

**MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION &  
RESULTS OF OPERATIONS FOR THE QUARTER & YEAR TO DATE PERIOD  
ENDED MARCH 31, 2009**

**May 12, 2009**

(dollar amounts in Canadian dollars unless otherwise indicated)

**Forward Looking Statements**

Certain statements contained in this Management's Discussion and Analysis ("MD&A") contains "forward-looking statements" within the meaning of the United States Securities Litigation Reform Act of 1995, and applicable Canadian Securities Legislation. Forward-looking statements include, but are not limited to, statements with respect to financial performance, opportunities, new market for growth and financial position. Generally these forward-looking statements can be identified by the use of forward-looking terminology such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecast", "intends", "anticipates", or "does not anticipate", or "believes" or variations of such words and phrases, or state that certain actions, events or results "may", "could", "would", "might", or "will be taken", "occur", or "be achieved". Please be cautioned that any such forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties. Actual results or developments may vary materially from those projected or implied in the forward-looking statements as a result of any number of factors, including currency exchange rate fluctuations; variability of operating results; dependence on certain industries; management of growth and expansion; integration of operations; ability to attract and retain key personnel; nature of sales; product complexity and product defects; international operations; material cost fluctuations and limited availability of raw materials; potential loss of customers; competition; industry contraction and slow economic growth; technological change and process development; environmental liability; need for additional financing; product liability; pricing pressure; ability to reduce costs; and other risks discussed in the section entitled "Risk Factors", in the Company's MD&A for the year end December 31, 2008.

The following MD&A of financial condition and results of operations of Coretec Inc. ("Coretec" or "the Company") for the three-month period ended March 31, 2009 and 2008 should be read in conjunction with the Company's consolidated financial statements and related notes contained in this interim report.

The purpose of this 2009 first quarter report is to provide an update to the information contained in the Company's MD&A section of the Company's 2008 Annual Report, which contains a more comprehensive discussion of the Company's strategy, capabilities to deliver results and risks. Management assumes that the reader of this document has access to the MD&A section of the Company's 2008 Annual Report. This document and other information can be downloaded in portable document format (PDF) from the Company's website at [www.coretec-inc.com](http://www.coretec-inc.com) or from the SEDAR website for Canadian regulatory filings at [www.sedar.com](http://www.sedar.com). To request a printed copy, the reader may also contact Coretec's transfer agent, Computershare Investor Services Inc., at 1-800-564-6253 or via email at [service@computershare.com](mailto:service@computershare.com) or Coretec Inc. at [www.coretec-inc.com](http://www.coretec-inc.com).

## Overview

Coretec is one of North America's leading fabricators of Printed Circuit Boards ("PCB"). The Company has an extensive product offering including double sided and multilayer rigid PCBs, flexible and rigid-flex PCBs, High Density Interconnect ("HDI") PCBs, as well as PCBs containing metal cores or heat sinks. The Company also offers a series of value added services to its customers such as computer automated design layout, field applications engineering, technology consulting and education, quick turn manufacturing and high volume facilitation in Asia.

The Company's marketing and sales focus is on servicing the product engineering requirements and expedited time-to-market needs of electronic equipment manufacturers, both original equipment manufacturers ("OEM") and contract equipment manufacturers ("CEM") also known as electronic manufacturing services ("EMS") companies. The Company targets its sales efforts on customers in some of the most technologically demanding segments of the electronics industry; namely heavy industrial, medical and military/aerospace.

The challenges in the North American PCB market include shortening electronic product life cycles, a trend towards inventory minimization, increasing product complexity, environmental sensitivity, the increasing significance of approvals (both customer specific and globally recognized), raw material inflation, skilled labour scarcity and competitive pressures from offshore and domestic manufacturers. To respond to these challenges the Company has 1) focused its sales and marketing efforts on the higher margin quick turn and prototype segments of the market; 2) invested in systems and equipment that enable the construction of advanced technology products; 3) created value added solutions directed at product developers and higher technology consumers; 4) committed to strong environmental stewardship; 5) achieved multiple sector specific and generic certifications; and 6) developed a strategy for higher volume product fulfillment in Asia.

