

# UNISERVE COMMUNICATIONS CORPORATION

## Management's Discussion and Analysis

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### Overview

The following discussion of results contains information relevant to the operations of Uniserve Communications Corporation ("the Company", "Uniserve", or "USS") as at the date of issuance of these statements. Unless otherwise stated, information is current to January 28, 2008, and all amounts are stated in Canadian dollars and results have been recorded and presented in accordance with Canadian Generally Accepted Accounting Principles. For additional financial details, please refer to the complete unaudited interim financial statements as at November 30, 2007.

Additional information on the Company's products and services is available at the Company's website at [www.uniserve.com](http://www.uniserve.com) and in the Company's public filings at [www.sedar.com](http://www.sedar.com).

### Forward Looking Statements<sup>1 2</sup>

Certain statements contained in this MD&A constitute forward-looking statements. In addition, other oral or written statements which constitute forward-looking statements may be made from time to time by or on behalf of Uniserve Communications Corporation. These forward-looking statements relate to the future financial condition, results of operations, or business of USS. These statements may be based on current expectations and estimates about the markets in which USS operates and management's beliefs and assumptions regarding these markets. These statements are subject to risks and uncertainties which are difficult to predict and assumptions which may prove to be inaccurate. The results or events predicted in the forward-looking statements contained in this MD&A may differ materially from actual results or events. Forward-looking statements contained in this MD&A represent USS's expectations and intentions as of the date hereof. USS disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

In particular, forward-looking statements do not reflect the potential impact of any mergers, acquisitions, divestitures, or other business combinations, or other transactions that may be announced. For further information – refer to the Risks and Uncertainties section at the end of this report. Investors are cautioned against attributing undue certainty to forward-looking statements.

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<sup>1</sup> In some cases, forward-looking statements may be identified by words such as "anticipate", "could", "expect", "seek", "may", "intend", "will", and similar expressions.

<sup>2</sup> Securities laws encourage companies to disclose forward-looking information so that investors can get a better understanding of the company's future prospects and make informed investment decisions.

## Non-GAAP Financial Measures

This section describes the non-GAAP financial measures we used in the MD&A to explain our financial results. It also provides reconciliations of the non-GAAP financial measures to the most comparable Canadian GAAP financial measures.

### EBITDA

We define EBITDA as earnings before interest, taxes, amortization (including amortization of stock-based compensation) and variable compensation.

We use EBITDA, among other measures, to assess the operating performance of our ongoing businesses without the effects of amortization expense and other items. We exclude amortization expense because it largely depends on the accounting methods and assumptions a company uses, as well as non-operating factors, such as the historical cost of capital assets. We exclude interest on debt as this cost is financing in nature. We exclude variable compensation as it is a performance amount based on EBITDA. We exclude the amortization of the Company's stock option plan as it is a non-cash expense and does not impact the Company's ability to service its debt.

EBITDA allows us to compare our operating performance on a consistent basis. We believe that certain investors and analysts use EBITDA to measure a company's ability to service debt and to meet other payment obligations, or as a common valuation measurement in the telecommunications industry. The most comparable Canadian GAAP financial measure is net income (loss). The table below reconciles net income (loss) to EBITDA on a consolidated basis.

Amounts in \$CDN	2008 Q2	2008 Q1	2007 Q4	2007 Q3	2007 Q2	2007 Q1	2006 Q4	2006 Q3	2006 Q2
Net income (loss) <sup>(1)</sup>	\$(194,646)	\$(1,103,453)	\$(1,804,379)	\$38,597	\$117,716	\$234,738	\$(413,210)	\$(329,039)	\$(45,703)
Variable compensation expense		-	60,000	-	-	-	60,000	-	-
Amortization expense	352,199	1,138,865	461,163	317,551	313,841	315,464	485,415	363,608	668,219
Interest expense	698,119	882,487 <sup>(2)</sup>	629,136	193,625	223,042	118,861	225,477	170,925	126,680
Income tax expense (recovery)	90,000	90,000	(23,066)	-	-	-	377,000	-	-
Stock Option Amortization	35,149	-	467,399	-	-	-	-	-	-
EBITDA	\$980,821	\$1,007,899	\$(209,747)	\$549,773	\$654,599	\$669,063	\$734,682	\$ 205,494	\$749,196

(1) Includes gain on US\$ denominated debt of \$96,780 in Q1 2008 and \$616,025 in Q2 2008.

