# PRISM EQUITIES INC.

# THIRD QUARTERLY REPORT

# 2000 - 2001

# Prism Equities Inc.
# Management's Discussion & Analysis of Financial Condition & Results of Operations
## <u>For Q3 Fiscal 2001</u>

**To The Shareholders:**

### Introduction

This discussion should be read in conjunction with the unaudited financial statements for the nine months ending August 31, 2001 and the Management Discussion and Analysis contained in the annual report.

### Overview

Prism Equities Inc. earned $570,472 or $.15 per share on a fully diluted basis for the nine months ending August 31, 2001 versus $261,903 or $0.10 per share for the same period in the 2000 fiscal year. For the three months ending August 31, 2001 after tax profit of $468,433 or $0.12 per share on a fully diluted basis represented an improvement of $511,269 over the same three-month period in fiscal 2000.

While pleased with the improvement over the financial results realized earlier in the year, and to last year's comparable period, management remains focused on further improvements. We do not expect the fourth quarter to be as profitable as the third because larger institutional sales for our medical hoisting device have not materialized as previously anticipated.

There is much to be done to improve our abilities and exploit available opportunities, particularly in an increased share in medical institutions and foreign homecare markets.

We are about to complete the development of a new type of lift based on unique technology, featuring tangible end user benefits. We expect market introduction early in the 2002 fiscal period and anticipate a positive impact on sales in the later stages of 2002.

Our non-core investment in Fosse Limited was sold at a small profit in the third quarter. We also sold U.K. based real estate and company automobiles acquired as part of the Westholme Limited acquisition in order to focus our capital on current assets required for growth and repayment of debt.

Zodiac Fabrics Limited continues to enjoy healthy sales growth and profitability. Its major equipment upgrade programme was finally completed in the third quarter which will increase cash flow available for debt reduction.

We continue to analyze acquisition opportunities but have found nothing that is both operationally attractive and reasonably priced. Efforts continue as the industry's structure favors consolidation.

**Results of Operations**

Total revenue for the third quarter was $6.1 million compared to $3.5 million in the third quarter of fiscal 2000, an increase of $2.6 millions (71.9%) over the same period last year. Total revenue for the nine months ending August 31, 2001 was $16.0 million compared to $8.1 million in fiscal 2000. While all subsidiaries experienced increased demand for their products during the quarter, $2.0 million of the third quarter increase in sales is attributable to the inclusion of Westholme Limited in the consolidated results for the full quarter compared to last year's inclusion for only part of the quarter. Westholme is a United Kingdom based distributor of homecare products, including ceiling lifts, acquired in August 2000.

Gross profit increased from $1.3 million in the third quarter of fiscal 2000 to $2.3 million in the third quarter of fiscal 2001. In the same period, gross profit as a percentage of sales increased from 36.0% of sales to 38.0%. Lower distributor gross margin sales by Westholme Limited were offset by the improvements in manufacturing gross margins achieved by Waverley Glen Systems Inc., our ceiling lift manufacturing subsidiary. Gross profit for the nine months ending August 31, 2001 was $6.0 million compared to $3.1 million in fiscal 2000.

Selling and administrative expenses increased by $189,950 to $1,356,403 for the third quarter of fiscal 2001 compared to the same period last year. The third quarter of last year included a management fee payable to a former shareholder of a subsidiary in final settlement of his rights to additional consideration under the terms of our acquisition of his company. Taking into account this non-recurring payment of $461,000 ($272,454 after tax), selling and administrative expenses have increased by $650,950 in the third quarter of fiscal 2001 compared to the same period last year. $415,000 of this increase is attributable to the inclusion of Westholme Limited in the consolidated results for the full quarter compared to last year's inclusion for only part of the quarter. The remaining $236,000 of the increase relates primarily to the addition of human resources. Selling and administrative expenses increased by $1.7 million to $4.0 million for nine months ending August 31, 2001 compared to the same period last year. Taking into account the non-recurring payment of $461,000, the increase for the nine months was $2,165,991 compared to the same period last year of which $1.5 million relates to Westholme Limited.

