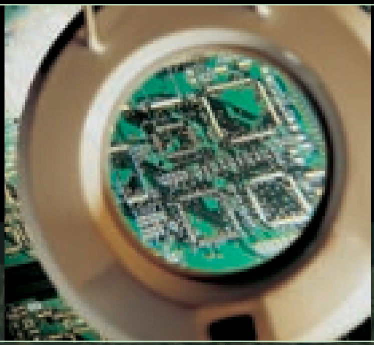
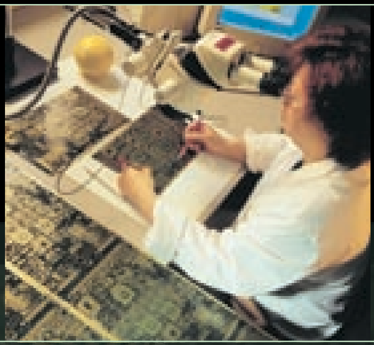
# Circuit World Corporation

Annual Report **2002**





**FRONT COVER:**
Jayesh Patel operating the Excellon System 2000 drilling machine

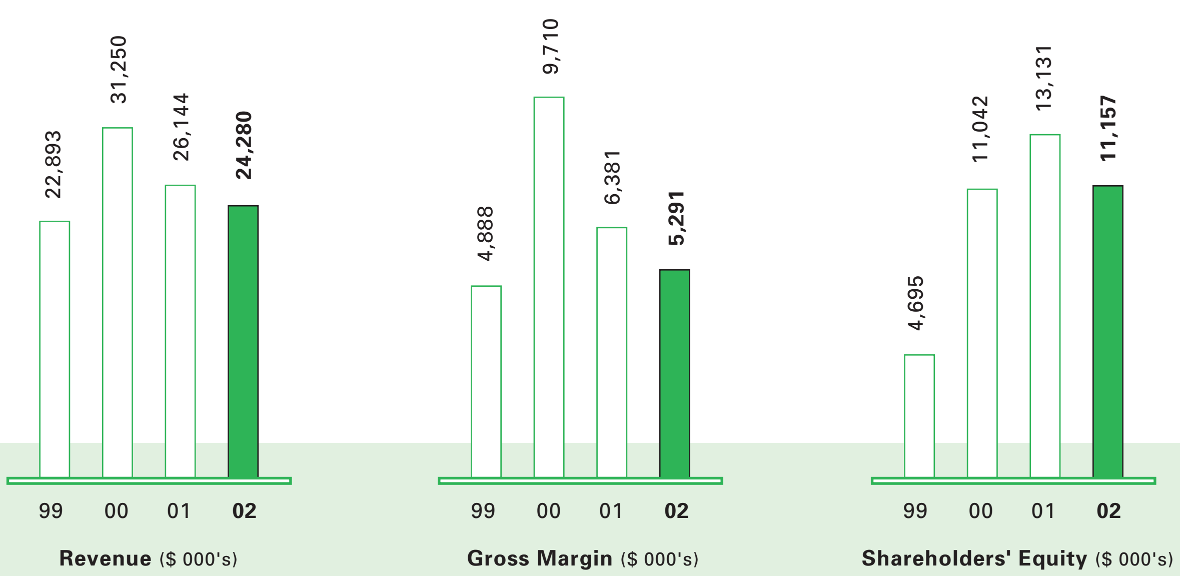
**ABOVE LEFT:**
Magnified printed circuit board in final inspection

**ABOVE CENTER:**
Sau-Chun Wong inspects product prior to shipment

**ABOVE RIGHT:**
ATG 16 head flying probe electrical tester

# Company Profile

**Circuit World** Corporation is one of the largest manufacturers of printed circuit boards in Canada. The Company manufactures complex multi-layer printed circuits for the avionics, telecommunications, power, testing and medical industries in North America. The Company, through its operating division, PC World, provides a comprehensive printed circuit manufacturing service, which includes design, prototype and medium volume production. Its principal focus is on the advanced technology segment of the electronics market.



# To Our Shareholders

2002 was another challenging year for the printed circuit industry. Economic conditions in our industry continued to decline with decreasing revenue and corresponding price pressures across all products and services. Although significant capacity has been decommissioned it has not been enough to off set the decline in end market demand.

OEM's (Original Equipment Manufacturers) continue to place tremendous pressure on CM's (Contract Manufacturers) and their supply chain for cost reductions year over year. This pressure has resulted in the reduction of already low gross margin performance from the entire sector. Several printed circuit companies have been operating with negative gross margins. We do not believe that this situation will be sustainable for many of those companies.

Revenue in 2002 declined by 7% from last year while unit volume increased by 7% high-lighting the price pressure being felt throughout our industry.

Revenue on a quarter over comparable quarter has increased in the last 2 quarters of 2002 and continued with a 17% increase in revenue growth for the first quarter in 2003. This trend is encouraging but there is no assurance that the general economy will continue to improve.

In spite of the above Circuit World continued to outperform most of its peers in the industry on both gross margin and retention of revenue. This was only possible through dramatic efforts by our employees. Improvements to our manufacturing efficiencies came through yield improvement, material price reductions and closer scrutinizing of product pricing.

Although we have done well in comparison to others in our industry Circuit World must improve its position further to support the level of capital expenditures in previous years.

