ("POS") terminals and other electronic terminals as distribution points (located in retail locations) 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, Java enabled cell phones, and web browsers are all potentially suitable distribution points.

Compared to the traditional method of delivering prepaid services using cards or plastic vouchers, distributing these 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.

## *Our Strategy*

Our primary goal is to maximize the number of transactions processed through our e-Fresh™ system globally. To achieve this goal, we plan to:

1. Deploy eFresh networks in additional countries
2. Grow each deployed eFresh network
3. Add new products and services for each network and that can overlap networks.

Our business model is scalable. By maximizing transactions, we also maximize revenues and net income. We generate our revenues from the distribution of virtual prepaid products through our NPP network, hardware and equipment sales, license fees from our international customers and related professional service fees.

We use context-specific strategies for different geographic markets and products. Generally, we will either create or operate an e-Fresh™ network ourselves by reselling purchased services (e.g. as the Company currently does in North America for prepaid telecommunications products), or we will license the e-Fresh™ software on a turnkey basis (e.g. as the company does in the United Arab Emirates), earning profits by charging a transaction based license fee.

When we operate an e-Fresh™ network ourselves, as we do in North America and Brazil, the business focuses on developing a low cost distribution strategy for its end point device software. To this end, we often use Independent Sales Organizations (“ISO”) as distribution partners. These companies deploy terminals used for payment processing and install our software application as a value added service for their merchants. We also sell directly to merchants who may not require an integrated payment/prepaid solution. This operating strategy requires a focus on the product mix being sold to maximize revenues and profits, strong supplier relationships, a clear dedication to operational excellence and a clear strategy for new products and services that can be added to the existing distribution network, all with an eye to maximizing transaction volumes.

When we license our software, as we do internationally, we provide technical support for our customers to make sure they have the opportunity to grow their businesses quickly and cost effectively. To help our licensees expand their distribution networks (serving to increase our revenues), we often provide customized solutions. Our licensing model often provides a tiered structure, stipulating minimum monthly fees should the monthly transaction not meet a required level.

We have also moved to providing software as a service (“SaaS”) solution for some of our international customers. This allows us to leverage our existing North American operations, e-Fresh™ servers, infrastructure and core competencies while at the same time letting our international customers focus on growing their business quickly, without expending the time and effort to set up a back office system. Our staff have extensive experience in managing all the operating details of the back office aspect of running an e-Fresh™ network. By letting our customers use this experience, we can immediately provide to them years of operating knowledge. The strategy further benefits the Company by deepening the relationship between our customers and us. The SaaS solution takes advantage of devices that can use the internet to securely connect to our North American server. These devices include POS terminals that use a cellular data connection, mobile phones and PC’s running our e-Fresh™ PC software. Depending on the extent of the services provided, we are able to charge a higher license fee to those customers using our SaaS offer than under our traditional licensing arrangements.

## *Overview of Revenues in Canada, the United States and Brazil*

As part of our strategy to develop recurring sources of revenues, we developed our own electronic distribution business across Canada, United States and Brazil under the Now Prepay™ brand. NPP

uses e-Fresh to distribute cellular and long distance products, financial products, prepaid gift cards and prepaid internet cards. In North America, NPP also sells its own branded long distance products: Now#1 and Connect Now. NPP is currently generating the majority of our revenues.

Going forward, we expect to increase sales through continued deployment of e-Fresh™ software to point-of-sale terminals through the NPP network in Canada, the United States and Brazil, increase the product base available to the NPP network and develop new international markets for the e-Fresh™ software. Due to the lower margins prevalent in our industry, our strategy continues to focus on increasing the volume of transactions processed or distributed through our system.

Prepaid telecom products (prepaid wireless sales dominate the revenues of the prepaid “basket of products” in every geographical market) are sold in a broad category of retail stores. Prepaid products are found in almost every convenience store in North American (not all using electronic delivery) and are also found in grocery, drug, check cashing, big box, and electronics stores, etc. Our strategy of partnering with Independent Sales Organizations gives us access to a broad range of merchant types, but typically small chains or independent locations. Our strategy of going direct to the retailer is targeted at larger national chains (for example ESSO) and independent locations that have a high sales volume of prepaid products. We have grown our terminals in Canada from 15,051 on October 31, 2010 to 15,383 on July 31, 2011.

The Company has supply contracts with all the major telecom companies in Canada and wholesale distributors in the United States. To date, we have signed national distribution contracts with five telecommunications companies. These contracts describe our commercial relationships with the telecom company and the terms under which we are permitted to resell their products. Generally, we issue a purchase order for the quantity of products we require, we take delivery electronically and we load the products onto our e-Fresh™ system (product files are encrypted throughout this process). These products are sold through retailers connected to the e-Fresh™ network. Our system tracks sales by each merchant and each week we automatically remove the appropriate funds from the merchant's designated bank account. We subsequently pay our suppliers and provide a commission to an ISO (if an ISO added the merchant to our network).

