# LOREX TECHNOLOGY INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

**The following is Management's Discussion and Analysis ("MD&A") of the financial position of LOREX Technology Inc. ("LOREX" or the "Company") and the financial review for the three months ended December 31, 2009 and 2008. This discussion should be read in conjunction with the Audited Consolidated Financial Statements and related notes. All amounts are in U.S. dollars unless otherwise stated.**

CAUTIONARY STATEMENTS REGARDING FORWARD LOOKING STATEMENTS

This MD&A for the three months ended December 31, 2009 was completed on February 25, 2010 and contains notes and explanations of important events to this date.

Certain information contained in this report may contain statements that are forward-looking, such as statements relating to anticipated future revenues of the Company and the success of product offerings. Such forward-looking information involves important risks and uncertainties that could significantly affect anticipated results in the future, and accordingly, such results may differ materially from those expressed in any forward-looking statements made by or on behalf of the Company. These risks and uncertainties include without limitation, changes in competition, changes in technologies that impact products being developed and sold by the Company, changes in customer demand and, the availability of raw materials required to manufacture the Company's products. Any of these risks and uncertainties could cause actual results to vary materially from current results or the Company's currently anticipated future results. The Company wishes to caution readers not to place undue reliance on such forward-looking statements that speak only as of the date made.

# Management's Discussion and Analysis

## OVERVIEW AND HIGHLIGHTS

## OVERVIEW OF THE BUSINESS

LOREX Technology Inc. ('LOREX') (NEX:LOX.H) provides businesses and consumers with leading edge video surveillance security solutions and sells its products under the LOREX and Digimerge brands. The LOREX brand, which caters to both small business and consumer markets, is available in thousands of retail locations across North America and in the UK. The Digimerge division distributes its products through major distributors in North America. Both brands concentrate on the sale of wired, wireless and IP security surveillance equipment including cameras, digital video recorders and all-in-one systems.

LOREX subsidiaries include; LOREX Canada Inc., Digimerge Technologies Inc., LOREX Corporation and Strategic Vista Corporation Limited, Hong Kong.

## REPORTING CURRENCY

The Company uses the U.S. dollar as its reporting currency.

The Company and its subsidiaries that use the Canadian dollar as the functional currency translate all assets and liabilities to U.S. dollars at the period end exchange rate and all revenue and expense items are translated to U.S. dollars at an average rate of exchange for the period for reporting purposes. Exchange rate differences arising on translation are deferred as a separate component of shareholders' equity. The U.S. dollar is the functional currency of certain of the Companies' subsidiaries – Digimerge Technologies Inc., LOREX Corporation and Strategic Vista Corporation Limited. For other U.S. subsidiaries that are considered fully integrated foreign operations, non-Canadian dollar monetary assets and liabilities are translated into Canadian dollars at the rate of exchange prevailing as at the consolidated balance sheet dates, while non-monetary assets and liabilities are translated at historical rates of exchange. Revenues and expenses are translated into Canadian dollars at the rate in effect at the date of transaction. Realized and unrealized foreign exchange gains and losses are included in net earnings for the period in which they occur.

## Q1 2010 OVERVIEW

## GENERAL OVERVIEW

The first quarter of 2010 was the fourth consecutive profitable quarter. In the first quarter of 2009, the Company recorded a loss of approximately $144,000 which included a foreign exchange loss of approximately $399,000.

## PRIVATE PLACEMENT

On October 7th, 2009, the Company raised approximately $407,000 (approximately $434,000 CDN) for working capital needs by issuing 4,336,195 common shares at $0.09 ($0.10 CDN).

## REPLACEMENT OF BANK INDEBTEDNESS

On December 22nd, 2009, the Company obtained a $10 million credit facility with a new lender and used the proceeds from this facility to repay the existing $13 million and $2 million credit facilities which had been in default as at September 30th 2009 and up until repayment. The amount available for borrowing under the new facility is subject to covenants that would be met if the Company achieves its 2010 business plan.

