



ENABLENCE TECHNOLOGIES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS ("MD&A")

FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2017

DATED: FEBRUARY 28, 2018

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following is a discussion and analysis of the financial condition of Enableness Technologies Inc. ("Enableness" or the "Company") at December 31, 2017 compared to June 30, 2017 and results of operations for the three and six months ended December 31, 2017 compared to the three and six months ended December 31, 2016.

This MD&A should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes for the three and six months ended December 31, 2017 as well as our audited consolidated financial statements and accompanying notes for the year ended June 30, 2017. References made herein to "Enableness", the "Company", "we" and "our" mean Enableness, its subsidiaries, collectively, unless the context indicates otherwise. All amounts (including numbers of common shares, options and warrants) included in the MD&A are in thousands, except per share amounts or as otherwise indicated. All financial amounts are in US\$, unless stated otherwise. Other continuous disclosure filings for the Company are available on [www.sedar.com](http://www.sedar.com)

While the financial statements have been prepared on the basis of accounting principles applicable to a going concern, several adverse conditions and events cast substantial doubt upon the validity of this assumption at this time. The Company's continued existence is dependent upon its ability to secure additional financing and to attain profitable operations. Management is active in addressing these issues although there is no assurance that they will be successful. If the going concern assumption were not appropriate for these financial statements, adjustments might be necessary in the carrying values of assets and liabilities and the balance sheet classifications.

The effective date of this MD&A is February 28, 2018.

### **FORWARD-LOOKING STATEMENTS**

This MD&A includes certain forward-looking statements that are based upon current expectations, which involve risks and uncertainties associated with our business and the environment in which the business operates. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements, including those identified by the expressions "anticipate", "believe", "plan", "estimate", "expect", "intend" and similar expressions to the extent they relate to the Company or its management. The forward-looking statements are not historical facts, but reflect management's current expectations regarding future results or events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. The Company does not undertake or accept any obligation to release publicly any updates or revisions to any forward-looking statements to reflect any change in the Company's expectations, except as prescribed by applicable securities laws.

Key assumptions made in preparing the forward-looking statements contained in this MD&A include, but are not limited to, the following:

- The Company will be able to raise sufficient financing to meet its financial obligations as they come due, and will be able to renegotiate certain financial obligations as they come due.
- The Company will continue to successfully reduce product costs to improve the Company's gross margin and/or avoid any margin erosion associated with competitive pricing pressure.
- Enableness will develop and deliver new products on time in order to satisfy the requirements of current and future customers and contribute to near-term profitability.
- Enableness will be able to attract and retain key people

## **SUBSEQUENT EVENTS**

Subsequent to the year end the Company received unsecured short term loans in the amount of \$1,208 of which \$230 was from related parties and bears interest at 10% (see Related Party section), \$478 was from non-related parties and bears interest at 10% and the balance of \$500 is non-interest bearing from a non-related party and includes a 2.5% financing fee.

## **OVERVIEW**

### ***ENABLENCE'S BUSINESS***

Enablence designs, manufactures and sells optical components and subsystems for all three segments of optical networks - access, metro and long-haul markets - to a global customer base. It utilizes its patented technologies, including planar lightwave circuit ("PLC") intellectual property, know-how and trade secrets in the production of an array of photonic components. The Company's product lines address: access - connecting homes and businesses to the network; metro - communication rings within cities of different sizes; and long-haul - linking cities, countries and continents. The Company offers leading expertise in transmission, switching & routing, wavelengths management, and signal performance management for networks ranging from 1.25 to 100 gigabits per second. The Company's current product line includes multiple wavelength channel transmission and receiving optical subassembly (TOSA/ROSA), and wavelength management products. The Company is expanding its TOSA/ROSA production capacity by collaborating with a manufacturing partner. The Company also earns revenues from engineering and design services, generally for products on the Company's roadmap and retains any IP developed under such contracts.

Enablence's PLC optical chip technology enables the integration of sub-components (such as waveguides, photodetectors, lasers and trans-impedance amplifiers) onto one silicon based platform, which forms a hybrid photonic integrated circuit ("PIC") chip. The Company's core technology is portable to many markets that require filtering technology to separate and multiplex various optical signals. The chip-based integration capabilities of the Enablence platform technology makes it a solution for an array of applications including telecommunications, cloud data centres, sensor systems, biomedical and aerospace applications.

## **RESULTS OF OPERATIONS**

### **Summary of Unaudited Quarterly Results**

The following table sets forth unaudited summary results of operations for the past eight quarters. The information for the fiscal period ended March 31, 2016 and subsequent quarters has been taken from our unaudited consolidated financial statements that, in management's opinion, have been prepared on a basis consistent with the unaudited consolidated financial statements for the fiscal period ended December 31, 2017.

All normal recurring adjustments necessary for a fair presentation of information presented, have been included in the amounts stated below to present fairly the unaudited quarterly results when read in conjunction with the above-noted consolidated financial statements.