The majority of growth to-date has come from our Canadian operations. This has been evidenced by our terminal growth outlined above. As the terminal growth slows in Canada, we will focus on increasing the transactions initiated and processed through each terminal. These will be done through sales and marketing efforts as well as increasing our product offering. In the U.S., we believe that there are still opportunities to increase our POS terminal deployment. We will continue to focus on adding and supporting ISOs, which will allow us to grow our North American operations. We have also grown our terminal presence in the U.S. from 1,007 terminals on October 31, 2010 to 1,230 on July 31, 2011. Our strategy in the U.S. is to support our ISOs and add ISOs to increase our terminal deployment.

In Brazil, our strategy is to market to retailers directly. We will also look at opportunities to expand our product offerings beyond telecommunications to include financial products. We have grown our terminal presence in Brazil from zero terminals on October 31, 2010 to 577 on July 31, 2011.

Our distribution model in North America and Brazil continues to be focused on higher volume of transactions with lower margins.

#### *International Revenues*

In our international markets, we receive higher margin revenue with minimal costs for us.

We also license our e-Fresh™ software to third-parties (service providers, retailers and retail distributors) allowing them to distribute electronic products and services with increased efficiency. By licensing to our customers, we are developing sources of recurring license revenues from a global and growing market. We receive recurring revenues from fees paid to us each time a transaction is completed on one of our

customers' terminals. We work closely with our international licensees to assist them in developing the necessary infrastructure to increase the size of our e-Fresh™ network. Historically we have provided licensee exclusivity in a geographical market. However, we have provided non-exclusive licenses for larger potential markets or for an initial period until customer performance is proven.

Consumers in countries outside Canada and the U.S. generally use prepaid products significantly more. We have experienced higher transactions per terminal outside North America.

By licensing our software, we have developed a global footprint for our e-Fresh™ network. We have customers throughout the world.

We expect to see continued growth in our higher-margin license revenues from our international customers. Our customer in the United Arab Emirates ("UAE") has contributed the majority of our license revenues to-date from transactions from the Middle East.

Our revenues from our license customers will continue to grow as our customers deploy POS terminals in their respective regions and add products to their portfolios.

We have also initiated the development and deployment of a mobile financial platform that will facilitate mobile financial transactions. We expect to receive license revenues from mobile network operators and financial institutions. We have one customer for this platform today.

#### *Cost of Revenues*

Costs of products and services sold consist of payments to carriers who provide cellular and long distance telephone time and various services associated with production and shipping of products, site commissions, transaction processing expenses and personnel. We do not have significant costs for our license revenues.

Additionally, we continue to pursue higher-margin license revenues. As we increase our international license revenues, we expect our gross margins will increase.

#### *General and Administrative Expenses*

General and administrative expenses consist primarily of compensation for employees in executive and operational functions, including finance and accounting. Other significant costs include professional fees for accounting and legal services, consulting fees, facilities costs, travel and general corporate overhead.

#### *Selling and Marketing Expenses*

Selling and marketing expenses consist primarily of compensation for employees engaged in the sales and marketing functions. Other significant costs include tradeshow participation, journal advertising, and travel. Significant effort and costs have been incurred to set up operations in Brazil and these costs being legal, travel, staffing, consulting are reflected within the selling and marketing expenses for the first nine months of 2011.

#### *Research and Development Expenses*

Our research and development expenses consist primarily of compensation costs for engineering personnel, costs associated with various software projects, including testing, developing prototypes and related expenses. We have initiated the development of a mobile financial platform that will facilitate mobile transactions for payroll and bill payment through the phone.

Our engineering personnel are located in our offices in Canada, China and the Middle East. We fund our operations in China because we believe this allows us to continue our development in a cost effective way. As a percentage of revenue, we expect our research and development expense to decrease as revenue increases.

### ***Critical Accounting Policies and Estimates***

There were no changes in our critical accounting policies and estimates from the year ended October 31, 2010.

#### *Revenue Recognition*

The Company's revenue is comprised of three sources: resale and distribution of prepaid products (principally prepaid cellular and prepaid long distance products); equipment and parts sales; and software license and the related services sales. Revenues are recognized when pervasive evidence of a sale arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable, and collectability is reasonably assured.

The Company's revenues are primarily generated from the distribution of prepaid long distance and cellular telephone time, principally from the sale of eVouchers and point of sale activated gift cards. Sales of prepaid calling cards and point of sale activated PINs, in accordance with Emerging Issues Committee ("EIC") No. 123, *Reporting Revenue Gross as Principal versus Net as an Agent*, are recognized on a gross basis as the Company is the primary obligor to its customer and incurs inventory risk.