The Company's sales are derived primarily from the manufacture and sale of rigid and rigid flex PCBs that are custom designed and customer specific. Non-labour related direct expenses consist of direct materials; namely laminates made of fibreglass and epoxy, as well as base and precious metals such as copper, tin, silver and gold. Indirect materials include photographic films and inks, as well as generic and specialty chemicals. The Company also uses carbide tools for the drilling, routing and cutting of their products.

The rigid and rigid flex PCB market in North America today is estimated to be US\$3-\$4 billion in terms of shipments. This includes PCB demand supplied by offshore producers.

The Company believes that an ongoing focus on the above-noted niche end markets will cause it to be less susceptible to import competition from lower cost, offshore jurisdictions. Those demand characteristics that favour domestic manufacturers include government restrictions, intellectual property concerns, freight time and costs, engineering intimacy requirements, compressed delivery requirements and order size.

## *Vision and Strategy*

Coretec's vision is to provide high quality PCBs to its customers on a timely basis. Coretec is focused on being the "go to" PCB company for the electronics industry.

In 2008, the Company experienced a 5.1% decline in revenues. In comparison, there was a 1.1% increase in shipments for the overall PCB industry in North America, according to IPC, the industry association based in Chicago ([www.ipc.org](http://www.ipc.org)). The major factor affecting the Company's revenue activity in 2008 was the strength of the Canadian dollar relative to the US dollar. From Q3 2007 through to Q3 2008 the US dollar versus the Canadian dollar exchange rate was close to or higher than parity. This affected the Company's ability to compete on contracts that were US dollar denominated. As a result, the Company atypically experienced bookings activity throughout the year that was inferior to the overall industry metrics (per IPC). In the final six months of 2008, Coretec's revenues were positively impacted by the appreciation of the US dollar versus the Canadian dollar. The US dollar versus the Canadian dollar exchange rate was very volatile during the latter part of 2008 and moved from approximately 1.06 as of September 30, 2008 to 1.22 by the end of 2008.

## **Recent Developments**

### *Restructuring*

The Company has initiated a reduced work schedule in the Toronto Operations. During Q1-2009 the Toronto Operations went from 80.5 hours per pay period to 69 hours per pay period. Annualized, the expected saving would be \$1.1 million. Subsequent to Q1-2009 salaried staff started a modified schedule working 9 days every pay period.

### *Bank Indebtedness*

On March 24, 2009, the Company entered into a new three year, \$10 million asset based lending ["ABL"] revolving credit line with Wells Fargo Canada to be used for day-to-day working capital and other expenditures. The covenants for this new facility include a requirement for the Company to achieve 75% of its forecasted "EBITDA" [earnings before interest, taxes, depreciation and amortization and foreign exchange gains or losses] on a quarterly basis as well as comply with certain administrative requirements. The amount of funding available under this line is based on 82% of eligible accounts receivable. The loan bears interest at prime plus 2.25% [currently 4.75% for US dollar line of credit and 5.5% for Canadian dollar line of credit], payable monthly. The initial proceeds from the Wells Fargo Canada loan were used to fully repay the outstanding Bank of Montreal loans and the new revolving credit line with Wells Fargo Canada will replace the Bank of Montreal's revolving credit facility.

At March 31, 2009 there were \$3.2 million in funds advanced [\$3.6 million – December 31, 2008] and no letters of credit had been issued against the revolving credit facility [nil – December 31, 2008]. Fund availability under the credit facility is calculated as eligible accounts receivable, less bank reserves and less the loan balance outstanding. Bank reserves are comprised of a general reserve and amounts deemed necessary by the bank to cover liabilities which take precedent. Fund availability at March 31, 2009 was \$4.7 million in addition to the \$3.2 million already borrowed.