## FINANCIAL PERFORMANCE

The Company's revenue for Q1 2010 was $10.5 million as compared to $10.6 million in Q1 2009. The $0.1 million decrease in revenue reflected a decline in International revenue as the Company curtailed those operations to focus on North American business.

Gross profit for Q1 2010 was $3.5 million (33.3% of revenues) as compared to $3.7 million (34.9% of revenues) in Q1 2009. The decrease was primarily the result of lower revenue and higher recorded inventory provisions.

Operating expenses for Q1 2010 were $3.3 million (31.4% of revenues) as compared to $3.8 million (35.8% of revenues) in Q1 2009. The prior year result included a loss on foreign exchange of $0.4 million.

Net profit for Q1 2010 was $0.1 million as compared to a net loss for Q1 2009 of $(0.1) million.

## QUARTERLY FINANCIAL RESULTS

(in thousands of dollars, except per share amounts)

| | ***2009*** | | | | ***2008*** | | | |
|---|---|---|---|---|---|---|---|---|
| For the quarters ending | Dec. 31 | Sept. 30 | June 30 | March 31 | Dec. 31 | Sept. 30 | June 30 | March 31 |
| Revenue | 10,499 | 11,798 | 12,796 | 11,590 | 10,626 | 11,096 | 10,217 | 12,625 |
| Earnings (loss) before interest, income taxes and amortization* | 465 | 710 | 528 | 387 | 96 | (112) | (1,061) | 434 |
| Earnings (loss) | 137 | 440 | 127 | 157 | (144) | (431) | (1,423) | 19 |
| Per share basis – basic | 0.00 | 0.02 | 0.00 | 0.01 | (0.01) | (0.02) | (0.05) | 0.00 |
| Per share basis - diluted | 0.00 | 0.01 | 0.00 | 0.01 | (0.01) | (0.02) | (0.05) | 0.00 |

****Earnings (loss) before interest, income taxes and amortization ("EBITDA") are not a measure of performance under Canadian GAAP. EBITDA should not be considered in isolation or as a substitute for Net Earnings nor as a measure of operating performance or profitability.***

Revenue for the trailing four quarters was $46.7 million, $2.1 million higher than for the preceding four quarters revenue of $44.6 million. The first quarter of 2010 was the fourth consecutive quarter of profit and the fifth consecutive quarter of positive EBITDA.

Further explanation of changes in revenue, gross margins and expenses are provided below in the comments on Consolidated Results of Operations.

## CONSOLIDATED RESULTS OF OPERATIONS

### Revenue

| ($000) | Three months ended December 31 2009 | 2008 |
|---|---|---|
| Revenue | 10,499 | 10,626 |
| Proportion of revenue from: | | |
| United States | 89% | 90% |
| Canada | 9% | 5% |
| Other | 2% | 5% |
| Proportion of revenue from top 5 customers | 43% | 52% |

**Q1 2010 compared to Q1 2009**

The slight quarter year over quarter year decline was the result of decreased International revenue which offset year over year growth in North American revenue. The Company as previously noted curtailed International operations in 2009 to focus on North American business and in an effort to reduce overheads and improve overall profitability.

### Gross Profit

| ($000) | Three months ended December 31 2009 | 2008 |
|---|---|---|
| Gross profit | 33.4% | 34.9% |

Cost of sales includes the cost of manufactured products based on freight on board (FOB) factory prices, inbound freight, duty, and provisions to record inventory at its net realizable value.

The Company outsources its manufacturing to third parties in South Korea, Taiwan, and China.

Gross profit in Q1 2010 was lower than Q1 2009 primarily as a result of higher inventory provisions recorded in recognition of an increasing rate of technological change in the industry and the Company's commitment to be the leader in innovation.

## Marketing, Selling and Operations Expenses

| ($000) | Three months ended December 31 2009 | 2008 |
|---|---|---|
| Marketing, selling and operations expenses | 2,246 | 2,283 |
| As a percentage of revenue | 21.4% | 21.5% |

The principal components of marketing and selling expenses are outbound freight and distribution costs associated with product shipments, warranty/repair service costs, and salary and commission expenses for both internal and external sales and support personnel. Other costs include sales display and detailing costs to ensure the Company's products are displayed to enhance revenues.