The resale of prepaid telecommunication services where the Company earns commissions on services sold and does not incur inventory risk are recognized at the date of sale as the Company's continued obligations effectively end on that date. These sales are recorded on a net basis. Equipment sales are ancillary to the resale of prepaid products. Equipment sales and parts revenue is recognized when delivered.

Software license and service revenues represent professional service fees received for customization of the e-Fresh software and transaction fees received from the processing of prepaid mobile airtime and other prepaid recharges. Customization fees are recognized at the completion of the contract and transaction-based fees are recognized at the time the transactions are processed.

### ***Non-GAAP Measures***

Adjusted EBITDA is not a calculation based on Canadian GAAP and should not be considered an alternative to Net Income in measuring the Company's performance, nor should it be used as an exclusive measure of cash flow.

EBITDA is a measure commonly reported and widely used by investors as an indicator of a company's operating performance and ability to incur and service debt, and as a valuation metric. While Adjusted EBITDA has been disclosed herein to permit a more complete comparative analysis of the Company's operating performance and debt servicing ability relative to other companies, investors are cautioned that Adjusted EBITDA as reported by the Company may not be comparable in all instances to EBITDA as reported by other companies.

Management defines Adjusted EBITDA as net income adjusted for, interest, taxes, depreciation expenses, amortization expenses, accretion expenses, foreign exchange differences and stock based compensation expenses.

Adjusted EBITDA can be calculated from the Company's consolidated statements of operations, comprehensive loss and accumulated deficit, as follows:

	Q3 2011	Q3 2010	YTD 2011	YTD 2010
Net Loss	\$ (1,389,867)	\$ (122,271)	\$ (3,209,581)	\$ (367,713)
Add:				
Interest	197,048	1,286	233,389	3,616
Accretion	126,741	-	225,452	-
Amortization	81,932	100,556	242,746	288,373
Loss (gain) on disposal of assets	(518)	280	8,748	(5,422)
Foreign exchange difference	(14,527)	(9,663)	6,573	(8,887)
Stock based compensation	45,733	32,875	141,494	34,279
Adjusted EBITDA	<u>\$ (953,458)</u>	<u>\$ 3,063</u>	<u>\$ (2,478,524)</u>	<u>\$ (55,754)</u>

### ***Convergence with International Financial Reporting Standards***

The Canadian Accounting Standards Board has announced that Canadian publicly accountable enterprises will be required to adopt International Financial Reporting Standards ("IFRS") effective for fiscal years beginning on or after January 1, 2011. Accordingly, the Company will adopt IFRS as the basis of preparation for its interim and annual financial statements for periods beginning on November 1, 2011 with a transition date of November 1, 2010 to allow for comparative financial information.

Although IFRS employs a conceptual framework that is similar to Canadian GAAP, differences in accounting policies will have to be addressed. In order to meet the requirement to transition to IFRS, the Company is undertaking a project to ensure compliance with the new standards by the adoption date. The Company's IFRS project plan comprises four stages: awareness, assessment, design and implementation. The assessment stage includes a detailed analysis of the differences between IFRS and Canadian GAAP and includes an assessment of the potential impact on financial reporting, accounting policies, systems, internal controls over financial reporting and financial covenants. The design phase includes the development of a transition plan and revised accounting policies. The implementation phase includes the Company-wide distribution of the revised accounting policies, training and implementation of dual reporting systems. The current focus of the project is determining detailed conversion steps necessary to adopt IFRS and the conversion of the fiscal 2011 income statement into the IFRS format that will be used for comparatives during fiscal 2012. Certain audit procedures of the opening balance sheet have been completed. The transition project is on schedule, and a timetable for developing the opening balance sheet and preparation of comparative information is in place for 2011.

### ***Financial Instruments***

The Company's financial instruments consist of cash, accounts receivable, accounts payable, accrued liabilities and convertible debentures. Cash is classified as held-for-trading and any period change in fair value is recorded through net income. Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable. Accounts payable and accrued liabilities are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Convertible debentures are also classified as other financial liabilities and are held at amortized cost, which upon their initial measurement is equal to the fair market value of discounted cash flows net of the fair market value of their embedded derivative. Interest and accretion expense is recorded in net income, as applicable.

It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximates their carrying values due to their short-term nature.

### **Summary of Quarterly Results**

The following statement of operations data presents the consolidated statements of operations for the past eight quarters (in thousands of dollars except per share amounts).