(2) Includes non-cash option expense relating to the transaction financing of \$258,082 and one-time bridge loan financing expense of \$120,000.

## About our Business

Uniserve operates under three distinct brands. Uniserve as a retail communications services provider, delivers voice and data services to over 85,000 retail consumers and small businesses across Canada. Under the Parasun banner, the Company delivers voice and data services to over 180,000 high-speed consumers through partnerships with over 200 cable system operators primarily in the USA, and, over the past year, Uniserve has been developing a social networking application under the Kinzin.com banner (currently in a public “beta” test) and has had, since October 2007, over 1 million people use their applications. “Kinzin.com”, is a private social network for families, designed to enhance family communications, and create an archive for family culture. The site offers applications that allow close friends and family to share private information in a convenient and entertaining way.

## Summary of Unaudited Quarterly Results

Quarter ending	Nov 30, 2007	August 31, 2007	May 31, 2007	Feb 28, 2007	Nov 30, 2006	August 31, 2006	May 31, 2006	Feb 28, 2006	Nov 30, 2005
Revenues	\$8,263,828	\$8,880,973	\$5,895,419	\$5,816,651	\$5,717,142	\$5,868,237	\$5,941,956	\$4,233,454	\$4,003,964
Net income (loss) before taxes	(104,646)	(1,013,453)	(1,804,379)	38,597	117,716	234,738	(41,924)	(329,039)	(45,703)
Net income (loss)	(194,646)	(1,103,453)	(1,804,379)	38,597	117,716	234,738	(413,210)	(329,039)	(45,703)
Net income (loss) per share*	\$(0.01)	\$(0.05)	\$(0.09)	\$0.01	\$0.01	\$0.01	\$(0.02)	\$(0.02)	\$(0.00)

\* Per share amounts restated to reflect the 8:1 share consolidation which occurred in 2005.

## The 2nd Quarter of Fiscal 2008

### Revenue

Second quarter consolidated revenues were \$8,263,828, an increase of \$2,546,686 (69.2%) over the same period the previous year. The Revenue increase is attributable to the incorporation of revenues (in Q2) from the acquisition of Parasun Technologies Inc. (“Parasun”) and Knowledge Based Telephony Systems Corp. (“KBT”) at the end of the 4<sup>th</sup> quarter, fiscal 2007. The reduction in revenue from Q1 to Q2 of fiscal 2008 was largely attributable to the significant reduction in the value of the Canadian dollar conversion of the American dollar receipts from the Company’s new Parasun operating division (approximately \$300,000) along with a reduction in software sales at Parasun from the previous quarter. In addition, the Company’s new Professional Services business had reduced revenues of approximately \$210,000 during the second quarter as it changed its revenue mix from a high dependence on low margin equipment sales to a focus on higher margin service revenue.

## Gross Margin

Gross margin for the quarter was \$4,027,219 compared to \$3,152,345 over the same period the previous year. Gross margin as a percentage of sales was 48.7% of revenues a reduction from 55% over the same period the previous year. The margin decline was the result of the addition of the Parasun and KBT businesses in May 2007 and their lower margin profiles and the lower Cdn\$ equivalent revenue from Parasun's primarily US\$ denominated revenues. Uniserve's traditional business continued to see a decline in the high margin dial-up service revenue.

## Operations and Service Delivery Costs

Consolidated operations and service delivery costs were \$3,325,028 compared to \$2,178,116 in the same quarter the previous year, an increase of \$1,146,912. Operations and service delivery costs as a percentage of revenue was 40.2% compared to 38.1% over the same period last year. Cost savings will be realized as the combined companies merge common internal functions over the next year.

## Sales and Marketing

Consolidated Sales and marketing expenditures were \$337,394 for the quarter, as compared to \$319,630 for the same period last year. The increase is attributable to the inclusion of the Sales and Marketing expenses of the acquired companies.

## Amortization

Amortization expense for the quarter was \$352,200, amortization expense for the same period in the previous year was \$313,841. The reduction in amortization from Q1 to Q2 2008 was the result of a change in the allocation of the purchase price of the Parasun and KBT acquisitions to better reflect the carrying values of the respective assets.