Our challenge moving forward will be to continue reducing our operating costs while taking market share from our competitors.

With approximately fifty million in capacity we must grow accordingly in order to achieve the returns our shareholders expect and deserve.

Circuit World believes that even a soft recovery could have a very positive effect on the remaining industry players.

Your company is one of the leaders in technology and service. The management and employees are determined to lead our industry into a recovery as economic conditions improve.

**Gordon A. Roseborough**
President and CEO

# Management Discussion and Analysis

## Results of Operations and Financial Condition and Outlook

This report is management's analysis of Circuit World Corporation's financial results for the years ended December 31, 2002 and 2001 and its outlook for the future. It should be read in conjunction with the audited Financial Statements and Accompanying Notes.

This document may contain forward-looking statements that reflect the current views and/or expectations of the Company with respect to its performance, business and future events. Such statements are subject to a number of risks, uncertainties and assumptions. Actual results and events may vary significantly from such statements.

## Overview

Circuit World Corporation is a leading manufacturer of high technology/high reliability printed circuit boards within the North American marketplace. Our customers are technological and market leaders in the aviation, medical, test, instrumentation and telecommunications industries. The Company is located in Scarborough, Ontario and employs approximately 170 skilled employees.

Our product offering is high complexity, time to market printed circuit boards that service the prototype through pre-production segment of the market. Our strategic focus complements the dramatic changes experienced in the North American printed circuit boards industry. High volume, medium technology manufacturing has migrated to Asia leaving North America as the provider of lower volume, high mix, high technology printed circuit solutions. Over the past 5 years management anticipated these market shifts and made substantial investments in people and capital to position itself to benefit from these future opportunities.

## Results of Operations

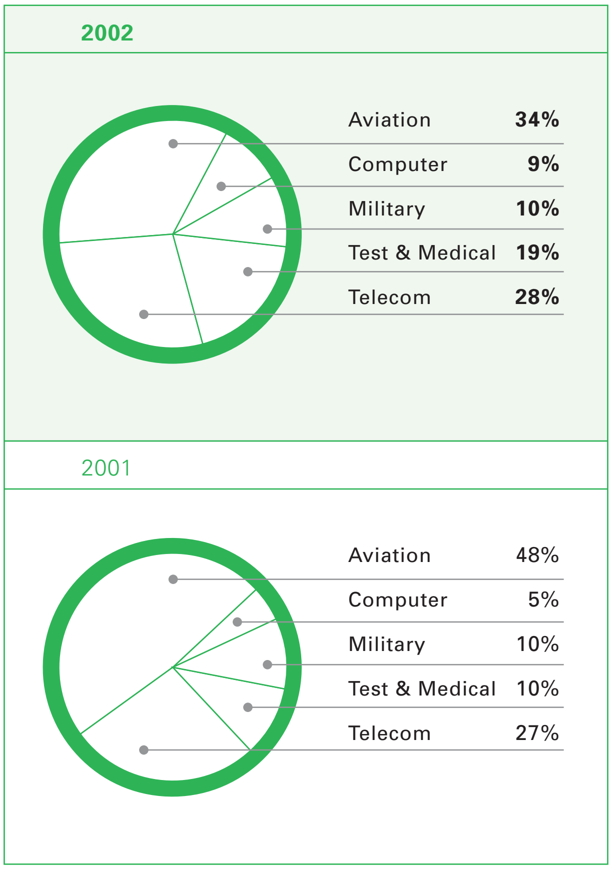
### REVENUE

Net sales for 2002 were $24,280,000 a decrease of 7% as compared with sales of $26,144,000 in 2001. The decrease in revenue is primarily attributable to the persistent downturn in the electronics industry. While revenue declined, the Company shipped 7% more units in 2002 as compared to 2001. This decrease in average pricing is partly due to a shift in product mix. Revenue from the higher margin quick-turn segment of our business (i.e. product manufactured with shortened lead times) decreased from 35% of overall revenue in 2001 to 31% in 2002.

Demand for volume orders remained weak during 2002 as the trend was towards a larger number of smaller quantity orders. This is due in part to the downturn in the printed circuit board industry and the shift to Asia of high volume low-to-medium technology product.

In fiscal 2002, the aviation segment of our business made up 34% of the Company's revenues. This percentage is down considerably from the 48% in 2001. The Company made a conscious effort in 2002 to decrease its reliance on any one specific industry. In doing so, the Company made significant inroads developing new customers in the medical segment of the market. Medical customers generally have a need for high technology, high reliability printed circuit boards which present an improved gross margin opportunity for the Company. All other market segments remained relatively flat over 2001.

Below is a chart depicting the market segmentation of the Company's revenue in 2002 and 2001.




Our ten largest customers accounted for 79% of net sales in fiscal 2002 and 81% of net sales in 2001. Three customers individually accounted for more than 10% of our net sales in 2002. The Company's largest customer accounted for 30% of net sales in fiscal 2002 compared with 46% in 2001. The next largest customer accounted for 16% of revenue in 2002.

Export sales to the United States represented 89% of overall sales, which was the same as the previous year.