<b>Consolidated Statement of Operations data</b>	<b>Three Months Ended</b>		<b>Three Months Ended</b>	
	<b>July 31</b>	<b>April 30</b>	<b>January 31</b>	<b>October 31</b>
	<b>2011</b>	<b>2011</b>	<b>2011</b>	<b>2010</b>
Revenues	\$ 28,429	\$ 26,651	\$ 26,521	\$ 29,744
Gross profit	1,338	1,321	1,374	1,716
Loss before income taxes	(1,390)	(1,375)	(443)	(24)
Net earnings (loss)	\$ (1,390)	\$ (1,375)	\$ (443)	\$ 40
Basic and diluted earnings (loss) per common share	\$(0.03)	\$(0.03)	\$(0.01)	\$0.00

<b>Consolidated Statement of Operations data</b>	<b>Three Months Ended</b>		<b>Three Months Ended</b>	
	<b>July 31</b>	<b>April 30</b>	<b>January 31</b>	<b>October 31</b>
	<b>2010</b>	<b>2010</b>	<b>2010</b>	<b>2009</b>
Revenues	\$ 31,464	\$ 30,373	\$ 30,351	\$ 32,589
Gross profit	1,613	1,499	1,482	1,564
Loss before income taxes	(122)	(139)	(106)	(763)
Net loss	\$ (122)	\$ (139)	\$ (106)	\$ (763)
Basic and diluted loss per common share	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.02)

### **Off-Balance Sheet Arrangements**

VendTek does not have any off-balance sheet arrangements.

### **Results of Operations**

#### **Comparison of the three and nine-month periods ended July 31, 2011 compared to the three and nine-month periods ended July 31, 2010**

Note: The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries.

The table below sets forth data from our statements of operations for the three and nine-month periods ended July 31, 2011 and 2010, expressed as a percentage of total revenue.

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
Prepaid revenue	98.53%	98.44%	98.33%	98.66%
Hardware revenue	0.11%	0.03%	0.08%	0.07%
Software revenue	1.36%	1.53%	1.59%	1.27%
Total revenue	100.00%	100.00%	100.00%	100.00%
Cost of products sold	95.29%	94.87%	95.06%	95.02%
Gross profit	4.71%	5.13%	4.94%	4.98%
General and administrative expense	5.12%	3.92%	4.79%	3.49%
Selling and marketing	2.42%	0.63%	2.47%	0.73%
Research and development	0.68%	0.67%	0.74%	0.65%
Restatement costs	0.00%	0.00%	0.00%	0.21%
Amortization	0.29%	0.32%	0.30%	0.31%
Other expenses	1.09%	(0.03)%	0.58%	(0.01)%
Loss before income taxes	(4.89)%	(0.39)%	(3.93)%	(0.40)%
Income taxes	0.00%	0.00%	0.00%	0.00%
Net loss	(4.89)%	(0.39)%	(3.93)%	(0.40)%

Three Months Ended July 31, 2011 Compared to Three Months Ended July 31, 2010

*Revenues*

Revenues for the quarter ended July 31, 2011, decreased \$3.0 million to \$28.4 million, or 9.6%, from \$31.5 million for the corresponding period of 2010.

Our prepaid revenues totalled \$28.0 million for the quarter ended July 31, 2011 compared to \$31.0 million for the same quarter in 2010. The \$2.9 million decrease was primarily a result of the impact of new entrants into the Canadian wireless market. Prepaid suppliers experienced a decline in prepaid customers as new entrants captured market share.

In the U.S., our virtual prepaid revenues were \$976,000 and \$1.1 million in the third quarter of 2011 and 2010 respectively. This equates to a 10.8% decrease for the quarter ended July 31, 2011 compared to the corresponding period in 2010. The decrease in our virtual prepaid revenues in the U.S. is primarily due to the decline in the U.S. dollar versus the Canadian dollar.

In Brazil, despite the fact that we received certification from the mobile operators in June, our virtual prepaid revenues were \$23,000 in the third quarter of 2011 and nil for the same quarter of 2010. We recognize our prepaid revenues in Brazil on a net basis. This reflects the fact that we do not have inventory for our virtual prepaid mobile top-up products. If we recognized the revenue consistent with our practice in North America, the revenues recorded would have been \$456,000 for the quarter.

Our software and related service revenues decreased by \$97,000, or 20.2%, to \$385,000 for the third

quarter of 2011 compared to \$483,000 for the same period in 2010. We received software and service revenues from the U.A.E, China, Africa and the U.S. This decrease in our software and related services revenues is due to the declining U.S. dollar compared to the Canadian dollar and lower transaction volumes with certain partners.

#### *Cost of Revenues*

Cost of revenues for the three months ended July 31, 2011 was \$27.1 million, or 95.29% of revenues, compared to \$29.9 million or 95.06% for the same period in 2010. The low margin is indicative of the virtual prepaid telecommunications industry.