## Interest and Bank Charges

Interest and bank charges for the quarter were \$698,119 compared with \$194,120 for the same period last year. The increase is attributable to the addition of the debt required for the purchase of Parasun and KBT.

## Liquidity and Capital Resources

As of November 30, 2007 the Company had a working capital deficit of \$7,248,641, (November 30, 2006 - \$5,716,506). The Company's current assets, being cash, accounts receivable, prepaid items and inventories and future tax assets, increased to \$4,377,430 compared to \$1,556,065 the previous year. The Company's working capital deficit increased from \$6,734,138 in Q1 due to an increase in the distributions to the Parasun vendors as part of the working capital adjustments and a shortfall in the funding from the Convertible Preferred offering. The addition of the debt obligations and significantly

increased interest payments along with the reduction in cash resulting from the currency exchange swing has generated operating cash shortfalls in Q2. The Company has made adjustments to its operating model to reduce costs in Q3.

Deferred revenue and income taxes payable are offset against future revenues and amortization respectively and short-term notes payable are due to a related party. The Company intends to close additional financings over the near term for proceeds up to \$2 Million.

## **Contractual Obligations and Commitments**

During the previous year and throughout the first two quarters the Company renegotiated supplier agreements resulting in shorter term obligations. In addition, more of the Company's services fall under tariffs set and regulated by the CRTC (Canadian Radio and Telecommunications Commission), reducing the need for long term contracts for pricing and provision of these services. Further, the Company has amalgamated a number of contracts amongst its service providers to take advantage of its purchasing power in the marketplace. These matters have increased the Company's flexibility in managing its margins in future periods. Outstanding commitments are as follows, as at November 30, 2007.

Year ending May 31	2008	2009	2010	2011	2012 and Beyond	Total
Related party debt repayments	1,813,944	-	-	-	-	\$1,813,944
Long term debt repayments	-	-	US\$750,000	US\$750,000	US\$8,500,000	US\$10,000,000
Supplier commitments	1,631,300	14,400	-	-	-	\$1,645,700
Operating leases	1,192,000	817,000	792,000	712,000	608,000	\$4,121,000

## **Outstanding Share Data**

As of November 30, 2007 the Company had 22,924,367 common shares outstanding, compared with 21,584,367 at the end of same period of the previous year.

As of November 30, 2007, the Company has 2,275,000 stock options outstanding at exercise prices of \$0.50. 1,245,000 are exercisable as of November 28, 2007.

On November 27<sup>th</sup> the Company closed the Fourth tranche of its Series A Preferred Share offering and issued 25,000 shares.

On December 13<sup>th</sup> the Company closed the Fifth tranche of its Series A Preferred Share offering and issued 2,000 shares.

As of January 28<sup>th</sup>, 2008 there has been no further change in the number of shares or options outstanding.

## **Disclosure Controls and Procedures**

Management is responsible for establishing and maintaining disclosure controls and procedures for the Company. Management has evaluated the effectiveness of the Company's disclosure controls and procedures and made some progress. As of the date of this report, it is the management's opinion that because of the items below, disclosure controls and procedures may not be effective to provide reasonable assurance that material items requiring disclosure are recorded, processed, summarized and reported on a timely basis, although the Company is performing other procedures to ensure the disclosures are completed in a timely manner.

## **Managements report on Internal Controls over Financial Reporting**

Management is responsible for certifying the design of the Company's internal control over financial reporting ("ICFR") as required by Multilateral Instrument 52-109 – "Certification of Disclosure in Issuers' Annual and Interim Filings." The Company's ICFR is intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with applicable Canadian GAAP.

Management carried out an assessment of the design of the Company's ICFR and concluded that the following disclosable weaknesses existed as at August 31, 2007. For all of the following weaknesses, Management is committed to, and has adequate resources with the assistance of external advisors, to remediate these weaknesses in the Company's ICFR.

### **Lack of segregation of duties:**

This weakness could result in a failure to prevent or detect errors or irregularities by employees in the normal course of business and could result in material misstatements in the financial statements. Due to limited resources, adequate segregation of duties within the accounting group was not achieved in 2006/2007. The result is that the Company is highly reliant on the performance of mitigating procedures during its financial close processes in order to ensure the financial statements present fairly in all material respects. Management is reviewing the current assignment of responsibilities and is taking steps to improve on segregation. In addition Management will identify and hire additional accounting resources where cost effective and required. Where it is not cost effective to obtain additional accounting resources, Management will review existing mitigating controls and, if appropriate implement changes to ICFR whereby more effective mitigating controls will be adopted.

