

## VendTek Systems Inc.

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

For the Fiscal Year Ended October 31, 2006

*This discussion should be read in conjunction with the audited consolidated financial statements and the related notes included elsewhere in this report. Except for statements of historical fact contained herein, the following information presented contains "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", "us" and "our" mean VendTek Systems Inc.*

*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.

We develop market and sell 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 directly and through our wholly owned subsidiaries; Now Prepay Corp. (Canada) ("NPC"), VendTek Systems Technologies (Beijing) Co., Ltd. ("VST") and VendTek Systems Asia Pacific (Singapore) Pte. Ltd. ("VAP").

Our principal product is our 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.

The e-Fresh™ software utilizes POS terminals and other electronic terminals as clients (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, 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.

VST 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 five years of operating history, VendTek

is continuing to build business with its primary customer in China and evaluating potential opportunities.

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

#### *Revenue*

We generate our revenues from the distribution of virtual prepaid products through our NPC network, hardware and equipment sales, license fees from our international customers and related professional service fees.

As part of our strategy to develop recurring sources of revenues, we developed our own electronic distribution business across Canada under the Now Prepay™ brand and our subsidiary NPC. NPC uses e-Fresh to distribute cellular and long distance products, financial products, prepaid gift cards and prepaid internet cards. NPC also sells its own branded long distance products: Now#1 and Connect Now. NPC is currently generating the majority of our revenues.

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.

Going forward, we expect to increase sales through continued deployment of e-Fresh™ software to point-of-sale terminals through the NPC network, increase the product base available to the NPC network and develop new international markets for the e-Fresh™ software. We also expect to see continued growth in the license sales from our United Arab Emirates ("UAE") customer resulting from more transactions.

#### *Cost of Revenues*

Costs of products and services sold 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, transaction processing expenses and personnel. We do not have significant cost of revenues for our license sales.

#### *Research and Development Expenses*

Our research and development expenses consist primarily of salaries, bonuses and benefits for engineering personnel, costs associated with various projects, including testing, developing prototypes and related expenses.

Our engineering personnel are located in our offices in Canada and China. 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.

#### *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. Some of our sales staff is located in China to support our sales initiatives there. We receive minimal revenues from our customers in Chinathat help offset our costs to maintain our Beijing sales and development office.

#### *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 and general corporate overhead.

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

The following discussion and analysis is based upon our consolidated financial statements, which have been prepared in conformity with Canadian generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. We evaluate our estimates including the determination of the fair value of stock-based compensation and financial instruments, the allowance for doubtful accounts, inventory valuation, tax provisions and the useful lives of property, plant and equipment including intangible assets. The discussion below is intended as a brief discussion of some of the judgments and uncertainties that can impact the application of these policies and the specific dollar amounts reported on our financial statements. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates under different assumptions or conditions, or if management made different judgements or utilized different estimates. Many of our estimates or judgements are based on anticipated future events or performance, and as such are forward-looking in nature, and are subject to many risks and uncertainties, including those discussed below and elsewhere in this annual report. Management does not undertake any obligation to update or revise this discussion to reflect any future events or circumstances.

We have identified some of our accounting policies that we consider critical to our operations and the understanding of our results of operations. This is neither a complete list of all our accounting policies, nor does it include all the details surrounding the accounting policies we have identified. There are other accounting policies that are significant to our company. For a more detailed discussion on the application of these and our other accounting policies, see note 2 to the consolidated financial statements for the year ended October 31, 2006.

#### *Revenue Recognition*

The Company's revenue is comprised of three sources: resale and distribution of prepaid telecommunication 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 an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable, and collectibility 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 prepaid calling cards and point of sale activated PINs. 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, being the retail merchant, and incurs inventory risk (including physical 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 and account for \$601,000 of revenue in fiscal 2006. Equipment sales are ancillary to the resale of prepaid products. Equipment sales and parts revenue is recognized when delivered.

