



## MANAGEMENT DISCUSSION AND ANALYSIS

**For the quarter and nine-month period ended September 30, 2005**

**October 28, 2005**

The following interim Management Discussion & Analysis (“MD&A”) provides a review of the significant developments and issues that influenced Roctest Ltd’s financial performance during its third quarter and nine-month period ended September 30, 2005. The MD&A should be read in conjunction with the interim consolidated financial statements for the nine-month period ended September 30, 2005 and the audited consolidated financial statements and annual MD&A for the year ended December 31, 2004, included in the Company’s annual report.

The Company has adopted, starting in 2005, a new fiscal calendar consisting in four quarters of 13 weeks each. This change facilitates different business processes while maintaining a comparable basis with previous years.

### **Company Profile**

Roctest designs, manufactures and markets sensors and high-precision measuring instruments for the industrial control, civil engineering, healthcare and defense markets. The Company is recognized for its leading-edge technology, the quality of its technical expertise and its product development capabilities.

The Company’s products are mainly sold internationally. During the last fiscal year, Roctest generated 83.8 % of its revenues outside Canada.

The Company has 140 employees at its plants in St-Lambert, Quebec City and Gretz-Armainvilliers (near Paris). Roctest is present in many countries through its network of agents and distributors. This commercial development network allows the Company to seize business opportunities in a number of the world’s regions where it can demonstrate its technical expertise.

The Company strategy will consist, for the coming quarters, to develop the markets of China, the USA and Europe for both products from the civil engineering measurement instruments and the fiber optic sensors sector. The strategy of FISO Technologies, a subsidiary of the Roctest Group specialized in the manufacturing and commercialization of fiber optic sensors, is to stimulate organic growth in its activities by forging agreements that will position itself as a preferred supplier to original equipment manufacturers (OEM). The strategy for the civil engineering sector will be to position itself as a consolidator in this highly fragmented market of multiple competitors.

The Company manages two distinct product lines, mainly, fiber optic sensors and civil engineering measurement instruments. The market for fiber optic sensors is an emerging sector offering numerous business opportunities. With regards to the civil engineering sector, Roctest holds approximately 10 % of the world’s market for measurement instruments, which provides enormous growth potential for the Roctest Group.



The following table presents a summary of certain selected consolidated financial information from the three-month and the nine-month periods ended September 30, 2005 and 2004.

	For the three month periods ended September 30,				For the nine month periods ended September 30,			
	2005		2004		2005		2004	
	\$	% of sales	\$	% of sales	\$	% of sales	\$	% of sales
<b>Consolidated earnings data</b>								
Sales	4,928,858	100.0	4,721,278	100.0	15,587,448	100.0	15,741,132	100.0
Cost of sales	2,549,158	51.7	2,367,524	50.1	8,918,506	57.2	8,771,337	55.7
Gross profit	2,379,700	48.3	2,353,754	49.9	6,668,942	42.8	6,969,795	44.3
Sales and administration expenses	1,492,605	30.3	1,311,612	27.8	4,577,700	29.4	4,067,128	25.8
Other administration, research and development and amortization expenses	586,076	11.9	506,522	10.7	1,920,206	12.3	1,663,048	10.6
Foreign exchange loss	265,284	5.4	403,988	8.6	292,441	1.9	229,200	1.5
Earnings (loss) before income taxes	35,735	0.7	131,632	2.8	(121,405)	(0.8)	1,010,419	6.4
Provision for (recovery of) income taxes	(92,581)	(1.9)	70,329	1.5	(209,552)	(1.4)	313,589	2.0
Net earnings	128,316	2.6	61,303	1.3	88,147	0.6	696,830	4.4
Earnings per share	0.03		0.01		0.02		0.15	
Weighted average number of shares outstanding	4,447,886		4,441,219		4,447,886		4,441,219	

The following table presents a summary of certain selected consolidated balance sheet information as of September 30, 2005 and December 31, 2004.

