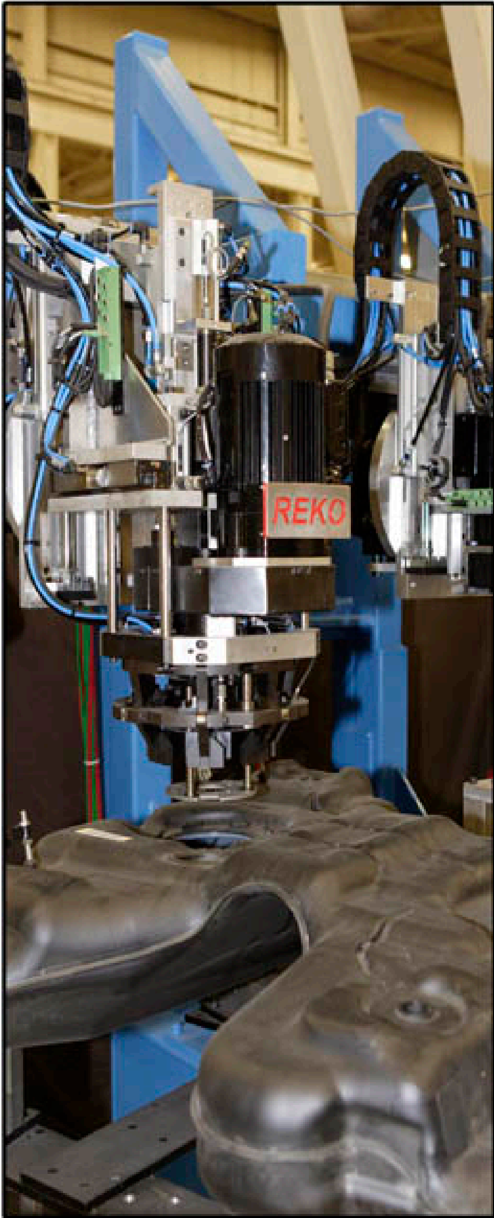


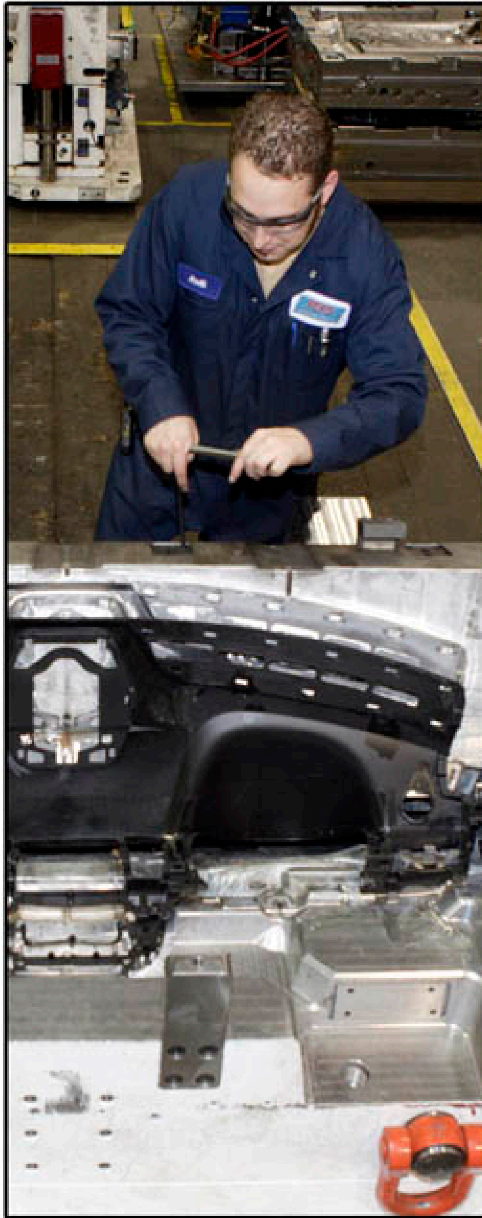

Automation

Injection Moulds

Precision Machining

# 2010 Annual Report

***REKO INTERNATIONAL GROUP INC. FINANCIAL HIGHLIGHTS***

| *(in 000's, except per share data)* | **2010** | **2009** | **2008** |
|---|---|---|---|
| Sales | 40,151 | 55,280 | 55,729 |
| Net profit (loss) | (7,469) | 199 | (3,529) |
| Profit (loss) per share (basic) | (1.16) | 0.03 | (0.49) |
| Shareholder's equity (per share) | 5.63 | 6.79 | 6.20 |
| Return on equity | (18.7%) | 0.5% | (7.9%) |
| Gross margin | (2.3%) | 16.3% | 6.6% |

## ***Chief Executive Officer's Message***

When reflecting upon fiscal 2010, I am inclined to take my mother's advice, "If you can't say anything nice, don't say anything at all".

This advice, however, was not given with Annual Reports in mind. However, notwithstanding the disappointing financial results, 2010 contained a number of positive elements.

Although we experienced a significant decline in sales during the first three quarters; year over year, we were still able to reduce our fixed costs, below previous levels. Some of the reduction was achieved via layoffs and structural changes. These types of management decisions, although necessary, are never easy, regardless of the circumstances.

It appears that the "bottom" for us occurred mid to late in the second quarter. Since then, we have seen improving signs in both the capital equipment market and in our diversification efforts. With sales at $12.6 million in the fourth quarter, compared to the previous three quarters which were under $9.4 million, we feel that market conditions are improving.

While we continue to have the impression that our customers are experiencing difficulty in obtaining commercial credit for capital investments, we are seeing improvements in both quoting volumes and serious inquiries that we believe will translate into much needed sales increases for fiscal 2011.