Software license revenues are recognized upon the customer's execution of a software license agreement, the receipt of a purchase order and shipment of the software, provided that no significant

vendor obligations remain outstanding. Where significant vendor obligations are negotiated, software license revenues are recognized only after these obligations have been satisfied.

Cost of revenues for the prepaid time consists primarily of long distance telephone time, standard telephone cards, net amounts earned on early payments to suppliers plus commissions to Independent Sales Organizations (ISO's) and sales agents. Direct costs include operational salaries, parts and accessories. Cost of revenues for transaction fees and services consist of network communication costs, maintenance and support of terminals and third-party processing costs. Cost of revenues does not include amortization.

#### *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 Section 3870 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. During the year ended October 31, 2005, and in accordance with one of the transitional options permitted under amended Section 3870, the Company retroactively applied the fair value based method to all employee stock options granted or repriced on or after January 1, 2002.

#### **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:

For the years ended October 31 (in thousands except for earnings or loss per share):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total assets	4,385	2,457	1,799
Total long-term liabilities	79	8	486
Revenue	58,018	38,354	21,742
Net income (loss) before income tax	716	(366)	(1,308)
Net income (loss) after income tax	751	(366)	(1,308)
Earnings (loss) per share <sup>1</sup>	0.02	(0.01)	(0.04)

#### **Summary of Quarterly Results**

Quarter Ended	Revenue	Earnings (Loss)	Earnings (Loss) per share <sup>1</sup>
October 31, 2006	16,826,650	231,367 <sup>(3)(4)</sup>	0.02
July 31, 2006	14,899,228	320,033 <sup>3</sup>	0.01
April 30, 2006	13,468,110	105,688 <sup>3</sup>	0.00
January 31, 2006	12,824,090	93,846 <sup>3</sup>	0.00
October 31, 2005	11,750,060	(65,492) <sup>2</sup>	(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)

- <sup>1</sup> Basic earnings (loss) per share are computed using the weighted average number of common shares outstanding during the periods. The treasury stock method is used for the calculation of diluted net earnings (loss) per share. Stock options and warrants are dilutive when the average market price of the common shares during the period exceeds the exercise price of the options and warrants. Diluted earnings per share assume all outstanding options and warrants have been exercised at the later of the beginning of the fiscal period or the date of issuance.
- <sup>2</sup> Includes non-cash year-end adjusting entries, all of which were recorded in the fourth quarter of fiscal 2005: consigned inventory reversal (\$191,000), stock-based compensation expense (\$126,000).
- <sup>3</sup> Includes non-cash adjusting entries recorded in each quarter of 2006: Stock-based compensation expense for fiscal 2006 totalled (\$291,000).
- <sup>4</sup> Includes year-end tax expense, all of which was recorded in the fourth quarter of fiscal 2006, of \$135,137 and a future income tax asset of \$170,500.

## **Results of Operations**

### **Comparison of year and quarter ended October 31, 2006 compared to the year and quarter ended October 31, 2005.**

*Note: The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries: NPC, VSTB, VSAP, and VendTek Industries Inc., which owns VendTek International Inc. (an inactive U.S. company).*

The table below sets forth data from our statements of operations for the three months ended October 31, 2006 and 2005 and the years ended October 31, 2006 and 2005, expressed as a percentage of total revenue.

	Three Months Ended October 31,		Year Ended October 31,	
	2006	2005	2006	2005
	(Unaudited)			
Prepaid telecommunication revenue	99.0%	99.9%	99.3%	99.7%
Hardware revenue	0.3%	0.0%	0.3%	0.3%
Software revenue	0.7%	0.1%	0.4%	0.0%
<b>Total revenue</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Cost of products sold	94.0%	95.5%	93.9%	95.9%
Gross profit	6.0%	4.5%	6.1%	4.0%
General and administrative expense	2.8%	3.6%	3.2%	3.6%
Selling and marketing	1.0%	0.5%	0.7%	0.4%
Research and development	0.6%	0.7%	0.6%	0.7%
Amortization	0.2%	0.4%	0.3%	0.4%
Income (loss) before benefit for income taxes	1.2%	(0.5)%	1.2%	(1.0)%
Benefit for income taxes	(0.2)%	–	–	–
<b>Net income (loss)</b>	<b>1.4%</b>	<b>–</b>	<b>1.3%</b>	<b>–</b>