	September 30, 2005	December 31, 2004
	\$	\$
<b>Consolidated balance sheet data</b>		
Working capital <sup>(1)</sup>	9,121,977	9,560,577
Property, plant and equipment	5,114,740	5,779,915
Total assets	21,487,589	22,071,615
Total long-term debt	2,527,265	3,115,932

(1) Working capital is defined as current assets minus current liabilities.

### Risks and uncertainties

For discussion of the risks that could affect our business, please refer to our annual MD&A for 2004. Since December 31, 2004 there have been no significant changes to our risks and uncertainties.



### Forward-looking statements

Certain statements made in this MD&A may constitute forward-looking statements and are subject to significant risks which are difficult to predict, uncertainties and assumptions which may prove to be inaccurate. The results or events predicted in these statements may differ materially from actual results or events. Certain of the risk factors which could cause results or events to differ materially from current expectations include the following : the length of the sales cycle and the fact that certain contracts are subject to delay, the capacity of the Company to maintain new product development at a high level and in an efficient manner, currency fluctuations and international events. The forward-looking statements contained in this document represent the Company's expectations as of October 28, 2005 and, accordingly, are subject to change after that date. However, the Company disclaims any intention to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

For the quarter ended September 30, 2005, earnings before interest, income taxes and amortization ("EBITDA") were \$329,406 versus \$483,307 in 2004. For the nine-month period ended September 30, 2005, EBITDA was \$862,594 compared to \$2,036,490 in 2004.

The change in EBITDA for the quarter was mainly due to a loss on foreign exchange of \$0.27 million compared with \$0.40 million in 2004, an increase of \$0.13 million in research and development spending net of grants and income tax credits and an increase in selling and administration expenses of \$0.18 million in comparison to 2004. The gross margin as a percentage of sales for the third quarter has decreased by 1.6 % compared to 2004.

For the nine-month period ended September 30, 2005 the decrease of EBITDA, compared to 2004, is mainly attributable to a decrease of \$0.30 million in gross margin, compared to 2004, an increase of \$0.28 million in research and development spending net of grants and income tax credits and an increase in selling and administration expenses of \$0.51 million. The decrease of the gross margin as a percentage of sales is mainly attributable to the fact that sales of the first quarter of 2005 included more products which were not manufactured by the Company, yielding lower margins, as well as the impact of lower sales from FISO which have a higher gross margin.

The gross margin has also been affected by foreign exchange fluctuations compared with 2004. The average exchange rates for the quarter, for the US and Euro currencies, have decreased by 8.1 % and 8.4 % respectively in 2005 in comparison to 2004. The average exchange rates, for the nine-month period ended September 30, 2005, for the US and Euro currencies, for their part have decreased by 7.8 % and 5.0 % respectively compared to the same period in 2004.



## RESULTS OF OPERATION AND FINANCIAL POSITION

**For the quarter ended September 30, 2005**, earnings before interest, income taxes and amortization (“EBITDA”) were \$329,406 compared to a profit of \$483,307 in 2004.

The decrease in EBITDA, as explained below, was mainly due to the fact that gross margin expressed as a percentage of sales decreased by 1.6 % compared to 2004. In addition, sales and administration expenses and research and development increased by \$0.18 million and \$0.13 million respectively compared to 2004. The loss on foreign exchange has decreased by \$0.14 million in comparison to the same period in 2004.

**For the nine-month period ended September 30, 2005**, EBITDA was \$862,594 compared to \$2,036,490 in 2004. The decrease in EBITDA is mainly due to a reduction in profitability. Indeed the deterioration of income before taxes represents a deficit in EBITDA of \$1,131,824, from a profit of \$1,010,419 in 2004 to a loss of \$121,405 in 2005.

Gross margin during the nine-month period ended September 30, 2005 reached 42.8 % compared to 44.3 % for the same period in 2004. Lower sale from FISO resulted in lower consolidated margins as the products from the fiber optic sensors sector have higher margins. In addition, during the nine month period ended September 30, 2005, the revenues included more products which were not manufactured by the Company on which a lower profit margin is earned. These products are part of total solutions proposed by the Company to fulfill certain contracts where we are providing the whole solution to our clients.