### **Information Technology:**

There are also weaknesses in the Company's information systems including weak access and program change controls and an undefined disaster recovery plan. The Company is in the process of reviewing these deficiencies.

**Income Taxes:**

The Company makes the necessary provision for income tax and other tax related expenses. Income tax is a highly technical area that requires an in-depth understanding of federal, provincial and state tax laws and the Company's accounting staff has only a fair and reasonable knowledge of the rules related to income tax accounting and reporting. Although these have not resulted in a material misstatement of the financial statements, this lack of knowledge represents a material weakness in the Company's control environment as a material error relating to income tax accounting or disclosure could go undetected. To address this risk, the Company consults with its third party expert advisors on a regular basis for advice. The annual audit is presented to the Audit Committee for its review and approval. As the Company grows, we plan to expand the number of individuals involved in the accounting function who have an enhanced level of tax knowledge.

**Changes to ICFR:**

There have been no changes to ICFR in the last interim period that have materially affected or are reasonably likely to materially affect ICFR.

**Complex and non-routine transactions:**

As required, the Company records complex and non-routine transactions. These sometimes are extremely technical in nature and require an in-depth understanding of Generally Accepted Accounting Principles ("GAAP"). The Company's accounting staff has only a fair and reasonable knowledge of the rules related to GAAP and reporting and the transactions may not be recorded correctly, potentially resulting in material misstatement of the financial statements of the Company. To address this risk, the Company consults with its third party expert advisors as needed in connection with the recording and reporting of complex and non-routine transactions. An annual audit is completed and presented to the Audit Committee for its review and approval. During audits, material misstatements detected are corrected by the Company. As the Company incurs future growth, we plan to expand the technical competence of the individuals involved in the accounting function.

## **Critical Accounting Estimates**

This Management's Discussion and Analysis of the Company's financial condition and results of operations is based on its consolidated financial statements, which are prepared in accordance with Canadian generally accepted accounting principals. The Company's significant accounting policies are described in Note 2 to its consolidated financial statements. The preparation of these financial statements requires that certain estimates and judgments be made that affect the reported assets, liabilities, revenues and expenses. These estimates and judgments are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Areas requiring the use of estimates include allowance for doubtful account of trade receivables, the rates of depreciation for software and equipment and amortization for intangible assets, the assumptions used in the determination of the fair value of stock-based compensation, the determination of the valuation allowance for future income tax assets and the net future cash flows attributed to intangible assets and goodwill for purposes of the allocation of

purchase prices for acquisitions and determining impairment. Anticipating future events cannot be done with certainty, therefore these estimates may change as new events occur, more experience is acquired and as the Company's operating environment changes. The Company considers the following to be its most critical accounting estimates:

**Impairment of Long-lived Assets:**

The carrying value of Long-lived assets, which include software and equipment, customer lists and intellectual property are periodically reviewed for impairment or whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. This requires the Company to forecast future cash flows to be derived from the utilization of these assets based upon assumptions about future business conditions and technological developments. Significant, unanticipated changes to these assumptions could require a provision for impairment in the future.

**Taxes:**

Estimates of future taxable income and the continuation of ongoing prudent tax planning arrangements have been considered in assessing the utilization of available tax losses. There are various tax returns which could be subject to audits in the future, the results of which could change the current and future tax positions of the Company. Further, there is uncertainty related to the amounts of deductions and tax pools realized in both acquired enterprises and the Company that could impact on the Company's tax position when clarified. Changes in circumstances and assumptions and clarifications of uncertain deductions and tax pools may require changes to the valuation allowances associated with the Company's future tax assets. The Company believes that adequate allowance have been provided for in the consolidated financial statements.

**Purchase Price Allocation and Goodwill Impairment:**

The Company has closed a number of acquisitions historically which requires the allocation of the purchase price to the assets and liabilities acquired based on their fair value with the excess allocated to goodwill. The determination of fair value requires significant assumptions about future business conditions, technological developments, future cash flows and discount rates. Changes in assumptions effect the allocation between tangible assets, intangible assets and goodwill. Furthermore, the Company performs an annual impairment test requiring the determination of the fair value of the reporting units to which goodwill relates and comparing the fair value to the carrying value. Significant unanticipated changes to these assumptions could require a provision for impairment.