Our efforts at cross training and sharing resources throughout the company have also been successful during the year. We have a number of experienced employees who have been re-deployed to areas of the business, where their specific expertise can be better utilized, or where the current demand simply requires the extra manpower. This flexibility and knowledge-sharing has been invaluable, and I want to thank all those who have supported and participated in this process. It gives us a depth and strength that I believe exceeds most of our competition.

We also continue to examine our non-labour costs and continue to find opportunities to reduce them via consolidation, standardization and improvements in processes. As we better match our abilities with the most profitable areas of the market, I believe that these efforts will strengthen our financial results.

Another positive is that while it has been a difficult year, we continue to have the support of our lenders. In so doing, they demonstrate faith in our ability to achieve the vision that we have for the company.

I would like to extend my personal gratitude to each of our employees, shareholders and members of our Board of Directors for their efforts, support and ideas during the past year. While there is still much to be done, I believe that 2011 will be an exciting and more successful year!

**"Diane St. John"**

Diane St. John
Chief Executive Officer

# MANAGEMENT'S DISCUSSION AND ANALYSIS

*The following is management's discussion and analysis of operations and financial position ("MD&A") and should be read in conjunction with the audited consolidated financial statements for the year ended July 31, 2010 and the audited consolidated financial statements and MD&A for the year ended July 31, 2009 included in our 2009 Annual Report to Shareholders. The audited consolidated financial statements for the year ended July 31, 2010 have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), and the audited consolidated financial statements for the year ended July 31, 2009 have been prepared in accordance with Canadian GAAP. When we use the terms "we", "us", "our", "Reko", or "Company", we are referring to Reko International Group Inc. and its subsidiaries.*

*This MD&A has been prepared by reference to the MD&A disclosure requirements established under National Instrument 51-102 "Continuous Disclosure Obligations" ("NI 51-102") of the Canadian Securities Administrators. Additional information regarding Reko International Group Inc., including copies of our continuous disclosure materials such as our annual information form, is available on our website at www.rekointl.com or through the SEDAR website at www.sedar.com.*

*In this MD&A, reference is made to gross margin, which is not a measure of financial performance under Canadian GAAP. The Company calculates gross margin as sales less cost of sales (including depreciation and amortization). The Company included information concerning this measure because it is used by management as a measure of performance, and management believes it is used by certain investors and analysts as a measure of the Company's financial performance. This measure is not necessarily comparable to similarly titled measures used by other companies.*

*All amounts in this MD&A are expressed in 000's of Canadian dollars, except per share data and where otherwise indicated.*

*This MD&A is current to September 23, 2010.*

## OVERVIEW

Reko designs and manufactures a variety of engineered products and services for original equipment manufacturers ("OEMs") and their Tier 1 suppliers. These products include plastic injection molds, fixtures, gauges, lean cell factory automation, high precision custom machining, and assemblies. Customers are typically OEMs or their Tier 1 suppliers and are predominantly in the automotive market. Divisions of Reko are generally invited to bid upon programmes comprised of a number of custom products used by the customer to produce a complete assembly or product.

For the automotive industry, the Company designs and builds plastic injection molds, hydro-forming dies, two shot molds, and compression molds. Injection molds range in size from less than one cubic foot to approximately four feet wide, ten feet long, and six feet high. They range in weight from approximately 100 pounds to 50 tons. Typically, plastic injection molds are expected to perform up to 1,000,000 production cycles with limited maintenance. Each production cycle lasts between 30 and 120 seconds. Reko has extensive experience and knowledge in mold design and material flow and the impact of pressure on segments of the mold/die. In addition, it designs and builds custom lean factory cell automation from use primarily in the automotive industry and specialty custom machines for other industries. The factory automation systems include asynchronous assembly and test systems, leak and flow test systems, robotic assembly/machines, vision work cells and various welding systems. For the transportation and oil and gas industry, the Company machines customer supplied metal castings to customer indicated specifications.

Our design and manufacturing operations are carried on in nine manufacturing plants located at two industrial sites in the suburbs of the City of Windsor in Southwestern Ontario.

## INDUSTRY TRENDS AND RISKS

Historically, our success has been primarily dependent upon the levels of new model releases of cars and light trucks by North American OEMs and our ability to source moulding and automation programmes with them. OEM new model releases can be impacted by many factors, including general economic and political conditions, interest rates, energy and fuel prices, labour relation issues, regulatory requirements, infrastructure, legislative changes, environmental emissions and safety issues.

*Continued support of our lenders could have a material impact on our profitability, financial condition and continued sustainability*

The Company operates in a capital-intensive business, has significant financing requirements placed on it by its customers and its financial resources are less than the financial resources of our customer base. There can be no assurance that, if, as and when the Company seeks additional equity or debt financing, it will be able to obtain the additional financial resources required to successfully compete in its markets on favourable commercial terms or at all. Additional equity financings may result in dilution to existing shareholders.

*Our recent operating performances may result in our customers assessing us a high-risk supplier thereby jeopardizing our opportunities for new business, which could materially impact our profitability and financial condition*

We incurred significant operating losses in fiscal 2010 as a result of the lack of commercial credit to support companies' capital equipment purchases. As more of our customers perform supplier credit risk evaluations, on a more frequent basis, their assessment of Reko could result in us being considered a high-risk supplier. Being categorized as a high-risk supplier could jeopardize our opportunities for new business awards.

*A slower than anticipated economic recovery or deterioration of economic conditions could have a material adverse effect on our profitability and financial condition.*

While the global economy is currently experiencing a gradual recovery, the global capital equipment market has not stabilized and improved to the same extent as the global automotive industry. As a result, considerable uncertainty remains as to the breadth and depth of a global economic and industry recovery, including the timing of a return to more normal market conditions. A slower than anticipated recovery or a deterioration of economic conditions, including a global or continent specific double dip recession, could have a material adverse effect on our profitability and financial condition.