As part of the credit facility Wells Fargo Canada (The Bank) holds a general security agreement on all of the Company's assets except for the Company's Toronto real estate, where it holds a second ranking charge behind the BDC.

#### Long Term Debt

In January 2009, the Company received two advances from BDC related to a financing agreement completed in 2008. The first advance was \$0.7 million against a \$3.0 million facility for infrastructure for the Sheppard facility of which \$2.0 million had been previously advanced in 2008. The second advance was US\$0.6 million [\$0.7 million] against a US\$3.0 million [\$3.8 million] facility for equipment of which US\$1.6 million [\$2.0 million] was previously advanced in 2008. In March 2009, the Company received \$0.3 million, its final advance against the \$3.0 million infrastructure facility.

Both BDC loans require a minimum consolidated working capital ratio for the Company of 1.2:1 and a long term debt/tangible equity ratio not to exceed 0.75:1. Both loans will be collateralized by the Sheppard land and building, and included the requirement for the guarantee of 25% of the loan balance by Coretec Holdings Inc, a wholly owned subsidiary.

Effective March 31, 2009, the Company has committed to pay a monthly standby fee on the undisbursed facility of 3% per annum.

#### *Toronto Consolidation Project*

During the first quarter the Company continued with its efforts to consolidate its two facilities in Toronto. In February 2009, the Company vacated five of the sixteen units at its Ellesmere facility which is anticipated to generate approximately \$180,000 in annual lease cost savings. The routing and final outer layer processes were moved to the Sheppard Facility during December and January which allowed the Company to vacate these units. Also during the first quarter the Company relocated its soldermask and ident processes to its Sheppard facility.

#### **Q1 2009 Business Highlights**

Sales for the quarter were \$20.2 million, representing an increase as compared to the Q1 2008 sales of \$18.5 million, and a decrease as compared to the fourth quarter of 2008 sales of \$22.8 million.

Gross margin in Q1 2009 was 9.8% of sales, an increase as compared to Q1 2008's gross margin of 9.2% of sales and a decrease as compared to Q4 2008 gross margin of 14.2%.

The Company recorded a loss from operations of \$0.7 million in Q1 2009 compared to a loss from operations of \$0.9 million in Q1 2008 and a profit from operations of \$0.3 million in Q4 2008.

The Company recorded a net loss of \$0.9 million or \$0.5 per share in Q1 2009 as compared to a net loss of \$1.0 million or \$0.06 per share in Q1 2008 and a net loss of \$0.5 million or \$0.03 per share for Q4 2008.

As at March 31, 2009, the Company had total working capital of \$6.5 million as compared to \$5.4 million at December 31, 2008.

Capital additions for Q1 2009 were \$0.6 million primarily related to the building of the infrastructure at the Sheppard facility, and some production equipment.

### Results of Consolidated Operations and Consolidated Losses

	Three months ended	
	March 31	
	2009	2008
	\$	\$
<b>Sales</b>	20,205	18,486
Cost of sales	18,220	16,790
<b>Gross profit</b>	1,985	1,696
<b>Expenses</b>		
Selling, general and administrative	2,699	2,579
Loss from operations	(714)	(883)
Interest and other expenses	236	200
Foreign exchange (gain) loss	64	(2)
Gain on disposal of property, plant and equipment	(130)	(32)
Income taxes	(884)	(1049)
Provisions for (recovery of ) income taxes	19	-
<b>Loss for the periods</b>	(903)	(1049)
Percentage loss	(4.6)%	(5.7)%

Consolidated revenues of \$20.2 million for the three month period ended March 31, 2009 increased by \$1.7 million or 9.2% as compared to \$18.5 million in the same period in 2008.