During the nine month period ended September 30, 2005, the Company took certain initiatives to improve its networks of agents and its presence with its agents and distributors. These initiatives resulted in an increase of the sales and administration expenses of \$0.51 million. Some of these expenses are non-recurring, such as hiring and firing expenses amounting to \$0.28 million. The sales and administration expenses, excluding these non-recurring expenses, would have amounted to 27.5 % of sales. The Company intends to reduce the proportion of these expenses as percentage of sales during the coming quarters.

The exchange rates situation for the US currency as well as for the Euro had a similar negative impact for the period compared to 2004. The appreciation for the US dollar versus the Canadian during the last quarter resulted in an important loss while during the first two quarters a loss of \$0.03 had been recognized. For the nine-month period ended September 30, 2005, the exchange rates fluctuations resulted in a loss of \$0.292 million compared to \$0.229 million for the same period in 2004.

### Revenue

**For the quarter ended September 30, 2005**, consolidated revenues reached \$4.93 million, an increase of 4.4 %, compared to 2004. The civil engineering sector recorded revenues of \$3.41 million while the fiber optic sensor sector’s revenues amounted to \$1.52 million. Revenues for the quarter from the civil engineering sector increased by 8.7 % while those of the fiber optic sensor sector decreased by 4.1 % compared to the same period in 2004.

The increase from the civil engineering sector comes mainly from growth in the Europe and USA markets.

The revenues for the fiber optic sensor sector have remained stable compared to the same period in 2004.



**For the nine month period ended September 30, 2005**, consolidated revenues of \$15.59 million decreased by 0.9 % compared to \$15.74 million in 2004. The civil engineering sector recorded revenues of \$11.55 million while revenues for the fiber optic sensor sector reached \$4.04 million. Revenues from the civil engineering sector rose by 5.4 % while those of the fiber optic technology decreased by 15.6 % compared to the same period in 2004.

The increase in revenues for the civil engineering sector for the nine month period ended September 30, 2005, is mainly due to the first quarter which leapt 15.1 % compared to 2004. The slight growth in revenues for the third quarter resulted mainly from maintaining a high level of activity in both the European and USA markets since the beginning of the year. The civil engineering sector, by the nature of its contracts, is subject to a delivery schedule set by the progress of the work on various sites where our equipment is installed.

For the fiber optic sensor sector, revenues decreased by \$0.74 million compared to the same period in 2004. This decrease in revenue is mainly attributable to lower demand from certain clients which have experienced delay in the launch of their new products, which had for consequence that they maintained a high inventory level of our own products.

## **Expenses**

### **Sales and administration**

**For the quarter ended September 30, 2005**, sales and administration expenses, compared with the second quarter, decreased from \$1.72 million to \$1.49 million, to stand at 30.3 % of revenue, compared with 27.8 % for 2004. During the quarter, non-recurring expenses related to the departure of certain employees amounted to \$0.11 million. In addition, the Company hired skilled employees to maintain its growth with its European OEM clients as well as its international markets.

**For the nine-month period ended September 30, 2005**, sales and administration expenses amounted to \$4.58 million representing 29.4 % of revenues compared with \$4.07 millions or 25.8 % of revenues in 2004. Sales and administration expenses increased during the nine month period ended September 30, 2005, compared to the same period in 2004, by \$0.51 million due principally to non-recurring expenses of approximately \$0.28 million. These non-recurring fees have been recorded in the second and third quarter of 2005. Sales and administration expenses as a percentage of revenue, excluding these non-recurring expenses incurred during the second quarter, for the nine-month period ended September 30, 2005, would have been 27.6 %.

### **Research and Development**

**For the quarter ended September 30, 2005**, research and development (“R&D”), increased, compared to 2004, by \$0.13 million. R&D expenses represent 5.9 % of revenue compared to 3.5 % for the same period in 2004.

**For the nine-month period ended September 30, 2005**, R&D expenses were \$0.93 million compared with \$0.65 million in 2004, representing an increase of 44 % over the same period in 2004. This increase follows the decision of the Company to accelerate the development of new products.

