



# Management's discussion and analysis



**Q2  
2008**

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**Period ending June 30, 2008**

# **1. MANAGEMENT DISCUSSION AND ANALYSIS REPORT AS OF AUGUST 15, 2008**

## **1.1 INTRODUCTION**

The following management discussion and analysis report includes a review of the consolidated financial statements of Conporec inc. (the "Company") for the period ending on June 30, 2008. It must be read together with the audited consolidated financial statements of the Company and the accompanying notes for the period ending on December 31, 2007. The statements have been prepared according to the Generally Accepted Accounting Principles of Canada (Canadian GAAP), and are in Canadian dollars.

## **1.2 FORWARD-LOOKING STATEMENTS**

This report contains forward-looking statements. All statements with the exception of those regarding historical facts are forward-looking statements. Shareholders may retrieve many of these statements by using words such as "estimates", "plans", "could", "can", "may", "intends", "anticipates", "continues", other similar words or the negative of these words. There is nothing to guarantee that the plans, intentions or expectations on which the forward-looking statements are based will be realized. The forward-looking statements are subject to risks, uncertainties and assumptions, including those dealt elsewhere in the present report. Although the Company believes that the forecasts in these forward-looking statements are reasonable, there is no guarantee that they will be accurate. The section "Risks factors" presents the risks that could have an effect on future income and that could cause the actual income to differ greatly from the one predicted in the forward-looking statements.

The information in the present report shows other factors that may have an effect on the operating income and performance of the Company. Please read these factors cautiously.

The forward-looking statements presented are subject to the conditions of the present report. The forward-looking statements included are provided as of the date of the report and the Company will not update or publicly review these forward-looking statements to account for any new information, subsequent events, results, circumstances or other.

## **1.3 ADDITIONAL INFORMATION**

All references to the "EBITDA" in this document are representative of the earnings before interest, income taxes and depreciation. The term "EBITDA" is not defined by the Canadian GAAP however the Company believes that the presentation of EBITDA makes it easier to understand the financial conditions, operating income and cash assets since EBITDA is used by the Company to meet its obligations regarding its bank debt, the purchase of capital assets and other operating needs as well as the financial needs for its development.

## **1.4 FINANCIAL INFORMATION**

The following table presents Company's last two years financial performance. The annual data is extracted from the detailed financial information included in the Company's audited consolidated financial statements and the accompanying notes. The quarterly data was extracted from the non-audited Company's consolidated financial statements and the accompanying notes.

### Comparative financial information

(in thousands of Canadian dollars, except for the amounts per share)

	Year 2007	Year 2006	Q2-2008	Q1-2008	Q4-2007	Q3-2007	Q2-2007	Q1-2007
	(audited)				(unaudited)			
Income	7,554 \$	8,004 \$	2,358 \$	3,000 \$	2,369 \$	1,542 \$	1,841 \$	1,803 \$
Direct operating expenses	6,480 \$	6,652 \$	2,077 \$	2,527 \$	2,031 \$	1,598 \$	1,457 \$	1,394 \$
<b>Gross profit</b>	<b>1,075 \$</b>	<b>1,352 \$</b>	<b>281 \$</b>	<b>473 \$</b>	<b>338 \$</b>	<b>(56) \$</b>	<b>384 \$</b>	<b>409 \$</b>
Sales and administration costs	4,414 \$	4,322 \$	825 \$	901 \$	1,295 \$	847 \$	1,209 \$	1,063 \$
<b>Ebitda</b>	<b>(3,340) \$</b>	<b>(2,970) \$</b>	<b>(544) \$</b>	<b>(427) \$</b>	<b>(957) \$</b>	<b>(903) \$</b>	<b>(825) \$</b>	<b>(654) \$</b>
Financial expenses	327 \$	883 \$	31 \$	10 \$	66 \$	44 \$	26 \$	191 \$
Depreciation and Amortization	687 \$	692 \$	169 \$	168 \$	172 \$	178 \$	171 \$	165 \$
Profit from write-off of debts and debentures	(6,924) \$	- \$	- \$	- \$	- \$	- \$	- \$	(6,924) \$
Others items	- \$	(19) \$	- \$	- \$	- \$	- \$	- \$	- \$
<b>Net profit (loss)</b>	<b>2,570 \$</b>	<b>(4,526) \$</b>	<b>(744) \$</b>	<b>(605) \$</b>	<b>(1,195) \$</b>	<b>(1,125) \$</b>	<b>(1,022) \$</b>	<b>5,913 \$</b>
Net profit (loss) per share	0.21 \$	(0.77) \$	(0.06) \$	(0.05) \$	(0.09) \$	(0.09) \$	(0.08) \$	0.60 \$
Weighted average number of shares outstanding (thousands)	11,976	5,862	12,692	12,692	12,692	12,692	12,651	9,829
Cash flows related to operating activities	(2,852) \$	(3,064) \$	(121) \$	219 \$	223 \$	(620) \$	(849) \$	(1,607) \$
Total assets	20,150 \$	20,089 \$	19,738 \$	20,222 \$	20,150 \$	20,249 \$	21,352 \$	21,758 \$
Total debts and debentures	1,821 \$	13,258 \$	1,701 \$	1,778 \$	1,821 \$	1,754 \$	1,790 \$	563 \$
Shareholder's equity	13,399 \$	1,756 \$	12,009 \$	12,800 \$	13,399 \$	14,619 \$	15,757 \$	16,715 \$