The increase is primarily due to the translation of U.S. dollar based sales to Canadian dollars, the Company's functional and reporting currency. Coretec generates approximately 80% of its revenues in U.S. dollars. The average \$U.S./\$CAD exchange rate for Q1 2009 was approximately 1.2430 as compared to approximately 1.004 for Q1 2008. Offsetting the increased sales related to foreign exchange was lower bookings experienced primarily in the Canadian operations in Q1 2009 due to the current economic conditions. The U.S. operations showed an increase in revenues over the same prior year period.

#### Revenues

#### Revenues by Geographic Segment in millions of dollars

	Q1 2009	% of Total	Q1 2008	% of Total	2009 vs. 2008	
United States	13.6	67	11.5	62	(18.0)%	United States
Canada	5.9	29	6.0	32	(1.6)%	Canada
Europe	0.7	4	1.0	6	(130.0)%	Europe
<b>Total</b>	<b>20.2</b>	<b>100</b>	<b>18.5</b>	<b>100</b>		

On a geographic segment basis, foreign exchange translation was a major contributor to the revenue increase, this was offset by decreased sales in Canada as compared to the prior year, on a consistent exchange rate basis.

### Revenue Percentage by Market Segment

	Q1 2009	Q1 2008
EMS	45%	48%
OEM	55%	52%
<b>Total</b>	<b>100%</b>	<b>100%</b>

Market segment sales fluctuated between EMS and OEM as compared to the prior year, but are within the range of management's expectations.

### Ten largest customers as a percentage of total revenue

	Q1 2009	Q1 2008	Change %
Ten largest customers	50%	41%	22.0%

Although the ranking of the top ten customers changed year over year, 7 of the top 10 customers remain the same. Revenue concentration of the top 10 customers increased by 22%.

### *Cost of Sales*

Cost of sales increased by \$1.4 million in Q1 2009 as compared to Q1 2008. The primary area of an increase relates to costs that vary with sales such as the materials used in making PCBs. In addition to the higher usage of materials, the Company purchases most of its materials in U.S. dollars, which cost more due to the weakening Canadian dollar over the prior year, although some of this cost was offset by decreased material prices. Materials represent approximately 30% of sales. During Q1 2009 the Company expensed \$0.1 million for severance costs. Severance costs included in cost of sales in Q1 2008 were \$0.2 million.

Depreciation and amortization is unchanged at \$1.1 million in Q1 2009 as compared to \$1.1 million in Q1 2008.

### *Gross Profit and Gross Margin*

The gross profit and gross margin for Q1 2009 was \$2.0 million and 9.8% respectively and is an increase of \$0.3 million and 17.6% as compared to the Q1 2008 result of \$1.7 million and 9.2%. The combination of increased revenues, primarily due to weakness of the Canadian dollar relative to the U.S. dollar and an element of fixed costs in cost of goods sold improved gross profit and gross margin in 2009.

### *Selling, General and Administrative ("SGA")*

SGA costs were \$2.7 million for Q1 2009, an increase of \$0.1 million as compared to Q1 2008. The primary reasons for the expenditure increase are related to the Canadian dollar versus US dollar exchange rate change, US denominated SG&A expenses, while lower in base currency, translated to a higher Canadian dollar amount on consolidation.

### *Interest and Other Expenses*

Interest and other expenses were slightly higher in Q1 2009 than in Q1 2008 due to the higher level of debt the Company is carrying in 2009.

### *Foreign Exchange*

During Q1 2009 the Company realized a \$0.1 million foreign exchange loss. As a result of the weakening of the Canadian dollar relative to the U.S. dollar, the Company had unrealized foreign exchanges gains offset by realized losses on forward contracts and write-off of bad debts. In Q1 2008 the Company realized a nil amount foreign exchange gain/loss as the Canadian dollar had little fluctuation relative to the U.S. dollar.

### *Gain on Disposal of Equipment*

A \$0.1 million gain was recorded in Q1 2009, on the sale of certain equipment deemed to be redundant at the Sheppard facility. In Q1 2008 a small gain was realized on the sale of certain equipment.

