



# **CORETEC INC.**

## **MANAGEMENT'S DISCUSSION & ANALYSIS ("MD&A") OF FINANCIAL CONDITION & RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009**

(dollar amounts in thousands of Canadian dollars unless  
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Canadian dollars)

**MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION &  
RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTH PERIODS  
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The following Management's Discussion and Analysis ("MD&A") of financial condition and results of operations of Coretec Inc. ("Coretec" or "the Company") for the three and nine-month periods ended September 30, 2009 is prepared as of November 9, 2009 and should be read in conjunction with the Company's consolidated financial statements and related notes for the three and nine month periods ended September 30, 2009.

The purpose of this 2009 third 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 SEDAR 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).

**FORWARD LOOKING INFORMATION**

Certain statements contained in this MD&A contain "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 well as in Section 9. herein.

**BASIS OF PRESENTATION**

The consolidated financial statements of the Company include the accounts of Coretec and its subsidiaries. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") on a going concern basis, which presumes the realization of assets and discharge of liabilities in the normal course of operation for the foreseeable future.

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**1. CORPORATE 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 sells to original equipment manufacturers ("OEM") and electronic manufacturing services ("EMS") companies across various end markets. The Company is however predominantly focused on end markets that are both technologically demanding and requiring rugged PCBs (a.k.a. high reliability), i.e. military/aerospace, medical and heavy industrial. The Company also focuses its sales and marketing efforts on demand that is time sensitive, i.e. engineering prototype and quick turn production ("QTA") PCBs.

The challenges in the North American PCB market include shortening electronic product life cycles, continuously advancing technology, just in time ordering practices, environmental sensitivity, the increasing significance of approvals (both customer specific and globally recognized), protectionism and trade restrictions, raw material inflation, skilled labour scarcity, availability of capital for investment in equipment and systems, as well as competitive pressures from offshore and domestic manufacturers.

The Company has deployed a number of strategies to differentiate itself from its domestic and offshore competitors. 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 and leadership; 5) achieved multiple sector specific and generic certifications; 6) developed a business model that provides customers with higher volume product fulfilment from lower cost regions; 7) taken steps to lower its fixed and variable cost structure to better match current production volumes; and 8) increased its focus on higher margin business.

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 Company believes that a continuous focus on lowering overhead, production, selling and administration costs are key to its future survival and prosperity. The Company believes, this, coupled with an ongoing focus on the above-noted niche markets, will position it to return to profitable growth.

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## **2. INDUSTRY CONDITIONS**

On October 30, 2009 the PCB industry's association (IPC) released the PCB shipments and bookings data for the North American market for the month of September. Rigid PCB shipments declined 15.9 percent and bookings were down 7.8 percent in the month relative to September 2008. Year to date, rigid PCB shipments were down 27.3 percent and bookings fell by 24.7 percent versus the first nine months of 2008. Rigid PCB shipments grew sequentially by 21.7 percent and rigid bookings increased 29.7 percent versus August 2009. The book-to-bill ratio (bookings ÷ shipments) for the North American rigid PCB industry in September 2009 was 1.09, representing the fifth consecutive month above parity. The continuing strong book-to-bill ratio and the sequential growth in bookings suggest that industry shipments in the fourth quarter will be on an upward trend.

## **3. RECENT DEVELOPMENTS**

### *Restructuring*

During the second quarter of 2009 and July of 2009 the Company initiated wide ranging restructuring efforts, both in operations and administration, to reduce cost and return to profitability. These efforts include the following actions:

- Continuing consolidation efforts among the Company's Toronto facilities
- Reducing direct and indirect labour hours through shift reductions and layoffs
- 10% pay cuts and wage reductions for indirect and salaried employees
- Reductions in benefits
- Discounts from suppliers
- Implementing energy conservation measures
- Tighter controls on maintenance functions
- Consolidation of IT functions
- Various cuts in selling, general and administration departments

These actions are expected to generate savings of approximately \$6.5 million annually.

The Company believes that these actions will enable it to return to profitability. However, the Company's ability to continue as a going concern is dependent on the Company's ability to return to positive cash flow and to comply with the covenants and other requirements of its lending institutions.

The restructuring plan resulted in a charge for severance expense of \$577 during the third quarter of 2009 and as at September 30, 2009 the Company has \$581 accrued for severance costs. The Company continues to analyze its staffing levels and believes additional redundancies are likely over the remainder of 2009.