## 1.5 Q2-2008 RESULTS ANALYSIS

The following tables present the results of the six-month period and the second quarter ending June 30, 2008 and a compare them with the corresponding periods of 2007.

### Summary of six-month results - Periods ending June 30, 2008 and 2007

	Six-month period		Increase	%	Note
	2,008	2,007	(Decrease)		
Income	5,358,373	3,643,937	1,714,436 \$	47.0%	1.5.1
Direct operating expenses	4,603,857	2,851,024	1,752,833 \$	61.5%	1.5.2
Gross profit	754,515	792,913	(38,398) \$	-4.8%	1.5.3
Sales and administration costs	1,725,654	2,272,586	(546,932) \$	-24.1%	1.5.4
Ebitda	(971,139)	(1,479,673)	508,534 \$	34.4%	1.5.5
Net profit (loss)	(1,349,461)	4,891,101	(6,240,562) \$	127.6%	1.5.6
<b>Net profit (loss) per share</b>	<b>(0.11)</b>	<b>0.43</b>	<b>(0.54) \$</b>		

### Summary of quarterly results - Periods ending June 30, 2008 and 2007

	Second quarter		Increase	%	Note
	2,008	2,007	(Decrease)		
Income	2,358,385	1,841,156	517,229 \$	28.1%	1.5.1
Direct operating expenses	2,077,119	1,457,203	619,916 \$	42.5%	1.5.2
Gross profit	281,266	383,953	(102,687) \$	0.0%	1.5.3
Sales and administration costs	825,154	1,209,249	(384,095) \$	-31.8%	1.5.4
Ebitda	(543,888)	(825,296)	281,408 \$	34.1%	1.5.5
Net profit (loss)	(744,136)	(1,022,218)	278,082 \$	27.2%	1.5.6
<b>Net profit (loss) per share</b>	<b>(0.06)</b>	<b>(0.08)</b>	<b>0.02 \$</b>		

### 1.5.1 INCOME

The Company ended its 2008 first six months period with revenues of \$5,4M, an increase of \$1,7M (or 47.0%) when compared with the same 2007 period. This increase is related to 2 factors:

1. An organic material volume increase generated from the new signed contract with the York municipality (Ontario) during the fourth quarter of 2007. Therefore, process facilities revenues improved to \$3,9M from \$3,3M for the same comparable periods;

2. The Mindarie Regional Council Recovery Facility (Australia) design/construction contract beginning did increase the development activities revenues from \$0,4M for the first six months of 2007 to \$1,5M for 2008.

For the second quarter of 2008, the revenues increase was 28.1% from \$1,8M for the second quarter of 2007 to \$2,4M in 2008.

#### **1.5.2 DIRECTS OPERATING EXPENSES**

The direct operating expenses were increased during the comparable six months period from \$2,9M to \$4,6M. The three following issues explain the costs increase:

1. The York contract volume increase has generated new operating expenses. Since the Bécancour facility is still under construction, the Company had to use costly subcontractors that offset the revenues increase. This situation will continue as long as the Bécancour facility will be under construction;
2. Recurring breakdowns at the Sorel-Tracy facility caused by non-quality material received from the Nicolet-Yamaska-Bécancour area. During the second quarter, Conporec was able to reduce significantly the number of breakdowns;
3. Expenses related to the design/construction contract of the Mindarie Regional Council Recovery Facility (Australia).