## GROSS MARGINS

The Company generated a gross margin of $5,291,000 or 22% in 2002 compared with $6,381,000 or 24% in 2001. The decrease in gross margin is partly due to severe price competition experienced throughout the year. It was management's continuous focus to control variable costs that prevented a much greater decline in gross margin. The cost-cutting measures included reductions in staffing, limited hiring, salary and wage reductions, reduced discretionary spending, manufacturing process improvements and lower raw material and supply costs.

## SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses were $3,885,000 a 16% decrease over the $4,598,000 of expenses incurred in 2001. The decrease was partly attained through one time non-recurring recoveries of previously reported expenses. Tighter cost control over discretionary spending was partially offset by increased commissions in 2002 as a result of the successful introduction of 52 new customers. Overall, headcount and salaries remained flat during the year.

Circuit World incurred $39,000 in research and development costs during fiscal 2002 compared with $139,000 in 2001. These costs support the introduction of new product and process technology. The Company expects R&D costs for 2003 to increase marginally above the fiscal 2002 levels.

## INTEREST

Interest costs decreased in fiscal 2002 to $291,000. This compares to $409,000 of interest costs in 2001. The decrease is a result of lower interest rates experienced in 2002 and lower bank borrowings throughout the year. Lower borrowings reflect the $3,761,000 net proceeds generated from the convertible debenture that was issued in the fourth quarter of 2001.

## NET LOSS

Net loss for the year was $1,959,000 or $0.28 per share as compared with a loss of $1,706,000 or $0.24 per share in fiscal 2001.

## Capital Expenditures

The Company invested modestly in plant and equipment in fiscal 2002 due primarily to having completed the investment program that began in 1997. The investment program was designed to enhance the manufacturing capability of the Company allowing it to compete in the mid to high technology segment of the printed circuit market. This program increased our capacity to enable the Company to attain revenue targets of approximately $50,000,000 (subject to product mix). Investment in plant and equipment totaled $1,140,000 during the year as compared to $5,137,000 in 2001.

The Company expects capital expenditures to be between $1,500,000 and $2,500,000 million in 2003. The Company believes that in the future, excluding any possible business acquisitions, most of its capital expenditures will be financed out of operating cash flow.

## Financial Condition

As at December 31, 2002, the Company had $1,612,000 in cash.

Accounts receivable at the year-end increased 52% to $4,397,000 from $2,893,000 in 2001. The increase resulted from higher sales in the last quarter of 2002 as compared with the previous year.

In 2002, inventory levels increased 6% or $139,000 from the prior year. The increase reflects higher sales and backlog.

In 2002, accounts payable and accrued liabilities increased by $263,000 or 7% compared to 2001. Included in the accounts payable and accrued liabilities balance was $186,000 that related to amounts owing to equipment vendors. In 2001, the amount owing to equipment vendors was $500,000.

## Cash Flow

Cash used through operating activities in fiscal 2002 amounted to $265,000 as compared to cash of $3,895,000 that was generated in 2001. The Company generated $1,044,000 in cash from operations prior to changes in non cash operating and working capital as compared to $1,420,000 generated in 2001. The Company used $1,309,000 to fund working capital requirements, primarily accounts receivable, in 2002. In 2001 the Company generated $2,475,000 through reductions in working capital.

Cash used in investing activities for fiscal 2002 amounted to $939,000 as compared to $5,043,000 in 2001. These amounts related mainly to capital expenditures made by the Company.

Cash used in financing activities amounted to $1,922,000 as compared to cash received of $4,324,000 in 2001. The company repaid $1,788,000 in term debt to its primary lenders as compared to $2,536,000 in 2001. In 2001, the Company raised net proceeds of $3,776,000 through a convertible debenture. In addition, the Company also established a new long-term credit facility with the Business Development Bank of Canada in the amount of $2,500,000.

## Risks and Uncertainties

The Company is subject to risks that may affect financial performance. During the yearly planning process, risks are identified and plans developed to manage and mitigate such risks.

The Company is exposed to foreign exchange fluctuations as the vast majority of the revenue is earned in U.S. dollars. Operating expenses are incurred mainly in Canadian dollars. However, most of the manufacturing materials and supplies are sourced in U.S. dollars, providing a natural hedge for much of the Company’s currency exposure.

Reliance on key customers is a risk facing the Company. Its largest customer accounted for 30% of 2002 revenues. If that customer were to reduce, delay or cancel any of their orders, this would adversely affect future revenue streams of the Company. However, to mitigate this risk, in March of 2002, the Company extended its long-term supply agreement with the customer for three years.

The current and future success of the Company is predicated on attracting and maintaining key employees. The competition for these employees is intense. Being a clear leader in technology, and offering incentives such as the Share Option Plan and the ESOP allows us to be competitive in attracting key personnel.

## Outlook

2002 was another challenging year for the printed circuit boards industry and the technology sector overall. The Company's financial results, although disappointing, were among the best in the industry.

With revenue down modestly year over year, it is important to note that sales have increased in each of the last six months over the comparable periods in 2001. We expect this to continue in the first quarter of 2003.

Over the past two years, significant capacity within our industry was permanently shut down. It is estimated that between 30% and 40% of peak capacity is now decommissioned. With this significant adjustment, the Company believes a moderate economic rebound could have a very positive effect on the remaining industry participants. With modern facilities and high technology offerings, the Company is ready to respond.

The advantage of modern facilities, combined with our alliance with a leading offshore manufacturer, has enabled the Company to offer turnkey support of a wider range of product technologies to a growing account base.