### Three Months Ended October 31, 2006 Compared to Three Months Ended October 31, 2005

### *Revenue*

Revenues for the quarter ended October 31, 2006 increased \$5.077 million to \$16.827 million, or 43%, from \$11.750 million for the corresponding period in 2005.

Our prepaid telecommunications revenue totalled \$16.660 million for the quarter ended October 31, 2006 compared to \$11.725 million for same quarter in 2005. The 42% increase is primarily due to ongoing installation of POS terminals across Canada for distribution of virtual prepaid telecommunications vouchers (or PINs) through our distribution network.

Our software and related service revenue increased by \$89,000 (or 475%) to \$108,000 for the fourth quarter of 2006 from \$19,000 for the same period in 2005. Software and services revenue increased because of a new licensing customer in the United Arab Emirates.

Our hardware revenue for the fourth quarter of 2006 was \$58,000 compared to \$6,000 in 2005. The increase was due to additional parts orders from our legacy vending machine customers and additional server sales related to our PIN sales.

### *Cost of Revenues*

Cost of revenues for the three months ended October 31, 2006 were \$15.823 million, or 94% of revenues, compared to \$11.227 million, or 95% of revenues for the same quarter in 2005. The low margin is indicative of the virtual prepaid telecommunications industry.

### *General and Administrative*

General and administrative expense increased \$87,000, or 19%, to \$545,000 in the three months ended October 31, 2006 as compared to \$458,000 for the three months ended October 31, 2005. As a percentage of revenue, general and administrative expenses were 3% and 4% for the three months ended October 31, 2006 and 2005, respectively.

Included in general and administrative expense for the three months in 2006 and 2005 was \$68,000 and \$116,000, respectively, of stock-based compensation expense. A further reason for the increase was additional professional fees incurred.

### *Sales and Marketing*

Our sales and marketing expense increased \$101,000, or 160%, to \$164,000 in the quarter ended October 31, 2006 as compared to \$63,000 for same period in 2005. As a percentage of revenue, sales and marketing expense was 0.97% and 0.54% for the three months ended October 31, 2006 and 2005, respectively. The increase is primarily due to additional sales and marketing initiatives for our NPC and international efforts.

### *Research and Development*

Product development costs for the three months ended October 31, 2006 were \$98,000, or approximately 0.58% of revenues. This compares to \$67,000, or approximately 0.70% of revenues for the quarter ended October 31, 2005.

## Year Ended October 31, 2006 Compared to the Year Ended October 31, 2005

### *Revenue*

Revenues for the years ended October 31, 2006 and 2005 were \$58.018 million and \$38.354 million respectively. This represents a \$19.664 million increase, or 51%, during 2006.

Our prepaid telecommunications revenue totalled \$57.6 million for 2006 compared to \$38.249 million for 2005. Prepaid telecommunication revenues are dependent on the number of locations we have established as part of our proprietary distribution network. We had 9,979 terminals at October 31, 2006, compared to 7,289 at October 31, 2005. Additionally, we increased the number of products available to our distribution partners including third-party gift cards.

Our software and related service revenue increased by \$217,000 (or 755%) to \$246,000 during 2006 from \$29,000 in 2005. Software and services revenue increased because of a new licensing customer in the United Arab Emirates.

Our hardware revenues for the year ended October 31, 2006 were \$172,000 compared to \$76,000 in the prior year. The increase was primarily due to additional server sales related to our prepaid PIN sales.

#### *Cost of Revenues*

Cost of revenues for 2006 were \$54.483 million, or 94% of revenues, compared to \$36.796 million, or 96% of revenues for the previous year. Higher sales volumes and our ability to utilize supplier discounts resulted in better margins.