Earnings before gain on sale of assets, interest, taxes, depreciation and amortization (EBITDA) increased 458% to $1.0 million in the third quarter of fiscal 2001 compared to the same quarter in 2000. EBITDA for the nine months ending August 31, 2001 was $2.2 million or 124% higher compared to the same period in fiscal 2000 reflecting the impact of fixed selling and administrative expenses in a seasonally weaker first quarter sales period.

Interest costs for the quarter were $191,689 compared to $97,875 in the same period last year and $603,621 for the nine months ending August 31, 2001 compared to $242,138 for the same period last year. This increase in interest costs reflects the cost of the new debt acquired to purchase Westholme Limited and to finance working capital growth.

Amortization costs increased to $266,538 in this quarter compared to $135,709 in the same quarter last year. Amortization costs increased to $844,842 in the nine months ending August 31, 2001 compared to $323,269 in the same period last year due to the increased depreciable and intangible asset base of the Company and its subsidiaries.

**Financial Position**

Working capital increased by $570,584 in the third quarter. The majority of the increase is attributable to an increase in accounts receivable due to a higher level of sales and a slower collection pattern through the summer months. This increase was offset by a reduction in prepaid expenses resulting from the application of deposits made in the second quarter for new production equipment that went into service in the third quarter.

Cash used for capital expenditures in the third quarter of 2001 totaled $428,831. The majority of these expenditures were the part of the major equipment upgrade programme in Zodiac Fabrics Inc.

Capital assets decreased in the quarter as a result of the sale and leaseback of land and building in the United Kingdom. An exchange of contracts occurred on August 31, 2001 for the sale of the land and building with a final settlement in early October 2001. Outstanding proceeds from the sale of the building are presented as other receivables on the balance sheet. The company also sold a number of company owned automobiles in the quarter and replaced them with leased vehicles. Proceeds from the sale of these assets will be used for working capital requirements and future debt reduction. A gain of $117,393 was recognized on the disposal of fixed assets in the quarter.

The Company sold its minority investment in the share capital of Fosse Ltd. and its parent company No. 354 Leicester Ltd. for proceeds of $218,718. Consideration was received in the form of $41,167 in cash and a fully secured note receivable totaling $177,551 repayable in 60 equal monthly installments commencing in July 2001. A small gain of $3,338 was recognized on the sale during the quarter.

Deferred charges increased by $185,919 in the quarter reflecting primarily the ongoing product development work being done within the medical products group.

New long-term debt in the amount of $300,000 was added during the quarter to finance the Company's purchase of capital assets. Offsetting the addition of the new term debt was the scheduled mortgage and capital lease payments and the annual principal repayment of the vendor take back notes.

Share capital increased by 62,500 common shares and $115,625 in the third quarter as a result of the exercise of share purchase warrants that were part of a private placement completed in conjunction with the acquisition of Westholme Limited.