#### *General and Administrative*

General and administrative expenses were \$1.46 million and \$1.23 million for the three months ended July 31, 2011 and 2010 respectively. As a percentage of revenue, general and administrative expenses were 5.12% and 3.92% for the three months ended July 31, 2011 and 2010 respectively. General and administrative expense increased mainly due to a provision for a GST audit related to prior years and \$92,000 related to our operations in Brazil.

Also included in general and administrative expenses were non-cash stock-based compensation expenses of \$46,000 and \$33,000 during the third quarter of 2011 and 2010. The increase in stock-based compensation expense was due to the granting of stock options in the third and fourth quarters of 2010 and during 2011.

#### *Sales and Marketing*

Our sales and marketing expenses were \$687,000 and \$198,000 for the third quarter of 2011 and 2010. As a percentage of revenue, sales and marketing expense was at 2.42% and 0.63% of revenues during the third quarter of 2011 and 2010 respectively. We incurred costs of \$489,000 in sales and marketing expenses, which were related to our new operations in Brazil. These costs were not incurred in 2010.

#### *Research and Development*

Product development costs for the three months ended July 31, 2011 and 2010 were \$194,000 and \$212,000. As a percentage of revenue, this was consistent at 0.68% and 0.67% during the third quarters of 2011 and 2010 respectively.

#### *Adjusted EBITDA*

Our adjusted EBITDA decreased to a deficit of \$953,000 from earnings of \$3,000 from the three months ended July 31, 2011, compared to the same period for 2010. This reduction was mainly the result of our investment of \$581,000 in the third quarter of 2011 in our Brazil operations as well as a provision of \$500,000 related to the results of a GST audit for our restated financial results for the years of 2006 - 2008.

#### *Amortization*

Amortization expenses were \$82,000 and \$101,000 for the third quarter of 2011 and 2010 respectively. The decrease in amortization expense is primarily due to some assets being fully amortized.

#### *Accretion on convertible debentures*

Accretion expenses were \$127,000 and nil for the third quarter of 2011 and 2010. The accretion expense is the result of the issuance of the convertible debentures during the year.

### *Interest on long term debt*

Interest expense was \$197,000 and \$1,000 for the third quarter of 2011 and 2010. The increase in interest expense is due to the issuance of convertible debentures during the year and a provision for interest on GST owing.

### *Net Loss*

The consolidated net loss was \$1.4 million for the third quarter ended July 31, 2011, compared with a net loss of \$122,000 for third quarter of 2010.

This increase in net loss during the quarter was primarily the result of our investment in our Brazil operations, a provision for the results of a sales tax audit, and the non-cash accretion on convertible debentures.

### *Nine Months Ended July 31, 2011 Compared to Nine Months Ended July 31, 2010*

#### *Revenue*

Revenues for the nine months ended July 31, 2011, decreased \$10.6 million to \$81.6 million, or 11.48%, from \$92.2 million for the corresponding period of 2010.

Our prepaid revenues totalled \$80.2 million for the nine months ended July 31, 2011 compared to \$91.0 million for the same period in 2010. The \$10.7 million decrease was primarily a result of the impact of new entrants into the Canadian wireless market. Prepaid suppliers experienced a decline in prepaid customers as new entrants captured market share.

The decrease in our Canadian prepaid revenues was partly offset by an increase in our U.S. revenues. In the U.S., our virtual prepaid revenues were \$3.2 million and \$3.0 million in the first nine months of 2011 and 2010 respectively. This equates to a 5.7% increase for the nine months ended July 31, 2011 compared to the corresponding period in 2010. The increase in our virtual prepaid revenue in the U.S. is due to our ongoing installation of POS terminals across the U.S.

In Brazil, despite the fact that we received certification from the mobile operators in June, our virtual prepaid revenues were \$28,000 during the nine months ended July 31, 2011 and nil for the same period of 2010. We recognize our prepaid revenues in Brazil on a net basis. This reflects the fact that we do not have inventory for our virtual prepaid mobile top-up products. If we recognized the revenue consistent with our practice in North America, the revenues recorded would have been \$467,000 for months since we launched.

Our software and related service revenues increased by \$123,000, or 10.5%, to \$1.3 million for the first nine months of 2011 compared to \$1.2 million for the same period in 2010. We received software and service revenues from the U.A.E, China, Africa and the U.S.

#### *Cost of Revenues*

Cost of revenues for the nine months ended July 31, 2011, were \$77.6 million, or 95.06% of revenues, compared to \$87.6 million, or 95.02% of revenues for the same nine months in 2010. The consistent low margin is indicative of the virtual prepaid telecommunications industry.

#### *General and Administrative*

General and administrative expense increased \$688,000, or 21.4%, for the nine months ended July 31, 2011 as compared to same period in 2010. As a percentage of revenue, general and administrative

expenses were 4.79% and 3.49% for the nine months ended July 31, 2011 and 2010 respectively. General and administrative expense increased mainly due to a provision for a GST audit, and an increase in compensation costs.

