

# Management Discussion & Analysis

**2010/2011**

Edmonton – 15 November 2010.

## Forward-looking Statements

Certain statements in this report may be deemed to be forward-looking statements within the meaning of the federal and provincial securities laws. Although management believes the expectations reflected in these forward-looking statements are based on reasonable assumptions, forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause actual results and performance of the Company to be materially different from any future results and performance expressed or implied by such forward-looking statements. Among these risks and uncertainties are:

- changes in the markets in general economic conditions;
- the extent, duration and strength of any economic recovery in the markets in which the company operates;
- changes in the Oil & Gas drilling market;
- the cost and availability of debt and equity financing;
- our ability to realize anticipated cost savings from our internal initiatives and to otherwise create and capture benefits of scale;
- our ability to obtain at reasonable cost, adequate insurance for catastrophic events, such as earthquakes, hurricanes and terrorist acts;
- changes in interest rates;
- other risks and uncertainties.

The forward looking statements should not be read as guarantees of future performance or results, and no assurance can be given that the expectations will be realized. The Company assumes no obligation to update or supplement forward-looking statements that become untrue because of subsequent events. Without limiting the foregoing, the words “believe”, “expect”, “anticipate”, “intend”, “estimate”, “plan” and similar expressions identify forward-looking statements.

## The Business

Estec Systems Corp. is a holding company that owns Allan R. Nelson Engineering (1997) Inc. Allan R. Nelson provides design engineering & forensic engineering services to the oil and gas, mining, manufacturing, transportation and forestry industries. The largest part of Allan R. Nelson’s business is design of masts and drilling structures to API 4F (American Petroleum Institute 4F Specification for Drilling and Well Servicing Structures).

## Summary of activities

The first quarter of this fiscal year sees the company returning to a break-even operation. Sales are up about 15% over the previous quarter, although they are still down 20% from last year. The first quarter last year still reflected our pre-recession sales levels. While we expect things to continue to improve over the balance of the year, December tends to be a short month and will probably drag down the next quarter.

While expenses in most categories are down from first quarter last year, advertising and promotion is significantly up as we start recruiting engineers for the economic recovery. Supplies and maintenance costs

are up a bit from last year, reflecting a continuing upgrade of computer systems. Bank and Interest charges are up from last year, reflecting a higher usage of our line of credit.

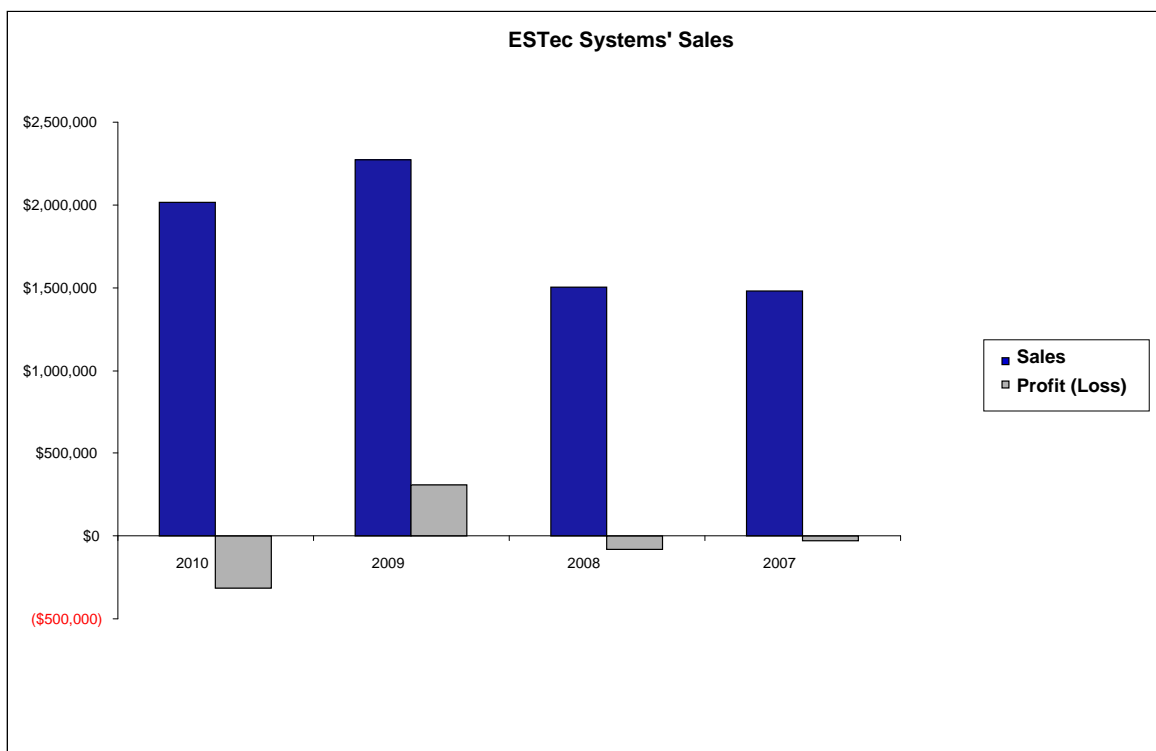
On the mergers and acquisitions front we continue to work with a couple of takeover targets to complete the due diligence. If we are able to move on one or more of these we will be issuing press releases. To get onto the press release distribution list contact [investor@estec.com](mailto:investor@estec.com).