Andrew A. McIntyre
President and Chief Executive Officer
October 29, 2001

# PRISM EQUITIES INC.
## CONSOLIDATED BALANCE SHEETS

| | August 31 2001 | November 30 2000 |
|---|---|---|
| | (unaudited) | (audited) |
| **ASSETS** | | |
| **Current** | | |
| Accounts receivable | **$4,582,319** | $4,266,302 |
| Inventory | **2,785,348** | 2,307,893 |
| Other receivables (note 4) | **654,477** | 0 |
| Prepaid expenses | **472,176** | 470,587 |
| Current portion note receivable | **38,201** | 0 |
| | **8,532,521** | 7,044,782 |
| **Long-term** | | |
| Capital (note 1 and 4) | **4,524,858** | 4,777,713 |
| Notes receivable | **219,568** | 78,429 |
| Other investments (note 3) | **19,631** | 235,011 |
| Deferred charges | **1,387,670** | 940,991 |
| Goodwill (note 1) | **2,786,836** | 2,962,086 |
| | **8,938,563** | 8,994,230 |
| | **$ 17,471,084** | $ 16,039,012 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **Current liabilities** | | |
| Bank indebtedness | **1,687,429** | 653,748 |
| Accounts payable and accrued liabilities | **2,484,371** | 2,759,922 |
| Income taxes payable | **269,277** | 495,461 |
| Current portion of long-term debt | **1,372,637** | 758,515 |
| | **5,813,714** | 4,667,646 |
| **Long-term debt** | **5,761,199** | 6,804,784 |
| **Future income tax liability (note 1)** | **526,585** | 468,341 |
| | **12,101,498** | 11,940,771 |
| **Shareholders' equity** | | |
| Capital stock (note 5) | **3,322,206** | 2,685,139 |
| Foreign exchange translation adjustment | **27,518** | (27,063) |
| Retained earnings | **1,953,059** | 1,373,362 |
| Contributed surplus | **66,803** | 66,803 |
| | **5,369,586** | 4,098,241 |
| | **$ 17,471,084** | $ 16,039,012 |

**Approved by the Board:**

"Signed - Andrew A. McIntyre"
**Director**

"Signed - Robert Gibb"
**Director**

# PRISM EQUITIES INC.
## CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | **August 31 2001** | August 31 2000 | **August 31 2001** | August 31 2000 |
| **Sales** | **$ 6,132,001** | $ 3,566,230 | **$ 16,000,975** | $8,126,416 |
| **Cost of goods sold** | | | | |
| Direct costs and manufacturing overhead | **3,733,200** | 2,212,861 | **9,785,806** | 4,848,153 |
| Amortization | **71,400** | 38,910 | **210,000** | 185,742 |
| | **3,804,600** | 2,251,771 | **9,995,806** | 5,033,895 |
| **Gross profit** | **2,327,401** | 1,314,459 | **6,005,169** | 3,092,521 |
| **Selling and administrative expenses** | | | | |
| Selling and administrative expenses | **1,356,403** | 1,166,453 | **3,992,070** | 2,287,079 |
| Interest | **191,689** | 97,875 | **603,621** | 242,138 |
| Amortization | **117,352** | 73,073 | **394,890** | 90,451 |
| Amortization of Goodwill | **77,786** | 23,726 | **239,952** | 47,076 |
| | **1,743,230** | 1,361,127 | **5,230,533** | 2,666,744 |
| **Income (loss) before undernoted** | **584,171** | (46,668) | **774,636** | 425,777 |
| Gain on sale of investments (note 3) | **3,338** | 0 | **3,338** | 0 |
| Gain on sale of fixed assets (note 4) | **117,393** | 0 | **115,323** | 0 |
| **Income before provision for income taxes** | **704,902** | (46,668) | **893,297** | 425,777 |
| **Provision for income taxes** | | | | |
| Current | **231,312** | (3,832) | **342,606** | 163,874 |
| Future | **5,157** | | **(19,781)** | 0 |
| | **236,469** | (3,832) | **322,825** | 163,874 |
| **Net income (loss) for the period** | **$ 468,433** | ($42,836) | **$ 570,472** | $ 261,903 |
| **Earnings (loss) per share** | | | | |
| **Basic** | **$0.14** | ($0.02) | **$0.18** | $0.12 |
| **Fully diluted** | **$0.12** | ($0.02) | **$0.15** | $0.10 |

# PRISM EQUITIES INC.
## CONSOLIDATED STATEMENTS OF RETAINED EARNINGS
(unaudited)

| | Nine months ended August 31 2001 | Nine months ended August 31 2000 |
|---|---|---|
| Retained earnings, beginning of period | $ 1,373,362 | $ 984,028 |
| Adjustment for changes in accounting policies | 9,225 | $ - |
| Net income for the period | 570,472 | 261,904 |
| Retained earnings, end of period | $ 1,953,059 | $ 1,245,932 |