For the second quarter of 2008, the direct operating expenses increased from \$1,5M to \$2,1M.

#### **1.5.3 GROSS MARGIN**

The Company gross margin was stable at \$0,8M during the comparable six months period. However, the gross margin percentage decreased to 14.1% from 21.8% mainly because of additional costs due to the delays in the construction of the Bécancour facility that affected its efficiency and the recurring breakdowns suffered at the Sorel-Tracy facility, especially during the first quarter of 2008.

#### **1.5.4 SALES AND ADMINISTRATION COSTS**

The sales and administration costs were improved for the first six months of 2008 from \$2,3M to \$1,7M, a decrease of 24.1%. Despite that, the Company continued to be very active in its development effort particularly in France and Ontario (Canada). For the second quarter of 2008, the Company decreased its sales and administration costs to \$0,8M from \$1,2M in 2007 second quarter.

Moreover, management considers that these development efforts must be perceived as a long-term investment that should lead to several national and international contracts. A contract closing such as the one in Australia is the result of many years of marketing efforts and is supporting the business plan deployment of Conporec

#### **1.5.5 EARNING BEFORE INTEREST, TAXES, DEPRECIATION AND AMORTIZATION (EBITDA)**

The Company shows a negative EBITDA of \$1,0M compared with a negative EBITDA of \$1,5M for the first six months of 2007, an improvement of 34,4% in 2008.

For the second quarter of 2008, EBITDA was negative at \$0,5M compared with a negative EBITDA of \$0,8M in 2007, an improvement of 34,1%.

### **1.5.6 NET PROFIT**

The Company finished its first six months of 2008 with a loss of \$1,3M (or - \$0,11 per share). For the second quarter of 2008, the loss was \$0,7M (or - \$0,06 per share) compared to a loss of \$1,0M (or - \$0,08 per share) in 2007.

### **1.5.7 CASH FLOW**

Operating activities before non cash working capital items used \$1,0M for the first six months of 2008, an improvement of \$0,7M compared with the same 2007 period. This improvement came from the loss reduction before the debts and debentures redemption gain.

For the second quarter of 2008, operating activities before non cash working capital items used \$0,6M compared to \$0,8M in 2007.

Investing activities used only \$0,1M during the second quarter of 2008 since construction works at La Prade facility were practically stopped. The Company is still working to complete his financing round to complete the construction of this 40,000 tons annual organic material facility. For now, Conporec is working with costly subcontractors for the realisation of its Bécancour contracts.

The Company reimbursed \$76,787 of its long term debt during the second quarter of 2008.

### **1.5.8 FINANCIAL SITUATION**

The cash on hand decreased at only \$0,4M at June 30, 2008.

The Company working capital stands at a negative \$3,5M at the end of the second quarter of 2008, compared with a negative \$2,0M at the end of December 2007.

The fixed assets increase to \$15,4M mainly following the works done at Parc Industriel La Prade. They are composed of the Sorel-Tracy facility which has a book value of \$10,3M and \$5,1M for the La Prade facility.

The intangible assets at \$0,6M are related to the acquired technology of Biomax in July 2005.

Following the redemption of most of its debts in March 2007, the Company balance sheet shows total debts of \$1,7M, a shareholder's equity of \$12,2M and a debt/equity ratio of only 14%.

## **1.6 GOING CONCERN**

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

In March 2007, following a repayment \$3,750,000 and the issuance of 831,963 common shares, the Company had redeemed debt totalling \$12,904,000 from its liabilities, resulting in a gain on debt redemption of \$6,924,000. On December 22, 2006 and February 21, 2007, Amsterdams Effectenkantoor B.V. («AEK») had completed a common share private investment totalling \$11,500,000 in the Company. This restructuring of the Company's debt and equity, the private investment and the revenues from current operations had ensured that the Company continued as a going concern throughout 2007 and throughout the first two quarters of 2008.