There was a slight decrease in marketing and selling expense in Q1 2010 from Q1 2009. In the prior year period, marketing, selling and operations expenses included provisions for bad debt of approximately $196,000 as the Company made allowances for certain International accounts. Excluding these amounts, marketing, selling and operations expenses increased in the current year period resulting from technical and other support costs incurred reflecting the Company's commitment to industry leading service. Management is considering alternative approaches to providing continuing high level support at lower overall cost.

## Administration Expenses

| ($000) | Three months ended December 31 2009 | 2008 |
|---|---|---|
| Administration expense | 602 | 687 |
| As a percentage of revenue | 5.7% | 6.5% |

The main components of administrative expenses are wages and benefits, professional fees, general and office expenses and costs associated with the public company reporting requirements.

Current year first quarter administration expense includes a reversal of stock based compensation expense of approximately $110,000 related to forfeited unvested stock options.

## Research and Development Expenses

| ($000) | Three months ended December 31 2009 | 2008 |
|---|---|---|
| Research and development | 226 | 213 |
| As a percentage of revenue | 2.2% | 2.0% |

Research and development expenses include the wages and benefits paid to individuals in the Company's product development group, sub-contractors and the amortization costs associated with capitalized tooling and product design costs.

Research and development expenses increased slightly in Q1 2010 from Q1 2009 primarily as a result of higher wages.

## Interest Expense

| ($000) | Three months ended December 31 2009 | 2008 |
|---|---|---|
| Interest expense | 165 | 159 |

The current year first quarter results include the expensing of costs that had been previously deferred, related to the loan facilities repaid in the quarter.

## Amortization of Capital Assets

| ($000) | Three months ended December 31 2009 | 2008 |
|---|---|---|
| Amortization of capital assets | 55 | 80 |

The primary capital assets of the Company subject to amortization are: furnishings and equipment, computer hardware and software, leasehold improvements and tooling.

During Q1 2010, the Company purchased approximately $6,000 of capital assets (Q1 2009 - $33,000).

## Loss (gain) on foreign exchange

| ($000) | Three months ended December 31 2009 | 2008 |
|---|---|---|
| Loss (gain) on foreign exchange | (30) | 399 |

In Q1 2010, the Company recognized a foreign exchange gain due to the impact of the strengthening of the Canadian dollar relative to the U.S. dollar on its U.S. denominated liabilities recorded in its Canadian subsidiaries. In Q1 2009, the Company recognized a foreign exchange loss due to the weakening of the Canadian dollar relative to the U.S. dollar.

## Income Taxes

| | Three months ended December 31 2009 | 2008 |
|---|---|---|
| Income tax rate | 44.1% | 0% |

The effective tax rate for Q1 2010 was 44.1%, which differs from the amount that would have been computed by applying the combined federal and provincial statutory income tax rate of 33.13%.

During the first quarter of 2010, certain subsidiaries became taxable while other subsidiaries had losses which were subject to valuation allowances. Certain Corporate reorganizations are being contemplated which are expected to improve future tax efficiencies.

## LIQUIDITY AND CAPITAL RESOURCES

In Q1 2010, cash increased by approximately $1,109,000 as the Company temporarily increased its cash during its transition to the new loan facility. The Company's policy is to transfer excess cash to reduce its loans outstanding.

As at September 30th, 2009, the Company was in default of its loan agreement and, on December 22nd, 2009, the Company replaced its $13 million and $2 million loan facilities with a $10 million facility from a new lender. Proceeds from the new facility were used to repay the loans. The new facility includes revolving credit loans bearing interest at U.S. floating Base Rate plus 1.75% for loan balances denominated in U.S. dollars, and at Canadian floating Prime Rate plus 1.75% for loan balances denominated in Canadian dollars. The credit line is secured by the accounts receivable and inventory of three of the Company's subsidiary's – LOREX Corporation, LOREX Canada Inc. and Digimerge Technologies Inc. The amount available under the facility is subject to a financial ratio as defined under the agreement.

