

# THE SKOR FOOD GROUP INC.

## MANAGEMENT DISCUSSION AND ANALYSIS

**DATE OF PREPARATION:** DECEMBER 21, 2007

**PERIOD:** THE YEAR ENDED AUGUST 31, 2007

### General

The following discussion and analysis provides a review of the consolidated financial conditions and operating performance of The Skor Food Group Inc. (the “Company” or “SKOR”) and its subsidiaries for the twelve month period ended August 31, 2007. This discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes. Any reference herein to 2007 shall mean the twelve month period ended August 31, 2007 and any reference herein to 2006 shall mean the twelve month period ended August 31, 2006.

### Compliance with General Accepted Accounting Principles

Unless otherwise indicated, the financial information presented is expressed in Canadian dollars and prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). SKOR utilizes earnings before interest and taxes, depreciation and amortization (“EBITDA”) as a measurement tool. This measure is a widely accepted financial indicator but it is not a measurement determined in accordance with GAAP.

### Overview

SKOR is a vertically integrated regional based food Company that manufactures and distributes products through its three operating divisions.

The Skor Food Service Ltd. operating division is a full service, wholesale food distributor to the food service industry, offering more than 7,000 items from its 200,000 square foot warehouse in Vaughan, Ontario. Skor Wholesale Cash and Carry is a wholesaler to the independent retail grocer, convenience store and food service industry with 12 locations throughout Southern Ontario selling more than 10,000 private label and name brand, frozen goods, refrigerated products and dry goods including confectionary and tobacco. SKOR services a wide range of multi location food retailers, Quick Service Restaurant chains, day care facilities, government institutions, independent food service operators as well as vending operators and convenience stores in Ontario from these two divisions.

On January 9, 2007, SKOR incorporated a wholly owned subsidiary Skor Culinary Concepts Inc. which then acquired 100% of the issued and outstanding shares of three Greater Toronto Area food manufacturing and processing companies for a total consideration of \$3.150 million less adjustments for working capital plus traditional closing costs. These acquired companies are in the business of manufacturing and distributing ready to eat sandwiches and meals for the catering, vending and institutional market.

Skor Franchise Inc., a subsidiary of SKOR, is in the process of reversing the core components of the asset purchase of Galaxie Diner in cooperation with the Vendor. The reversal process is expected to be completed in the second quarter of the current fiscal year. SKOR expects to recoup its full investment in Galaxie Diner. In the interim, the operations will be treated as “discontinued operations” until such time as the disposal is completed and as such, our discussions with respect to the operation will be limited.

### Overall Performance

#### The Industry

The food service industry is characterized as a mature industry growing at a level consistent with the geographical population expansion. There are a limited number of food service distributors providing country-wide service to the

restaurant and hospitality industry with the majority of food service firms focused on servicing niche geographic, product or ethnic markets. Successful food distributors compete on high quality service, competitive prices and breadth and depth of product offering. SKOR is considered a mid size regional provider of products focused on the institutional and regional based quick service restaurant chains located throughout Ontario.

The wholesale cash and carry business in Ontario is also a mature industry. The marketplace is dominated by large firms such as National Grocers (Loblaws) and Sam's Club (Wal-Mart) and Costco, who supply both retailers and consumers from the same locations. Skor Cash and Carry is positioned as the largest independent cash and carry operator servicing the independent retail market. SKOR competes with numerous smaller geographic and ethnic focused competitors with single locations offering a limited breadth of products. Customers are price sensitive on certain key product lines (tobacco, confectionary and name brand beverages) where margins are historically very competitive.

The food manufacturing industry is also a mature business, growing at rates consistent with geographical population expansion. Specifically focusing on manufactured product for the vending and catering industry in the Greater Toronto Area, the business is mature but is extremely fragmented with no dominant, industry leader. The market offers considerable opportunity for consolidation in the GTA market over the next few years as existing operators seek out viable and attractive exit strategies.

## **Risks**

### **Risks and Uncertainties**

Management is focused on maximizing profits and enhancing shareholder value by proactively managing the internal and external risks of the business. Some of these risk factors are summarized below;

- Credit risk associated with selling to independent food service operators and convenience store retailers;

SKOR manages its accounts receivable diligently, nonetheless, a material component of the business is transacted with independent operators (i.e. family owned and operated). Typically, family owned firms are not well capitalized and may experience a higher level of failure in the initial years of operation. The risk of non payment is mitigated by obtaining additional security where appropriate and restricting the terms to industry standards. As an additional tool to reduce overall credit risk, third party accounts receivable insurance through Euler Hermes was instituted in the first quarter of fiscal 2007.