# PRISM EQUITIES INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | **August 31 2001** | August 31 2000 | **August 31 2001** | August 31 2000 |
| **Cash was provided by (applied to):** | | | | |
| **Operating activities** | | | | |
| Net income (loss) for the period | **$468,433** | $ (42,836) | **$570,472** | $ 261,904 |
| Items not affecting cash: | | | | |
| Future income tax liability | **6,256** | 0 | **(19,781)** | (158,900) |
| Amortization | **266,539** | 135,709 | **844,842** | 323,269 |
| Gain on disposal of fixed assets | **(117,393)** | - | **(115,323)** | - |
| Gain on sale of investments | **(3,338)** | - | **(3,338)** | - |
| Net change in non-cash working capital | **(570,584)** | 465,609 | **(1,263,623)** | 304,487 |
| | **49,913** | 558,482 | **13,249** | 730,760 |
| **Investing activities** | | | | |
| Proceeds from sale of automobiles | **152,736** | - | **162,675** | - |
| Proceeds from sale of building | **629,496** | - | **629,496** | - |
| Acquisition of subsidiary | **(32,201)** | (3,416,239) | **(32,201)** | (3,416,239) |
| Proceeds on sale of investments | **218,718** | - | **218,718** | - |
| Purchase of capital assets | **(428,831)** | (88,556) | **(781,111)** | (599,715) |
| Other assets | **0** | - | **-** | 9,309 |
| Deferred costs | **(185,919)** | (323,260) | **(570,769)** | (485,802) |
| | **353,999** | (3,828,055) | **(373,192)** | (4,492,447) |
| **Financing activities** | | | | |
| Issuance, net of repayment, of notes receivable | **(177,551)** | 14,138 | **(175,799)** | 18,882 |
| Issuance of other receivable | **(629,496)** | - | **(629,496)** | - |
| Advance of long term debt | **300,000** | 3,900,000 | **300,000** | 3,900,000 |
| Repayment of long-term debt | **(288,304)** | (380,721) | **(482,511)** | (626,735) |
| Issuance of capital stock | **115,625** | 431,547 | **337,068** | 885,259 |
| | **(679,726)** | 3,964,964 | **(650,738)** | 4,177,406 |
| **Effect of exchange rate changes on cash** | **(21,713)** | 1,380 | **(23,000)** | 1,380 |
| **Increase (decrease) in cash balance for the period** | **(275,814)** | 695,391 | **(1,010,681)** | 415,719 |
| **Cash (bank indebtedness), beginning of the period** | **(1,389,902)** | (536,818) | **(653,748)** | (257,146) |
| **Cash (bank indebtedness), end of the period** | **($1,687,429)** | $159,953 | **($1,687,429)** | $159,953 |

# PRISM EQUITIES INC.

**Notes to Consolidated Financial Statements**

### 1. Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared by the Corporation in accordance with accounting principles generally accepted in Canada on a basis consistent with those followed in the most recent audited financial statements, except for the method of accounting for income taxes and computing diluted earnings per common share as described in Note 2. These unaudited financial statements do not include all the information and footnotes required by generally accepted accounting principles for annual financial statements and therefore should be read in conjunction with the audited consolidated financial statements and notes included in the Corporation's Annual Report for the year ended November 30, 2000.

### 2. Change in accounting policies

Effective December 1, 2000, the Corporation adopted the liability method of accounting for income taxes as required by the new CICA section #3465.

Under the new accounting section future tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the corresponding tax bases of assets and liabilities measured using the enacted or substantively enacted tax rates expected to apply to taxable income

Prior to the new standard, income tax expense was determined using the deferral method of tax allocation. Future tax expense was based on items of income and expense that were reported in different years in the financial statements and tax returns and measured at the tax rate in effect in the year the difference originated.

The change in accounting policy has been applied retroactively as at November 30, 2000 and resulted in increases in capital assets of $54,750., goodwill of $32,500 and future income tax liability of $78,025. The cumulative effect, of this change, as of December 1, 2000, was an increase in opening retained earnings of $9,225. Comparative financial statements have not been restated.