*The bankruptcy of any of our major customers, and the potential corresponding disruption of the automotive supply chain, could have a material adverse effect on our profitability and financial condition.*

The short-term viability of several of our automotive customers appears to have improved as a result of restructuring actions in the past few years, as well as direct government financial intervention in the automotive industry in 2009. However, there can be no assurance that these restructuring actions will be successful in ensuring their long-term viability, nor can there be any assurance that government financial assistance will be made available at levels necessary to prevent automobile manufacturer failures in the future. The bankruptcy of any of our major customers could have a material adverse effect on our profitability and financial condition. Additionally, since automobile manufacturers rely on a highly interdependent network of suppliers, a bankruptcy could materially disrupt operations and the financial condition of one or more of our Tier 1 customers, which could have a material adverse effect on our profitability or financial condition.

*Our short-term profitability could be adversely affected by the costs associated with rationalization and downsizing of some of our operations or other significant, non-recurring costs*

As part of our cost reduction strategy we may further rationalize some of our operating facilities. In the course of such rationalization, we may incur further restructuring, downsizing and/or other significant non-recurring costs related to plant closings and employee severance costs. Such costs could have an adverse effect on our short-term profitability. In addition, we are working to turn around financially underperforming divisions; however, there is no guarantee that we will be successful in doing so with respect to those divisions.

*Our inability to diversify our sales could have an adverse effect on our profitability and financial condition*

Although we supply molds, gauges, fixtures and factory automation to all of the leading automobile manufacturers, a significant majority of our sales are to three such customers. While we have diversified our customer base somewhat in recent years and continue to attempt to further diversify, particularly to increase our business with European and Asian based automobile manufacturers, there is no assurance we will be successful. Our inability to successfully grow our sales to non-traditional customers could have an adverse effect on our profitability and financial condition

*We may not be able to successfully compete against suppliers with operations in developing markets, which could have an adverse effect on our profitability and financial condition*

Many of our customers have sought, and will likely continue to seek to take advantage of lower operating costs in China, India, Brazil, Indonesia, Russia and other developing markets. While we continue to expand our manufacturing sources, with a view to taking advantage of these lower cost countries, we cannot guarantee that we will be able to fully realize such opportunities. The inability to quickly adjust our manufacturing sources to take advantage of opportunities in these markets could harm our ability to compete with our suppliers operating in or from such markets, which could have an adverse effect on our profitability and financial condition.

*Significant long-term fluctuations in relative currency values could have an adverse effect on our profitability and financial condition*

Although, our financial results are reported in Canadian dollars, a significant portion of our sales are realized in U.S. dollars. Our profitability is affected by movements in the U.S. dollar against the Canadian dollar. As a result of our hedging program, foreign currency transactions are not fully impacted by movements in exchange rates. However, our hedging program is designed to hedge our accounting risk (the risk associated with our foreign exchange balances on our balance sheet at any point in time) but does not hedge our economic risk (the risk associated with all of our foreign exchange balances and potential balances regardless of whether those balances and potential balances are on our balance sheet at any one particular time). Despite these measures, significant long-term fluctuations in relative currency values could have an adverse effect on our profitability and financial condition and any sustained change could adversely impact our competitiveness.

*The continuation or intensification of pricing pressures and pressure to absorb additional costs could have an adverse effect on our profitability*

We face significant pricing pressure, as well as pressure to absorb costs related to tooling design and machine design, as well as other items previously paid for directly by automobile manufacturers. These pressures are expected to continue, even as the industry begins to recover from the global recession. The continuation or intensification of these pricing pressures and pressure to absorb additional costs could have an adverse effect on our profitability and financial condition.

*The consequences of the automotive industry's dependence on consumer spending and general economic conditions could materially impact our profitability and financial condition*

The global automotive industry is cyclical and largely tied to general economic conditions. The recent economic downturn and current suggested economic recovery has resulted in significant reductions in consumer spending which has severely impacted our OEM and Tier 1 customers. As our customers revisit their business models and make design changes to existing models and new vehicle introductions, the market for tooling and factory automation may decline.

*The financial viability of our supply base could materially impact our profitability and financial condition*

The global economic conditions have weakened the financial stability of our supplier base. While our exposure to individual entities in our supply chain is largely limited to steel suppliers and mold grainers, both of which tend to be mandated by our customers, we are still exposed to multiple relatively small niche market players whose declining financial viability may present challenges for securing the necessary inputs to our build process.

*The increasing pressure from our customers to launch new awards without adequate design support could materially impact our profitability and financial condition*

As the automotive industry rushed to restructure its operations and deal with the frequent production slow downs that were commonplace, our OEM and Tier 1 customers substantially reduced the design support offered to new vehicle launches. Without an adequate level of support, the quality of information provided to tool builders to begin their work dropped significantly. In addition, tool builders' ability to manipulate poor quality information was limited as the appropriate resources to approve the manipulations were not available from the OEM or Tier 1. This introduced significant inefficiencies to the process and impaired the ability of the tool builder to manufacture molds at the same profitability as in the past.

*The increasing pressure from our customers to absorb their traditional overhead costs, including program management and design feasibility, could materially impact our profitability and financial condition*

As the automotive industry rushes to restructure its operations, services typically provided by our Tier 1 customers in the areas of program management and design feasibility have been abandoned to meet internal financial targets. As this layer of oversight and engineering disappeared from our customers, Reko is expected to fill the void. To date, Reko has been able to meet this challenge using internal resources. However as additional cuts are made at our Tier 1 customers, increased pressure to fill this void may result in the need for Reko to increase its overhead to fulfill this role.