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*TSX Listing Review*

On September 16, 2009 the TSX announced it is reviewing the common shares of the Corporation with respect to meeting the continued listing requirements. The Company has been granted 120 days in which to regain compliance with these requirements, pursuant to the Remedial Review Process. Coretec has begun the process of applying to list on an alternative exchange.

*Takeover bid*

On October 26, 2009 the Company received an unsolicited offer from DDi Corp. ("DDi") for \$0.20 per share. As a result of the publicly announced bid by DDi the Company has received a number of offers from potential purchasers. The Company's Board has formed a Special Committee to review these offers. The Board of Directors have not hired any agents and have not put the Company up for sale.

*Private Placement*

On October 22, 2009 the Company announced that it is proposing to complete a non-brokered private placement of up to 1,000 units of the Company, each Unit consisting of one convertible debenture of the Company in the principal amount of \$1 and 10,000 common share purchase warrants of the Company constituting, in aggregate, \$1,000 principal amount of Convertible Debentures and 10,000,000 Warrants, with the proceeds thereof to be used for general working capital purposes.

The Convertible Debentures will mature on the date that is three years following the closing date of the Private Placement. The rate of interest per annum payable on the outstanding Convertible Debentures will be 12.00% from the date of issue, payable semi-annually in arrears. The Company will satisfy the interest payments, in cash, or half (6.00%) in cash and half (6.00%) in common shares of the Company, where the share price will be based on the weighted average trading price for the 5 trading days prior to the date any such interest becomes due and payable, on December 31 and June 30 of each year, commencing December 31, 2009. The December 31, 2009 interest payment will represent accrued interest for the period from the Closing Date to but excluding December 31, 2009.

The Convertible Debentures will be convertible at the holder's option into common shares of the Company at any time prior to the Maturity Date, at a conversion price of \$0.10 per Common Share, being at a rate of 10,000 Common Shares per \$1 principal amount of Convertible Debentures, subject to standard anti-dilution provisions.

Each Warrant shall be exercisable for one Common Share at a price of \$0.13 per Common Share at any time prior to 5:00 p.m. (Toronto time) on the date that is three years following the Closing Date.

Pursuant to the Private Placement, up to an aggregate of: (i) 10,000,000 Common Shares are issuable upon conversion of the Convertible Debentures; (ii) 6,000,000 Common Shares are issuable to satisfy future interest payments on the Convertible Debentures; and (iii) 10,000,000 Common Shares are issuable upon exercise of the Warrants, representing approximately 144% of the issued and outstanding common shares of the Company, on a non-diluted basis, prior to issuance. A total of 18,021,807 Common Shares are currently issued and outstanding.

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The Private Placement is subject to the approval of the Toronto Stock Exchange and since the Private Placement will: (i) provide for the issuance to insiders of the Company of greater than 10% of the number of outstanding Common Shares; (ii) be deemed under the rules of the TSX to materially affect control of the Company; and (iii) provide for the issuance of greater than 25% of the currently outstanding Common Shares, the rules of the TSX require that the Company obtain approval of the Private Placement from the holders of a majority of the Common Shares, excluding the votes attached to the Common Shares held by the insiders of the Company who are subscribing to the Private Placement and their associates and affiliates. Such approval may be obtained in writing from shareholders without the requirement to convene a shareholders meeting for such purposes. However, the rules of the TSX also allow for exemptions to the shareholder approval requirement in certain circumstances.

It is expected that various insiders and other shareholders will participate in the Private Placement.

Due to the fact that Mr. Langston and/or Mr. Morrison are anticipated to subscribe for Units pursuant to the Private Placement, the Private Placement will be a "related party transaction" for the purposes of Multilateral Instrument 61-101 – Protection of Minority Security Holders in Special Transactions (MI 61-101). The Company will rely on the financial hardship exemption from the valuation and minority approval requirements of MI 61-101 contained in paragraph (g) of Section 5.5 and (e) of 5.7. Coretec has consulted with the independent directors in respect of the transaction and the board of directors, including each of the independent directors have determined that the transaction is designed to improve its financial position and the transaction is reasonable.

As a result of Coretec's review of recently received proposals from third parties with respect to a possible sale of Coretec, Coretec has requested and obtained from the TSX an extension to the closing date of its previously announced private placement of debentures and warrants to November 30, 2009.