	<u>31-Mar</u> <u>2016</u>	<u>30-Jun</u> <u>2016</u>	<u>30-Sep</u> <u>2016</u>	<u>31-Dec</u> <u>2016</u>	<u>31-Mar</u> <u>2017</u>	<u>30-Jun</u> <u>2017</u>	<u>30-Sep</u> <u>2017</u>	<u>31-Dec</u> <u>2017</u>
Revenue	\$ 544	\$ 680	\$ 548	\$ 925	\$ 738	\$ 1,236	\$ 1,926	\$ 1,230
Gross Margin	(247)	(720)	(175)	(137)	(246)	\$ (171)	\$ 106	\$ (649)
GM %	(45.4%)	(105.9%)	(31.9%)	(14.8%)	(33.3%)	(13.8%)	5.5%	(52.8%)
Expenses								
Research & development	1,177	1,227	1,134	1,040	1,027	1,414	1,435	927
Sales & marketing	1	9	6	7	69	79	47	60
General & administration	704	509	535	558	532	712	567	588
Stock-based compensation	71	112	84	82	81	53	33	33
Expenses	<u>1,953</u>	<u>1,857</u>	<u>1,759</u>	<u>1,687</u>	<u>1,709</u>	<u>2,258</u>	<u>2,082</u>	<u>1,608</u>
Operating loss	<u>(2,200)</u>	<u>(2,577)</u>	<u>(1,934)</u>	<u>(1,824)</u>	<u>(1,955)</u>	<u>(2,429)</u>	<u>(1,976)</u>	<u>(2,257)</u>
Finance and other expense	(24)	(316)	(94)	(127)	(217)	(44)	(358)	(412)
Gain on settlement of debt	-	176	-	-	-	-	-	-
Loss on sale of equipment	(127)	-	-	-	-	-	-	-
Foreign exchange (loss) gain	17	8	(1)	(14)	(11)	19	5	(37)
Net loss	<u>(2,334)</u>	<u>(2,709)</u>	<u>(2,029)</u>	<u>(1,965)</u>	<u>(2,183)</u>	<u>(2,454)</u>	<u>(2,329)</u>	<u>(2,706)</u>
Weighted average shares outstanding	469,858	395,085	509,071	515,707	560,541	589,403	621,929	621,929
Basic and diluted income (loss) per share	(\$0.01)	(\$0.01)	\$0.00	(\$0.01)	\$0.00	(\$0.01)	(\$0.00)	(\$0.00)
Adjusted EBITDA <sup>(1)</sup>	(1,888)	(2,406)	(1,710)	(1,617)	(1,685)	(2,163)	(1,747)	(2,028)

(1) Adjusted EBITDA does not have a standardized meaning according to IFRS and is defined and reconciled to net income (loss) below.

## NON-GAAP FINANCIAL MEASURES

Management reports and analyzes its financial results and performance using a range of financial measures. Some of these measures, such as revenues, net income and cash flow from operating activities, are defined by IFRS. Other measures are not defined by IFRS.

One key non-IFRS measure used by management is “Adjusted EBITDA”. The Company discloses Adjusted EBITDA as a supplemental non-GAAP financial performance measure because the Company believes it is a useful metric by which to compare the performance of our business from period to period. The Company understands that measures similar to Adjusted EBITDA are broadly used by analysts, rating agencies and investors in assessing our performance. Accordingly, we believe that the presentation of Adjusted EBITDA provides useful information to investors.

Adjusted EBITDA comprises: net income (loss) excluding the following: finance income and expense, income tax recovery and expense, depreciation, amortization, losses on write-off or sale of equipment, foreign exchange gains and losses in earnings, and stock-based compensation expense. Therefore, it may not be comparable to similar measurements presented by other companies. The reconciliation of Adjusted EBITDA with the IFRS measure of net income (loss) is as follows:

	<u>31-Mar</u> <u>2016</u>	<u>30-Jun</u> <u>2016</u>	<u>30-Sep</u> <u>2016</u>	<u>31-Dec</u> <u>2016</u>	<u>31-Mar</u> <u>2017</u>	<u>30-Jun</u> <u>2017</u>	<u>30-Sep</u> <u>2017</u>	<u>31-Dec</u> <u>2017</u>
Net loss for the period	(2,334)	(2,709)	(2,029)	(1,965)	(2,183)	(2,454)	(2,329)	(2,706)
Add (deduct):								
Net interest and other expense	24	316	94	127	217	44	358	412
Amortization	241	59	140	125	189	213	196	196
Gain on settlement of debt	-	(176)	-	-	-	-	-	-
Loss on sale of equipment	127	-	-	-	-	-	-	-
Foreign exchange (gain) loss	(17)	(8)	1	14	11	(19)	(5)	37
Stock-based compensation expense	71	112	84	82	81	53	33	33
<b>"Adjusted EBITDA"</b>	<u>(1,888)</u>	<u>(2,406)</u>	<u>(1,710)</u>	<u>(1,617)</u>	<u>(1,685)</u>	<u>(2,163)</u>	<u>(1,747)</u>	<u>(2,028)</u>

## SUMMARY OF RESULTS FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2017 COMPARED TO THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2016

The following table sets forth a summary of key earnings information from our consolidated financial statements for the three and six months ended December 31, 2017 and 2016.

	Three months ended			Six months ended			
	December 31,		Increase	December 31,		Increase	
	2017	2016	(decrease)	2017	2016	(decrease)	
Revenues	\$ 1,230	\$ 925	\$ 305	\$ 3,156	\$ 1,473	\$ 1,683	114%
Cost of revenues	1,879	1,062	817	3,699	1,785	1,914	107%
Gross margin	(649)	(137)	(512)	(543)	(312)	(231)	43%
	(53%)	(15%)		(17%)	(21%)		
Operating expenses:							
Research and development	927	1,040	(113)	2,362	2,174	188	9%
Sales and marketing	60	7	53	107	13	94	723%
General and administrative	588	558	30	1,155	1,093	62	6%
Stock based compensation	33	82	(49)	66	166	(100)	(60%)
Total operating expenses	1,608	1,687	(79)	3,690	3,446	244	7%
Loss from operations	(2,257)	(1,824)	(433)	(4,233)	(3,758)	(475)	13%
Other income (expenses):							
Finance and other income (expense)	(54)	-	(54)	(55)	-	(55)	
Finance expense	(358)	(127)	(231)	(715)	(221)	(494)	69%
Foreign exchange gain(loss)	(37)	(14)	(23)	(32)	(15)	(17)	
Net loss	(2,706)	(1,965)	(741)	(5,035)	(3,994)	(1,041)	21%
Other comprehensive income (net of tax):			-			-	
Foreign currency translation gain(loss)	(43)	120	(163)	212	135	77	36%
Comprehensive loss	\$ (2,749)	\$ (1,845)	\$ (904)	\$ (4,823)	\$ (3,859)	\$ (964)	20%