In relation to credit facilities entered into during fiscal 2007, the Company issued 500,000 warrants at a strike price of Cdn. $0.3025 to the lender. The fair value of the warrants was recorded to contributed surplus. As a result of a replacement of the facility on December 22, 2009, the warrants expired on January 21, 2010.

### Working Capital

Accounts Receivable

The Company's accounts receivable balance decreased by $2.3 million from $6.8 million at September 30, 2009, to $4.5 million at December 31, 2009 due primarily to the timing of shipments and collections.

Inventory

The Company's inventory balance decreased by $0.6 million from $8.6 million at September 30, 2009 to $8.0 million at December 31, 2009. The decrease was primarily the result of timing differences in purchases from suppliers.

Accounts Payable and Accrued Liabilities

The Company's accounts payable and accrued liabilities decreased by $0.6 million from $6.0 million at September 30, 2009 to $5.4 million at December 31, 2009, primarily as a result of timing differences in both purchases and payments to suppliers and non recurring accruals such as the $260,000 loan prepayment fee included in the September 30, 2009 accruals which related to the old credit facilities.

## Capital and Intangible Assets and Expenditures

Capital and intangible assets, net of accumulated amortization, decreased by approximately $40,000 from approximately $374,000 at September 30, 2009 to approximately $334,000 at December 31, 2009. Capital asset purchases were approximately $6,000. No additions to intangible assets were made.

## Capital Stock and Dividends

As at December 31, 2009, the Company had 31,290,278 common shares outstanding, 150,000 Class B preferred shares and 12,500,000 convertible preferred shares. On October 7, 2009, the Company issued 4,336,195 common shares in exchange for approximately $407,000 (approximately $434,000 CDN) in gross proceeds that were used for working capital requirements. The Company has not declared any dividends on its common shares over the past three fiscal years and does not plan to declare or pay any dividends on its common or preferred shares in the next twelve months.

The Company issued no new stock options in Q1 2010 (Q1 2009 – nil). 1.35 million options were forfeited during Q1 2010 (Q1 2009 – nil).

## RELATED PARTY TRANSACTIONS

Amounts recorded for rent with a party related through the estate of a late director, which held an equity interest subject to a voting trust having significant influence over the shares of the Company were nil (Q1 2009 - $13,886). In addition, the Company incurred approximately $80,000 (Q1 2009 – nil) in legal fees from a law firm in which one of the directors is a partner, and approximately $50,000 (Q1 2009 – nil) in advisory fees from a company in which one of the directors is an owner.

Related party transactions have been recorded at the exchange amount, which is the amount of consideration established and agreed by the related parties.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). Significant accounting policies and methods used in the preparation of the financial statements are described in note 1 to the Company's 2009 year end Audited Consolidated Financial Statements. Certain of the policies are more significant than others and are therefore considered critical accounting policies. Accounting policies are considered critical if they rely on a substantial amount of judgment in their application or if they result from a choice between accounting alternatives and that choice has a material impact on reported results or financial position. The policies identified as critical to the Company are discussed below.

### Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. The Company evaluates its estimates and assumptions on a regular basis, based on historical experience and other relevant factors. Significant estimates are used in determining, but are not limited to, the allowance for doubtful accounts; provision for returns; inventory valuation; income tax valuation allowances; the useful lives and valuation of capital and intangible assets; goodwill and product development; and the fair value of the reporting unit for the purpose of the goodwill impairment test. Actual results could differ materially from those estimates.

### Revenue recognition

The Company earns all of its revenue from the sale of products to its customers. Revenue is recognized when title passes to customers, generally at the time goods are received by the customer, and when there is reasonable assurance of the consideration that will be received, taking into account the extent to which goods may be returned. Cash discounts, volume discounts and certain marketing programs provided to customers are deducted from revenue when earned.

## Inventory

Inventory is valued at the lower of cost and net realizable value. The Company performs a quarterly assessment of its inventory value, taking into consideration factors such as inventory reliability, future demand for the inventory, expected new product introductions, competitive pressures and numerous other factors. A change to these assumptions could impact the valuation of inventory and have a resulting impact on margins.