### **Amortization of Capital Assets**

**For the quarter ended September 30, 2005**, amortization of capital assets stood at \$0.252 million compared with \$0.298 million in 2004, a decrease of 15.7 %.



**For the nine-month period ended September 30, 2005**, amortization of capital assets totaled \$0.84 million, a decrease of 4.3 % compared to the same period in 2004. The decrease of amortization expenses for the nine-month period ended September 30, 2005 compared with the same period in 2004 is mainly attributed to the fact that the acquisition level has been lower in 2005.

### **Interest and Foreign Exchange**

**For the quarter and the nine-month period ended September 30, 2005**, the Company incurred interest expenses mainly on its long term debt. The interest expense on long term debt compared to 2004 has remained stable. No additional borrowings were made during the third quarter of 2005.

The Company is exposed to foreign exchange adjustments. During the third quarter of 2005, the change in exchange rates fluctuations of the US dollar and euro has resulted in a loss of \$0.265 million while fluctuations during the third quarter of 2004 resulted in a loss of \$0.404. The Company recorded a loss of \$0.292 million for the nine-month period ended September 30, 2005 compared to a loss of \$0.229 million in 2004.

During the second quarter of 2005, the company changed its accounting policy to translate the financial statements of one of its French subsidiaries, Télémac S.A., which is now considered a self-sustaining operation while it was considered an integrated operation in the past. Currency translation rules of foreign self-sustained operations provide that the gains or losses on translation are deferred and shown in a separate component in shareholders' equity. This change increased the cumulative translation adjustment in the shareholders' equity for the quarter ended September 30, 2005 by an amount of \$ 0.09 million and by an amount of \$0.24 million for the nine month period ended September 30, 2005.

The exchange rates used at September 30, 2005 to translate the balance sheet items were 1.16 for the US dollar and 1.40 for the euro. Transactions relating to earnings are translated at the daily exchange rate for each currency.

The Company reduces the exchange risk through the purchase of foreign exchange forward contracts. As at September 30, 2005, the Company's currency exchange contracts stood at \$2.05 million, compared with \$1 million as at December 31, 2004.

### **Income Taxes**

**For the nine-month period ended September 30, 2005**, income taxes included a recovery of future income taxes amounting to \$219,020. These income tax recoveries represent the tax benefit from the losses of subsidiaries which had not been recorded at December 31, 2004. The tax rate reflects a mix of the various income tax rates in the Canadian and foreign jurisdictions in which the Company operates. This rate fluctuates depending on the proportion of net income by jurisdiction to consolidated net income.

### **Net Income**

**For the quarter ended September 30, 2005**, net income was \$0.13 million, or \$0.03 per share, compared with \$0.06 million, or \$0.01 per share, in 2004. The profitability turnaround results mainly from an increase in sales of 4.4 %, a loss on foreign exchange of \$0.265 million compared to a loss of \$0.404 million in 2004, an increase of sales and administration expenses of \$0.18 million compared to 2004, an increase in R&D expenses of \$0.13 million compared to 2004, these increments being offset by an income tax recovery of \$0.09 million.



**For the nine-month period ended September 30, 2005**, net income amounted to \$0.088 million or \$0.02 per share compared to a net income of \$0.697 million or \$0.15 per share in 2004. The profitability of the first nine months of 2005, compared to the same period in 2004, has been negatively impacted by the decrease in revenue of 15.6 % of the fiber optic sector, the products of this sector having high profit margins. In addition, during the nine month period ended September 30, 2005, sales and administration expenses increased by \$0.51 million, including non-recurring costs of approximately \$0.28 million related to hirings and lay-offs. R&D expenses increased by 44 %, compared to 2004, with the main objective to increase the development of new products.

In addition, an income tax recovery of \$0.21 million has been recorded during the nine month period ended September 30, 2005.

### **Cash Flows from Operations**

**For the quarter ended September 30, 2005**, cash flows from operations amounted to \$0.53 million compared to \$0.62 million in 2004. Working capital of the Company decreased by \$0.44 million compared to December 31, 2004 from \$9.56 million to \$9.12 million.