Enablene converts foreign currency-denominated transactions related to the statement of comprehensive loss at the average exchange rates for the periods. As such, changes in the exchange rate between the United States dollar and the Canadian dollar can have an impact on the reported results for each fiscal period. The average exchange rate for the three and six months ended December 31, 2017 in terms of the Canadian dollar equivalent of US\$1 was CAD \$1.2715 (three months ended December 31, 2016 – CAD \$1.334) and CAD \$1.262 (six months ended December 31, 2016 – CAD \$1.319).

### REVENUES

Revenue for the three months ended December 31, 2017 was \$1,230 as compared to \$925 for the same period of the prior year and revenue for the six months ended December 31, 2017 was \$3,156 as compared to \$1,473 for the same period of the prior year. The increase in the current year's periods is primarily due to the increase in sales volume of the Company's new TOSA/ROSA product in the current quarter compared to the same quarter of the prior year.

During the six months ended December 31, 2017 one customer accounted for 79% of the Company's total revenue and during the six months ended December 31, 2016 one customer accounted for 66% of the Company's total revenue.

The geographic split of revenue (based on ship-to location of the customer) is as follows:

	Three months ended		Six months ended	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
	\$	\$	\$	\$
Americas	193	-	203	96
Asia Pacific	1,034	770	2,514	1,155
Europe, Middle East, Africa	3	155	439	222
	1,230	925	3,156	1,473

## **GROSS MARGIN**

The Company's cost of revenues is comprised of a number of elements, some of which vary directly with the level of revenues, such as material costs and the cost of products manufactured by third parties, and some of which do not vary significantly with the level of revenues, including many overhead costs such as compensation of operations staff, amortization and facilities costs.

Gross margin for the three months ended December 31, 2017 was (\$649) as compared to (\$137) for the same period of the prior year. Gross margin for the six months ended December 31, 2017 was (\$543) as compared to (\$312) for the same period of the prior year. This decrease in the current year's periods compared to the prior year's is associated with, a) the additional costs of our Suzhou facility in the current year's period (which is within its first full year of operations), as well as, b) a larger portion of the fixed cost component of the Fremont fabrication facility being absorbed into cost of sales due to the reduced inventory production at the Fremont facility (caused by production delays at our contract manufacturer).

## **OPERATING EXPENSES**

**R&D** expense for the three months ended December 31, 2017 was \$927 as compared to \$1,040 for the same period in the prior year, a decrease of \$113 or 11%. R&D expense for the six months ended December 31, 2017 was \$2,362 as compared to \$2,174 for the same period in the prior year, a increase of \$188 or 9%. The increase for the year to date period is primarily due to the increase in materials and technical services to support our contract manufacturer in the areas to product development and production ramping.

**Sales & Marketing** expense for the three months ended December 31, 2017 was \$60 as compared to \$7 for the same period of the prior year, and for the six months ended December 31, 2017 was \$107 compared to \$13 for the same period of the prior year. The increase relates to sales and marketing activities associated with the new products.

**General & Administration** expense for the three months ended December 31, 2017 was \$588 as compared to \$558 for the same period of the prior year, and for the six months ended December 31, 2017 was \$1,155 compared to \$1,093 for the same period of the prior year.

**Stock-based compensation** expense for the three months ended December 31, 2017 was \$33 as compared to \$82 for the same period of the prior year, and for the six months ended December 31, 2017 was \$66 as compared to \$166 for the same period of the prior year. The decrease in the current year's expense compared to the prior year mainly relates to option grants issued in prior years that have now been fully expensed.

## **FINANCE AND OTHER INCOME**

Enableness invests cash and cash equivalents in short-term investments with financial institutions. Interest income is a function of prevailing interest rates and the amount of funds invested.

## **FINANCE EXPENSE**

The Company's interest expense is a function of the balance of debt, and applicable interest rates, and the average foreign exchange rate between the underlying currency of the debt security and the U.S. dollar.

Interest and finance expense for the three months ended December 31, 2017 was \$358 as compared to \$127 for the prior year, an increase of \$231. Interest and finance expense for the six months ended December 31, 2017 was \$715 as compared to \$221 for the prior year, an increase of \$494. The increase primarily relates to a combination of the interest on the convertible debentures in the current year's period as well as the interest on the increased level of term debt provided by EDC as compared to the prior year's same period.