The Company has incurred recurring operating losses and its accumulated deficit amounts to \$19,113,865 as at June 30, 2008

Conporec Inc. has announced that the Company requested and obtained on August 8, 2008 an initial ordinance from the Court under the terms of the Companies' Creditors Arrangement Act (CCAA). Until this initial 30 days period or until any other delay decided by the Court, this ordinance aims the Canadian activities of Conporec but do not affect its subsidiary companies Conporec SAS (France) and Conporec PTY (Australia).

The hypothesis of the exploitation continuity of the Company is based on its ability to obtain a temporary financing followed by an additional financing that is necessary to support its reorganization as per the CCAA Act. The management is currently looking on various financing scenarios and financing plan that would ensure the exploitation continuity beyond December 31, 2008. The current financial statements do not include any rectification, reclassification of assets and liability that could be necessary if the Company is unable to pursue its activities (see also note 10 – Subsequent Events of the Financial Report).

### 1.7 ISSUED AND OUTSTANDING SHARES

An unlimited number of common shares with no face value are authorized. On November 29, 2007, the Company proceeded to a ten to one consolidation of its outstanding common shares. All references to number of shares and per-share data include the consolidation.

They were no shares issuance during the quarter ending on June 30, 2008.

	<u>NUMBER</u>	<u>VALUE</u>
Balance as of December 31, 2007	12,692,413	\$24,130,837
No transaction during the quarter	0	\$ 0
Balance as of June 30, 2008	<u>12,692,413</u>	<u>\$ 24,130,837</u>

### 1.8 STOCK OPTIONS

The Company granted 75,000 options at an officer during the second quarter of 2008. These options are exercisable gradually during the next five years at the price of \$0.95 (see note 6 of the financial report). 40,000 options were cancelled during the quarter.

### 1.9 WARRANTS

Note 6 of the financial report presents the warrants still exercisable at the end of June 2008. During the quarter, 839,518 warrants granted June 23, 2005 expiring three years after at an exercisable price of \$5.70 each, were cancelled.

### 1.10 DEBTS AND DEBENTURES

The note 5 of the quarterly consolidated financial statements shows the detail of the debts and debentures as per June 30, 2008.

### 1.11 DERIVATIVE FINANCIAL INSTRUMENTS

The Company has no access to hedging instruments for foreign exchange risks of other nature.

### 1.12 OFF-BALANCE SHEET ARRANGEMENTS

The Company has no significant off-balance sheet agreement other than lease for its business place and rent of office equipments which will require disbursements of \$39,024 and \$3,404 each year for 2009, 2010 and 2011.

### 1.13 RELATED PARTY TRANSACTIONS

The following table presents transactions between related parties.

	<b>6 months June 30 2008</b>	<b>12 months December 31 2007</b>
<b>Transactions with companies controlled by directors</b>	<b>\$</b>	<b>\$</b>
Directs operating costs	3,000	21,510
Additions to property, plant and equipment	-	445,000

These transactions are in the normal course of business and measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

At the end of the period, accounts payable and accrued liabilities included the following amounts due to related parties:

	<b>June 30 2008</b>	<b>December 31 2007</b>
Shareholders	1,000	-
Companies controlled by directors	-	-
	1,000	-

### 1.14 ACCOUNTING POLICIES

The significant accounting policies adopted by the Company are indicated in notes "2" and "3" of the audited consolidated financial statements of December 31, 2007.

### 1.15 USE OF ESTIMATE

The Company consolidated financial statements were prepared by management in accordance with the Canadian GAAP. During the preparation of these financial statements, management must make estimates and formulate assumptions in regards to the amounts in the consolidated financial statements and accompanying notes. The actual results may differ from these estimates. According to management, the consolidated financial statements were adequately prepared using good judgment within their relative importance and according to the accounting principles summarized hereunder.

#### 1.15.1 FIXED ASSETS AND INTANGIBLE ASSETS WITH LIMITED-LIFE

The fixed assets and intangible assets with a limited useful life from Biomax in 2005 were accounted at cost and amortized according to their life estimated, the period during which we believe the assets will contribute to the future cash flow of the Company. The use of different assumptions based on the useful life could result in different book values.