*Revolving line of credit*

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 ("Wells Fargo") to be used for day-to-day working capital and other expenditures. Wells Fargo holds a general security agreement on all of the Company's assets except for the Company's buildings and real estate in Toronto, Denver and Cleveland, where it holds a second ranking charge behind the Business Development Bank of Canada ("BDC"), GE Capital and Zion's Bank, respectively. The covenants for this new facility included a requirement for the Company to achieve 75% of its forecasted "EBITDAFX" [earnings before interest, taxes, depreciation and amortization and foreign exchange gains or losses] on a quarterly basis as well as to comply with certain other covenants. The amount of funding available under the line is based on 82% of eligible accounts receivable. The revolver loan currently bears interest at the Canadian Prime Rate plus 5.25% [currently 7.50%], payable monthly. The initial proceeds from the Wells Fargo loan were used to repay the outstanding Bank of Montreal loans and the new revolving credit line with Wells Fargo replaces the Bank of Montreal's ("BMO") revolving credit facility.

At June 30, 2009 the Company was in default of the EBITDA and stop loss covenants for which it received a waiver from Wells Fargo on August 13, 2009.

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The waiver from Wells Fargo included the following amendments, among others, to the terms of the Wells Fargo Credit Agreement:

- Interest rate increased to the greater of Canadian or US Prime rate (as applicable) plus 5% or 7.25% per annum
- Minimum EBITDA covenants exclude normalizing adjustments for losses with respect to foreign exchange
- Revised EBITDA and Net Income covenants to reflect the Company's reforecast for 2009

At September 30, 2009 there was \$4.6 million outstanding on the revolving line of credit [\$3.6 million – December 31, 2008]. Funds availability under the revolving line of credit are 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 September 30, 2009 was \$1.9 million (in excess of the amount outstanding).

*Long Term Debt*

In January 2009, the Company made a \$0.7 million draw against the BDC facility for infrastructure. In March 2009, the Company drew an additional \$0.3 million, its final advance against the facility.

In January 2009, the Company made a US\$0.6 million [\$0.7 million CAD] draw against the US\$3.0 million facility [\$3.2 million CAD] for equipment. In August 2009, the Company made an additional draw of US\$0.8 million [\$0.8 million CAD] and the final draw of US\$0.1 million [\$0.1 million CAD] was made in October 2009.

The BDC loans require the Company to maintain a minimum consolidated working capital ratio of 1.2:1 and a long term debt/tangible equity ratio of 0.75:1. The Company was in default of the working capital covenant with BDC as at September 30, 2009, for which it received a waiver on November 9, 2009.

The BDC loans are collateralized by the Company's Toronto land and building, and include the requirement for the guarantee of 25% of the loan balance by Coretec Holdings Inc, a wholly owned subsidiary, which owns the shares of the Company's U.S. companies.

Effective March 31, 2009, the Company is contracted to pay a monthly standby fee on the undisbursed portion of the BDC US\$3 million facility at a rate of 3% per annum.

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*Toronto Consolidation Project*

During 2009 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. The routing and final outer layer processes were moved to the Sheppard Facility during December 2008 and January 2009, which allowed the Company to vacate these units. Also during the first quarter the Company relocated its soldermask, ident and inspection and test processes to its Sheppard facility. During the second quarter of 2009 the Company moved its primary imaging operation to its Sheppard facility. Furthermore the Company completed the transfer of its interlayer operations by the beginning of third quarter of 2009. By June 30, 2009 the company had exited half of the 60,000 square foot lease at the Ellesmere facility.

*Q3 2009 Business Overview*

Sales for the third quarter of 2009 were \$16.3 million, as compared to sales of \$20.3 million in the same quarter in 2008, a decrease of \$4.0 million or 20%.

Sales for the nine months ending September 30, 2009 were \$54.4 million, as compared to sales of \$58.2 million in the first nine months of 2008, a decrease of \$3.8 million or 7%.

Gross margin as percentage of sales was 8% in the third quarter of 2009, as compared to Q3 2008 gross margin of 12% of sales.

The Company recorded a net loss of \$2.0 million or \$0.11 per share in Q3 2009 as compared to a net loss of \$0.5 million or \$0.03 per share in Q3 2008.

The Company recorded a net loss of \$5.3 million in the nine month period ended September 30, 2009, as compared to a net loss of \$1.8 million for the same comparable period in 2008.

As at September 30, 2009, the Company had total working capital of \$2.0 million as compared to \$5.4 million at December 31, 2008.