Management remains committed to creating value for our shareholders, customers and our employees.

Marissa Suva completes final inspection

# Management's Responsibility for Financial Statements

The information in this annual report is the responsibility of management. The financial statements have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles and in accordance with the accounting policies set out in note 1 to the financial statements. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Management believes that reasonable care and judgment is applied in making such estimates and assumptions.

Management maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and that transactions are authorized, recorded and reported properly. Management reviews these accounting controls on an ongoing basis and reports its findings and recommendations to the Audit Committee of the Board of Directors.

The Board of Directors carries out its responsibility for the financial statements principally through its Audit Committee, consisting of 3 members, who are outside directors. This committee reviews the consolidated financial statements with management prior to submission to the Board for approval.

The Company's external auditors, Deloitte & Touche LLP, have audited the financial statements and their opinion on these statements is set out below.

**Gordon Roseborough**
President and Chief Executive Officer
February 12, 2003

**John Bartkiw**
Chief Financial Officer
February 12, 2003

# Auditors' Report

**To the Shareholders of Circuit World Corporation**

We have audited the balance sheets of Circuit World Corporation as at December 31, 2002 and 2001 and the statements of operations and (deficit)/retained earnings and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

**Chartered Accountants**
Toronto, Ontario
February 12, 2003

# Balance Sheets

| December 31, 2002 and 2001 (in thousands of dollars) | 2002 | 2001 |
|---|---|---|
| **ASSETS** | | |
| CURRENT | | |
| Cash | **$ 1,612** | $ 4,738 |
| Accounts receivable | **4,397** | 2,893 |
| Inventories (Note 2) | **2,325** | 2,186 |
| Prepaid expenses | **94** | 165 |
| | **8,428** | 9,982 |
| PLANT AND EQUIPMENT (Note 3) | **11,849** | 13,779 |
| OTHER ASSETS | **124** | 139 |
| | **$ 20,401** | $ 23,900 |
| **LIABILITIES** | | |
| CURRENT | | |
| Accounts payable and accrued liabilities | **$ 3,820** | $ 3,557 |
| Current portion of long-term debt (Note 4) | **1,542** | 1,998 |
| Current portion of convertible subordinated debenture (Note 5(e)) | **790** | — |
| | **6,152** | 5,555 |
| LONG-TERM DEBT (Note 4) | **3,092** | 4,424 |
| CONVERTIBLE SUBORDINATED DEBENTURES (Note 5(e)) | **—** | 790 |
| | **9,244** | 10,769 |
| COMMITMENTS (Note 9) | | |
| **SHAREHOLDERS' EQUITY** | | |
| SHARE CAPITAL - COMMON SHARES (Note 5) | **7,329** | 7,329 |
| SHARE CAPITAL - CONVERTIBLE PREFERRED SHARES (Note 5(g)) | **3,761** | 3,776 |
| EQUITY COMPONENT OF CONVERTIBLE SUBORDINATED DEBENTURES (Note 5(e)) | **10** | 10 |
| CONTRIBUTED SURPLUS | **1,426** | 1,426 |
| (DEFICIT) RETAINED EARNINGS | **(1,369)** | 590 |
| | **11,157** | 13,131 |
| | **$ 20,401** | $ 23,900 |

APPROVED BY THE BOARD

Director

Director

# Statements of Operations and (Deficit) Retained Earnings

| Years ended December 31, 2002 and 2001 (in thousands of dollars except per share amounts) | **2002** | 2001 |
|---|---|---|
| SALES | **$ 24,280** | $ 26,144 |
| COST OF SALES | **18,989** | 19,763 |
| GROSS MARGIN | **5,291** | 6,381 |
| EXPENSES | | |
| Selling, general and administrative | **3,885** | 4,598 |
| Amortization of plant and equipment | **3,035** | 2,941 |
| Interest on long-term debt | **291** | 409 |
| Research and development | **39** | 139 |
| | **7,250** | 8,087 |
| NET LOSS | **(1,959)** | (1,706) |
| RETAINED EARNINGS, BEGINNING OF YEAR | **590** | 2,296 |
| (DEFICIT) RETAINED EARNINGS, END OF YEAR | **$ (1,369)** | $ 590 |
| LOSS PER SHARE | | |
| Basic and fully diluted | **$ (0.28)** | $ (0.24) |

# Statements of Cash Flows

| Years ended December 31, 2002 and 2001 (in thousands of dollars) | **2002** | 2001 |
|---|---|---|
| **NET (OUTFLOW) INFLOW OF CASH RELATED TO THE FOLLOWING ACTIVITIES** | | |
| OPERATING | | |
| Net loss | **$ (1,959)** | $ (1,706) |
| Items not affecting cash | | |
| Cancelation of shares (Note 5(b)) | **(6)** | — |
| Issuance of shares in settlement of director's fees (Note 5(b)) | **6** | 19 |
| Amortization of other assets | **22** | 17 |
| (Gain) loss on disposal of plant and equipment | **(54)** | 149 |
| Amortization of plant and equipment | **3,035** | 2,941 |
| | **1,044** | 1,420 |
| Changes in non-cash operating working capital (Note 7) | **(1,309)** | 2,475 |
| | **(265)** | 3,895 |
| INVESTING | | |
| Additions to plant and equipment | **(1,140)** | (5,137) |
| Other assets | **112** | 95 |
| Proceeds on disposal of plant and equipment | **89** | 94 |
| | **(939)** | (5,043) |
| FINANCING | | |
| Issuance costs of convertible preferred convertible shares (Note 5(g)) | **(15)** | — |
| Convertible subordinated debentures (Note 5(g)) | **—** | 3,776 |
| Other assets | **(119)** | — |
| Increase in long-term debt | **—** | 3,084 |
| Repayment of long-term debt | **(1,788)** | (2,536) |
| | **(1,922)** | 4,324 |
| (DECREASE) INCREASE IN CASH | **(3,126)** | 3,271 |
| CASH, BEGINNING OF YEAR | **4,738** | 1,467 |
| CASH, END OF YEAR | **$ 1,612** | $ 4,738 |