### *Net Loss and Loss per Share*

The Company recorded a net loss of \$0.1 million, or \$0.05 per share in Q1 2009, as compared to a net loss of \$1.0 million or \$0.06 per share in Q1 2008.

Because the Company reported a loss in each of the first quarters of 2009 and 2008 there is no impact of dilution by options on shares outstanding.

### **Summary of Financial Condition as at March 31, 2009 as compared to December 31, 2008**

	<b>March 31, 2009 \$</b>	<b>December 31, 2008 \$</b>
Current assets	<b>22,215</b>	<b>23,179</b>
Total assets	<b>54,037</b>	<b>55,448</b>
Current liabilities	<b>15,749</b>	<b>17,808</b>
Total liabilities	<b>27,453</b>	<b>27,998</b>
Total shareholders' equity	<b>26,584</b>	<b>27,450</b>
Total Liabilities and shareholders' equity	<b>54,037</b>	<b>55,448</b>

The financial condition of the Company is not materially different at March 31, 2009 as compared to its most recently completed financial year-end December 31, 2008.

## Capital Additions

Capital additions for Q1 2009 were \$0.6 million. Capital additions primarily related to the building of the infrastructure at the Sheppard facility, and some production equipment. Comparatively, capital additions in Q1 2008 were \$0.7 million related to the building of the infrastructure at the Sheppard facility.

## Liquidity and Capital Resources

At March 31, 2009 the Company's principal source of liquidity included cash of \$0.7 million trade accounts receivable of \$14.9 million, and \$4.7 million availability on its operating line of credit of \$10.0 million. Working capital was \$6.5 million at March 31, 2009.

Comparably, at December 31, 2008, the Company's principal source of liquidity included cash of \$1.1 million, trade accounts receivable of \$15.5 million, and \$3.9 million availability on its operating line of credit of \$8.0 million. Working capital was \$5.4 million at December 31, 2008.

The operating line of credit is collateralized by accounts receivable and a general security agreement against all of the Company's assets, except for the Company's Toronto real estate, where it ranks second behind BDC. The terms of the operating line of credit are based on 82% of eligible accounts receivable net of certain reserves. At March 31, 2009, the total general and other reserves totaled \$1.7 million, compared to \$3.8 million at December 31, 2008

### *Summary of Cash Flows*

The following table summarizes the Company's cash flows for the periods indicated

	Three months ended	
	March 31	
	2009	2008
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Income (loss) for the period		
From continuing operations	(903)	(1,049)
Non-cash items		
Depreciation	1,114	1,142
Stock-based compensation	26	23
Loss (gain) on disposal of equipment	(130)	(32)
Unrealized foreign exchange loss (gain)	(1,312)	377
Long-term incentive plan compensation	11	18
Amortization of deferred finance charges	35	5
Change in restricted Cash	297	-
Working capital	183	305
Cash provided by operating activities	(679)	789
Cash (used) provided in financing activities	784	(1,372)
Cash provided by (used in) investing activities	(572)	(705)
Effect of exchange rate changes on cash	7	44
Net increase (decrease) in cash during the period	(460)	(1,244)

### *Cash Provided by (Used in) Operating Activities*

Cash used in operating activities was \$0.7 million for Q1 2009 as compared to cash provided by operations of \$0.8 million for Q1 2008. The cash used in Q1 2009 primarily relates to an unrealized foreign exchange loss of \$1.3 million, offset by cash provided by changes in restricted cash and change in non-cash working capital where accounts payable used cash of \$2.6 million in the period offset by accounts receivable providing cash of \$2.8 million in Q1 2009. A significant portion of the decrease in both accounts receivable and accounts payable is due to both the Company and its vendors tightening credit and also the effect of unrealized foreign exchange on the U.S. dollar portions of both accounts.