Capital additions during Q3 2009 amounted to \$0.3 million, primarily related to infrastructure for the Company's consolidation project at the Toronto facility. The cost to complete these projects is estimated to range between \$0.5 million and \$1.0 million and is expected to be completed by April 2010 depending on the Company's available cash flow.

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**4. REVIEW OF FINANCIAL RESULTS**

**Results of Consolidated Operations for the three months ended September 30, 2009  
compared with 2008 (in thousands of dollars).**

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>Sales</b>	16,258	20,299	54,400	58,201
Cost of sales	14,972	17,861	49,940	51,484
<b>Gross profit</b>	1,286	2,438	4,460	6,717
<b>Expenses</b>				
Selling, general and administrative	2,772	2,925	8,247	8,019
Loss from operations, before the following:	(1,486)	(487)	(3,787)	(1,302)
Interest and other expenses, net	281	145	805	512
Foreign exchange (gain) loss	166	(58)	700	51
(Gain) loss on disposal of property, plant and equipment, net	13	(42)	(145)	(52)
Loss before income taxes	(1,946)	(532)	(5,147)	(1,813)
Income taxes	63	-	116	5
<b>Net loss for the period</b>	(2,009)	(532)	(5,263)	(1,818)
<b>Cumulative loss, beginning of period</b>	(37,587)	(33,304)	(34,333)	(32,018)
<b>Cumulative loss, end of period</b>	(39,596)	(33,836)	(39,596)	(33,836)
<b>Loss per share</b>				
Net loss per share, basic and diluted	(\$0.11)	(\$0.03)	(\$0.29)	(\$0.10)

*Revenues*

Consolidated revenues for the third quarter of 2009 were \$16.3 million, as compared to revenues of \$20.3 million in the same quarter in 2008, a decrease of \$4.0 million or 20%.

The decrease in revenues resulted primarily from a decrease in production volumes due to current economic conditions. Coretec generates approximately 75-90% of its revenues in U.S. dollars. The average USD/CAD exchange rate for Q3 2009 was approximately 1.10 as compared to approximately 1.04 for Q3 2008. Had the exchange rate remained constant between quarters, the decrease in revenues would have been approximately \$4.8 million or 24%. This compares to a PCB industry year over year revenue decline as at September 30, 2009, according to IPC, of approximately 27%.

Revenue Percentage by Market Segment

	Q3	Q3
	2009	2008
EMS	49%	49%
OEM	51%	51%
Total	100%	100%

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Ten largest customers as a percentage of total revenue

	Q3 2009	Q3 2008	Change %
Ten largest customers	43%	45%	(4)%

*Cost of Sales*

Costs of sales for the third quarter were \$15.0 million or \$2.9 million lower than the \$17.9 million reported during the same period in 2008. The decrease is directly attributable to reduced sales of \$4.0 million, partially offset by the fact that cost of sales as a percentage of sales increased from 88% in 2008 to 92% in 2009. As indicated above, in Q3 2009 production volumes dropped significantly from the same period in 2008.

Effective August 1, 2009 the Company implemented a significant reduction in workforce. As of September 30, 2009 the Company had 436 active employees, this compares to 548 active employees at June 30, 2009, a 20% reduction in work force. Of the reduction in employees there were approximately 90 on temporary layoff status at September 30, 2009. The 436 employees at September 30, 2009 compares to 581 employees at September 30, 2008, a reduction in work force year over year of 25%.

*Selling, General and Administrative ("SG&A")*

SG&A costs were \$2.8 million in Q3 2009 as compared to \$2.9 million for Q3 2008, a decrease of \$0.1 million. The decrease is primarily due to reduced bad debt expense of \$0.4 million, reduced salaries and wages, partially offset by severance expense of \$0.6 million (recorded in the third quarter of 2009). During Q3 2009 the Company took steps to reduce costs throughout the organization including 10% pay cuts and other reductions in benefits.

*Interest Expense*

Interest expense was \$0.3 million in three months ended September 30, 2009 as compared to \$0.1 million in the same period in 2008, resulting from generally higher debt levels due to funding the Toronto consolidation project and the need to fund operating losses.

*Foreign Exchange*

During Q3 2009 the Company realized a loss of \$0.2 million as compared to a gain of \$0.1 million in the same period in 2008. The FX loss resulted from strengthening of the CAD/USD exchange rates. The Company's subsidiaries are treated as integrated and all USD monetary items are translated to Canadian dollars through the income statement.