### Selected Annual Information

	Year ended June 30, 2010	Year ended June 30, 2009	Year ended June 30, 2008	Year ended June 30, 2007
<b>Total Revenues</b>	2,013,985	2,274,494	1,501,239	1,481,851
<b>Income/(loss) before discontinued operations and extraordinary items</b>	(313,211)	312,330	(77,992)	(28,047)
<b>Basic income/(loss) per share</b>	(0.03)	.03	(0.01)	(0.003)
<b>Diluted income/(loss) per share</b>	(0.03)	.03	(0.01)	(0.003)
<b>Net income/(loss)</b>	(313,211)	312,330	(77,992)	(28,047)
<b>Basic income/(loss) per share</b>	(0.03)	.03	(0.01)	(0.003)
<b>Diluted income/(loss) per share</b>	(0.03)	.03	(0.01)	(0.003)
<b>Total Assets</b>	756,475	834,749	717,839	537,409
<b>Total long-term financial liabilities</b>	381,981	365,000	373,968	326,907

The end of the 2007 fiscal year and the beginning of the 2008 fiscal year, the Oil & Gas drilling sector went through a major pull back. The Oil companies radically reduced the drilling activity in an attempt to force the drilling contractors to reduce prices. This had an effect on our business which is dependant to a large extent on the activity in the Oil & Gas drilling sector. While activity in the Oil & Gas drilling sector has not significantly increased, toward the end of the 2008 fiscal year and the beginning of the 2009 fiscal year, investment in new drilling rig designs has returned to near normal levels. This pullback is a normal part of the business cycle for the Oil & Gas drilling sector.

Sales in the 2009 fiscal year have been significantly improved by changes we made in the sales/marketing department. In the 2010 fiscal year we were hit by the on-going economic slowdown. Our workload dropped significantly and that was compounded by the loss of our engineering manager. At this time the workload has started to rise again and we expect the 2011 fiscal year to show a significant recovery.



### Summary of Quarterly Results

	For the 3 months ended 30 Sept 2010	For the 3 months ended 30 June 2010	For the 3 months ended 31 March 2010	For the 3 months ended 31 Dec. 2009
Total Revenues	\$ 514,200	\$ 444,510	\$ 448,210	\$ 496,125
Income/(loss) before discontinued operations and extraordinary items	27,909	(254,315)	(69,988)	(75,911)
Basic and diluted income / (loss) per share	0	(.03)	(.01)	(.01)
Net income/(loss)	27,909		(69,988)	(75,911)
Basic and diluted income / (loss) per share	0	(.03)	(.01)	(.01)

	For the 3 months ended 30 Sept 2009	For the 3 months ended 30 June 2009	For the 3 months ended 31 March 2009	For the 3 months ended 31 Dec. 2008
Total Revenues	\$ 625,140	\$ 610,879	\$ 622,114	\$ 530,496
Income/(loss) before discontinued operations and extraordinary items	87,003	163,694	43,071	43,177
Basic and diluted income / (loss) per share	.01	.02	0	0
Net income/(loss)	87,003	163,694	43,071	43,177
Basic and diluted income / (loss) per share	.01	.02	0	0

The variation in sales is due to the oil & gas sector economic activity. The engineering revenues have been significantly impacted by the slow down in drilling activity during the 2008 fiscal year. The 2008 and 2009 sales have been significantly improved by changes in our sales/marketing department.

### Liquidity

The company has positive working capital. Over the next year the company expects to meet all cash requirements from cash flow. While the company has a significant amount of its receivables invested in a small number of clients, these funds are largely attributable to insurance clients and the insurance company has reserves allocated to pay these accounts. Management believes it has appropriately managed the company's credit risk.

### Capital Resources

The company has a \$250,000.00 line of credit available for any emergent capital outlays or other cash flow requirements. As of the end of September, this line of credit has been drawn to \$180,000. Capital expenditures planned for the coming year are expected to be covered out of operating cash flow and leveraging existing assets. However the company has engaged a mergers and acquisitions consultant to assist us in finding a suitable takeover candidate. Should a suitable candidate be found, the company may go to the market to raise a portion of the cost of the take-over.