	<b>December 31,</b>	June 30,
	<b>2017</b>	2017
	<b>\$</b>	<b>\$</b>
Short-term Loans (a)	<b>1,265</b>	1,194
Loan from Export Development Canada (b)	<b>3,994</b>	3,856
	<b>5,259</b>	5,050
Less current portion	<b>3,627</b>	3,472
Long-term portion	<b>1,632</b>	1,578

- (a) During the fiscal year ended June 30, 2017, the Company obtained non-interest bearing, unsecured short-term loans in the amount of \$5,231 CAD from certain related and unrelated parties of which \$1,755 CAD of the loans were repaid during the year, \$385 was converted to equity, \$1,156 was exchanged for a convertible debenture, leaving an unpaid balance of \$1,194 (\$1,549 CAD) at June 30, 2017. The exchange of debt instruments represented a substantial modification to the terms of the existing financial liability. As a result it was accounted for as a modification. No gain or loss was recognized on the modification. On April 1, 2017, the terms of the loan were changed to start accruing interest at the rate of 10% per annum. The remaining balance of \$1,194 at June 30, 2017 was paid in July 2017 which included principal of \$1,138 and interest of \$56. During the six months ended December 31, 2017, the Company obtained 10% interest bearing unsecured short term loans from a related party in the amount of \$365 plus interest of \$7, and obtained non-interest bearing unsecured short term loans in the amount of \$1,215 inclusive of financing costs of \$36. As at December 31, 2017 the total amount of \$1,587 remains owing on these loans.
- (b) On March 3, 2016, the Company closed a secured term loan facility with Export Development Canada ("EDC") of \$3 million CAD. In August 2016, the loan facility was increased to \$5 million CAD. The loan facility is designed to finance up to 85% of the value of purchase orders from a major telecommunications equipment provider, ZTE Corporation, a strategic investor in the Company. The loan facility is available in the form of a term loan for a period of 18 months from the date of the initial draw down which was in March 2016. Repayment of principal is to commence 18 months after the first draw on the loan. Principal then is to be repaid in 17 equal monthly instalments. Interest is payable monthly at the rate of prime plus 10% resulting in a rate of 13.2% at December 31, 2017 (June 30, 2017 -12.7%). The loan facility is secured against all of the assets of the Company and is guaranteed by the Company's subsidiaries. On October 30, 2017, the Company received a principal repayment extension from EDC resulting in the first monthly principal repayment being deferred to commence in March 2018. At December 31, 2017 the principal amount drawn on the EDC term facility is \$3,964 plus interest accrued of \$30.

## **FOREIGN EXCHANGE GAIN (LOSS)**

Foreign exchange gains and losses include realized and unrealized gains and losses on foreign exchange, including those that arise as a result of converting assets and liabilities denominated in currencies other than the functional currency of the entity into the functional currency of the entity at the balance sheet date and realized gains or losses arising from the settlement of these balances during the period.

During the three and six months ended December 31, 2017 the Company recorded a foreign exchange loss of \$37 and \$14 as compared to a loss of \$32 and \$15 in the same periods of the prior year.

## **INCOME TAXES**

There were no income taxes payable or recoverable during the current or prior year's three and six months ended December 31, 2017.

## **NET LOSS**

The net loss from operations for the three months ended December 31, 2017 was \$2,706 as compared to a net loss of \$1,965 for the same period of the prior year. The net loss from operations for the six months ended December 31, 2017 was \$5,035 as compared to a net loss of \$3,994 for the same period of the prior year.

## **FOREIGN CURRENCY TRANSLATION GAIN**

During the three and six months ended December 31, 2017 the Company recorded a foreign exchange translation loss of \$43 and a gain of \$212 as compared to a gain of \$120 and \$135 in the same periods of the prior year.

## **LOSS PER COMMON SHARE**

The table below presents the basic and diluted loss per common share for each of the comparative fiscal periods.

	<b>Three months ended December 31,</b>		<b>Six months ended December 31,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Basic and diluted loss per common share:				
From continuing operations	\$ (0.00)	\$ (0.01)	\$ (0.01)	\$ (0.01)
Weighted Average Number of Common Shares	621,929	515,707	621,929	509,123

Due to the net loss from operations, financial instruments, including warrants and options, are anti-dilutive.

## **OUTLOOK**

The Company's financial position continues to remain challenged. The Company will need to raise additional financing to carry out its business plan. In the event the Company is unable to raise the additional financing, the Company will have to look at other alternatives including the possibility of ceasing operations. The Company also continues to be highly dependent on additional equity

financing in the longer term, until revenues and gross margins increase to a point at which operations become profitable. There is no certainty that additional funding in the immediate or longer term will be secured.

As reported previously, in February 2016, the Company signed an updated Business Cooperation Agreement with a Strategic Investor, and related party, in conjunction with the closing of equity financing of CAD\$4.6 million from the same investor. Products covered under the Agreement include advanced TOSA/ROSA products which are based on our unique hybrid integration technology. The volume requirements for products covered under this Agreement are expected to increase significantly over time. We are expected to meet certain milestones in connection with the Agreement. This is an important step for the Company on its roadmap to entering the high end TOSA/ROSA market which places significant reliance on our PLC integration platform and provides a growth engine for the Company in the foreseeable future.

For the six months ended December 31, 2017 and the year ended June 30, 2017, a significant portion of our revenue was generated from the sale of our TOSA/ROSA products. These products are the first products we have commercialized that utilize our unique hybrid integration technology. Current sales volumes are however constrained by manufacturing capacity as well as the Company's financial and working capital position. The contract manufacturer that we have engaged with has not yet been able to produce our product in sufficient quantities to meet the product volume requirements of our customer. Revenue growth is dependent upon either increases in production quantities at our current contract manufacturer or through the introduction of an additional contract manufacturer.

During the third quarter of fiscal 2017, our new subsidiary in China, Suzhou Enablence Optoelectronic Technologies Co, Ltd., commenced operations. This facility will allow us to expand chip processing capacity, reduce chip manufacturing costs and allow us to provide better customer service. As a result, our chip production cost is expected to be reduced significantly due to lower labor costs and enhanced production procedures. We will continue to reduce our production costs along with improving our progress in process automation and capacity expansion.