### *Cash Used in / Provided by Financing Activities*

Cash provided by financing activities of \$0.8 million for Q1 2009 relates to advances of \$1.7 million from BDC on existing equipment and infrastructure facility's, offset by the repayment of \$0.5 million of long-term debt and the repayment of \$0.4 million of bank indebtedness. The 2008 amounts reflect the repayment of \$0.3 million of long-term debt and the repayment of \$1.1 million of bank indebtedness.

### *Cash Used in Investing Activities*

Cash used in investing activities in Q1 2009 relates primarily to expenditure of \$0.6 million which included the building of infrastructure at the Sheppard facility and the purchase of capital equipment. The Q1 2008 expenditure of \$0.7 million included the building of infrastructure at the Sheppard facility (\$0.2 million) and the purchase of capital equipment (\$0.5 million).

### *Financing Arrangements and Ratios*

Total interest bearing debt including bank indebtedness, was increased to \$16.5 million at March 31, 2009 as compared to \$15.4 million at December 31, 2008.

This increase relates to advances from BDC relating to equipment and infrastructure as described in the summary of cash flows section above. As at March 31, 2009 the Company's consolidated ratio of interest bearing debt to equity was 62%, compared to 56% at December 31, 2008. Without the inclusion of bank indebtedness in both periods the interest bearing debt to equity was 50% and 43.0% as at March 31, 2009 and December 31, 2008 respectively. The increase in the ratios relates primarily to advances from BDC as described above.

### *Interest Rate Exposure*

The Company's interest rate risk primarily arises from its floating rate debt in particular its revolving line of credit and BDC loans. At March 31, 2009, \$10.0 million of the Company's total debt, is subject to movements in floating interest rates [December 2008 - \$10.3 million].

## **Critical Accounting Policies and Estimates**

### *Changes in and Significant New Accounting Policies*

Note 1 to the Q1 2009 consolidated financial statements describes two new standards from the Canadian Institute of Chartered Accountants that the Company has adopted. There was no impact to the financial statements as a result of these changes, outside of additional disclosure in the notes to the consolidated financial statements.

Coretec's significant accounting policies are described in note 2 of the 2008 audited consolidated financial statements.

The preparation of the consolidated financial statements in conformity with Canadian Generally Accepted Accounting Principles ("GAAP") requires management to make estimates and assumptions that affect: the reported amounts of assets and liabilities; the disclosure of contingent assets and liabilities at the date of the consolidated financial statements; and the reported amounts of revenue and expenses in the reporting period. Management believes that the estimates and assumptions used in preparing its consolidated financial statements are reasonable and prudent; however, actual results could differ from those estimates.

The Company's accounting policies have been reviewed and discussed with the Company's Audit Committee.

### **Critical Accounting Estimates**

#### **As at March 31, 2009, the Company carried the following critical estimated reserves:**

Warranty reserve: \$.2 million. This reserve is estimated by using the Company's past historical experience with respect to the cost of warranties and applying a reserve based on a percentage of sales. The amount reserved on a percentage of sales bases is adjusted periodically by the Company based on changes in past experience or any evidence that would cause a material change in expected future experience.

Ellesmere refurbishment reserve: \$0.1 million. This reserve was estimated by using the Company's historical experience with respect to returning units at its Ellesmere facility to a condition deemed acceptable to the landlord.

Allowance for doubtful accounts: \$0.2 million. This amount has been determined by reviewing trade accounts receivable and assessing the likelihood of collecting the amounts. The actual collection of accounts receivable outstanding at March 31, 2009 may be better or worse than the amount included in the allowance for doubtful accounts.

Inventory reserves: \$0.6 million. This amount has been determined by applying a formula to raw materials where, if the raw material item has not been purchased during the last twelve months and the quantity on hand is greater than twenty-four months of consumption based on the consumption rate of the prior twelve month period.