#### *General and Administrative*

Our general and administrative expense increased \$494,000 to \$1.862 million for the year ended October 31, 2006 as compared to \$1.368 million for the year ended October 31, 2005. As a percentage of revenue, general and administrative expenses were 3% and 4% for the year ended October 31, 2006 and 2005, respectively.

Included in general and administrative expense for 2006 and 2005 was \$291,000 and \$126,000, respectively, of stock-based compensation expense. General and Administrative expenses also increased as a result of additional compensation expenses and professional fees.

#### *Sales and Marketing*

Our sales and marketing expense increased \$282,000, or 200%, to \$423,000 during the year ended October 31, 2006 as compared to \$141,000 for 2005. As a percentage of revenue, sales and marketing expenses were less than 1% in 2006 and in 2005. The increase was primarily due to our increased efforts to increase the number of terminals in Canada and expand our international licensing efforts.

#### *Research and Development*

Our product development costs for the year ended October 31, 2006, were \$359,000, or approximately 0.62% of revenues. This compares with \$267,000 or approximately 0.70% for 2005. The increase of the expense is attributed to increased personnel and increased use of contract labour. The focus of this group is to support existing programs and to develop new networks and platforms.

#### *Amortization*

Amortization expense increased to \$175,000 in 2006 compared to \$147,000 for 2005. The increase is due to increased purchases of point-of-sale terminals that are depreciated on a straight-line basis over three years.

### *Provision for Income Taxes*

Consolidated net income before taxes was \$715,000 for the year ended October 31, 2006, compared with a loss of \$366,000 for 2005. Our provision for income taxes was \$135,000 for 2006 and we did not record a provision in 2005. The increase in tax provision was due to an increase in Canadian taxable income. We have reduced our tax expense by \$171,000 based on our estimate that we will, more likely than not, realize some of our non-capital loss carry forwards available to us in Canada.

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

As of October 31, 2006, cash totaled approximately \$764,000 compared to approximately \$247,000 at October 31, 2005.

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

Net cash used in operating activities totalled \$634,000 and \$518,000 during the years ended October 31, 2006 and 2005, respectively. In 2006, cash was used primarily for payments of accounts payable, accrued expenses, and purchases of inventory. In 2005, cash was used primarily to fund operating losses.

#### *Cash Flows from Investing Activities*

Investing activities used cash of \$297,000 and \$86,000 during the years ended October 31, 2006 and 2005, respectively. The funds were primarily used to purchase POS equipment.

#### *Cash Flows from Financing Activities*

Financing activities provided cash of \$1.448 million and \$342,000 during the years ended October 31, 2006 and 2005, respectively. In each of the periods, cash was provided primarily by issuance of shares from the exercise of options and warrants. We also used long-term financing to purchase our POS equipment. These activities were partially offset by the repayment of a convertible debenture.

At October 31, 2006, we completed a private placement and issued about 1.429 million shares for gross proceeds of \$500,000. We received about \$165,000 prior to our year-end and the remaining funds totalling about \$335,000 on November 8, 2006.

#### *Financial Condition*

We believe that we have sufficient cash and working capital to meet our obligations as they become due in 2007. We plan capital expenditure for fiscal 2007 in line with prior years.

We expect to continue using funds generated from our existing operations to further finance the expansion of prepaid cellular business in Canada. Working capital is managed by rate of inventory turnover, collection terms with customers and terms granted by suppliers. Our cash flow is dependant on our ability to continue to manage the business cycle. Limited credit facilities from vendors may limit our working capital and cash flows to expand the business. As this business expands, we anticipate the need to purchase additional inventory and POS terminals. A risk to our liquidity is that customers do not pay in a timely manner creating a negative cash flow situation. In fiscal 2006, \$250,000 was used in investing activities for the purchase of point-of-sale terminals to be used to distribute prepaid products in Canada.