- Certain operating costs may not be passed on to customers;

In light of the competitive operating and low-inflationary environment, it is difficult to pass on price increases to offset higher costs for such items as fuel, utilities and property taxes. SKOR manages this risk by reviewing its operations and associated costs on a continual basis.

- Economic reliance on discretionary cash flow of the consumer for a portion of the business;

SKOR services a broad range of customers including government institutions, municipalities, quick service restaurants, retailers and independent food service operators. In tougher economic times, consumers may spend less of their discretionary income on dining out which could cause a contraction in the market size to which SKOR sells. Management believes that SKOR is somewhat sheltered from this market fluctuation, given its solid foundation of institutional business together with its focus on the quick service restaurant market, which tends to be less sensitive to consumer spending.

- Competitive marketplace;

SKOR is a well positioned regional competitor in a marketplace which has three distinct segments; large national, broad-line distributors; the family owned niche providers of product focused on either a geographic or ethnic market; or the mid-tier regional firms which are focused on providing broad-line product coverage to a regional market. SKOR competes in the Ontario regional segment against firms of all sizes. Given the market dominance of three large well capitalized firms (Loblaws, Wal-Mart and Costco), SKOR does not attempt to compete head on with these firms, however, certain product lines must be kept competitive to maintain traffic flow and customer loyalty. As such, certain product lines such as

tobacco operate on extremely low gross margins; however, SKOR is attempting to reduce the reliance on these product categories by focusing its energies on expanding its higher margin product lines.

- Product obsolescence and spoilage;

SKOR is a distributor of a broad range of products and as such does not feel that product obsolescence or spoilage is an issue which could materially impact financial results. Inventory is well managed and as such, products which are extremely sensitive and therefore have a limited shelf life are purchased on a just-in-time basis for specific customer orders.

- Low Margin and Inflation;

Profit levels may be negatively impacted during periods of price deflation as margins remain consistent, however, revenue may decline. During periods of inflation, it is possible that customers may resist paying higher prices for product costs passed on by the manufacturer to the distributor.

- Changes to distribution channels initiated by Suppliers

During the course of normal business operations, suppliers may attempt to reduce, eliminate or change the distribution channels or pricing to those channels. These distribution channel changes may result in a reduction in business through SKOR which could have a material effect on revenue and gross margin.

- Seasonality and weather

The business may experience fluctuations resulting from a number of factors such as economic conditions, effects of severe weather and seasonality in certain market areas due to their proximity to traditional vacation destinations.

## **Results of Operation- Year Ended August 31, 2007**

### **Revenue**

Consolidated revenue increased by 17.0% on a year over year basis from \$154,054,467 to \$180,160,588. The revenue increase is attributed primarily to the full year inclusion of revenue from the Wholesale Cash and Carry acquisition, which was completed on March 31, 2006. The acquisitions completed in the current fiscal year were responsible for 3.5% of overall revenue.

### **Cost of Sales and Gross Profit**

Gross profit margins increased on an absolute basis by 0.76% from 12.38% in 2006 to 13.14% in 2007. Margins were negatively impacted by the full year inclusion of the Wholesale Cash and Carry business, which accounted for approximately 50% of overall revenue at margins of less than 7%.

On a forward looking basis, gross profit margins are expected to be in the 12-14% range as tobacco margins will continue to negatively impact the overall returns. Margins may also fluctuate dependent upon the mix of products sold to customers throughout the year.

### **Expenses**

On a consolidated basis, operating expenses for 2007, excluding the provision for income taxes, interest and amortization increased by 46.6% to \$22,366,884 from \$15,257,888 in 2006.

Total operating expenses, including interest and amortization increased by 47.6% to \$23,752,912 from \$15,990,825. Negatively impacting expenses was higher amortization (\$565,846 increase) and the inclusion of twelve months of costs from the Cash and Carry versus five months the prior year and seven months of costs associated with the operations of Skor Culinary Concepts Inc.

## Stock Based Compensation (“SBC”)

The company applies a fair value based method of accounting to all stock-based payments. For fiscal 2007, stock based compensation was \$9,850, a decrease of \$46,666 from the prior year’s \$56,516. The expenses are reflected in operating expenses.