Driven by the global trend in datacenter construction, we are seeing growing demand for PLC chips as well as TOSA/ROSA for use in datacenter transceiver modules. We believe that our PLC platform and proprietary PIC technology enable cost effective solutions to meet the rapid growth in datacenter transceivers demand. Our ability to develop low cost datacenter solutions, as well as securing customer orders for data center applications, is important for us to diversify our revenue stream and to achieve financial success in this new emerging datacenter marketplace.

Assuming the immediate financing requirements are achieved, we expect that over the next few quarters, our financial status will continue to be impacted by a number of factors: 1) The pursuit of additional equity financing from potential investors; The timing and amount of funding from our investors will impact the timing of the ramp-up of our production capacity and our product delivery, which is currently constrained by limited financial resources. 2) The success of continuing with cost efficiencies and production improvement initiatives; We aim to further reduce costs and expect that our profitability on TOSA/ROSA products will improve significantly as a result of product development and capacity expansion. Profitability will also be impacted by pressure from our customers to reduce the selling price per unit as volumes increase and the marketplace for these products evolves.

## **LIQUIDITY**

The Company's objectives when managing its liquidity and capital structure are to generate sufficient cash to fund the Company's operating, debt service and organic growth requirements.

During the six months ended December 31, 2017 the Company obtained short term debt financing in the amount of \$1,203 (also see Subsequent Events).

During the year ended June 30, 2017 the Company secured convertible debenture financing of \$5,780 (\$7,500 CAD, see Convertible Debenture financing below), new equity investments of \$3,730, warrant exercises of \$1,591 and an \$2,000 increase in a loan facility designed to finance customer purchase orders (see *Finance Expense section above as well as details below*). In addition the Company received short term bridge financing during the 2017 fiscal year which was partially converted to equity and convertible debentures in June 30, 2017.

The authorized share capital of the Company consists of an unlimited number of common shares and an unlimited number of preferred shares, issuable in series. At December 31, 2017, there are 621,929 common shares and no preferred shares outstanding.

The Company has sustained significant losses since its inception, and expects to continue to incur losses in its next few quarters. The Company's ability to reach profitability is dependent on successful introduction of new products, improved margins, revenue growth and additional financing. There can be no assurance that Enableness will gain adequate market acceptance for its new products or be able to generate sufficient gross margins to reach profitability.

Enableness has not generated positive cash flow from operations since its inception, and has relied on cash from the issuance of shares and debt to fund its operations. The table below sets out the cash, cash equivalents, and working capital at December 31, 2017 and June 30, 2017.

	<b>December 31, 2017</b>	<b>June 30, 2017</b>
Cash and Cash Equivalents	\$ 118	\$ 5,082
Restricted cash	<u>4</u>	<u>4</u>
	<b><u>122</u></b>	<b><u>5,086</u></b>
Working capital (deficiency)	<b>(4,141)</b>	196

The working capital deficiency from operations at December 31, 2017 was \$4,141 as compared to a positive working capital position of \$196 at June 30, 2017. The reduction of the working capital during the current quarter was mainly due to cash used in operations partially offset by a net increase in non-cash working capital items.

The chart below highlights the Company's cash flows during the three and six months ended December 31, 2017 and 2016.

	Three months ended December 31		Six months ended December 31	
	2017	2016	2017	2016
<b>Cash used in Operating activities</b>	<b>(1,795)</b>	(3,081)	<b>(4,724)</b>	(5,135)
<b>Investing activities</b>				
Purchase of property, plant and equipment	(119)	(18)	(237)	(381)
	<b>(119)</b>	(18)	<b>(237)</b>	(381)
<b>Financing activities</b>				
Advances from (repayments on) short term loans	1,203	1,014	209	1,014
Advances from long term loans	-	-	-	2,109
Net proceeds from issuance of shares	-	1,459	-	1,459
Proceeds from the exercise of warrants	-	682	-	688
	<b>1,203</b>	3,155	<b>209</b>	5,270
Effect of foreign currency translation	(212)	120	(212)	136
Net change in cash and cash equivalents	<b>(923)</b>	176	<b>(4,964)</b>	(110)

At December 31, 2017, the Company had cash available of \$118 (not including \$4 of restricted cash). The Company consumed \$4,724 in operating activities for the six months ended December 31, 2017 compared to \$5,135 for the same period of the prior year, which was mainly due to the increase in accounts receivable as a result of the increase in revenues, as well as the increased R&D activity.

During the six months ended December 31, 2017, the Company obtained 10% interest bearing unsecured short term loans from a related party in the amount of \$365 plus interest of \$7, and obtained non-interest bearing unsecured short term loans in the amount of \$1,215 inclusive of financing costs of \$36. As at December 31, 2017 the total amount of \$1,587 remains owing on these loans (also see Subsequent Events).

*Convertible Debenture financing during prior fiscal year*

On June 30, 2017 the Company issued a total of \$5,780 (\$7,500 CAD) of unsecured convertible debentures (the "Debentures") of which \$4,624 of the Debentures were issued through a private placement for cash, and \$1,156 were issued as a result of a debt settlement agreement with a creditor to settle outstanding short term loans received by the Company during the year. The Debentures bear interest at a rate of 10% per annum, are payable quarterly commencing on September 30, 2017, and are convertible, at the option of their holder, into common shares of the Company (the "Shares") at a price of \$0.08 CAD per Share. The Debentures mature on June 30, 2020.