*Current outsourcing and in-sourcing trends could materially impact our profitability and financial condition*

As global market conditions weakened in the last 2 years, demand for our customers' products also weakened. During periods of weakened demand, our customers traditionally revisit outsourcing decisions as a method of maintaining their employment levels. As a result of this and other factors, some of our customers decided to bring work in-house that in the recent past would have been performed by Reko. Depending upon the depth and breadth of the current economic recovery, Reko may continue to experience significant reduction in outsourced work orders.

*Changes in consumer demand for specific vehicles could materially impact our profitability and financial condition*

The global automotive industry is cyclical and consumer demand for automobiles is sensitive to changes in economic and political conditions, including interest rates, energy prices, employment levels and international conflicts, including acts of terrorism. Automotive production and more importantly for Reko, the frequency of automotive model changes, is affected by consumer demand and may be affected by macro economic factors. As a result of these and other factors, some of our customers are currently experiencing, and/or may experience in the future, reduced consumer demand for all or a portion of their vehicles, leading to reduced product offerings.

*The consequences of shifting market shares among vehicle or automobile manufacturers could materially impact our profitability and financial condition*

Although we supply tooling, secondary automation and manufacturing work cells to almost all of the leading automotive manufacturers, a significant majority of our sales are to the Detroit 3. We are attempting to further

diversify our customer base, particularly to increase our business with Asian-based and European-based automotive manufacturers.

Generally speaking, the current shifting market demand in favour of automobiles produced by Asian-based and European-based companies represents a mid-term opportunity for Reko. However, in the short-term, Reko is constrained by its exposure to the products manufactured by the Detroit-3.

*The consequences of a decrease in the world's energy reduction programs could materially impact our profitability and financial condition*

Certain of our activities are tied to machining of energy efficient locomotive engines. An adverse change in the current worldwide economic demand for energy efficient locomotive engines could result in reduction in the demand for our machining operations.

*The failure to identify and develop new technologies and to successfully apply such technologies to create new products could have a material adverse effect on our profitability and financial condition*

Like our Tier 1 customers, we continue to invest in technology and innovation. Our ability to anticipate changes in technology and to successfully develop and introduce new and enhanced products on a timely basis using such technologies will be a significant factor in our ability to remain competitive. If there is a shift away from the use of such technologies, our costs may not be fully recovered. In addition, if other technologies in which our investment is not as great or our expertise is not as fully developed emerge as the industry-leading technologies, we may be placed at a competitive disadvantage, which could have a material adverse effect on our profitability and financial condition.

*The failure of one or more major financial institutions could affect the amount of credit available to us or subject us to counterparty risk in connection with derivative transactions, which could significantly impact our financial condition*

Since September 2008, several major financial institutions in the United States have failed or required significant government intervention in order to prevent collapse. The turmoil in the financial sector had a significant effect on the global economy, and contributed to the global recession. The failure of other major financial institutions around the globe could lead to further disruptions in capital and credit markets and could adversely affect our and our customers' ability to access needed liquidity for working capital. In addition, in the event of a failure of a financial institution in which we invest our cash reserves, that is a counter party in a derivative transaction, or a lender to us, we face the risk that our cash reserves or liquidity available to us may be significantly reduced. All of these risks could have a significant impact on our financial condition.

*Our dependence upon key personnel could materially impact our profitability and financial condition*

The success of Reko is dependent on the services of a number of the members of its management team. The experience and talents of these individuals is a significant factor in the Company's growth and success. The loss of one or more of these individuals without adequate replacement could have a material adverse effect on the Company's operations and business prospects. To partially mitigate this concern, the Company has sourced key man insurance on several members of the management team and continues to maintain an active succession planning process for management.

*Our inability to utilize tax losses could materially impact our profitability and financial condition*

We incurred tax losses in both Canada and the United States, which we may not be able to fully or partially offset against future income in those countries. In the case of the United States, we may not be able to utilize these losses at all if we cannot generate profits in the United States.

*We could record impairment charges in the future, which could materially impact our profitability and financial condition*

Annually, we must test our capital assets, future income taxes and any other long-lived assets for impairment whenever indicators of impairment exist. The bankruptcy of a significant customer could be an indicator of impairment. In addition, to the extent that forward-looking assumptions regarding the impact of improvement plans on current operations, outsourcing and other new business opportunities are not met, impairment charges could occur.

*Our failure to successfully identify, complete, and integrate acquisitions could materially impact profitability and financial condition*

While we have not completed an acquisition in a number of years, we may do so in the future. In those product areas in which we identified acquisitions as critical to our business strategy, we may not be able to identify suitable acquisition targets or successfully acquire any suitable targets, which we identify. Additionally, we may not be able to successfully integrate or achieve anticipated synergies from those acquisitions, which we do complete.

*Significant changes in law, government regulations or accounting regulations could materially impact our profitability and financial condition*

A significant change in the current regulatory environment in our principal markets could impact future profitability. In particular, our profitability could be adversely impacted by significant changes in the tariffs and duties imposed on our products. In addition, we could be affected by changes in tax or other laws, which impose additional costs on automobile manufacturers or consumers, or more stringent fuel economy requirements on manufacturers, of sport-utility vehicles, light trucks and other vehicles from which we derive some of our sales.

*Environmental laws and regulations could materially impact our profitability and financial condition*

We are subject to a wide range of environmental laws and regulations relating to air emissions, wastewater discharge, waste management and storage of hazardous substances. We are also subject to environmental laws requiring investigation and clean up of environmental contamination. Estimating environmental clean-up liabilities is complex and heavily dependent on the nature and extent of historical information and physical data relating to the contaminated sites, the complexity of contamination, the uncertainty of which remedy to apply, and the outcome of discussions with regulatory authorities relating to the contamination. In addition, these environmental laws and regulations are complex, change frequently and have tended to become more stringent and expensive over time. Therefore, we may not have been, and in the future may not be, in complete compliance with all such laws and regulations, and we may incur material costs or liabilities as a result of such laws and regulations significantly in excess of amounts we have reserved.