Also included in general and administrative expenses were non-cash stock-based compensation expenses of \$141,000 and \$34,000 during the first nine months of 2011 and 2010. The increase in stock-based compensation expense was due to the granting of stock options in the third and fourth quarters of 2010 and during 2011.

#### *Sales and Marketing*

Our sales and marketing expenses increased \$1.3 million, or 197.9%, to \$2.0 million in the nine months ended July 31, 2011 as compared to \$675,000 for same period in 2010. As a percentage of revenue, sales and marketing expense was 2.47% and 0.73% for the nine months ended July 31, 2011 and 2010 respectively. We incurred approximately \$1.3 million in sales and marketing expenses, which were related to our new operations in Brazil.

#### *Research and Development*

Product development costs for the nine months ended July 31, 2011 and 2010 were \$605,000 and \$598,000. As a percentage of revenue, this was 0.74% and 0.65% for the nine months ended July 31, 2011 and 2010 respectively.

#### *Adjusted EBITDA*

Our adjusted EBITDA decreased to a deficit of \$2.5 million from a deficit of \$56,000 from the nine months ended July 31, 2011, compared to the same period for 2010. This reduction was mainly the result of our investment in our Brazil operations, and a provision related to the results of a sales tax audit.

#### *Restatement Costs*

Restatement costs consist of accounting, legal and consulting costs incurred. We did not incur any restatement costs in the first nine months of 2011 compared to \$190,000 in the same period of 2010. These costs related to the restatement of our 2006 and 2007 annual financial statements and the quarters ended January 31, April 30 and July 31, 2009

#### *Amortization*

Amortization expense decreased to \$243,000, or 0.30% of revenue, in the nine months ended July 31, 2011 compared to \$288,000, or 0.31% of revenue, for the same period in 2010. The decrease in amortization was due to some assets being fully amortized.

#### *Accretion on convertible debentures*

Accretion expenses were \$225,000 and \$nil for the first nine months of 2011 and 2010 respectively. The increase in accretion expense is due to the issuance of the convertible debentures occurring this year.

#### *Interest on long term debt*

Interest expense was \$233,000 and \$4,000 for the nine month periods ended July 31 of 2011 and 2010 respectively. The increase in interest expense is due to the issuance of the convertible debentures this year and a provision for interest on sales tax owing in the amount.

#### *Net Loss*

The consolidated net loss was \$3.2 million for the nine-month period ended July 31, 2011, compared with a net loss of \$368,000 for same period of 2010.

This increase of \$2.8 million in net loss was primarily the result of our investment in our Brazil operations, a provision for the results of a sales tax audit, interest, and the non-cash accretion on convertible debentures issued this year.

### ***Liquidity and Capital Resources***

As at July 31, 2011 our cash balance was \$3.1 million compared to \$4.8 million as at October 31, 2010. Our cash position can fluctuate significantly from period to period, largely as a result of differences in the timing, size and number of transactions, the timing of the receipt of proceeds from retailers, and the timing of the payment of net amounts due to suppliers. We generally collect proceeds from retailers within seven days of the transaction and pay suppliers approximately 21 days following the purchase of inventory. Specifically, we normally collect our cash every Wednesday. If collections from retailers or suppliers happen near a period end, our cash position will be affected accordingly.

#### *Cash Flows Used in Operating Activities*

Net cash used by operating activities was \$4.9 million during the nine months ended July 31, 2011, compared to cash provided of \$136,000 during the nine months ended July 31, 2010. In the nine months ended July 31, 2011, cash was primarily reduced by a \$2.3 million increase in inventory, \$335,000 increase in accounts receivable, \$346,000 increase in deposits and \$239,000 increase in prepaid expenses. Cash was also reduced due to a decrease in deferred revenue of \$19,000. Our accounts receivable balance was higher due to the timing of collections. The inventory balance was higher due to timing of inventory purchases.

Cash was increased due to an increase in accounts payable of \$934,000. This increase in accounts payables is due to the timing of our payments cycle.

#### *Cash Flows from Investing Activities*

Investing activities used cash of \$126,000 in the first nine months of 2011 and \$151,000 in 2010. The funds were primarily used to purchase equipment and software.

#### *Cash Flows from Financing Activities*

Financing activities provided cash of \$3.3 million and \$132,000 during the nine months ended July 31, 2011 and 2010, respectively. During the first nine months of 2011, cash was provided primarily from \$2.8 million from issue of convertible debentures and \$936,000 from the issue of shares. We also received \$76,000 from exercised stock options. This was partially offset by the \$512,000 increase of our restricted cash and \$4,000 repayment of leases.