## EBITDA

EBITDA, before taking into account relocation costs and income/loss associated with the Skor Franchise Division, decreased by \$2,435,420 to \$1,385,432 from \$3,820,852 the prior year. On a basic and fully diluted basis, EBITDA was \$0.05 per share a decline from \$0.18 and \$0.17 respectively the prior year.

## Net Earnings

Net earnings, after tax and relocation costs, decreased by 1,934,529 to a loss of \$205,582 from earnings of \$1,728,947 the prior year.

Earnings before tax, relocation costs and income/loss associated with Skor Franchise decreased by \$3,175,114 to a loss of \$87,199 from earnings of \$3,087,915 in the prior year.

## Selected Annual Information

	2007	2006	2005
Sales	\$180,160,588	\$154,054,467	\$81,514,600
Earnings/(loss) before income tax and other items	(87,199)	3,087,915	2,691,933
Net earnings/(loss)	(205,582)	1,728,947	1,709,289
Earnings/(loss) per share-basic	(.00)	.08	.11
Earnings/(loss) per share- diluted	(.00)	.08	.10
Total Assets	30,205,117	33,222,052	13,697,782
Total Long Term Liabilities	3,713,776	1,837,573	2,443,314
Cash dividends declared	0	0	0

The preparation of the financial statements is in conformity with generally accepted accounting principles.

## Results of Operation- Fourth Quarter Ended August 31, 2007

### Revenue

Revenue for the fourth quarter ended August 31, 2007 was \$46,823,709 compared to \$65,251,069 in the comparable period the prior year, representing an \$18,427,360 (28.2%) decrease on a year over year basis. A \$19,335,876 decline in tobacco revenue, caused by a major supplier’s change in distribution methods was the largest contributing factor to the revenue decline.

### Gross Profit

Gross profit was \$6,504,645 for the period which is a \$630,862 decrease from the \$7,135,507 achieved in the prior year period. As a percentage of revenue, gross profit margins increased to 13.90% from 10.9% in the prior year. The primary reason for the margin improvement was the sales mix at the Cash and Carry together with the newly acquired business at Skor Culinary Concepts Inc.

## Expenses

Total operating expenses in the current quarter (including stock based compensation, selling, administration, warehouse, delivery and amortization) were \$7,622,272(16.3% of revenue) compared with \$6,285,591(9.63% of revenue) in the prior year. Absolute costs increased due to the inclusion of Skor Culinary Concepts Inc. together with a \$192,014 increase in amortization costs. Costs as a percentage of revenue increased in the quarter, primarily due to the decline in tobacco revenue associated with the direct to store delivery by a major supplier in the first quarter of fiscal 2007

## Stock Based Compensation (“SBC”)

Nil

## Normalized EBITDA

Excluding one time events such as relocation costs, stock based compensation, loss on the disposal of equipment and one time events related to uncollectible bad debts, normalized EBITDA was \$(630,564) for the period compared to \$1,455,880 in the corresponding period last year. On a basic share basis, EBITDA was \$(0.02) per share for the fourth quarter.

## Net Earnings

A pre-tax loss of \$1,196,451 (\$0.04/share) in the fourth quarter compares to a \$793,136 (\$0.03/share) profit in the comparable period the prior year. On an after tax basis, the loss for the current quarter was \$973,008 (\$0.04/ share) compared with \$493,854 (\$0.02/ share) profit in the prior year.

## Summary of Quarterly Results

	Q4 2007	Q3 2007	Q2 2007	Q1 2007	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Revenue(\$)	46,823,709	47,824,362	40,536,162	44,976,355	65,251,069	49,934,439	18,354,074	20,514,885
Earnings/(loss) before tax and extraordinary items(\$)	(1,134,594)	272,832	86,522	688,041	763,161	845,453	626,049	853,252
Net Earnings/(loss)(\$)	(973,008)	257,846	30,119	479,461	493,854	531,939	229,215	473,939
EPS-Basic	(0.04)	.01	.00	.02	.02	.02	.01	.03
EPS-Diluted	(0.04)	.01	.00	.02	.02	.02	.01	.03
Outstanding Shares-Basic	25,792,148	25,748,670	25,748,670	25,703,340	25,491,279	24,969,105	17,938,757	17,938,757

All amounts are in CDN Dollars.