#### 1.15.2 IMPAIRMENT OF LONG LIVED ASSETS

The long term assets were reviewed to determine whether they were subject to depreciation when events or changes in situation indicate that the book value of an asset may not be recoverable. The depreciation is valued by comparing the asset book value with the undiscounted future net cash flows anticipated in addition to its residual value. If an asset value is subject to depreciation, the amount of depreciation to be booked would correspond to the surplus of the book asset value of the asset over its fair market value.

### **1.15.3 STOCK-BASED COMPENSATION AND OTHER PAYMENTS**

Compensation related to the stock options granting is calculated according to the Black-Scholes pricing model. The Company considers estimates and assumptions concerning the risk-free interest rate, expected duration and expected volatility in order to establish the fair value of the stock options. The use of different assumptions could result in different compensations book values.

The Company's management must provide several assumptions that could affect the results of the stock options value, considering that the Company has little historical data. Consequently, the Company used assumptions according to its best judgment based on comparisons on the market and other available information sources.

### **1.16 SUBSEQUENT EVENTS**

Conporec Inc. ("Conporec" or the "Company"), announced on August 11, 2008 that the Company requested and obtained an initial ordinance from the Court under the terms of the Companies' Creditors Arrangement Act (CCAA). Until this initial 30 days period or until any other delay decided by the Court, this ordinance aims the Canadian activities of Conporec but do not affect its subsidiary companies Conporec SAS (France) and Conporec PTY (Australia).

The Board of Directors of Conporec, of which all the members remain in position, estimates that obtaining such an ordinance and the possible deposit of a Plan of Arrangement to the creditors are the only solutions to regain a viable financial health. Ernst &Young has been appointed as controller. In addition to the CCAA statutory responsibilities, Ernst &Young will also assist the management of Conporec to develop a Plan of Arrangement that could be acceptable for the creditors and to define the financial restructuring plan of the Company.

In addition, Conporec received notification from Hera Holdings SA about their intention not to pursue the contemplated private placement under the disclosed terms and conditions and for which the closing date was planned July 31<sup>st</sup> 2008. Conporec and Hera Holdings SA currently study other ways to team up in the development of projects. Consequently, Conporec definitively withdraws its intention to conclude a private placement according to the beforehand disclosed terms.

Consequently of the review of its operations under the terms of the LACC, Conporec also announces the temporary shut down of its Sorel-Tracy municipal solid waste facility. The resumption of the activities will be function of a new contractual agreement with the customers of this installation. However, Conporec continues its source separated organics composting activities at the La Prade Environmental Park (Bécancour, Ca) and also all of its engineering and construction activities, in particular for the Tournan-en-Brie plant (France) and for the Mindarie Regional Council plant (Australia).

In order to support the financial restructuring of Conporec, an arm's length subscriber has the intention to subscribe to a CA\$1.5M mortgage. This mortgage is conditional to a due diligence and a negotiation between the parties, which have to be completed within the next fifteen days. Conporec will disclose the name of the aforementioned subscriber at the end of this period and will also disclose any new information about the current situation of the Company.

### **1.17 CONTROLS AND PROCEDURES**

#### **1.17.1 DISCLOSURE CONTROLS AND PROCEDURES**

Conporec Inc.'s management evaluated the effectiveness of the design and operation of its disclosure controls and procedures, as defined under Multilateral Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings. The evaluation was performed under the supervision of the President and Chief Executive Officer ("CEO") and the Executive

vice president and Chief Financial Officer (“CFO”). Based on the evaluation of disclosure controls and procedures, the CEO and CFO have concluded that the Company’s disclosure controls and procedures were effective as at June 30, 2008.

#### **1.17.2 INTERNAL CONTROL OVER FINANCIAL REPORTING**

Conporec Inc.’s management is responsible for designing such internal controls over financial reporting, to provide reasonable insurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. No charges were made in Conporec Inc.’s internal control over financial reporting during the quarter ended June 30, 2008, that have materially affected, or are reasonably likely to materially affect, Conporec Inc.’s internal control over financial reporting.

#### **1.18 RISK FACTORS**

The risk factors that the Company is facing are described in section 3.7 of the 2007 annual information form. Additional risks and uncertainties that the Company is unaware of or deems to be negligible at this time could also adversely affect its operations. If any of these risks became reality, the Company's activities, financial situation, liquid assets and operating results could be significantly affected.