| | | |
|---|---|---|
| DISCLOSURE OF CASH PAYMENTS | | |
| Interest | **$ 288** | $ 381 |

# Notes to the Financial Statements

December 31, 2002 and 2001

## 1. Summary of Significant Accounting Policies

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are presented in Canadian dollars.

**INVENTORIES**

Raw materials and spare parts are valued at the lower of cost and replacement cost. Work-in-process and finished goods are valued at the lower of cost and net realizable value. Cost is determined on the first-in, first-out basis.

**PLANT AND EQUIPMENT**

Plant and equipment are recorded at cost, net of related government grants and investment tax credits. The assets are amortized using the straight-line method over their estimated useful lives as follows:

| | |
|---|---|
| Machinery and equipment | 5 to 7 years |
| Furniture and fixtures | 4 years |
| Leasehold improvements | Term of the lease |
| Computer equipment | 4 years |
| Computer software | 3 years |

**OTHER ASSETS**

The costs relating to the issuance of convertible subordinated debentures in May 1999 and the re-negotiation of the credit facilities in 2002 are being amortized over the life of the related long-term liability.

**REVENUE RECOGNITION**

Revenue from the sale of manufactured products is recognized when the product is shipped and the related liability is transferred to the customer.

**TRANSLATION OF FOREIGN CURRENCIES**

Assets and liabilities are translated into Canadian dollars at the rate of exchange prevailing at year-end. Revenues and expenses are translated at the average monthly exchange rates. Exchange gains and losses are included in operations.

**MEASUREMENT UNCERTAINTY**

The preparation of the Company's financial statements, in accordance with Canadian generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amount of assets and liabilities such as reserves for bad debts, inventory obsolescence and warranty provisions and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting year. Due to the inherent uncertainty involved in making such estimates, actual results reported in future periods could differ from those estimates.

**INCOME TAXES**

The Company has adopted the recommendations of the Canadian Institute of Chartered Accountants on accounting for income taxes, which require the use of the liability method of accounting for income taxes. Under the liability method of tax allocation, future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities, and are measured using the substantively enacted tax rates and laws that are expected to be in effect in the periods in which the future income tax assets or liabilities are expected to be settled or realized.

**RESEARCH AND DEVELOPMENT**

Research and development expenses are expensed as incurred, except where certain development costs meet the criteria for capitalization.

**STOCK-BASED COMPENSATION PLANS**

At December 31, 2002 the Company has a stock-based compensation plan for certain employees, officers and directors. No compensation expense is recognized for these plans when stock or stock options are issued. Any consideration paid on exercise of stock options or purchase of stock is credited to share capital.

## 2. Inventories

| (in thousands of dollars) | **2002** | 2001 |
|---|---|---|
| Raw materials and spare parts | **$ 1,025** | $ 1,016 |
| Work-in-process | **468** | 428 |
| Finished goods | **832** | 742 |
| | **$ 2,325** | $ 2,186 |

## 3. Plant and Equipment

| (in thousands of dollars) | | **2002** | |
|---|---|---|---|
| | **Cost** | **Accumulated Amortization** | **Net Book Value** |
| Machinery and equipment | **$ 23,324** | **$ 12,474** | **$ 10,850** |
| Furniture and fixtures | **954** | **918** | **36** |
| Leasehold improvements | **3,518** | **2,555** | **963** |
| | **$ 27,796** | **$ 15,947** | **$ 11,849** |

| (in thousands of dollars) | | 2001 | |
|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value |
| Machinery and equipment | $ 22,495 | $ 9,691 | $ 12,804 |
| Furniture and fixtures | 946 | 895 | 51 |
| Leasehold improvements | 3,339 | 2,415 | 924 |
| | $ 26,780 | $ 13,001 | $ 13,779 |

## 4. Long-Term Debt

| (in thousands of dollars) | 2002 | 2001 |
|---|---|---|
| Term loan secured by a first charge on certain property, with interest at bank base rate plus 0.25% per annum, repayable in monthly principal payments of $41,000 to January 2007. | **$ 2,009** | $ 2,500 |
| Term loan secured by a first charge on certain property, with interest at bank prime plus 1.75% per annum, repayable in monthly principal payments of $7,848 to June 2005 | **235** | 356 |
| Term loan of U.S. $1,513,000 (2001 - $2,244,000) secured by a first charge on certain property, with interest at U.S. bank prime plus 1.75% per annum, repayable in monthly principal payments of U.S. $50,430 to June 2005 | **2,390** | 3,566 |
| | **4,634** | 6,422 |
| Less amounts due within one year | **1,542** | 1,998 |
| | **$ 3,092** | $ 4,424 |

Principal payments required on long-term debt in each of the next five years are as follows:

| (in thousands of dollars) | |
|---|---|
| 2003 | $ 1,542 |
| 2004 | 1,542 |
| 2005 | 1,017 |
| 2006 | 492 |
| 2007 | 41 |
| | $ 4,634 |

## 5. Share Capital

### (A) AUTHORIZED SHARES

The authorized share capital consists of an unlimited number of common shares and an unlimited number of preferred shares, issuable in series, with the attributes of each series to be fixed by the Board of Directors.