## Goodwill

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on their fair values. The amount of goodwill disclosed on the consolidated balance sheet changed during the year due to foreign exchange.

Goodwill is not amortized and is tested for impairment annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of a reporting unit exceeds its fair value, in which case, the implied fair value of a reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as the value of goodwill, is determined in a business combination, using the fair value of the reporting unit as if it was the purchase price. When the carrying amount of reporting unit goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess and is presented as a separate line in the statement of operations and comprehensive income. The Company conducted its annual goodwill assessment in the fourth quarter of fiscal 2009 and fiscal 2008 and concluded there was no impairment in the recorded value of the goodwill.

### Income taxes

The Company provides for income taxes using the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between financial statement values and tax values of assets and liabilities and are measured using substantively enacted income tax rates and laws expected to be in effect when the differences are expected to reverse. The Company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

## CHANGE IN ACCOUNTING POLICIES

Goodwill and Intangible Assets

In February 2008, the Canadian Institute of Chartered Accountants issued Handbook Section 3064, Goodwill and Intangible Assets ("Section 3064"). Section 3064 states that upon their initial identification, intangible assets are to be recognized as assets only if they meet the definition of an intangible asset and the recognition criteria. This section also provides further information on the recognition of internally generated intangible assets, including research and development costs. As for subsequent measurement of intangible assets, goodwill, and disclosure, Section 3064 carries forward the requirements of the old Handbook Section 3062, Goodwill and Other Intangible Assets. The new section was effective on October 1, 2008, however, the Company determined that this section did not impact the consolidated financial statements.

Credit Risk and Fair Values of Financial Assets and Liabilities

In January 2009, the CICA issued Emerging Issues Committee ("EIC") Abstract No. 173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. The EIC provides guidance on evaluating credit risk of an entity and counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments. The application of this EIC had no effect on the Company's consolidated financial statements.

## RECENT ACCOUNTING PRONOUNCEMENTS

Convergence to International Financial Reporting Standards ("IFRS")

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. The AcSB has recently confirmed that accounting standards in Canada for public companies are to converge with IFRS effective for fiscal periods beginning on or after January 1, 2011. The Company has assembled an IFRS transition team which has started to assess the impact of the convergence of Canadian GAAP and IFRS, and will implement the new IFRS standards.

Consolidated Financial Statements

In January 2009, the CICA issued Handbook Section 1601, Consolidated Financial Statements, which replaces the existing standards. This section establishes the standards for preparing consolidated financial statements and is effective for 2011. Earlier adoption is permitted. Management is currently evaluating the impact of adopting this standard on the Company's consolidated financial statements.

Financial Instruments – Disclosures

In June 2009, the CICA amended Handbook Section 3862, Financial Instruments – Disclosures, to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair value of financial assets and financial liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than the quoted prices for which all significant inputs are based on observable market data, either directly or indirectly. Level 3 valuations are based on inputs that are not based on observable market data. This amended standard is effective for annual financial statements relating to fiscal years ending after September 30, 2009. Management is currently evaluating the impact of adopting this standard on the Company's consolidated financial statements.

## RISK FACTORS

The risks and uncertainties described below are not the only risk factors affecting the Company. Additional risks and uncertainties not presently known to the Company or that are currently deemed immaterial also may impair the Company's business operations. If any of the following risks actually occur, the business, results of operations and financial condition of the Company could be materially and adversely affected.

### Credit risk

Credit risk arises from the possibility that certain parties will be unable to discharge their obligations. The Company routinely assesses the financial strength of its customers and mitigates against identified exposure primarily by lowering credit limits and/or reducing or ending business activity with high risk accounts.

### Customer concentration risk

The Company is dependent on a few customers for the majority of its product sales. In Q1 2010, ten customers accounted for approximately 60% of total sales (Q1 2009 – 71%. Management continues to add to its customer base in order to reduce its customer concentration risk. If any significant customer discontinues its relationship with the Company for any reason, or significantly reduces expected purchase commitments for the Company's products, the business prospects and corresponding financial condition could be materially adversely affected.