As the Debentures are convertible into common shares at the option of the holder, they have been accounted for into their component parts. Management has determined the fair value of the Company's liability to make future payments of principal and interest to be \$4,694 and the fair value of the holders' conversion option to be \$1,086. The carrying value of the debentures is accreted to the principal amount over the term to conversion through a charge to interest expense. The carrying value of the equity component of \$1,086 is recorded to contributed surplus. The Company determined the carrying value of the liability by discounting the stream of future cash payments of interest and principal at an estimated market rate of 18% for a similar liability that does not have an associated conversion/equity component. The carrying value of the debentures will be accreted to the principal amount over the term to conversion through a charge to interest expense. Professional and financing costs of \$378 were incurred to complete the issuance of

the Debentures. The portion of the financing fees that relate to the Debentures have been split between debt and equity in the same proportion as the Debentures were split between debt and equity. The debt financing costs of \$307 is being amortized over the three year term of the debt. The equity financing costs of \$71 have been charged to contributed surplus. During the six months ended December 31, the Company recorded accretion of \$604 to interest expense and \$32 of amortization of the debt financing costs. Of the \$299 quarterly interest due on September 30, 2017 and December 31, 2017, \$16 has been paid and the balance has been waived on a short term basis.

#### Equity Financing during prior fiscal year

On June 30, 2017 the Company issued 7,143 common shares at a price of \$0.07 CAD per share as a result of a debt settlement agreement with a creditor, settling short term bridge financing in the amount of \$385. The securities issued under the Securities for Debt Transaction are subject to a four-month hold period pursuant to applicable securities laws until October 31, 2017.

On May 29, 2017 the Company closed a first tranche of equity financing at a price of \$0.07 CAD per share for gross proceeds in the amount of \$1,579 resulting in the issuance of 30,700 common shares. On June 21, 2017 a second tranche of the equity financing was completed at a price of \$0.07 CAD per share for gross proceeds of \$461 resulting in the issuance of 8,543 common shares. Share issuance costs of \$133 were incurred to complete these financings.

On December 22, 2016, the Company completed the first tranche of financing in the amount of \$1,482 at a price of \$0.08 CAD per share resulting in the issuance of 25,000 shares. On January 12, 2017 the Company then completed a second tranche of financing with the issuance of 6,250 shares for gross proceeds of \$381. Share issuance costs of \$40 were incurred to complete these financings.

During the fiscal year ended June 30, 2017 a total of 35,242 warrants were exercised for gross proceeds of \$1,591 resulting in the issuance of 35,242 common shares. Upon the exercise of these warrants, the fair value as determined at the time of issue of the warrants of \$427, and originally recorded to contributed surplus, was transferred to share capital.

## **CAPITAL RESOURCES**

Enablene finances its operations through the issuance of common shares and debt. The Company may also receive cash proceeds on the issue of additional common shares on the exercise of options and warrants depending in part on the market price for its shares.

The Company periodically evaluates the opportunity to raise additional funds through either the public or private placement of equity capital to strengthen its financial position and to provide sufficient cash reserves to protect itself from the effects of the volatile economic conditions that are difficult to predict.

See the Liquidity and Subsequent Events sections above for details on financings completed during the six months ended December 31, 2017 and for loans secured during and subsequent to the period. The continued debt and equity funding will help to position Enablene to address the increased demand it is experiencing in its 100G/s components business and to focus on its customer needs and future growth opportunities.

Enablene is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. There are 621,929 common shares issued and outstanding as of February 28, 2018 and no preferred shares issued and outstanding. The common shares of Enablene trade on the TSX Venture Exchange under the symbol "ENA" or "ENA.V".

## OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

The table below presents the Company's contractual obligations from operations.

	To Dec 31 2018	To Dec 31 2019	To Dec 31 2020+	Total
	\$	\$	\$	\$
Accounts payable and accrued liabilities	4,699	-	-	4,699
Notes payable	4,105	1,774	-	5,880
Convertible debentures	881	598	6,277	7,756
<b>Total</b>	<b>9,685</b>	<b>2,372</b>	<b>6,277</b>	<b>18,334</b>

The Company is required to comply with certain obligations with respect to the loan payable to Export Development Canada which is secured against the assets of the Company (see Finance Expense section above and the references to notes payable).

The Company is exposed to currency risk as certain transactions are denominated in Canadian dollars. Management is evaluating foreign exchange risk management strategies, however, the Company has not entered into forward, swap or option contracts to manage its exposures to fluctuations in foreign exchange rates.

Enablence has not entered into any other material off-balance sheet arrangements such as guarantee contracts, contingent interests in assets transferred to unconsolidated entities, or derivative instrument obligations, or with respect to any obligations under a variable interest entity arrangement.

## TRANSACTIONS WITH RELATED PARTIES

On February 2, 2016, the Company closed a private placement with ZTE Corporation ("Strategic Investor") for 77,000 shares at a price of \$0.06 CAD per common share for proceeds of \$4,620 CAD. The Strategic Investor holds approximately 15.3% of the issued and outstanding shares of the Company at December 31, 2017 (June 30, 2017 – 15.3%). As part of the financing, (i) the Strategic Investor entered into a voting agreement with certain shareholders of the Company to vote in favour of one nominee of the Strategic Investor to the Board of Directors of the Company, (ii) the Strategic Investor will have a right of participation to maintain its percentage of shareholdings in the Company in future issuances of securities by the Company, and (iii) the Company has put in place a Product Roadmap Development Committee which will make recommendations to the Board of Directors on future product development (iv) an updated version of the Business Cooperation Agreement from December 2014 was signed by the Company and the Strategic Investor.

During the six months ended December 31, 2017, the Company had sales of \$2,487 to ZTE (December 31, 2016 - \$966). At December 31, 2017, the Company had an accounts receivable balance with ZTE of \$1,119 (June 30, 2017 - \$814).

As at December 31, 2017, China TriComm Ltd. ("TriComm") owned 30,000 Enablence common shares of the Company. TriComm is controlled by Zhiyin Gao, previously a director.