**For the nine-month period ended September 30, 2005**, negative cash flows from operations amounted to \$0.75 million compared to a positive cash flow of \$2.07 million in 2004. The decrease is mainly the result of the reduced profitability of the Company, a net income for the nine-month period ended September 30, 2005 of only \$0.088 million compared to \$0.697 million for the same period in 2004. In addition, we note a negative increase in the variation of non-cash working capital items from \$0.258 million in 2004 to (\$1.568) million in 2005.

### **Liquidity and Cash Resources**

**At September 30, 2005**, the Company held \$2.76 millions in cash and cash equivalents and temporary investments compared to \$4.43 million as at December 31, 2004. The cash and cash equivalents are made up of cash on hand, bank balances and short-term liquid investments with maturity dates equal or less than three months.

### **Capital Investments**

Capital acquisitions for the third quarter were \$0.094 million compared to \$0.223 million in 2004, and \$0.308 million for the nine month period of 2005, compared to \$0.543 in 2004. The acquisitions of 2004 and 2005 relate mainly to management software systems, certain R&D and production equipment as well as building maintenance.

### **Long Term Debt and Lease Commitments**

During the third quarter and for the nine-month period ended September 30, 2005, the Company, did not contract new debt nor change its current operating lease commitments.



### Share Capital and Stock Options

**At September 30, 2005**, there were 4,451,219 common shares issued and outstanding.

**For the quarter ended September 30, 2005**, the cost of compensation paid in stock options, based on the fair value method, was recognized in net earnings with the corresponding credit to contributed surplus for an amount of \$0.030 million compared with \$0.022 million in 2004.

**For the nine-month period ended September 30, 2005**, the cost of compensation paid in stock options was recorded in net earnings with a corresponding credit to contributed surplus of \$0.092 million compared with \$0.015 million in 2004. These costs have been adjusted during the second quarter of 2004 to take into account forfeited options.

The Company's quarterly and annual financial information as well as its annual information form are available on SEDAR ([www.sedar.com](http://www.sedar.com)) and on its website ([www.roctest.com](http://www.roctest.com)).



## QUARTERLY REVIEW

### Financial Information (in millions of \$)

	2005				2004			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>SALES</b>	5.22	5.44	4.93		5.06	5.96	4.72	5.59
<b>COST OF SALES</b>	3.17	3.20	2.55		2.91	3.50	2.37	3.27
<b>GROSS MARGIN</b>	2.05	2.24	2.38		2.15	2.46	2.35	2.32
<b>EXPENSES</b>								
Sales and Administration	1.38	1.72	1.49		1.30	1.45	1.31	1.42
Scientific Research Cost	0.54	0.58	0.53		0.38	0.45	0.53	0.53
Scientific Research Cost	(0.24)	(0.24)	(0.24)		(0.20)	(0.15)	(0.36)	(0.31)
Interest on Long-term Debt	0.04	0.04	0.04		0.06	0.04	0.04	0.05
Amortization	0.31	0.28	0.25		0.28	0.30	0.30	0.42
Foreign Exchange Gain (Loss)	0.08	(0.05)	0.27		(0.08)	(0.09)	0.40	0.11
	2.11	2.33	2.34		1.74	2.00	2.22	2.22
<b>EARNINGS (LOSS)</b>								
<b>Before income taxes</b>	(0.06)	(0.09)	0.04		0.41	0.46	0.13	0.10
<b>INCOME TAXES</b>	(0.01)	(0.10)	(0.09)		0.08	0.16	0.07	(0.21)
<b>NET EARNINGS(LOSS)</b>	(0.05)	0.01	0.13		0.33	0.30	0.06	0.31
<b>EARNING (LOSS) PER SHARE</b>	(0.01)	0.00	0.03		0.07	0.07	0.01	0.03
<b>EBITDA</b>	0.29	0.24	0.33		0.77	0.78	0.48	0.59
Total Assets	22.07	21.15	21.49		22.30	22.00	21.70	22.07