## **Disclosure controls**

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”), on a timely basis so that appropriate decisions can be made regarding public disclosure. An evaluation of the effectiveness of the design and operation of the Company’s disclosure controls and procedures was conducted as of December 31, 2008 by and under the supervision of the Company’s management, including the CEO and the CFO. Based on this evaluation, the CEO and the CFO have concluded that the Company’s disclosure controls and procedures (as defined in Multilateral Instrument 52-109 - Certification of Disclosure in Issuers’ Annual and Interim Filings of the Canadian Securities Administrators) are effective to ensure that the information required to be disclosed in reports that the Company files or submits under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified in such legislation. Under the supervision of the CEO and CFO, the Company has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. This design evaluation included documentation activities, management inquiries and other reviews as deemed appropriate by management in consideration of the size and nature of the Company’s business. There were no changes in the Company’s internal controls over financial reporting during the most recent interim period that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

## **Internal control over financial reporting**

Management is responsible for certifying the design and effectiveness of the Company’s internal controls over financial reporting [“ICFR”]. Because of its inherent limitations, ICFR may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

In Q1-2009, management, including the Chief Executive Officer and Chief Financial Officer, carried out an assessment of the design and effectiveness of the Company’s ICFR and identified disclosable weaknesses, which are listed below as at March 31, 2009. The Company understands these weaknesses are considered to be common areas of deficiencies for many smaller listed companies in Canada. The Company does however review its quarterly financial results at a site level with the CEO and CFO, site personnel and senior accountants, and at a consolidated level with its Audit Committee and also consults with its external auditors at least on a quarterly basis regarding such matters. As a result, the Company believes its ICFR are effective and have not resulted in a misstatement to the financial statements despite the disclosable weaknesses.

### *Segregation of Duties*

Given limited staff, certain duties within the accounting and finance department, and the purchasing and receiving departments, cannot be properly segregated. Management has concluded based upon the employees involved and the control and review procedures in place, including executive management and the Audit Committee oversight, that the risks associated with such lack of segregation are not significant enough to justify the cost with adding employees to clearly segregate duties.

### *Controls over Information Technology and Information Systems*

Formal information systems security policies have not been developed and there are no offsite redundant data storage and servers. These deficiencies could potentially result in inappropriate or unauthorized transactions, there may also be difficulties to recover financial data in the case of the destruction of the Company's data systems. In 2009, the Company plans to formalize information systems security policies and investigate offsite redundant data storage.

### *Consistent Application of Corporate Policies and Procedures*

Corporate policies and procedures are not applied on a consistent and timely basis across all of the divisions of the Company. In fiscal 2009, the Company plans to continue to work towards consistent application of Company policies.

### *Complex and non-routine transactions*

As required, the Company records complex and non-routine transactions. These transactions can be technical in nature and require a higher level of understanding Canadian GAAP. To address this risk, the Company's Chief Executive Officer and Chief Financial Officer review the monthly, quarterly and annual financial statements with site personnel and senior accountants. In addition an annual audit is completed by the Company's auditors, and presented to the Audit Committee for its review and approval. At a future date, the Company may consider expanding the technical expertise of the accounting function. In the interim, the Company continues to train its accounting personnel and encourages ongoing education to improve their technical skills.

Subsequent to December 31, 2008, the Company continues to direct additional resources to assessing and improving the identified deficiencies and the overall control environment and governance processes within the Company, but has not made any material changes to its system of internal controls over financial reporting.

## **Risk Management**

The following are updates to certain risks and uncertainties described in the Company's MD&A for the year ended December 31, 2008, and should be read together with the Company's MD&A for the year ended December 31, 2008, which is available on SEDAR ([www.sedar.com](http://www.sedar.com)) or on Coretec's website at [www.coretec-inc.com](http://www.coretec-inc.com).

### *Exchange Rate Fluctuations*

The Company's business activities are conducted primarily in Canadian dollars and U.S. dollars for the Canadian operations and U.S. dollars for the U.S. operations.