## Transactions with related parties

During the year the Company had business transactions with corporations controlled by certain directors of the Company. These transactions, which were at market prices, are as follows:

	For the three months ended 30 September 2010	For the three months ended 30 September 2009
Payment of rent to 262233 Alberta Ltd.	\$ 22,500	\$ 22,500
Advances from directors, non-interest bearing, unsecured	\$ 166,911	\$ 166,911
Advances from corporations controlled by directors, non-interest bearing, unsecured	\$ 223,285	\$ 198,893
	<u>\$ 390,196</u>	<u>\$ 365,804</u>

Advances from related parties have no fixed terms of repayment and the parties waived their right to receive any repayment in the current fiscal year therefore these amounts have been classified as long term.

Included in trade accounts payable is \$0 (2009 - \$746) owing to a director.

## Equity Transactions

During the period no options were granted to employees and directors of the company.

No stock options were cancelled or expired.

## Off Balance Sheet Transactions

**Top drive manufacture:** The Technology Licensing Agreement between Farr Canada, a division of McCoy Corporation (MCB: TSX) and Allan R. Nelson Engineering (1997) Inc. provides for royalty payments to Allan R. Nelson Engineering (1997) Inc. in relation to the licensing for the manufacture and sale of the top drives based upon designs prepared by Allan R. Nelson Engineering (1997) Inc.

Farr Canada has hired a dedicated product manager who is marketing the top drive and has established a facility for manufacturing top drives. Top Drive sales typically have a long lead time. We anticipate that sales will start when the economy starts to show signs of growth for the oil & gas drilling sector.

## Financial Instruments

The Company's financial instruments consist of accounts receivable, bank indebtedness, accounts payable and accrued liabilities, and advances from related parties.

### Fair value

The carrying amount of the Company's accounts receivable, bank indebtedness, accounts payable and accrued liabilities approximate their fair value due to the short-term maturities of these instruments.

The fair value of the advances due to related parties are less than carrying value, as the amounts are non-interest bearing. As the amounts have no terms of repayment, the fair value cannot be calculated with any degree of certainty. Therefore fair value has not been estimated.

The fair value of bank indebtedness is measured under level 1 of the fair value hierarchy. The three levels of the fair value hierarchy are described as follows:

- Level 1: Values based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.
- Level 2: Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.
- Level 3: Value based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

The Company is exposed to risks of varying degrees of significance from its use of financial instruments which could affect its ability to achieve its strategic objectives for growth and stakeholder returns. The principal risks to which the Company is exposed, and the actions taken to manage them, are described below.

#### Credit risk

The Company is exposed to credit risk through trade receivables and work in progress. In the normal course of business, the Company evaluates the financial condition of its customers on a continuing basis and reviews the credit worthiness of all new customers. Management assesses the need for allowances for potential credit losses by considering the credit risk of specific customers, historic trends, and other information.

Management believes that credit risk is mitigated in the insurance claim work they perform, due to insurance companies being required to sequester funds when a claim is pending. Credit risk is mitigated in other segments of their business by progress billing, limiting work for overdue clients, and occasionally requiring deposits.

The Company is subject to a concentration of credit risk with respect to \$77,917 (16%) in accounts receivable from the Company's largest customer at September 30, 2010. Concentration of credit risk is mitigated by having concentrations with credit worthy customers.

#### Interest rate risk

Interest rate risk is the risk that the value of a financial instrument might be adversely affected by a change in the interest rates. In seeking to minimize the risks from interest rate fluctuations, the Company manages exposure through its normal operating and financing activities. The Company does not enter into derivative financing contracts for speculative purposes. The Company is exposed to interest rate risk primarily through its floating interest rate operating line. At September 30, 2010 the operating line was drawn to \$180,000 and therefore fluctuations in interest rate would not materially affect the operating results of the Company.

#### Liquidity risk

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they become due, or can only do so at excessive cost. The Company's growth is financed through a combination of cash flows from operations and borrowings under the existing credit facilities. Liquidity risk management serves to maintain a sufficient amount of cash and to ensure the Company has financing sources to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation. The Company establishes budgets and cash estimates to ensure it has the necessary funds to fulfill its obligations.

The following monetary liabilities are current in nature, and therefore mature in less than one year:

\$ 42,073	Outstanding cheques
\$180,000	Bank operating line
<u>\$148,868</u>	Accounts payable and accrued liabilities
\$370,941	Total

Long term monetary liabilities of \$390,196 consist of advances from related parties with no terms of repayment. Therefore, the effective maturity date is undetermined. The parties have waived their right to payment in the current fiscal year.