### Foreign exchange risk

Varying portions of the Company's Canadian subsidiaries' sales, purchases, operating costs and borrowings are denominated in Canadian dollars. This results in cash, accounts receivable, accounts payable and accrued liabilities balances being denominated in Canadian dollars. Changes in the value of the Canadian dollar versus the U.S dollar impacts the financial results reported by the Company.

The Company translates its Canadian subsidiaries' balance sheet at the period end rate. A 10 percent change in exchange rate of the Canadian dollar against the U.S. dollar as per below at December 31, 2009 would have increased equity and net income by the amount shown below. This analysis assumes that all other variables remain constant.

| | Net income | |
|---|---|---|
| | 10% Strengthening | 10% Weakening |
| Three months ended December 31, 2009 | $54,361 | ($54,361) |

The Company generates approximately 89% of its revenues in U.S. dollars and product purchases are transacted in U.S. dollars. As a result, the Company reports its financial results in U.S. dollars. However, certain expenses incurred by the Company, primarily salaries to Canadian employees and other operating costs, are paid in Canadian dollars, and these exceeded Canadian denominated revenues in the first quarter of 2010 and 2009. Changes in the value of the Canadian dollar versus the U.S. dollar impacts the financial results reported by the Company. A weakening of the U.S. dollar against the Canadian dollar would thus result in a relative increase in the cost of Canadian denominated net expenditures.

The Company does not currently use any financial instruments to hedge against currency risk, but may do so in the future.

Liquidity risk

In maintaining a sufficient liquidity level, the Company manages timely accounts receivable collection and inventory turnover to facilitate cash flows and to sustain excess availability. In an environment of economic uncertainty, the Company is subject to an increased risk of customer payment defaults or more delayed customer payment patterns which could result in a reduced borrowing base and lower availability from its lender. The Company actively assesses the creditworthiness of its customers and adjusts credit limits where it considers appropriate. In some cases, this may limit the level of shipments the Company will make to a customer, which would also contribute to reduced cash flow and availability due to lower revenue.

The future minimum operating lease commitments and contractual repayments on bank loans for the next two years are as follows:

| For the twelve months ending December 31 | 2010 | 2011 |
|---|---|---|
| Credit facility | $ 4,418,047 | $ – |
| Accounts payable and accrued liabilities | As due | – |
| Lease commitments | 292,768 | 263,696 |

Interest rate risk

The Company is exposed to interest rate risks arising from the $10,000,000 revolving credit facility that bears interest at U.S. Floating base rate plus 1.75%. Unfavourable changes in the applicable interest rate may result in an increase in interest expense. The Company does not use derivative instruments to reduce its exposure to interest rate risk.

As at December 31, 2009, the Company had approximately $4,418,000 outstanding under the revolving credit facility.

Cash flow sensitivity analysis on variable credit facilities

| | NET INCOME | |
|---|---|---|
| | 100 bp increase | 100 bp decrease |
| 3 months ending December 31, 2009 | $ (11,136) | $ 11,136 |

## Financing Risks

As at September 30th, 2009, the Company's credit facility was in default, and on December 22, 2009 the Company repaid this facility and entered into a new facility with a new lender. The new facility is subject to covenants including a quarterly fixed charge ratio covenant. The Company met this covenant in the first quarter of 2010 and expects to meet this covenant in each of the remaining 2010 quarters on the basis of its current forecast. In addition, the Company's borrowings are limited to a borrowing base amount that is calculated using the accounts receivable of its North American operating companies and the inventory of LOREX Corporation. The borrowing base is subject to certain reserves and limitations. The Company expects to have sufficient availability in 2010 on the basis of its current borrowing base formula, although there is a risk that changes to the borrowing base formula or lower than forecasted results would limit the Company's ability to fund operations. The Company raised $1.1 million ($1.25 million CDN) during 2009 by issuing 12,500,000 preference share receipts and approximately $407,000 (approximately $434,000 CDN) in Q1 2010 by issuing 4,336,195 common shares which lowered outstanding loan balances in support of working capital requirements.