### (B) COMMON SHARES

| (in thousands of dollars) | 2002 | | 2001 | |
|---|---|---|---|---|
| | **Number of Shares** | **Stated Capital** | Number of Shares | Stated Capital |
| Balance, beginning of year | **7,115,286** | **$ 7,329** | 7,106,874 | $ 7,310 |
| Cancellation of shares | **(2,804)** | **(6)** | — | — |
| Issuance of new shares | **3,158** | **6** | 8,412 | 19 |
| Balance, end of year | **7,115,640** | **$ 7,329** | 7,115,286 | $ 7,329 |

## (C) COMMON SHARE OPTIONS AND WARRANTS

| | **2002** | 2001 |
|---|---|---|
| Number, beginning of year | **965,100** | 1,111,850 |
| Issuance of options - employee stock option plan | **78,000** | 21,000 |
| Cancellation of options | **(6,875)** | (167,750) |
| Expiry of share purchase warrants (Note 5(f)) | **(187,000)** | — |
| Number, end of year | **849,225** | 965,100 |

## (D) OUTSTANDING SHARE OPTIONS AND WARRANTS

| **December 31, 2002 (see Note 5(c))** | **Number of Shares** | **Exercise Price** | **Expiry Vesting** | **Description Date** |
|---|---|---|---|---|
| **Employee options** | **8,325** | **$ 6.00** | **Vested** | **2005** |
| **Employee options** | **52,500** | **$ 2.80** | **Vested** | **2007** |
| **Employee options** | **190,000** | **$ 2.00 - 2.80** | **Vested** | **2008** |
| **Employee options** | **100,000** | **$ 1.20** | **Vested** | **2009** |
| **Employee options** | **399,400** | **$ 1.90 - 2.60** | **2002 - 2004** | **2006** |
| **Employee options** | **21,000** | **$ 2.00** | **2002 - 2004** | **2007** |
| **Employee options** | **78,000** | **$ 1.70** | **2003 - 2005** | **2008** |
| **Number, December 31, 2002** | **849,225** | | | |

| December 31, 2001 (see Note 5(c)) | Number of Shares | Exercise Price | Expiry Vesting | Description Date |
|---|---|---|---|---|
| Employee options | 8,450 | $ 6.00 | Vested | 2005 |
| Employee options | 54,750 | $ 2.80 | Vested | 2007 |
| Employee options | 190,000 | $ 2.00 - 2.80 | 1999 - 2002 | 2008 |
| Employee options | 100,000 | $ 1.20 | 2000 - 2002 | 2009 |
| Employee options | 403,900 | $ 1.90 - 2.60 | 2002 - 2004 | 2006 |
| Employee options | 21,000 | $ 2.00 | 2002 - 2004 | 2007 |
| | 778,100 | | | |
| Share purchase warrants (Note 5(f)) | 187,000 | $ 2.86 | Vested | 2002 |
| Number, December 31, 2001 | 965,100 | | | |

**5. Share Capital (Continued)**

**December 31, 2002**

| Range of Exercise Prices | Number Outstanding at December 31, 2002 | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable at December 31, 2002 | Weighted-Average Exercise Price |
|---|---|---|---|---|---|
| **$ 1.20** | **100,000** | **7.3 years** | **$ 1.20** | **100,000** | **$ 1.20** |
| **$ 1.70** | **78,000** | **6.5 years** | **$ 1.70** | **—** | **$ —** |
| **$ 1.90 - $ 2.40** | **214,400** | **6.5 years** | **$ 2.04** | **200,400** | **$ 2.04** |
| **$ 2.50 - $ 3.00** | **448,500** | **4.2 years** | **$ 2.68** | **355,667** | **$ 2.70** |
| **$ 6.00** | **8,325** | **2.0 years** | **$ 6.00** | **8,325** | **$ 6.00** |
| **Totals** | **849,225** | | | **664,392** | |

December 31, 2001

| Range of Exercise Prices | Number Outstanding at December 31, 2002 | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable at December 31, 2002 | Weighted-Average Exercise Price |
|---|---|---|---|---|---|
| $ 1.20 | 100,000 | 8.3 years | $ 1.20 | 100,000 | $ 1.20 |
| $ 1.90 - $2.40 | 214,400 | 7.5 years | $ 2.04 | 160,100 | $ 2.05 |
| $ 2.50 - $3.00 | 642,250 | 5.2 years | $ 2.71 | 453,583 | $ 2.76 |
| $ 6.00 | 8,450 | 3.0 years | $ 6.00 | 8,450 | $ 6.00 |
| Totals | 965,100 | | | 722,133 | |

### (E) CONVERTIBLE SUBORDINATED DEBENTURES

The Company issued $1,800,000 convertible subordinated debentures in 1999 having a maturity date of May 13, 2003 with interest of 9% per annum in year 1, 10% per annum in years 2 and 3, and 11% in year 4, payable monthly. Each $10,000 principal amount debenture is convertible, at the option of the holder, at any time prior to the maturity date into 3,333 common shares. This represents a conversion price of $3.00 per common share.