#### Market risk

The Company is exposed to market risk through its reliance on the oil industry. Management believes the risk faced by the Company with regard to market risk is an acceptable risk faced in the ordinary course of business.

#### **Future Accounting Standards**

The Canadian Institute of Chartered Accountants (CICA) has issued several new accounting standards which will affect the Company's financial statements in subsequent fiscal years.

a) Convergence with International Financial Reporting Standards (IFRS)

The Accounting Standards Board ("AcSB") establishes financial accounting and reporting standards for use by Canadian entities. It also participates in the development of internationally accepted accounting standards. The AcSB is accountable to the Accounting Standards Oversight Council, an independent body established in September 2000 by the CICA. On February 13, 2008, the AcSB announced that the use of International Financial Reporting Standards ("IFRS") is required for fiscal years beginning on or after January 1, 2011 for publicly accountable profit-oriented enterprises. IFRS will replace Canada's current GAAP. Entities will be required to provide comparative IFRS information for the previous fiscal year. The Company is evaluating the impact of the adoption of IFRS. Management recognizes the new accounting policies, and has investigated their impact on the company financial statements. The transition to IFRS on June 30, 2012 is expected to proceed smoothly.

b) Business Combinations, Consolidated Financial Statements and Non-Controlling Interest

In January 2009, the CICA issued CICA Handbook Section 1582, Business Combinations ("Section 1582"), Section 1601, Consolidations ("Section 1601"), and Section 1602, Non-Controlling Interests ("Section 1602"). These sections replace the former Section 1581, Business Combinations, and Section 1600, Consolidated Financial Statements, and establish a new section for accounting for a non-controlling interest in a subsidiary.

Section 1582 establishes standards for the accounting for a business combination, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. It provides the Canadian equivalent to IFRS 3, Business Combinations (January 2008). The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011.

Section 1601 establishes standards for the preparation of consolidated financial statements.

Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS International Accounting Standards (“IAS”) 27, Consolidated and Separate Financial Statements (January 2008).

Sections 1601 and 1602 apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year. All three sections must be adopted concurrently. Management is currently evaluating the impact of the adoption of these sections.

## **Risk and Uncertainty**

The following factors among others could cause our actual results to differ materially from those projected in our forward-looking statements:

- The effects of fluctuations in interest rates or currency values
- The effects of war or terrorist activities
- The effects of disease or illness on local, national or international economies
- The effects of disruption to public infrastructure
- The effects of disruptions to our internal IT infrastructure
- The effects of industry or worldwide economic or political conditions
- The effects of regulatory or statutory developments
- The effects of competition in the geographic or business areas in which we operate
- The effects of undetected fraud
- The actions of management and staff
- Potential liability claims as a result of the work we perform
- Credit risk associated with accounts receivable
- The effects of technological changes

Investors and the public should carefully consider these factors, other uncertainties and potential events as well as the inherent uncertainty of forward looking statements when relying on these statements to make decisions with regards to ESTec. Except as required by law, we do not undertake to update any forward looking statements, whether written or verbal that may be made from time to time by the organization, or on its behalf.



## **Controls and Procedures**

The Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have evaluated the effectiveness of the company's disclosure controls and procedures and assessed the design of the company's internal control over financial reporting as of September 30, 2010, pursuant to the requirements of Multilateral Instrument 52-109.

Management has recognized that weakness exists in segregation of duties. The small administrative staff makes it difficult to have adequate segregation of duties. While it is recognized as a weakness, management has no plans to change in the short term. It is believed that the monitoring that is in place is sufficient to control the risk.

Minor weaknesses in HR practices, invoice preparation practices and computer data security have been identified by management. Management is currently reviewing procedures to minimize these weaknesses as much as possible.

Specific reviews of controls and procedures have been undertaken to identify any changes required by the transition to IFRS.

## **Other MD&A Requirements**

Additional information relating to ESTec Systems and its subsidiaries can be found on SEDAR at [www.sedar.com](http://www.sedar.com). Press releases announcing activities of the company will be posted on our web site [www.estec.com](http://www.estec.com).

On Behalf of the Board of Directors – November 15, 2010  
Anthony B. Nelson  
President

## Corporate Directory

### Directors & Officers

**H. Margaret Nelson**, Director, CFO

**Allan R. Nelson**, Director

**Anthony B. Nelson**, President, Director

**David E. Wright**, Director

**Barbara E. Fraser**, Director

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## Auditors

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## Share Transfer Agent

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## Stock Exchange Listing

The shares of ESTec Systems Corporation are listed on the **Toronto**

### **Venture Exchange**

Trading Symbol: **ESE**