*Net Loss and Loss per Share*

The Company recorded a net loss in Q3 2009 of \$2.0 million, or \$0.11 per share as compared to a net loss of \$0.5 million in Q3 2008 or \$0.03 per share.

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**Results of Consolidated Operations for the nine months ended September 30, 2009  
compared with 2008**

*Revenues*

Consolidated revenues for the nine months ended September 2009 were \$54.4 million, as compared to revenues of \$58.2 million in the same period in 2008, a decrease of \$3.8 million or 7%.

The year-to-date decrease in revenues resulted primarily from a decrease in production volumes due to current economic conditions. Coretec generates approximately 75-90% of its revenues in U.S. dollars. The average USD/CAD exchange rate for the nine months ended September 2009 was approximately 1.17 as compared to approximately 1.02 for the same nine month period in 2008. Had the exchange rate remained constant between periods, the decrease in revenues would have been approximately \$10.0 million or 17%. The decrease in production volumes is primarily due to current economic conditions. This compares to a PCB industry year over year revenue decline as at September 30, 2009, according to IPC, of approximately 27%.

Revenue Percentage by Market Segment

	YTD September 2009	YTD September 2008
EMS	46%	49%
OEM	54%	51%
Total	100%	100%

*Cost of Sales*

During the nine month period ended September 30, 2009, costs of sales were \$49.9 million as compared to \$51.5 million during the same period in 2008, a decrease of \$1.6 million. The decrease is directly attributable to reduced sales of \$3.8 million partially offset by the fact that cost of sales as percentage of sales increased from 88% in 2008 to 92% in 2009. As indicated above, during the period, assuming an equivalent USD/CAD FX exchange rate, volumes dropped significantly. However, as a result of the consolidation project in Toronto and the resulting disruption in production activities, through June 2009 labour was maintained at equivalent levels to the 2008 period, while fewer panels were produced.

Effective August 1, 2009 the Company implemented a significant reduction in workforce. As of September 30, 2009 the Company had 436 active employees, this compares to 548 active employees at June 30, 2009, a 20% reduction in work force. Of the reduction in employees there were approximately 90 on temporary layoff status at September 30, 2009. The 436 employees at September 30, 2009 compares to 581 employees at September 30, 2008, a reduction in work force year over year of 25%.

In addition there were startup issues with respect to several new and/or transferred processes in Toronto which resulted in significant yield challenges and rework. This was partially offset by the benefit from a change in the estimate for valuing spares inventory at all sites.

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

SGA costs were \$8.2 million for the nine months ended September 2009 as compared to \$8.0 million for the same period in 2008, an increase of \$0.2 million. The primary reasons for the increase is due to increased severance expense of \$0.9 million, higher legal and accounting/audit fees resulting from inefficiencies in the Company's finance function, partially offset by reduced headcount and lower bad debt expense of \$0.5 million.

*Interest Expense*

Interest expense of \$0.8 million was incurred during the nine month period ended September 30, 2009 as compared to \$0.5 million during the same period in 2008, resulting from higher average debt balances and higher amortization of deferred financing fees from costs incurred to enter into the new Wells Fargo revolving facility. Wells Fargo began charging default interest on the outstanding balance on the revolving credit line of an additional 3% effective June 1, 2009. As part of the waiver provided by Wells Fargo in August 2009 the additional interest rate charged became permanent.

*Foreign Exchange*

During the nine month period ended September 30, 2009 the Company realized a \$0.7 million foreign exchange loss as compared to a \$0.1 million loss in the same period in 2008, an increased loss of \$ 0.6 million. This resulted from significant negative fluctuations in CAD/USD exchange rates. The Company's subsidiaries are treated as integrated and all USD monetary items are translated to Canadian dollars through the income statement.

*Gain on Disposal of Equipment*

A \$0.1 million gain was recorded in the nine month period ended September 30, 2009, on the sale of certain equipment deemed to be redundant at the Sheppard facility. A similar gain of \$0.1 million was also realized during the same period in 2008.

*Net Loss and Loss per Share*

The Company recorded a net loss of \$5.3 million, or \$0.29 per share in the nine month period ended September 2009, as compared to a net loss of \$1.8 million or \$0.10 per share in the same period in 2008.