*TSX delisting review could materially impact the level of liquidity in the trading of Reko's shares and/or materially impact the price at which Reko's shares may trade*

On September 10, 2010, the TSX advised the Company that it would be conducting a continued listing review. If the Company is found by the TSX to no longer meet the minimum listing requirements of the TSX, the Company's securities may be delisted from the TSX which could have a material adverse affect on the trading price of Reko's shares, particularly if an alternative listing of the securities on the TSX Venture Exchange or on another stock exchange could not be obtained.

*Potential volatility of Reko's share prices could materially impact the financial returns earned by our shareholders*

The market price of the Company's common shares has been, and will likely continue to be, subject to fluctuations in response to a variety of factors, many of which are beyond the Company's control. These fluctuations may be exaggerated if the trading volume of the common shares remains low. In addition, due to the evolving nature of its business, the market price of the common shares may fall dramatically in response to a variety of factors, including quarter-to-quarter variations in operating profits, announcements of technological or competitive developments by the Company or its competitors, large short-term fluctuations in foreign exchange rates, acquisitions or entry into strategic alliances by the Company or its competitors, the industry or its customer's industry and general market and economic conditions.

*Interest of the majority and minority shareholders may be in conflict with the interests of the Company*

As of the date of this AIF, The Reko Family Corporation owns directly or indirectly 58.0% of the outstanding shares of the Company. As such, The Reko Family Corporation will be able to elect or remove the directors of the Company and to exercise control in certain respects over the Company's affairs.

## CHANGES IN ACCOUNTING POLICY

On August 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") accounting standards Section 3064 "Goodwill and intangible assets". The Company adopted this new recommendation effective August 1, 2009 without restatement of prior periods.

## UNUSUAL ITEMS

### Renegotiated financial covenant with secondary term lender

a) During the third quarter, the Company requested certain revised financial covenants with its primary lender for Reko's third and fourth quarters. The lender agreed to the revised financial covenants and a term sheet between the Company and the lender was signed on May 27, 2010.

b) During the fourth quarter, the Company requested its secondary term lender permanently waive its sole financial covenant for Reko's fiscal 2010 year. The secondary term lender agreed to the Company's request.

## AVERAGE FOREIGN EXCHANGE/FINANCIAL AND OTHER INSTRUMENTS

Reko is exposed to the impacts of changes in the foreign exchange rate between Canadian and United States ("U.S.") dollars. More specifically, approximately 90% of the Company's sales and 20% of its costs are incurred in U.S. dollars. In addition, the Company maintains a significant asset on its balance sheet which represents unutilized non-capital losses available to reduce future taxable income in the U.S. and it operates a sales office in the U.S., where it maintains working capital and capital assets.

In order to minimize our exposure to the impacts of changes in the foreign exchange rate, the Company maintains a forward foreign exchange hedging programme ("Programme"). Reko's Programme is based on maintaining our net exposure to the U.S. dollar (total U.S. exposure less forward foreign exchange contracts) between positive and negative $2,000. This Programme is designed to minimize the Company's exposure to foreign exchange risks over the mid-term. As a consequence of this mid-term exposure protection, the Company is subject to short-term paper gains and losses on its net exposure to the U.S. dollar, most particularly during periods when our net exposure to the U.S. dollar is outside of our target exposure. During periods of rapid fluctuation in the foreign exchange rate between the Canadian dollar and the U.S. dollar, regardless of our net exposure to the U.S. dollar, the Company can generate significant gains or losses, which will materially impact financial results. These significant gains or losses are entirely related to mark-to-market accounting rules and represent the product of our net exposure to the U.S. dollar and the change during any given month of the value of the U.S. dollar in relation to the Canadian dollar.

During each of the last four quarters, the maximum amount of the Company's month-end exposure to the U.S. dollar has been:

| Fiscal Period | Total U.S. exposure before hedging programme | Forward foreign exchange contracts booked | Net exposure to the U.S. dollar |
|---|---|---|---|
| Q4 – 2010 | $26,050 | $24,800 | $ 1,250 |
| Q3 – 2010 | $23,488 | $24,100 | $ (612) |
| Q2 – 2010 | $23,798 | $25,600 | $ (1,802) |
| Q1 - 2010 | $29,937 | $27,300 | $ 2,637 |

As a result of the Company's purchase of forward foreign exchange contracts ("FFECs"), the Company is subject to changes in foreign exchange rates that may not be consistent with changes in the current quoted foreign exchange rates. More specifically, the Company's foreign exchange risk is split such that its net exposure to the U.S. dollar, as detailed above, is subject to change in market foreign exchange rates on a monthly basis and the remainder of its U.S. dollar exposure is subject to foreign exchange risks based on the specific foreign exchange rate contained in its FFECs. The table below presents a comparison between actual foreign exchange rates and Reko's effective rate on its booked FFECs.

| | For the three months ended July 31, | | | | For the year ended July 31, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | | 2009 | | 2010 | | 2009 | |
| | Actual | Reko effective | Actual | Reko effective | Actual | Reko effective | Actual | Reko effective |
| U.S. Dollar equals Canadian Dollar | 1.0393 | 1.0655 | 1.1321 | 1.1262 | 1.0489 | 1.1032 | 1.1755 | 1.0749 |

The Company's FFECs represent agreements with an intermediary to trade a specific amount of U.S. dollars for Canadian dollars at a specific rate on a specific date. Currently, the date is between one and two years after the date on which the FFEC is booked. The specific rate entered into is not necessarily indicative of what either the intermediary or Reko believes the foreign exchange rate will be on the date the settlement of the trade occurs, rather it is a rate set by the intermediary which Reko can either accept or reject.