On September 15, 2000, debentures with a fair value of $1,000,000 were converted at a reduced conversion price of $2.40 per share.

The balance of the convertible debentures, which represent $800,000 remain outstanding under the original terms of the debentures. The equity component of these debentures has been included in shareholders' equity. The remaining outstanding debentures are convertible into common shares at $2.86 consistent with the dilution feature in the debentures.

### (F) PRIVATE PLACEMENT OF UNITS

Through a private placement on May 13, 1999, the Company issued 374,000 units at $2.50 per unit for gross proceeds of $935,000. Each unit comprises one common share and one half of one share purchase warrant. Each whole warrant entitled the holder to acquire an additional common share at a price of $2.60 per share during the first twelve months, $2.67 per share in the second twelve months and $2.86 per share in the final twelve months. As at December 31, 2002, the share purchase warrants had expired.

### (G) CONVERTIBLE PREFERRED SHARES

On November 22, 2001 the Company completed a private placement of a $4,437,500 convertible unsecured subordinated debenture.

The convertible debenture had a term of one year from the date of closing, and carried a coupon of 6%, payable semi-annually, and was convertible at any time up until November 22, 2002, at the option of the holder, into 1,775,000 voting convertible preferred shares of the Company (a conversion rate of $2.50 per share), representing 19.9% of the voting shares of the Company. The convertible debenture was converted on November 22, 2002. The voting convertible preferred shares have the same voting rights as common shares, will pay no dividends, and will be convertible into common shares of the Company on a one for one basis at the option of the holder for no additional payment.

The preferred conversion ratio is "1 preferred share to 1 common share". If (a) the Company's 2002 sales, excluding any sales derived from acquisitions were greater than $22,000,000 or (b) the Company's 2002 earnings before interest, tax and amortization ("EBITDA") were positive, then the conversion remains "1 preferred share to 1 common share". Both of the tests described above were met.

The convertible preferred shares automatically convert into common shares when the Company's yearly sales, excluding acquisitions, exceed $55,000,000 and the Company has positive yearly EBITDA. Otherwise, the convertible preferred shares are convertible into common shares at the discretion of the convertible preferred shareholder.

### (H) EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings (loss) per share:

| (in thousands of dollars) | **2002** | 2001 |
|---|---|---|
| **NUMERATOR** | | |
| Net loss | **$ (1,959)** | $ (1,706) |
| Numerator for basic loss per share - net loss applicable to common shares | **(1,959)** | (1,706) |
| Effect of dilutive securities: | | |
| Interest on convertible debentures | **—** | — |
| Numerator for diluted loss per share - net loss applicable to common shares | **$ (1,959)** | $ (1,706) |
| **DENOMINATOR** | | |
| Denominator for basis loss per share - weighted average shares | **7,115** | 7,109 |
| Effect of dilutive securities: | | |
| Convertible debentures | **—** | — |
| Options | **—** | — |
| Dilutive potential common shares | **—** | — |
| Denominator for diluted earnings per share - adjusted weighted average shares and assumed conversions | **7,115** | 7,109 |
| Basic and fully diluted loss per share | **$ (0.28)** | $ (0.24) |

**5. Share Capital (Continued)**

**(I) PRO FORMA STOCK BASED COMPENSATION TO EMPLOYEES**

As permitted under Canadian generally accepted accounting principles, stock based compensation is not recorded in the accounts of the Company under the fair value method of accounting for all employee stock based compensation. The Company must however disclose the pro forma effect on net loss and loss per share the options would have on the Company if accounted for under the fair value method.

The fair value of stock options used to compute pro forma net loss and net loss per share is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

| Weighted Average assumptions | |
|---|---|
| Expected dividend yield | 0.0% |
| Expected volatility | 79.5% |
| Risk-free interest rate | 5.0% |
| Expected option life in years | 6 years |

Had the Company applied the fair value method. The reported net loss and loss per common share would have increased to the pro forma amounts indicated below for the year ended December 31, 2002.

| (in thousands of dollars) | 2002 |
|---|---|
| Net loss – as reported | **$ 1,959** |
| Pro forma stock option expense | **32** |
| Net loss – pro forma | **1,991** |
| | |
| Basic and diluted loss per common share – as reported | **$ (0.28)** |
| Pro forma stock option expense impact | **—** |
| Basic and diluted loss per share – pro forma | **$ (0.28)** |

## 6. Income Taxes

The Company accounts for income taxes under the liability method. Under the liability method, a future tax asset would be recorded only to the extent that, based on available evidence, it is more likely than not that a future tax asset would be realized. The tax asset will be reduced by a valuation allowance to the extent that it is more likely than not that the asset would not be realized. The valuation allowance will be reviewed and adjusted, as appropriate for each reporting period. The Company has established the valuation allowance at 100% of all future tax assets.