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*Summary of Financial Condition as at September 30, 2009 as compared to December 31, 2008*

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	\$	\$
<b>ASSETS</b>		
<b>Total current assets</b>	16,723	23,179
Property, plant and equipment, net	30,893	32,122
Other assets	70	147
<b>TOTAL ASSETS</b>	<b>47,686</b>	<b>55,448</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Total current liabilities</b>	14,711	17,808
Long-term debt	10,725	10,190
<b>Total liabilities</b>	<b>25,436</b>	<b>27,998</b>
<b>Total shareholders' equity</b>	<b>22,250</b>	<b>27,450</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>47,686</b>	<b>55,448</b>

## 5. LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2009 the Company's principal source of liquidity included cash of \$0.4 million, accounts receivable of \$10.8 million, and \$1.9 million available on its operating line of credit. Working capital was \$2.0 million at September 30, 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. Working capital was \$5.4 million at December 31, 2008.

## 6. LIQUIDITY OUTLOOK

The Company had total working capital of \$2.0 million as at September 30, 2009 compared to \$5.4 million at December 31, 2008.

As at September 30, 2009 the Company was in violation of working capital covenant under its term debt facilities with BDC. The Company received a waiver with respect to this on November 9, 2009 (see Note 1 to the second quarter 2009 financial statements and Section 2. of this document, for further information).

Due to the downturn in the economy and slowing sales revenues as well as the negative impact of the strengthening Canadian dollar on its Canadian operations, the Company has been required to utilize much of its financing flexibility. As of November 9, 2009 the Company has approximately \$1.3 million of availability remaining on its revolving line of credit. If these conditions continue or worsen, the Company may not be able to meet its obligations as they become due. The Company has taken significant restructuring actions to reduce labour costs as well as SG&A costs and believes that this will result in improved financial performance.

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The Company currently projects, through careful management of working capital, it will maintain positive availability on its revolving line of credit through the end of 2009 and early 2010. Company management is currently reviewing all areas of expenditures, to reduce and/or defer cash requirements, thereby extending the funding horizon. Alternatively, it would be required to seek additional funding via a private placement or from the capital markets. In such an event, there can be no assurance that such funding would be available on terms acceptable to the Company.

*Summary of Cash Flows*

The following table summarizes the Company's cash flows for the three and nine month periods ended September 30, 2009 and 2008:

	Three months ended September 30,		Nine months ended September 30,	
	2009 \$	2008 \$	2009 \$	2008 \$
<b>OPERATING ACTIVITIES</b>				
Net loss for the period	(2,009)	(532)	(5,263)	(1,818)
<b>Cash provided(used) by operating activities</b>	165	686	(378)	1,442
<b>FINANCING ACTIVITIES</b>				
<b>Cash provided(used) by financing activities</b>	155	(291)	1,372	(179)
<b>INVESTING ACTIVITIES</b>				
<b>Cash used in investing activities</b>	(288)	(412)	(1,771)	(2,923)
Foreign exchange effect on cash	29	(199)	35	144
<b>Net increase (decrease) in cash during the period</b>	61	(216)	(742)	(1,516)
Cash, beginning of period	327	529	1,130	1,829
<b>Cash, end of period</b>	388	313	388	313

*Cash Provided by (Used in) Operating Activities*

Cash provided by operating activities was \$0.2 million for the three month period ended September 30, 2009 in comparison to \$0.7 million for the same period in 2008. The \$1.5 million higher net loss in 2009 was partially offset by a \$0.8 million improvement in the management of working capital.

In the nine months ended September 30, 2009 cash used in operating activities was \$0.4 million as compared to cash provided by operating activities of \$1.4 million for the same period in 2008. The increase in cash used of \$1.8 million primarily resulted from the additional loss of \$3.5 million incurred during 2009 as compared to 2008, partially offset by a \$1.4 million improvement in the management of working capital.

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*Cash Provided by Financing Activities*

Cash provided from financing activities during the third quarter amounted to \$0.2 million, related to a \$0.8 million advance from BDC, partially offset by a \$0.5 million repayment of long-term debt and \$0.2 million decrease in the Wells Fargo line of credit.

Cash provided by financing activities of \$1.4 million for the nine month period ended September 30, 2009 relates to an advance of \$2.5 million from BDC as well as a net \$0.9 million increase in advances on the revolving line of credit, offset by the repayment of \$1.8 million of long-term debt and payment of \$0.3 million in deferred finance fees.