## Business Risks

Although the market for the Company's products is expanding, its ability to remain competitive is dependent upon assessing changing markets and providing new products and functionality. The Company believes that its future success depends upon its ability to enhance current products and develop and introduce new product offerings with enhanced performance and functionality at competitive prices. While there can be no assurances that the Company will be able to develop new products to meet changes in the marketplace or that the sale of such new products will be profitable, the Company pays close attention to and anticipates changes in the market. Sales Management meets regularly with its customers to identify current and anticipated end-user requirements.

## Supplier and Customer Risks

The Company purchases its products from a number of select manufacturers in the Far East. The Company relies on these sources for product development, product reliability, timely delivery and future product warranty support. If a supplier were to discontinue, restrict the supply or interrupt servicing repairs, the Company would attempt to replace the supplier in a timely manner. If it could not do so, the Company's business may be harmed by the resulting product manufacturing and delivery delays. In addition, the failure of the Company's products to perform to customer/consumer expectations could give rise to product warranty claims and/or returns. To minimize this production risk, the Company contracts with a number of sources to perform its manufacturing requirements and performs quality assurance testing in the Far East and in North America. In addition to these risks, the Company relies on its customers honouring their purchase orders. Should a customer fail to honour its order, the Company would be required to sell its overstock to different customers. To mitigate this risk, the Company sources product that can be sold to different customers in a variety of channels.

## Competitor and Industry Risks

The Company expects that additional competition may develop from existing surveillance/security companies and from new entrants as demand for product expands and the market for these products becomes more established. Certain of the Company's competitors have greater financial resources than the Company and may be able to sustain recurring losses to establish market share at the Company's expense. Competition may force price reductions affecting gross margins. The Company must continue to innovate with newer technology to maintain and expand its customer base. The demand for security solutions by small business in a challenging economic environment may affect the revenues of the Company.

Reliance on Key Employees and Third Party Relationships

The Company's ability to develop and sell its products will depend, to a great extent, on its ability to attract and retain highly qualified personnel and to develop and maintain third party relationships for assistance in the conduct of research efforts, product development and manufacturing and sales support. Competition for such personnel and relationships is intense. The Company is highly dependent on the principal members of its management staff as well as its third party relationships, the loss of whose services might impede the achievement of development objectives. The persons working with the Company are affected by a number of influences outside of the control of the Company. The loss of key employees and/or key collaborators may affect the speed and success of product development. Although the Company believes that its collaborative partners will have an economic motivation to commercialize the Company's product included in any collaborative agreement, the amount and timing of resources diverted to these activities generally is expected to be controlled by the third party.

Patents and Technology Risk

The Company has risk related to infringing the rights of third parties including patents. The Company may be required to obtain indemnities from third parties or licenses under patents or other proprietary rights of third parties. No assurance can be given that any indemnities or licenses required under such patents or proprietary rights will be available on terms acceptable to the Company. If the Company does not obtain such indemnities or licenses, it could encounter delays in introducing one or more of its products to the market while it attempts to design around such patents, or could find that the development, manufacture or sale of products requiring such licenses could be foreclosed. In addition, the Company could incur substantial costs in defending itself in claims brought against the Company on such patents.

In addition, while the Company is actively involved in the design and development of innovative products. There is a risk that others will develop products featuring technologies which may undermine the Company's offerings which could delay or reduce sales opportunities.

## DERIVATIVE INSTRUMENTS AND OFF-BALANCE SHEET ARRANGEMENTS

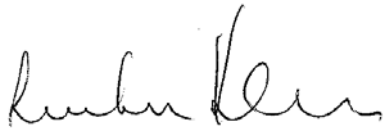
As at December 31, 2009, the Company was not party to any derivative instruments or off-balance sheet arrangements.

## OUTLOOK

The Company's current projections indicate profitability for the full fiscal year in 2010. The timing of new product introductions is expected to occur later in 2010 than in the prior year, which is expected to result in a decline in year over year second quarter revenue.

## ADDITIONAL INFORMATION

Further information on the Company, including its Annual Information Form, is available on SEDAR at www.sedar.com.



Reuben Klein
Chief Executive Officer

Jordan Schwartz
Chief Financial Officer

February 25, 2010