### ***Financial Condition***

As at July 31, 2011, our cash position was \$3.1million and we had current assets of \$13.1 million, current liabilities of \$10.7 million.

Since inception, the Company has financed its operations and expansion through operating profits, and the issuance of equity and debt instruments. The Company will continue to allocate significant resources through 2012 to advance its growth strategy. With the expectation that we will continue to incur ongoing negative cash flows from operations, the Company must raise new funds in the near term in order to continue these initiatives. We believe the proposed financing (described more fully in our Subsequent Events section below) will meet the funding requirements until cash flows from operations will support our ongoing capital requirements.

We will remain disciplined and carefully monitor our monthly operating cash usage to adjust as necessary to the changing business environment. Despite the continuing general malaise of the economy and equity markets, the we are confident that we have generated sufficient interest to allow us to obtain additional financing from external sources.

### **Share Capital**

We have authorized capital consisting of unlimited common shares without par value and unlimited preference shares without par value. The shares of the Company are publicly traded on the Toronto Stock Venture Exchange under the symbol "VSI".

As at the date of this MD&A, there are 49,212,319 shares and 4,712,000 stock options outstanding.

### **Summary of Options Activity**

We have a Stock Option Plan (the "Plan") whereby we may grant options to our directors, officers and employees. The terms and conditions of options granted under the Plan are determined solely by our 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.

The following table summarizes the continuity of the Company's stock options:

	Number of shares	Weighted average exercise price
Balance, October 31, 2010	4,912,000	\$ 0.61
Granted	125,000	0.67
Cancelled or forfeited	(132,142)	0.50
Exercised	(192,858)	0.40
Balance, July 31, 2011	4,712,000	\$ 0.63

### **Summary of Warrants Outstanding**

The following table summarizes the continuity of the Company's warrants:

	Number of shares	Weighted average exercise price
Balance, October 31, 2010	0	\$ 0.00
Issued	2,372,500	0.91
Exercised	0	0.00
Balance, July 31, 2011	2,372,500	\$ 0.91

### ***Related Party Transactions***

The Company has a lease commitment and during the three and nine months ended July 31, 2011, paid rent of \$12,447 and \$37,341 (2010 - \$12,447 and \$37,341) to a company in which a director has a minority equity interest. On November 1, 2008, the Company signed a three year lease agreement, which expires October 31, 2011. In addition to minimum lease payments of \$4,149 per month, the facility lease requires payment of a proportionate share of taxes and strata fees.

During the nine month period ended July 31, 2011, the Company recognized \$450,738 (USD \$459,000) of revenue from a shareholder of the Company. As at July 31, 2011, \$95,550 (USD \$100,000) of this amount is recorded within accounts receivable. The shareholder also participated in the financings completed by the Company (notes 4 and 5). The shareholder contributed 25% of the total amount raised.

The transactions were in the normal course of operations and, in management's opinion, undertaken with the terms and conditions consistent with arms' length transactions.

### ***Subsequent event***

On September 12, 2011, the Company announced a non-brokered private placement to raise up to \$3,000,000. The private placement consists of up to 5 million units at a price of \$0.60 per unit. Each unit will consist of one common share in the capital of the Company and one-half warrant. Each full warrant will be exercisable to acquire one additional common share for three years from the closing of the private placement at a price of \$0.75 cents per common share.

The Company has received an expression of interest from Prinvest Offshore SAL, which currently owns approximately 24.4% of the Company's common shares, to acquire at least \$2 million of the proposed financing. However, there can be no assurances that such a financing will be completed.

### ***Outlook***

We have a multi-point strategy to drive growth with the primary goal of increasing the number of transactions processed through our e-Fresh™ system globally.

We have three main priorities for 2011:

1. Successful launch of our operations in Brazil.
2. Continue to increase international license revenues
3. Increase profitability of our North American operations.

### ***Revenues***

Going forward, we expect to focus on increasing transaction volumes and sales by deploying e-Fresh™ software to point-of-sale terminals through the Now Prepay network in North America, Brazil and by supporting existing and adding new partners in international markets.

In Canada, we expect that we will continue to add additional POS terminals and products. While the terminal growth in Canada will unlikely match the growth we have already experienced, we expect that we will see transaction growth from products recently added to our system such as Ukash, prepaid credit cards, and international mobile top-up. These additional products do not require significant capital outlay.

In the U.S., we expect that we will continue to support our existing ISOs and add new ISOs. We believe that our successful execution of this strategy in Canada can be replicated in the U.S. As our ISOs continue to deploy new POS terminals, we believe that we can cost effectively increase our NPP network. We also expect to add additional products to our network in the U.S. We are planning to add additional financial products and bill payment services.