Our cash flow from operations is impacted by our margin on sales. Increased pricing competition may reduce margins and our ability to negotiate favorable supply contracts will impact our margin, net income and operating cash flow.

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 and related party debt. VendTek's operations, development and expansion are financed from the cash flow generated from operating activities, including 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. We have no minimum purchase or supply agreements in place. The Company's current minimum annual contractual obligations are as follows for the years ending October 31:

2007	\$	67,975
2008		67,975
2009		67,975
		<hr/>
	\$	203,925
		<hr/>

***Convertible Debentures***

On November 29, 2001, we 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 charged to operations over the five-year term. The debentures attracted - interest at a rate of 9.5% 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 us and the discounted cash flow of repayments based on an annual rate of 12%, which was consistent with similar borrowings available to us, without conversion features. The remaining portion of \$466,000 was classified as a long-term liability. The debt component of \$34,000 was accreted to its face value at maturity over the term of the debt through a charge to interest expense. Upon the debenture's maturity, the \$34,000 equity component was reclassified to share capital.

As at October 31, 2006, we had 41,883,483 common shares issued and outstanding.

***Summary of Options Granted***

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 \$
Outstanding, October 31, 2005	4,410,900	0.20
Granted	150,000	0.33
Exercised	(587,900)	0.20
<u>Outstanding, October 31, 2006</u>	<u>3,973,000</u>	<u>0.20</u>

### ***Summary of Warrants***

The following table summarizes the continuity of the Company's 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
<u>Balance at October 31, 2006</u>	<u>-</u>	<u>-</u>

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

During the year ended October 31, 2006, we paid rent of \$46,462 (2005 - \$50,753) to a company in which a director has a minority interest. Our premises lease with the related company was renewed for a three-year term effective November 1, 2006 expiring on October 31, 2009. This transaction was in the normal course of operations and, our opinion, undertaken with the same terms and conditions as a transaction with an unrelated third party.

### ***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.

Management is of the opinion that we have sufficient cash resources and working capital to meet ongoing obligations as they come due during the next fiscal year. We plan capital expenditures in fiscal 2007 to exceed 2006 with potential acquisitions and expansion into the U.S. market.

Management plans to continue using cash flow generated from operations to finance the continued expansion of the Now Prepay network in Canada and the United States. Generally, cash flow terms

from suppliers are net 25 days and net 10 days for collections from customers. Credit facilities from our vendors are limited and may restrict our working capital and cash flow to develop the business. An ongoing risk to our liquidity is customer non-payment. However, given the low dollar value generated by each individual customer, this would not create a negative cash flow situation. Substantial growth for the prepaid business is in part dependant on increased credit limits from our suppliers to finance the purchase of inventory, which, historically, has not been a problem.

Cash flow from operations is influenced by our sales margins. Pricing competition among our suppliers of prepaid products may reduce margins. Our ability to negotiate contracts will impact our margins, cash flow and net income.

Required capital for fiscal 2007 will depend on several factors including, but not limited to, the amount of resources we will commit to network development, new product development and prospective strategic alliances and acquisitions of new products and/or other businesses.

Possible future alliances, acquisitions and product initiatives may increase capital requirements. We may seek funding from a combination of sources, including equity and debt financing. No assurances can be given that additional financing will be available to the Company.

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

VendTek does not have any off-balance sheet arrangements.

#### ***Controls and Procedures***

As of the end of fiscal year 2006, management has carried out an evaluation of the effectiveness of the operation of the Company's disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of the Company's management. Based upon that evaluation, management has concluded that the Company's disclosure controls and procedures are effective at October 31, 2006. There have been no changes in internal controls over financial reporting in connection with this evaluation that occurred during the fourth quarter of fiscal 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

We are continuing to evaluate our internal controls and we expect to make necessary improvements and enhance the reliability over financial reporting.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted is recorded, processed, summarized and reported within time periods specified in the Securities and Exchange Commissions rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the Company's reports filed is accumulated and communicated to management as appropriate, to allow timely decisions regarding required disclosure.

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