*Cash Used in Investing Activities*

Cash used in investing activities for the third quarter 2009 amounted to \$0.3 million which relates primarily to expenditures for infrastructure at the Sheppard facility and the purchase of capital equipment. The Company spent \$0.4 million during the three month period ended September 30, 2008 related to infrastructure at Sheppard and on certain pieces of capital equipment.

For the nine months ended September 30, 2009 cash used in investing activities was \$1.8 million and related primarily to expenditures of \$2.0 million, which included the infrastructure at the Sheppard facility, and the purchase of capital equipment, offset by gain on disposal of certain fixed assets. In the nine month period ended September 2008 the Company spent \$4.3 million for infrastructure at Sheppard and on certain pieces of capital equipment.

*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 September 30, 2009, \$14.0 million of the Company's total debt, is subject to movements in floating interest rates [December 2008 - \$12.0 million].

## **7. CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

*New Accounting Policies*

Note 2 to the third quarter 2009 consolidated financial statements describes new standards issued by 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.

During the second quarter of 2009 the Company changed its estimate for valuing inventory spares included in finished goods inventory across all its sites to better reflect the sales of spares to its customers. This change in estimate resulted in an increase in income during the second quarter of 2009 of \$0.5 million.

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

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The preparation of the consolidated financial statements in conformity with 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.

## **8. CONTROLS AND PROCEDURES**

### *Internal control over financial reporting*

As part of its evaluation of the design of internal controls, and the testing of these controls, management identified control weaknesses with respect to documentation, safeguarding of assets, inventory costing, support of fixed asset subledgers, tax accounting and timely preparation of tax returns, segregation of duties, lack of reconciliations, lack of approvals, cut-off errors, and general controls and accounting knowledge and training. During the second and third quarters of 2009 the Company replaced several members of the Finance staff including the CFO, Controller and Accounting Manager. The Company will continue to improve the identified deficiencies and the overall control environment and governance processes within the Company. As a result of the reconciliations and review procedures performed, the Company does not believe these weaknesses had a material impact on the Company's financial reporting.

### *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 and backup support is minimal. These deficiencies could potentially result in inappropriate or unauthorized transactions. There may also be difficulties to recover financial data in the case of the loss or destruction of the Company's data systems.

## **9. RISKS AND UNCERTAINTIES**

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).

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*Exchange Rate Fluctuations*

The Company's business activities are conducted primarily in U.S. dollars and to lesser extent Canadian dollars.

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 costs and costs of locally sourced supplies and inventory) are denominated in Canadian dollars at its Canadian site. Approximately 70-90% 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.

*Product Complexity and Product Defects*

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

*Plant Relocation*

Coretec is undertaking the consolidation of its Toronto manufacturing operations. The Company has yet to relocate its multilayer lamination process and certain metal finishing processes. There is meaningful risk associated with the ongoing consolidation particularly as it relates to costs of equipment and process relocation, disruptions to its day to day operations, potential for reduced productivity and production yields, Sheppard facility preparations, and refurbishment of Ellesmere premises as leased units are vacated. Although the Company has completed the majority of the consolidation work it 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. 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.

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*Liquidity*

As a result of the economic environment the Company is experiencing a tightening of its working capital from lower sales and lower production volumes. The Company has taken action to reduce its cost structure; however the Company's ability to continue as a going concern is dependent on the Company's ability to return to profitable operations and to comply with the covenants and other requirements of its lending institutions. The financial statements do not reflect adjustments to the carrying value of assets and liabilities and the reported expenses and balance sheet classifications of assets and liabilities that would be necessary should the going concern assumption be inappropriate, and such adjustments could be material.

**10. SUMMARY OF QUARTERLY RESULTS**

	Q4-07 \$	Q1-08 \$	Q2-08 \$	Q3-08 \$	Q4-08 \$	Q1-09 \$	Q2-09 \$	Q3-09 \$
Revenues	18,888	18,486	19,415	20,299	22,839	20,205	17,937	16,258
Income (loss) from operations	(882)	(883)	68	(487)	264	(714)	(1,587)	(1,486)
Net loss	(1,374)	(1,049)	(237)	(532)	(499)	(903)	(2,351)	(2,009)
Loss per share								
Basic and Diluted	(0.07)	(0.06)	(0.01)	(0.03)	(0.03)	(0.05)	(0.13)	(0.11)

**11. ADDITIONAL INFORMATION**

*Share Capital*

As of September 30, 2009, the Company had 18,021,807 common shares outstanding. As at September 30, 2009 the Company had 1,382,500 stock options outstanding, of which 515,825 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)).