## Capital Investments and Acquisitions

Excluding the assets acquired in conjunction with the acquisitions, \$904,658 was invested during the year in property plant and equipment. The investment in capital equipment provides the necessary infrastructure to support our near term and mid-term growth prospects

Subject to no material changes to the operations, we expect capital expenditures to return to more normal levels in fiscal 2008.

There were no acquisitions in the fourth quarter.

## **Liquidity and Capital Resources**

### **Working Capital**

Working capital consists primarily of inventory and accounts receivable. As at August 31, 2007, SKOR had a working capital ratio of 1.59:1, and working capital of \$7,880,693. On a year over year basis, working capital decreased by \$3,619,141 as a result of the repayment of long term debt (\$610,639) and the acquisition of fixed assets (\$904,658) utilized in the day to day operations of the business and the increase in the current portion of long term debt (\$1,876,203). Excluding the current portion of bank debt, working capital was \$11,594,469 at year end. SKOR has adequate working capital and available lines of credit to support projected near term growth.

SKOR maintained approximately 24 days worth of inventory at quarter end, an amount which is considered adequate to effectively service its customers. Inventory declined by \$4,840,209 on a year over year basis, as the Cash and Carry Division has more effectively managed its tobacco inventory in light of the decline in volumes in that product segment.

Based upon the level of business being transacted by SKOR, working capital is deemed adequate to support near term organic growth. As income is retained in the business and recognizing that capital expenditures are expected to return to historical levels, working capital is expected to strengthen. The firm manages its working capital and draws on its bank operating facility to maximize supplier early payment discounts and special pricing opportunities where deemed appropriate.

### **Bank Debt**

At year end, SKOR had an operating line of credit of \$6,000,000 with a Schedule A Canadian Chartered Bank, (secured by a charge on the assets of the company), which was deemed sufficient to meet the near term operating requirements of the business. The operating facility was less than 20% drawn at year end.

In conjunction with the acquisition of the Manufacturing Division, SKOR entered into a new \$3.0 million term financing facility with a Schedule "A" Chartered Bank. All payments are current, however, the fourth quarter financial results were dramatically below budget and this has caused SKOR to be offside on one of its debt service covenants. Management is working with its bank to negotiate more appropriate and favourable covenant terms. Approximately \$1,000,000 of the new term facility is interest only until January 2008 at which time the remaining principal balance at that time is to be amortized over a three year period.

The existing credit facilities are deemed adequate to support the organic growth of the consolidated group, providing additional flexibility to fund future growth.

Contractual Obligations	Payments Due by Period (\$)				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long Term Debt	3,713,776	1,317,635	2,396,141	0	0
Capital Lease Obligations	0	0	0	0	0
Operating Leases	7,722,609	2,605,005	4,531,881	495,747	89,976
Purchase Obligations	0	0	0	0	0
Other Long Term Obligations	0	0	0	0	0
Total Contractual Obligations	11,436,385	3,922,640	6,928,022	495,747	89,976

### **Capital Expenditure Commitments**

Skor has no capital commitments outstanding as at year end.

## **Capital Resources**

SKOR is underleveraged with a long term debt to equity ratio of 0.22:1. The shortened amortization period of the term debt will result in a strengthening balance sheet as earnings are retained in the Company and debt is repaid.

At the present time, the Company has approved lease facilities with its lenders that are less than 20% funded. These available credit facilities are deemed sufficient to support SKOR's near term lease requirements.

## **Financial Instruments and Other Instruments**

The company is exposed to certain interest rate risks, which have been identified earlier under the bank debt section and are summarized below.

At quarter end, SKOR is exposed to interest rate risk as it relates to its operating credit. Based upon expected usage of \$2,000,000.00, each 25 basis point change in borrowing costs impacts quarterly interest expense by \$1,250.00.

The floating rate term facilities provided by a Schedule "A" Bank exposes SKOR to interest rate risk; however, the facility offers the ability for SKOR to convert to a fixed rate option at any time. At this time, a 25 basis point change in floating rate borrowing costs impacts quarterly interest expense by \$2,000, based upon projected average utilization of \$3,200,000 for the next twelve month period.

SKOR has not utilized derivatives to hedge or speculate on interest rate changes.

## **Off Balance Sheet Arrangements**

SKOR has issued indemnities in respect to letters of credit issued by its bank for letters of credit in favour of certain customers for future performance under specific contracts. As at August 31, 2007, there was \$20,000 worth of letters of credit issued and outstanding.