| (in thousands of dollars) | 2002 | 2001 |
|---|---|---|
| Future tax asset for: | | |
| Tax losses carried forward | **$ 1,100** | $ 2,130 |
| Future tax deductions | **100** | |
| Non-deductible reserves | **900** | |
| Excess of undepreciated capital cost for tax purposes over net book value of plant and equipment | **5,210** | 4,230 |
| | **7,310** | 6,360 |
| Valuation allowance | **7,310** | 6,360 |
| Future tax asset | **$ —** | $ — |
| Provision for income taxes | | |
| Income taxes at statutory rate | **$ (680)** | $ (590) |
| Tax losses carried forward | **(1,030)** | (520) |
| Future tax deductions | **(50)** | |
| Non-deductible reserves | **780** | |
| Excess of amortization over capital cost allowance | **980** | 1,110 |
| Provision for income taxes | **$ —** | $ — |

If not utilized, the Company's non-capital loss carry forwards at December 31, 2002 will expire as follows:

| (in thousands of dollars) | |
|---|---|
| 2003 | $ 5 |
| 2004 | 1,521 |
| 2006 | 66 |
| 2007 | 1,588 |
| | $ 3,180 |

## 7. Changes in Non-Cash Operating Working Capital

The changes in non-cash operating working capital are comprised of the following:

| (in thousands of dollars) | 2002 | 2001 |
|---|---|---|
| Accounts receivable | **$ (1,504)** | $ 2,155 |
| Inventories | **(139)** | 1,511 |
| Prepaid expenses | **71** | 22 |
| Accounts payable and accrued liabilities | **263** | (1,213) |
| | **$ (1,309)** | $ 2,475 |

## 8. Financial Instruments

The Company's earnings are affected by fluctuations in interest rates and foreign exchange rates, and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to interest rate risk. The Company may enter into foreign exchange contracts with respect to its anticipated future cash flows from time to time.

**8. Financial Instruments (Continued)**

**CREDIT RISK**

Credit risk arises from the potential that a counterparty will fail to perform its obligations. The Company is exposed to credit risk from customers. However, the Company has a number of customers which minimizes concentration of credit risk, and the Company carries insurance with respect to certain of these customers.

**FOREIGN CURRENCY RISK**

Foreign currency risk arises because of fluctuations in exchange rates. The Company conducts a significant portion of its business activities in foreign currencies, primarily United States dollars. The assets, liabilities, revenue and expenses that are denominated in foreign currencies will be affected by changes in the exchange rate between the Canadian dollar and these foreign currencies.

**INTEREST RATE RISK**

Interest rate risk arises because of the fluctuation in interest rates. Significant portions of the Company's debt obligations are subject to interest rates, which vary with the lending institution's prime rates.

The Company has determined that the estimated fair value of financial instruments approximated their carrying value at December 31, 2002 and 2001. Fair value estimates are made at a specific point in time, using available information about the financial instrument. These estimates are subjective in nature and often cannot be determined with precision.

## 9. Commitments

**(A)** Minimum net annual rentals under operating leases for plant and office premises are as follows:

| (in thousands of dollars) | |
|---|---|
| 2003 | $ 360 |
| 2004 | 180 |
| | $ 540 |

The lease on the premises expires in June 2004, and includes an option to renew for five years at market rate.

**(B)** The Company operates an Employee Stock Ownership Plan (ESOP) whereby all employees are eligible to participate. Employees who participate are eligible to contribute 3% of their base earnings towards the open market purchase of the Company's common shares. The Company matches 50% of the employee's contribution each month. If certain yearly business targets are attained, the Company will contribute an additional 50%. The Company contributed $43,000 towards the ESOP in 2002 (2001 - $59,000). All Company contributions are used for the purchase of Company shares on behalf of the employees.

## 10. Segmented Information and Export Sales

Export sales were $21,520,000 and $23,348,000 during 2002 and 2001, primarily to the U.S. The Company does not have any reportable segments for years ended December 31, 2002 and December 31, 2001.

## 11. Comparative Figures

Certain comparative figures from the prior year have been restated to conform to the current year's presentation.

# Corporate Directory

## DIRECTORS

**Ray G. Harris**
Chairman, Circuit World Corporation
Consultant and Director, Bank of China (Canada)

**Gordon Roseborough**
President & Chief Executive Officer,
Circuit World Corporation

**Robert Beutel**
Vice-President, Oakwest Corporation Limited

**Valentine Lee**
Consultant

**Colin Walker**
Partner, Crosbie & Company Inc.

## OFFICERS

**Gordon Roseborough**
President and Chief Executive Officer

**John Bartkiw**
Vice-President and Chief Financial Officer

**Hardeep Heer**
Vice-President, Operations

**Robert Clarke**
Vice-President, Sales and Marketing

**Tom Gaber-Katz**
Vice-President, Finance and Administration

## ANNUAL GENERAL MEETING

All shareholders and other interested parties are cordially invited to attend the Annual General Meeting of Shareholders on Wednesday, June 25, 2003 at 10am at the Toronto Board of Trade, Downtown Centre, 1 First Canadian Place (entrance via Bay or Adelaide Street), 3rd Floor, Toronto, Ontario, Canada M5X 1C1.

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## STOCK LISTING

The Company's shares are traded on the Toronto Stock Exchange under the symbol CCW.

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