**Future Accounting Policies**

The Canadian Institute of Chartered Accountants has issued three new standards that apply to the Company effective June 1, 2007:

Financial Instruments - Recognition and Measurement; Hedges; and Comprehensive Income. These new standards are expected to affect the measurement, recognition and disclosure of the Company's financial instruments going forward.

**Risks and Uncertainties**

USS has identified the following significant business risks that affect its ability to continue the execution of its business plan. Accordingly, in evaluating the Securities of the Company, the following risks factors should be considered:

1. The internet access, telephone services and web hosting markets are highly competitive and the competitive landscape includes companies of a much greater size than Uniserve. The Company may not be able to compete successfully against current or future competitors, many of who have greater financial resources.
2. The Company is pursuing growth by acquisition. There are risks associated with this acquisition strategy. These risks include:
  - a. Possible difficulties in assimilating the acquired operations, personnel and costs related to restructuring;
  - b. Possible distraction of management's attention and disruption to ongoing business;
  - c. Possible difficulties to successfully incorporate acquired assets into the Company's business;
  - d. Possible difficulties in maintaining uniform standards, controls, procedures, and policies which could confuse subscribers or otherwise adversely affect the business's image or operations; and
  - e. Possible changes in management or operations from a transaction may impair relations with employees and subscribers.
3. Any future transaction could require
  - a. The issue of additional equity securities, which would dilute current shareholder interest in the Company, and/or
  - b. Additional debt, which could affect liquidity of the Company. The resulting expenses or amortization of goodwill could reduce net income or increase net losses from operations.
4. The company depends on continued use of the Internet and telephone networks by subscribers and continued subscriber access by means provided by the Company.
5. The market for internet access, telephone and other related services is characterized by rapidly changing technology, industry standards, subscriber needs, and new service and product introductions. Such changes may render the company's existing technologies obsolete or less desirable. Offering new services may require significant amounts of capital, which the Company may or may not be able to raise on acceptable, or any, terms. Economies of scale in the industry may change significantly with advances in technology.
6. Additional capital may be required. The Company must continue to develop its services to compete and meet the increasing demands for service quality, availability, and competitive pricing. Significant funds may be required for purposes such as:
  - a. Funding growth and increases in operating expenses to accommodate a larger organization;
  - b. Developing and introducing new products or services;
  - c. Funding acquisition or amalgamation related costs;

- d. Otherwise respond to unanticipated developments or competitive pressures.
7. If the company does not have sufficient cash resources in reserve, from operations, or a credit facility to meet the above-noted requirements, it will be necessary to seek alternative sources of financing. The Company may not be able to raise needed cash on acceptable terms or at all. A financing may be completed on terms that are dilutive to shareholders.
8. The business depends on its network infrastructure capacity. Future success depends on the capacity, reliability and security of the network infrastructure of the Company including both owned equipment and services from third party network providers.
9. Network security breaches and inappropriate use by Internet users. Future success depends on the security of the Company's networks and those of its third party service providers.
10. Attracting and retaining key personnel. Future success depends on the continued efforts of the senior management team and its technical, marketing, finance and sales personnel.
11. Principal shareholders and management can exercise significant influence. The Company's largest shareholder controls approximately 21% of the Company's shares. As a result, this shareholder may exercise significant influence over most matters requiring shareholder approval, including the selection of directors and the approval of significant corporate matters, such as amalgamations or change-of-control transactions.
12. Developments in regulations, laws, and tariffs. Internet access and telephone service providers are regulated by the Canadian Radio Television and Telecommunications Commission and other related government agencies, in addition to having to conform to regulations applicable to businesses generally. Internet-related regulatory policies are continuing to develop, and it is possible that the industry could be further regulated in the future.
13. Foreign Exchange Rate changes can significantly impact Revenues and Net Income where costs are expensed in one currency and revenues are received in another. Approximately 25% of the Company's revenue is denominated in US dollars and as the Canadian dollar appreciates the Company's financial performance is adversely affected. The Company has hedged this exposure to some degree by borrowing US denominated loans. The Company expects exposure to fluctuations in the value of the US dollar to grow as the business continues to grow rapidly in the US.