Effective March 1, 2001, the Corporation retroactively adopted the new recommendations of the CICA with respect to the computation of diluted earnings per common share. Under the new standards, the treasury stock method is used for calculating diluted earnings per share. Previously, the imputed earnings approach was used.

Diluted earnings per common share for the third quarter of 2000 and the nine months ended August 31, 2000 were unaffected by this change.

### 3. Other Investment

During the quarter the company sold its minority investment in the share capital of Fosse Ltd. and its parent company No. 354 Leicester Ltd. Consideration was received in the form of $41,167. in cash and fully secured notes totaling $177,551. repayable in 60 equal monthly installments commencing in July 2001.

### 4. Other Receivable

An exchange of contracts occurred on August 31, 2001 for the sale and leaseback of the land and building in the United Kingdom. Outstanding proceeds from the sale of the land and building are presented as Other Receivables on the balance sheet. This receivable was subsequently collected in early October 2001. The company has entered into a ten-year lease at current market rates. A gain of $121,095 was recognized on the sale.

### 5. Share Capital

The authorized and issued share capital consists of the following:

| | August 31 2001 | November 30 2000 |
|---|---|---|
| **Issued and outstanding:** | | |
| Common shares | 3,342,780 | 2,833,887 |
| Share Capital | $3,322,206 | $2,685,139 |

On April 26, 2000, a rights offering was completed with 322,238 common shares and 322,238 warrants issued pursuant to the offering. Two warrants entitled the holder to purchase one common share for $1.85 Canadian. The warrants expired April 25, 2001. On April 25, 2001, 292,791 share purchase warrants were exercised resulting in the issuance of 146,393 common shares for net proceeds of $221,443.

During the quarter, a $300,000 note payable due to the spouse of the company's president was converted, at the option of the holder, into common shares of the Corporation. The note was convertible at the rate of 1 common share for $1 of principal resulting in the issuance of 300,000 common shares.

On July 31, 2000, in conjunction with the acquisition of Westholme Ltd., a private placement was completed. 281,250 common shares were issued with warrants convertible into 140,625 common shares on or before July 31, 2001. On July 31, 2001, 62,500 common shares were issued for net proceeds of $115,625.

## 6. Earnings per share

The following is a reconciliation of the numerator and denominator of the basic and diluted per share computations:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | **August 31 2001** | August 31 2000 | **August 31 2001** | August 31 2000 |
| Net income (loss) | **$468,433** | ($42,836) | **$570,472** | $261,903 |
| After-tax income from convertible securities | **18,494** | 0 | **61,867** | 70,693 |
| Adjusted income for fully diluted earnings per share | **$486,927** | (42,836) | **$632,339** | $332,596 |
| Weighted average number of common shares outstanding | **3,301,340** | 2,343,657 | **3,096,755** | 2,136,288 |
| Effect of dilutive securities | **850,886** | 0 | **990,178** | 1,151,384 |
| Weighted average number of dilutive common shares outstanding | **4,152,226** | 2,343,657 | **4,086,933** | 3,287,672 |
| Basic earnings per share | **$0.14** | ($0.02) | **$0.18** | $0.12 |
| Fully diluted earnings per share | **$0.12** | ($0.02) | **$0.15** | $0.10 |