The Company's Canadian operations generate sales with payment in both U.S. and Canadian dollars, and materials and equipment are purchased in both U.S. and Canadian dollars. The majority of its non-material costs (including payroll facilities' costs and costs of locally sourced supplies and inventory) are denominated in Canadian dollars. Approximately 81% of revenues of the Canadian operations and approximately 20% of its operating expenses are transacted in U.S. dollars. As a result, the Company may experience trading and translation gains or losses because of volatility in the exchange rate between the Canadian dollar and the U.S. dollar.

At March 31, 2009 the Company had outstanding foreign exchange forward contracts to sell US\$0.5 million at an exchange rate of \$1.0385 Canadian. The mark-to-market value at March 31, 2009 that is recorded in income is an unrealized loss of \$0.1. The Company does not purchase any derivative instruments for speculative purposes.

#### *Product Complexity and Product Defects*

The Company is still not fully optimized in its operations, thereby experiencing defects during manufacturing, resulting in scrapped or reworked product. Effects of this lack of production optimization may result in not meeting the customer's delivery expectations, delivering poor quality product to the customer and the potential loss of the customer.

#### *Plant Relocation*

Coretec is undertaking the consolidation of its Toronto manufacturing operations. There is meaningful risk associated with the consolidation particularly as it relates to costs of equipment and process relocation, Sheppard facility preparations, and refurbishment of Ellesmere premises as leased units are vacated. The Company may need to obtain additional long-term financing to complete the project and complete it on a timely basis. There can be no assurance that the Company will obtain financing or sufficient financing to complete this project.

#### *Cost Structure*

A significant portion of the Company's operating expenses are fixed in nature and expenditures on capacity, information systems, capital equipment, etc., are based, in part, on anticipated revenue for future periods. Decreases in demand for the Company's products can create an underutilization of the Company's capital assets and increases the relative component of the Company's fixed costs resulting in reduced gross margins. Fixed costs such as administrative, public company and selling expenses also have a large fixed cost component and the Company may not be able to reduce these costs sufficiently or quickly enough to respond to lower revenues in future periods. The Company continues to monitor the effectiveness and profitability of its operating facilities, each of which performs at varying levels of capacity and contribution.

#### **Quarterly Comparison**

	<b>Q2-07</b>	<b>Q3-07</b>	<b>Q4-07</b>	<b>Q1-08</b>	<b>Q2-08</b>	<b>Q3-08</b>	<b>Q4-08</b>	<b>Q1-09</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Continuing operations:								
Revenues	21,816	21,895	18,888	18,486	19,415	20,299	22,839	20,205
Income(loss) from operations	(129)	(260)	(882)	(883)	68	(487)	264	(714)
Income (loss)	(645)	(644)	(1,374)	(1,049)	(236)	(532)	(499)	(903)
Earnings (loss) per share								
Basic and Diluted	(0.03)	(0.03)	(0.07)	(0.06)	(0.01)	(0.03)	(0.03)	(0.05)

## **Additional Information**

### *Share Capital*

As of March 31, 2009, the Company had 18,021,807 common shares outstanding. As at March 31, 2009 the Company had 1,139,000 stock options outstanding, of which 512,325 were exercisable.

### *Public Securities Filings*

Other information about the Company, including the annual information form and other disclosure documents, reports, statements or other information that is filed with Canadian securities regulatory authorities can be accessed through SEDAR at ([www.sedar.com](http://www.sedar.com)).

### *Outlook*

The Company has experienced nine consecutive quarters of losses. Although sales were lower in Q1 2009 as compared to Q4 2008, the loss per share was \$0.05 in Q1 2009 as compared to a loss of \$0.03 in Q4 2008. The Company continues to actively augment and upgrade its sales force to drive more bookings and sales. The Company has undertaken staff hour reductions during Q1 2009 and due to synergies from the ongoing consolidation of the Ellesmere facility to the Sheppard facility has, for the most part, not replaced individuals that have left voluntarily. Based on these measures that the Company has taken and continues to take, including the consolidation of operations into the Sheppard facility, the Company is forecasting improvements in both sales and a reduction to its net loss.