As at December 31, 2017, Irix Holding Ltd. ("Irix"), owned 39,408 Enablence common shares of the Company. Irix is a joint venture controlled by TriComm and Win Brand, which are companies controlled by a previous director. The CEO and CFO of the Company also have ownership interests in Irix and Winbrand. The following transactions took place between Irix and the Company during the six months ended December 31, 2017 and the fiscal year ended June 30, 2017 (also see Subsequent Events):

- During the fiscal year ended June 30, 2017, Suzhou Irix Ltd (“Suzhou Irix”), controlled by Irix, incurred certain start-up and production costs in the amount of \$61 on behalf of Suzhou Enablence Optoelectronic Technologies Co., LTD, which is reflected in accrued liabilities at December 31, 2017 (June 30, 2017 - \$61).
- During the fiscal year ended June 30, 2017 Enablence had made \$99 of sales to Suzhou Irix and made purchases of \$128 from Suzhou Irix the net amount of which was recorded to cost of revenues. During the six months ended December 31, 2017 Enablence incurred expenses owing to Suzhou Irix in the amount of \$590. As at December 31, 2017 the Company had the following amounts recorded relating to these transactions: an account receivable balance due from Suzhou Irix of \$4 (June 30, 2017 - \$44) and an accounts payable amount owing to Suzhou Irix of \$590 (June 30, 2017 - \$44).
- During the fiscal year ended June 30, 2017 Suzhou Irix provided other consulting services and materials to Enablence. As a result, at December 31 the Company has an amount of \$60 set up as an accrued liability owing to Suzhou Irix (June 30, 2017 - \$60).

In January 2016 the Company entered into a one year R&D Services Agreement (the “Service Agreement”) with Suzhou Irix Ltd. and Irix Photonics Inc. (“Irix Photonics”). Irix Photonics was created to carry out the operations of Irix and is a company controlled by the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) of Enablence. Pursuant to the Service Agreement, for R&D services provided by Irix Photonics for the development of a new product and assistance in ramping up its volume production, Enablence is contracted to pay Irix Photonics \$150/month (“Service Fees”) over the 2016 calendar year. In addition, if certain agreed upon volume production milestones are met during the twelve month period, Irix Photonics may be eligible for the payment of a success fee (“Success Fee”). The Success Fee amounts to \$2 million less any Service Fees previously paid. The Company retains ownership of all Intellectual Property associated with the products under the agreement. Pursuant to this agreement, the Company paid Irix Photonics a total of \$1,800 of which \$900 was paid during fiscal year 2016 and \$900 was paid in fiscal year 2017. The Company signed a new services agreement with Irix Photonics for the 2017 calendar year at a monthly fee of \$130, as well as a base royalty on certain future products at 3% of net sales and additionally a potential 17.5% bonus royalty on gross margin on such products if certain targets are met. As of December 31, 2017 the Company had paid Irix Photonics \$1,235 of monthly fees under this new contract and had \$325 recorded as an accrued liability.

In addition, at December 31, 2017, an amount of \$492 (June 30, 2017 - \$432) is included in accounts payable and accrued liabilities relating to consulting services provided by Irix. Of this amount, \$60 was incurred and recorded to consulting fee expense during the six months ended December 31, 2017 relating to services provided through Irix, by Todd Zhang, also the CFO of Enablence (December 31, 2016 - \$60). During the six months year ended December 31, 2017 \$Nil (Year ended June 30, 2017 - \$Nil) was paid relating to these consulting services.

Paradigm Capital Partners Limited (“PCPL”) is a shareholder of Enablence and is a company controlled by close family members of a director of Enablence. The following transactions took place with PCPL, its affiliates and individuals related to PCPL (collectively “Paradigm”), since June 30, 2016:

- During the year ended June 30, 2017, a controlling shareholder of Paradigm provided short term loans to the Company of \$3,241 and converted a portion of the loans to equity, exchanged a portion into convertible debentures and then was repaid the remaining balance of \$1,194 in July 2017

- Paradigm earned \$474 of commissions relating to the equity and debenture financing the Company closed during May and June 2017.
- During the six months ended December 31, 2017 the Company received \$290 in unsecured short term bridge loans from a controlling shareholder of Paradigm accruing interest at a rate of 10% amounting to \$6 (see Subsequent Events).

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. During the six months ended December 31, 2017 the Company did not enter into any material transactions with related parties outside of those noted elsewhere in the MD&A.

## **RISKS AND UNCERTAINTIES**

The Company operates in a dynamic, rapidly changing environment that involves risks and uncertainties, and as a result, management expectations may not be realized for a number of reasons. An investment in Enablene common shares is speculative and involves a high degree of risk and uncertainty. The Company is highly dependent on additional financing to continue operations and there is no certainty that it will be able to obtain such financing. The current global economic crises pose additional risks and uncertainties which may materially affect management's expectations.

Any investor should also consider carefully these risks and the risks and uncertainties that are detailed in our Annual MD&A filed October 27, 2017 and available at [www.sedar.com](http://www.sedar.com).

## **CRITICAL ACCOUNTING ESTIMATES**

The Company's consolidated financial statements are prepared in accordance with IFRS recognition and measurement principles that often require Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts presented and disclosed in the consolidated financial statements. Management reviews these estimates and assumptions on an ongoing basis based on historical experience, changes in business conditions and other relevant factors as it believes to be reasonable under the circumstances. Changes in facts and circumstances may result in revised estimates, and actual results could differ from those estimates. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

### Estimates

#### *Useful lives of depreciable assets*

The useful lives of depreciable assets have been determined based on Management's estimated utility of the assets. Uncertainties in these estimates relate to technological obsolescence and wear and damage of assets.