During the fourth quarter, the Company recorded a pre-tax loss of approximately $196 related to the fair value of its U.S. dollar exposures, as compared to a pre-tax loss of $840 in the prior year's fourth quarter. For the year ended July 31, 2010, the Company recorded a pre-tax gain of $268, as compared to a pre-tax loss of $1,510 in the prior year. These foreign exchange gains or losses are reported as part of our sales.

At the end of the year, we held FFECs of $24,800 compared to $25,400 at the end of the prior year. During fiscal 2010, on average we held FFECs of $25,600, compared to $25,700 during the prior year.

The following table outlines the level of FFECs presently maintained and the average effective rate of these contracts:

| Fiscal Period | Contract value booked (000's) | Effective average rate |
|---|---|---|
| Q4 – 2010 | $24,800 | 1.0538 |
| Q1 – 2011 | $18,900 | 1.0507 |
| Q2 – 2011 | $14,000 | 1.0453 |
| Q3 - 2011 | $10,500 | 1.0411 |

The Company notes that at current levels of FFECs and U.S. dollar denominated assets and liabilities, an increase in the value of the U.S. dollar against the Canadian dollar results in the Company recording gains and an increase in the value of the Canadian dollar against the U.S. dollar results in financial losses for the Company.

Foreign currency transactions are recorded at rates in effect at the time of the transaction. Forward exchange contracts are recorded at month-end at their fair value, with unrealized holding gains and losses recorded in sales.

Additional information with respect to financial instruments is provided in Note 1 and Note 15 to Reko's audited financial statements, which by this reference are hereby incorporated herein.

## RESULTS OF OPERATIONS

*Sales*

Sales for the year ended July 31, 2010 decreased $15.1 million, or 27%, to $40.2 million compared to $55.3 million in fiscal 2009.

The decrease in sales was largely related to:

- A general freeze in the capital equipment market caused by the lack of commercial credit available in the marketplace; and,
- Decreases in the amount earned per hour by our facilities, largely caused by the increased competition for the few projects that were available.

Items offsetting the decrease in sales discussed above include:

- Increased sales volume related to our work on projects that were out-sourced to low cost countries;
- Increased sales volume on work performed in the plastic injection molded interior parts portion of the automotive industry; and,
- Changes in the fair value of foreign exchange future contracts, as described above.

*Gross Margin*

The gross margin for the year ended July 31, 2010 decreased $9,939 to a gross loss of $947 or 2.4% of sales, compared to $8,992, or 16.3% of sales, in the previous fiscal year.

The decrease in gross margin was largely related to:

- Inability to cover our fixed overhead costs, as a result of our reduced sales levels.

These factors were partially offset by:

- Reduced labour costs associated with our second quarter layoffs;
- Productivity and efficiency improvements implemented in the previous year; and,
- Cost savings measures implemented during the second and third quarter designed to offset the impacts of our reduction in sales volumes.

*Selling and administration*

Selling and administration expenses ("S,G&A") decreased by $1,111, or 15.6%, to $5,990, or 14.9% of sales for the year ended July 31, 2010, compared to $7,101, or 12.8% of sales for the same period in the prior year. During the year, we incurred various restructuring charges of $163 included in S,G&A. The decrease in S,G&A was produced by savings achieved as a result of:

- Reductions in wages and benefits as a result of our second quarter 2010 layoff and terminations and our 2009 restructuring activities;
- Reduction in our restructuring costs as compared to the prior year;
- Reductions in professional fees associated with lower SR&ED tax credit opportunities;
- Reductions in the costs of commissioned sales representatives, as a result of the reductions in our sales levels; and,
- improvements in cost containment activities associated with discretionary business expenses including office, travel and promotion.

These factors were partially offset by:

- Increased capital tax costs associated with a capital tax refund received in the prior year; and,
- Increased bank charges associated with our covenant renegotiations.

*Earnings overview*

On an all-inclusive basis, the net loss for the year was $7,469, or $1.16 per share, compared to a net income of $199, or $0.03 per share, in the prior year.

## LIQUIDITY AND CAPITAL RESOURCES

Cash flow from operations decreased $3,651 from proceeds from operations of $3,643 in the prior year to a use of funds of $8 in the current year.

The decrease in cash flow from operations is primarily a result of:

- Our inability to generate sufficient sales levels to cover our fixed overhead expenses.

This factor was partially offset by:

- Increase in cash collections during the year, generated from recognized sales in the prior year.

During the year, a capital lease on a machining centre came up for renewal and the Company did not refinance the capital lease in advance of its due date. Accordingly, on February 25, 2010, the Company made the required balloon payment of $675 on the capital lease through our operating line of credit.

*Financial covenants*

The Company met its financial covenants at the end of the fourth quarter of 2010. During the fourth quarter, the Company requested that its secondary term lender permanently waive its sole financial covenant for fiscal 2010, to which our secondary term lender agreed.

The Company believes it has sufficient operating room with respect to its financial covenants for the next fiscal year and does not anticipate being in breach of any of its financial covenants during this period.

*Capital assets and investment spending*

For the year ended July 31, 2010, the Company invested $889 in capital assets. The entire amount of this spending is considered maintenance capital expenditure intended to refurbish or replace assets consumed in the normal course of business.

*Cash resources/working capital requirements*

As at July 31, 2010, Reko had borrowed $12,989 on its revolving line of credit, net of its cash on hand at year-end, compared to $9,396 at April 30, 2010 and $9,416 at July 31, 2009. The revolver borrowings increased by approximately $3,593 in the quarter and increased approximately $3,573 for the year. We expect borrowings to display a slight mid-term decreasing trend over the next four quarters.