## **Transactions with Related Parties**

In the most recent year and in the normal course of business, SKOR purchased approximately \$912,763 (2006-\$987,369) and sold \$21,161 (2006-\$36,226) worth of product at or below market rates, from/to a Company, which certain officers and directors of SKOR have a financial interest in.

SKOR has no other contractual obligations with respect to inter-company transactions.

## **Legal Proceedings**

There has been no activity on the outstanding claims reported at last year end. The amount of any potential loss is indeterminable at this time and accordingly, no provision has been made in these financial statements.

The vendor of Galaxie Diner, which assets were acquired by Skor Franchise Inc. in August 2006, has taken full responsibility to defend actions brought against itself and Skor Franchise Inc. related to a plaintiff's claim of an error in a certain disclosure made by the vendor at the time of close. Skor Franchise Inc. is fully indemnified by the Vendor for any potential liability or costs associated with claims arising from the acquisition. In this regard, no provision for loss has been made in these financial statements.

## **Management Changes**

Nil

## **New Accounting Pronouncements**

Nil

## Disclosure Controls

The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining the Company's disclosure controls and procedures, including adherence to the Disclosure Policy adopted by the Company.

The Chief Executive Officer and the Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures as of August 31, 2007, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its subsidiaries would have been known to them.

## Capital Stock – Common Shares as at December 21, 2007

Issued and Outstanding (August 31, 2006)	25,623,670
Add:	
Options (Expiry March 22, 2009)	140,000
Options (Expiry October 27, 2008)	145,000
Options (Expiry January 2009)	80,000
Options (Expiry December 2009)	100,000
Issuance of Shares (Exercise of Options)	<u>525,000</u>
Diluted	26,613,670

## Significant Events during the Quarter

Nil

## Subsequent Events

On October 25, 2007, SKOR, through its Skor Culinary Concepts Inc. subsidiary, agreed to provide interim funding and management in support of a formal restructuring proposal initiated by an arm's length firm, 888930 Ontario Inc., operating as City Wide Catering. Subsequent to the successful completion of the proposal, it is expected that SKOR will acquire 100% of the shares owned by the existing management of 888930 Ontario Inc.

## Outlook

In the past six months, the wholesale cash and carry business has rationalized products, developed the information systems to monitor and control pricing at the store level and has reduced operating costs where ever possible. The challenging market environment, which includes intense competition and aggressive pricing, has made it extremely difficult to grow the business in the convenience channel segment. In this regard, we will focus our energies on a number of initiatives to grow the food service segment of the business. Management has developed a three part strategy to improve the cash and carry performance and this includes more aggressive marketing, reassessment of specific unit viability and other options to maximize shareholder value.

The Food Service Division will continue to aggressively seek out new customer relationships while expanding its business with current customers through a more aggressive and proactive sales approach. At the same time, supplier partnerships will be managed with the expectation of improving the overall pricing structure of our purchases. The warehouse and logistics operations were restructured in the first quarter of fiscal 2008, leading to a 10% reduction in staffing levels compared to August 31, 2007. We expect this restructuring to enhance profitability beginning in the second quarter of the current fiscal year.

We expect to consolidate the manufacturing operations at Skor Culinary Concepts in the second quarter of the current fiscal year which will enable the group to more efficiently manufacture its products while building the capacity to grow the business over the near term. We expect to see a positive impact from the consolidation of manufacturing operations in the third quarter of the current fiscal year, having identified opportunities to reduce annual operating costs by more than \$500,000 beginning in the second quarter.

## **Additional Information**

Additional information relating to the Corporation is available under the Corporation's profile on the SEDAR website at [www.sedar.com](http://www.sedar.com). Shareholders may contact the Corporation to request copies of the financial statements and MD&A by: (i) mail to 10 Ronrose Drive, Vaughan Ontario L4K 4R3 or (ii) fax to (905) 532-3627.

## **Forward-Looking Information**

The Company and its representatives periodically make written and oral forward-looking statements, including those contained in this document and all documents and reports disseminated to shareholders and the public. Forward-looking statements involve significant risk, uncertainties and assumptions that could result in actual results being different from anticipated performance. SKOR cautions readers to the risks, uncertainties and assumptions of forward-looking statements. Although the forward-looking statements the Company makes are based on what management believes to be reasonable assumptions at the time the statements are made, the Company cannot guarantee or assure prospective investors that actual results will be consistent with SKOR's forward looking statements.