In Brazil, we have launched our operations during the second quarter of 2011. To date, we have signed national distribution contracts with telecommunications and financial service companies. We expect that we will also add additional products throughout the year. Our revenue growth will be dependent on the number of POS terminal additions and the number of transactions per terminal. We expect the POS terminal growth and number of transactions to grow as the year progresses and the number of products available to be processed increases. We had previously expected that we would reach 3,000 terminals by the end of the fiscal year. Since we received our certification from all the mobile network operators in June, we expect that we will have 1,200 terminals at year-end.

International markets for prepaid telecommunications products are larger than North America. We expect to see continued growth in higher-margin license revenues from our international customers. While our partner in the UAE has contributed the majority of license revenues to-date from transactions in Asia, we expect that our new partners in Africa will grow in 2011 and contribute increasing license fees as their operations expand. We will continue to expand our international network by seeking additional license opportunities.

We also expect to growth in revenues related to mobile financial transactions. We are in the process of developing and deploying a mobile financial transaction platform for a mobile network operator in Asia. When completed, our platform will facilitate transactions related to payroll and bill payment.

### *Gross Profit Margins*

Generally, while we expect our revenue mix to continue to be dominated by our Canadian revenues (due to the way we recognize our revenues), the global scope of our operations is better evidenced by our gross margins. For example, in 2010, while 1.6% of our revenues were derived from international license revenues, 30% of our gross margin was from international license revenues.

In Canada, we expect to see continued margin pressure as the prepaid telecommunication market matures. This may be partially offset by the increase in sales for higher-margin financial products. This may also be the case for the U.S.

In Brazil, we recognize revenues on a net basis. As revenues increase in Brazil, our gross profit margins will increase as there is relatively little cost of revenue associated with the sale.

Internationally, we receive 100% margin transaction fees. Currently, we process about 200,000 transactions a day, which improve our lower margin distribution revenues in North America.

We expect our gross margins percentage to increase as our international revenues increase.

### *Operating Expenses*

While we focus on reducing our costs, we expect our operating expenses to remain consistent as a percentage of revenues. However, we expect that our operating expense directed towards our

Canadian market will shift as our international operations expand. For example, for our Brazil operations, we expect to add additional staff and incur professional fees as we expand our operations.

### ***Risks Related to our Business***

There has been no significant change in our risk factors from those described in our October 31, 2010 Management Discussion and Analysis. Please refer to our October 31, 2010 Management Discussion and Analysis for more information.

### ***Forward-looking Statements***

This Management's Discussion and Analysis contains statements, which are not current statements or historical facts and are "forward-looking information" within the meaning of applicable Canadian securities laws. All statements, other than statements of historical fact, contained in this Management's Discussion and Analysis constitute forward-looking information. Wherever possible, words such as "plans", "expects" or "does not expect", "budget", "forecasts", "projections", "anticipate" or "does not anticipate", "believe", "intent", "potential", "strategy", "schedule", "estimates" and similar expressions or statements that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved and other similar expressions have been used to identify forward-looking information. These forward-looking statements relate to, among other things the Company's expectations regarding future growth, results of operations (including, without limitation, future production and sales, and operating and capital expenditures), performance (both operational and financial), business and political environment and business prospects (including the timing and development of new deposits and the success of exploration activities) and opportunities.

Although the forward-looking information in this Management's Discussion and Analysis reflects the Company's current beliefs on the date of this Management's Discussion and Analysis based upon information currently available to management and based upon what management believes to be reasonable assumptions, the Company cannot be certain that actual results, performance, achievements, prospects and opportunities, either expressed or implied, will be consistent with such forward-looking information. By its very nature, forward-looking information necessarily involves significant known and unknown risks, assumptions, uncertainties and contingencies that may cause the Company's actual results, assumptions, performance, achievements, prospects and opportunities in future periods to differ materially from those expressed or implied by such forward-looking information. These risks and uncertainties include, among other things, revenue growth, operating results, the market demand for our products, product development, and litigation as well other factors described in the Risks Related to Our Business Section above. There may be other factors that cause results, assumptions, performance, achievements, prospects or opportunities in future periods not to be as anticipated, estimated or intended.

There can be no assurances that forward-looking information and statements will prove to be accurate, as many factors and future events, both known and unknown could cause actual results, performance or achievements to vary or differ materially, from the results, performance or achievements that are or may be expressed or implied by such forward-looking statements contained in this Management's Discussion and Analysis. Accordingly, all such factors should be considered carefully when making decisions with respect to the Company, and prospective investors should not place undue reliance on forward-looking information. Forward-looking information is as of September 29<sup>th</sup>, 2011. The Company assumes no obligation to update or revise forward-looking information to reflect changes in assumptions, changes in circumstances or any other events affecting such forward-looking information, except as required by applicable law.

## **VendTek Systems Inc.**

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