Reko has a $20,000 revolver available to it; however, based on our current lender defined margining capabilities, our borrowings are limited to $19,583, of which approximately $6,381 was unused and available at the end of the year. Under the terms of our credit facilities, Reko must achieve certain financial covenants including a maximum Total Debt to Tangible Net Worth, a minimum Current Ratio and a minimum Debt Service Coverage Ratio. At the present time, our primary lender has agreed to temporarily waive the minimum Debt Service Coverage Ratio. In its place, our primary lender has instituted a minimum monthly EBITDA target. As previously discussed, Reko is confident about its ability to meet these financial covenants over the next fiscal year.

*Contractual obligations and off-balance sheet financing*

| Contractual obligations | Payments due by period | | | | |
|---|---|---|---|---|---|
| | **Total** | **Less than 1 year** | **1 – 3 years** | **4 – 5 years** | **After 5 years** |
| Long-term debt | $14,033 | $12,346 | $1,624 | $63 | $-- |
| Capital lease obligations | 569 | 335 | 234 | -- | -- |
| Operating leases | 3 | 2 | 1 | -- | -- |
| Purchase obligations | -- | -- | -- | -- | -- |
| Other long-term obligations | -- | -- | -- | -- | -- |
| **Total contractual obligations** | **$14,605** | **$12,683** | **$1,859** | **$63** | **$--** |

Except as disclosed elsewhere in this MD&A, there have been no material changes with respect to the contractual obligations of the Company during the year.

Reko does not maintain any off-balance sheet financing.

*Share capital*

The Company had 6,420,920 common shares outstanding at July 31, 2010. During the year, no options were granted and no options were exercised.

*Outstanding share data*

| Designation of security | Number outstanding | Maximum number issuable if convertible, exercisable or exchangeable for common shares |
|---|---|---|
| Common Shares | 6,420,920 | |
| Stock options issued | 117,000 | |
| Stock options exercisable | 98,000 | |
| Total (maximum) number of common shares | | 6,518,920 |

## CRITICAL ACCOUNTING ESTIMATES

The Company's discussion and analysis of its results of operations and financial position is based upon the consolidated financial statements, which have been prepared in accordance with Canadian GAAP. The preparation of the consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities. On an ongoing basis, management evaluates these estimates. However, actual results differ from these estimates under different assumptions or conditions.

Management believes the following critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements of the Company. Management has discussed the development and selection of the following critical accounting policies with the Audit Committee of the Board of Directors and the Audit Committee has reviewed its disclosure relating to critical accounting estimates in this MD&A.

*Allowances for doubtful accounts receivable*

In order for management to establish appropriate allowances for doubtful accounts receivable, estimates are made with regard to economic conditions, potential recoverability through our accounts receivable insurer, and the probability of default by individual customers. The failure to estimate correctly could result in bad debts being either higher or lower than the determined provision as of the date of the balance sheet.

*Revenue recognition and tooling and machinery contracts*

Revenue from tooling and machinery contracts is recognized on the percentage of completion basis. The percentage of completion basis recognizes revenue and cost of sales on a progressive basis throughout the completion of the tooling or machinery.

Tooling and machinery contracts are generally fixed; however, price changes, change orders and program cancellation may affect the ultimate amount of revenue recorded with respect to a contract. Contract costs are estimated at the time of signing the contract and are reviewed at each reporting date. Adjustments to the original estimates of total contract costs are often required as work progresses under the contract. When the current estimates of total contract revenue and total contract costs indicate a loss, a provision for the entire loss on the contract is made. Factors that are considered in arriving at the forecasted profit or loss on a contract include, amongst other items, cost overruns, non-reimbursable costs, change orders and potential price changes.

*Impairment of long-lived assets*

Management evaluates capital assets for impairment whenever indicators of impairment exist. Indicators of impairment include prolonged operating losses or a decision to dispose of, or otherwise change the use of, an existing capital asset. If the sum of the future cash flows expected to result from the asset, undiscounted and without interest charges, is less than the reported value of the asset, asset impairment must be recognized in the financial statements. The amount of impairment to be recognized is calculated by subtracting the fair value of the asset from the reported value of the asset.

Management believes that accounting estimates related to capital assets are 'critical accounting estimates' because: (i) they are subject to significant measurement uncertainty and are susceptible to change as management is required to make forward-looking assumptions regarding their impact on current operations; and (ii) any resulting impairment loss could have a material impact on the consolidated net income and on the amount of assets reported on the Company's consolidated balance sheet.

*Future income taxes and SR&ED tax credits*

Future tax assets in respect of loss carry forwards and scientific research and experimental design credits relate primarily to legal entities in Canada and the United States. The Company evaluates the realization of its future tax assets by assessing the valuation allowance and by adjusting the amount of such allowance, if necessary. The facts used to assess the likelihood of realization are a forecast of future taxable income and available tax planning strategies that could be implemented to realize the future tax assets. The Company has, and continues to use, tax planning strategies to realize future tax assets in order to avoid the potential loss of benefits.

## CONTROLS AND PROCEDURES

Management is responsible for implementing, maintaining and testing the operating effectiveness of adequate systems of disclosure controls and procedures. There are inherent limitations to the effectiveness of any system of disclosure including the possibility of human error and circumvention or overriding of the controls and procedures. Accordingly, even effective controls and procedures can only provide reasonable assurance of achieving their corporate objectives.

Our management used the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework to evaluate the effectiveness of internal controls over financial reporting. We carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures during fiscal 2010, and concluded that Reko's controls and procedures are operating effectively to ensure that the information required to be disclosed is accumulated and communicated to management including the Chief Executive Officer and the Chief Financial Officer. A similar evaluation was performed in fiscal 2009.