#### *Share-based compensation*

The estimation of share-based compensation requires the selection of an appropriate valuation model and consideration as to the inputs necessary for the valuation model chosen. The Company has made estimates as to the volatility of its own share price, the probable life of share options granted and the time of exercise of those share options. The model used by the Company is the Black-Scholes valuation model.

#### *Fair value measurement*

Management uses valuation techniques to determine the fair value of financial instruments. This involves developing estimates and assumptions consistent with how market participants would price the instrument. Management bases its assumptions on observable data as far as possible

but this is not always available. In that case management uses the best information available. Estimated fair values may vary from the actual prices that would be achieved in an arm's length transaction at the reporting date.

### Judgments

#### *Recognition of deferred income tax assets*

Management continually evaluates the likelihood that its deferred tax assets could be realized. This requires Management to assess whether it is probable that sufficient taxable income will exist in the future to utilize these losses within the carry-forward period. By its nature, this assessment requires significant judgment.

#### *Inventories*

Inventories are initially recognized at cost, and subsequently at the lower of cost and net realizable value. Management estimates the net realizable values of inventories, considering the most reliable evidence available at each reporting date. The future realization of these inventories may be affected by future technology or other market driven changes that may reduce future selling prices.

#### *Going concern risk assessment*

The assessment of the Company's ability to continue as a going concern and raising additional debt or equity financing or attaining sufficient revenues to achieve and sustain profitability for the ensuing year, and to fund planned research and development activities, involves significant judgment base on historical experience and other factors including expectation of future events that are believed to be reasonable under the circumstances.

#### *Impairment*

Determining if there are any facts and circumstances indicating impairment loss or reversal of impairment losses is a subjective process involving judgment and a number of estimates and interpretations in many cases. In assessing impairment, Management estimates the recoverable amount of each asset or cash-generating unit based on expected future cash flows and uses an interest rate to discount them. Estimation uncertainty relates to assumptions about future operating results and the determination of a suitable discount rate.

#### *Functional currency*

An area of judgment that has a significant effect on the amounts recognized in these consolidated financial statements is the determination of functional currency. The determination of the Company and its subsidiaries' functional currency often requires significant judgment where the primary economic environment in which they operate may not be clear. This can have a significant impact on the consolidated results of the Company based on the foreign currency translation methods used.

## **CHANGES IN ACCOUNTING POLICIES**

The following is a list of standards and amendments that have been issued but are not yet effective and have not yet been adopted by the Company:

### IFRS 9 – Financial Instruments

The final version of IFRS 9 (2014) was issued in July 2014 as a complete standard including the requirements for classification and measurement of financial instruments, the new expected loss impairment model and the new hedge accounting model. IFRS 9 (2014) will replace IAS 39 Financial instruments: recognition and measurement. IFRS 9 (2014) is effective for reporting periods beginning on or after January 1, 2018. The Company is currently assessing the impact of

the standard on its consolidated financial statements. The Company expects to apply the standard for its consolidated financial statements dated June 30, 2019.

#### IFRS 15 - Revenues

IFRS 15, issued in May 2014, specifies how and when entities recognize, measure, and disclose revenue. The standard supersedes all current standards dealing with revenue recognition, including IAS 11 Construction contracts, IAS 18 Revenue, IFRIC 13 Customer loyalty programs, IFRIC 15 Agreements for the construction of real estate, IFRIC 18 Transfers of assets from customers, and SIC 31 Revenue - barter transactions involving advertising services. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five step analysis of transactions to determine whether, how much and when revenue is recognized. Amendments to IFRS 15, issued in April 2016, clarify some requirements and provide additional transitional relief for when an entity first applies IFRS 15. IFRS 15, and the amendments, are effective for annual periods beginning on or after January 1, 2018. The Company is currently assessing the impact of this standard on its consolidated financial statements. The Company expects to apply the standard for its consolidated financial statements dated June 30, 2019.

#### IFRS 16

IFRS 16, issued in January 2016, introduces a single lessee accounting model that requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. The standard will supersede IAS 17 Leases, IFRIC 4 Determining Whether an Arrangement Contains a Lease, SIC-15 Operating Leases - Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. The Company is currently assessing the impact of this standard on its consolidated financial statements. The Company expects to apply the standard for its consolidated financial statements dated June 30, 2020.

#### IFRS 2 Share-based payments

Amendments to IFRS 2, issued in June 2016, provide clarification on how to account for certain types of share-based payment transactions. The amendments provide requirements on the accounting for:

- The effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments;
- Share-based payment transactions with a net settlement feature for withholding tax obligations; and
- A modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

The amendments are effective for reporting periods beginning on or after January 1, 2018. The Company is currently assessing the impact of these amendments on its consolidated financial statements. The Company expects to apply the amendments for its consolidated financial statements dated June 30, 2019.

#### IFRIC 22 Foreign currency transactions and advance consideration

IFRIC 22 was issued in December 2016 to provide guidance on accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. The new interpretation is effective for annual periods beginning on or after January 1, 2018. The Company is currently assessing the impact of this interpretation on its consolidated financial statements. The Company expects to apply the interpretation for its consolidated financial statements dated June 30, 2019.

## **FINANCIAL AND OTHER INSTRUMENTS**

Enablence's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, convertible debentures and notes payable. Unless

otherwise noted, it is the opinion of Enablence's management that Enablence is not exposed to significant interest, currency or credit risk arising from these financial instruments. The fair value of these financial instruments approximates their carrying value due to their short-term maturity or capacity of prompt liquidation.

#### **ADDITIONAL INFORMATION**

Additional information related to the Company can be found on SEDAR at: [www.sedar.com](http://www.sedar.com).