## 7. Information by Industry Segment

### a) Industry segments:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | **August 31 2001** | August 31 2000 | **August 31 2001** | August 31 2000 |
| **Net revenues from customers outside the enterprise** | | | | |
| Industrial knitted fabrics | **$1,359,776** | $1,188,329 | **$3,572,092** | $3,045,713 |
| Medical products | **4,770,291** | 2,339,766 | **12,423,210** | 4,982,568 |
| Other | **1,934** | 38,135 | **5,673** | 98,135 |
| Total | **6,132,001** | 3,566,230 | **16,000,975** | 8,126,416 |
| **Operating profit (loss) before interest and income tax** | | | | |
| Industrial knitted fabrics | **$231,033** | $196,649 | **$643,852** | $469,015 |
| Medical products | **807,403** | (85,954) | **1,232,477** | 349,586 |
| Other | **(141,845)** | (59,488) | **(379,411)** | (150,685) |
| Total | **$896,591** | $51,207 | **$1,496,918** | $667,916 |
| **Total assets** | | | | |
| Industrial knitted fabrics | **$5,111,601** | $5,019,731 | **$5,111,601** | $5,019,731 |
| Medical products | **12,041,185** | 9,530,459 | **12,041,185** | 9,530,459 |
| Other | **318,296** | 1,094,083 | **318,296** | 1,094,083 |
| Total | **$17,471,082** | $15,644,273 | **$17,471,082** | $15,644,273 |
| **Capital asset expenditures** | | | | |
| Industrial knitted fabrics | **$356,940** | $196,755 | **$486,520** | $941,603 |
| Medical products | **70,056** | 39,147 | **326,195** | 212,033 |
| Other | **1,835** | 0 | **21,444** | 43,735 |
| Total | **$428,831** | $235,902 | **$834,159** | $1,197,371 |
| **Amortization** | | | | |
| Industrial knitted fabrics-amortization of deferred charges | **$0** | $0 | **$2,632** | $0 |
| Industrial knitted fabrics-amortization of capital assets | **93,737** | 60,000 | **240,087** | 180,000 |
| Industrial knitted fabrics-amortization of goodwill | **1,625** | 0 | **4,875** | 0 |
| Medical products-amortization of capital assets | **49,808** | 42,567 | **231,458** | 81,399 |
| Medical products-amortization of deferred charges | **42,761** | 6,238 | **114,858** | 6,238 |
| Medical products-amortization of goodwill | **72,911** | 23,726 | **235,077** | 47,076 |
| Other - amortization of capital assets | **3,496** | 978 | **9,255** | 1,956 |
| Other - amortization of deferred charges | **2,200** | 2,200 | **6,600** | 6,600 |
| Total | **$266,538** | $135,709 | **$844,842** | $323,269 |
| **Total industry segments** | | | | |
| Net revenue from customers outside the enterprise | **$6,132,001** | $3,566,230 | **$16,000,975** | $8,126,416 |
| Segmented operating profit before the following | **896,591** | 51,207 | **1,496,918** | 667,915 |
| Interest expense | **191,689** | 97,875 | **603,621** | 242,138 |
| Provision for income taxes | **236,469** | (3,832) | **322,825** | 163,874 |
| Net profit | **$468,433** | ($42,836) | **$570,472** | $261,903 |
| **Export sales** | | | | |
| Industrial knitted fabrics | **853,192** | 555,944 | **2,135,981** | 1,665,522 |
| Medical products | **704,008** | 939,252 | **1,715,718** | 1,816,089 |
| Total | **$1,557,200** | $1,495,196 | **$3,851,699** | $3,481,611 |

**b) Geographic segments:**

| | | | | |
|---|---|---|---|---|
| **Sales** | | | | |
| Canada | **$3,397,338** | $2,833,400 | **$8,314,105** | $7,393,586 |
| United Kingdom | **2,734,663** | 732,830 | **7,686,870** | 732,830 |
| Total | **$6,132,001** | $3,566,230 | **$16,000,975** | $8,126,416 |
| **Capital assets** | | | | |
| Canada | **$4,365,486** | $3,772,304 | **$4,365,486** | $3,772,304 |
| United Kingdom | **159,372** | 895,273 | **159,372** | 895,273 |
| Total | **$4,524,858** | $4,667,577 | **$4,524,858** | $4,667,577 |
| **Goodwill** | | | | |
| Canada | **$366,200** | $385,276 | **$366,200** | $385,276 |
| United Kingdom | **2,420,636** | 2,650,507 | **2,420,636** | 2,650,507 |
| Total | **$2,786,836** | $3,035,783 | **$2,786,836** | $3,035,783 |

## 8. Seasonal Nature of Business

The Corporation has historically experienced lower demand for its products and services in the first quarter of the fiscal year.  This demand pattern is principally a result of the Christmas holidays when less medical equipment is prescribed and installed.