Based on these evaluations, the Chief Executive Officer and the Chief Financial Officer concluded that Reko's disclosure controls and procedures and internal controls over financial reporting do not include any material weaknesses and that they were effective in recording, processing, summarizing and reporting information required to be disclosed within the time period specified in the Canadian Securities Administrators (CSA) rules.

## QUARTERLY RESULTS

The following table sets out certain unaudited financial information for each of the eight fiscal quarters up to and including the fourth quarter of fiscal 2010, ended July 31, 2010. The information has been derived from the Company's unaudited consolidated financial statements, which in management's opinion, have been prepared on a basis consistent with the audited consolidated financial statements contained elsewhere in this Annual Report and include all adjustments necessary for a fair presentation of the information presented. Past performance is not a guarantee of future performance and this information is not necessarily indicative of results for any future period.

| | | **Oct/08** | **Jan/09** | **Apr/09** | **July/09** |
|---|---|---|---|---|---|
| Sales | | $13,881 | $16,480 | $14,791 | $10,125 |
| Net income (loss) | | 437 | 875 | 240 | (1,353) |
| Earnings (loss) per share: | Basic | 0.06 | 0.12 | 0.05 | (0.20) |
| | Diluted | 0.06 | 0.12 | 0.05 | (0.20) |
| | | **Oct/09** | **Jan/10** | **Apr/10** | **July/10** |
| Sales | | $9,255 | $8,794 | $9,329 | $12,773 |
| Net income (loss) | | (1,177) | (1,867) | (2,269) | (2,156) |
| Earnings (loss) per share: | Basic | (0.18) | (0.29) | (0.36) | (0.33) |
| | Diluted | (0.18) | (0.29) | (0.36) | (0.33) |

## NORMAL COURSE ISSUER BID

The Company does not currently have an open Normal Course Issuer Bid.

## SELECTED ANNUAL CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data has been derived from, and should be read in conjunction with the accompanying audited consolidated financial statements for the year ended July 31, 2010, which are prepared in accordance with Canadian GAAP.

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| **Income statement data** | | | |
| Sales | $40,151 | $55,277 | $55,729 |
| Net income (loss) for the year | (7,469) | 199 | (3,529) |
| Earnings (loss) per share – basic | (1.16) | 0.03 | (0.49) |
| Earnings (loss) per share – diluted | (1.16) | 0.03 | (0.49) |
| **Financial position data** | | | |
| Working capital | $131 | $16,941 | $14,891 |
| Working capital excluding mortgage bullet included in current liabilities | 11,423 | 16,941 | 14,891 |
| Total assets | 73,401 | 83,500 | 84,434 |
| Bank indebtedness, net of cash | 12,989 | 9,416 | 12,982 |
| Long-term debt due within one year | 12,678 | 2,640 | 2,453 |
| Long-term debt | 1,925 | 15,181 | 14,821 |
| Shareholders’ equity | 36,156 | 43,617 | 44,108 |

## INTERNATIONAL FINANCIAL REPORT STANDARDS (IFRS)

For Reko’s financial year ended July 31, 2012, Reko will no longer report its financial results using Canadian GAAP, as a result of changes announced by The Canadian Institute of Chartered Accountants in March 2008. Instead it will report its financial results using IFRS. This change affects all entities that are considered publicly accountable entities. Reko is considered a publicly accountable entity due to its listing on the Toronto Stock Exchange.

While not all GAAP and IFRS are different, one of the most significant changes deals with the overriding premise in GAAP that financial reporting is based on historical cost, while IFRS’ overriding premise is fair value.

Due to the potential pervasiveness of the changes inherent in moving to IFRS, a significant amount of time is necessary for management to plan its implementation. Possible impacts, besides external financial reporting, include, but are not limited to: banking agreements, business processes, information systems, employee and management incentive programmes, and legal agreements.

During the past two years, management:

- Engaged internal resources to understand the new rules;
- Educated its primary accounting staff on the differences between GAAP and IFRS;
- Concentrated its efforts on those portions of IFRS that are different than GAAP;
- Identified those business processes that have the potential for amendment to properly transition to IFRS;
- Finalized its policy selections both on conversion and post conversion; and,
- Evaluated new financial statement disclosure.

As a result of this analysis, management has determined that the following financial statement line items will be impacted by the conversion to IFRS:

- Capital assets – on conversion to IFRS, Reko will need to revalue its capital assets. Reko is currently collecting information before deciding whether this revaluation will be based on fair value assessments or reconsideration of prior year amortization. At the present time, insufficient information is available to determine whether or not the revaluation of our capital assets will result in an increase or decrease in their net book value and whether or not the amount will be material;
- Current portion of deferred income taxes – under IFRS, there is no requirement nor is it allowed, to calculate and present the current portion of deferred income taxes (that portion of deferred income taxes expected to be recognized in the current year) as part of an entity's financial statements. Accordingly, Reko advises that the current portion of its deferred income taxes will be reduced to $Nil on conversion to IFRS. This reduction to $Nil, will impact the amount of the Company's current assets in future periods and any financial ratios or covenants that include the calculation of current assets;
- Deferred income taxes – on conversion to IFRS, Reko will need to revalue its capital assets. As a result of revaluing its capital assets, Reko will also revalue its deferred income taxes as it relates to its capital assets. At the present time, insufficient information is available to determine whether or not the revaluation of deferred income taxes will be material and whether deferred income taxes will increase or decrease as a result;
- Contributed surplus – on conversion to IFRS, Reko will need to revalue its contributed surplus as a result of timing differences in the recognition of stock compensation expenses. Until August 1, 2011, Reko is unable to calculate the exact amount of this adjustment. As a result of this adjustment, Reko anticipates its contributed surplus will increase however it does not expect the amount to be material;
- Retained earnings – as a result of all of the above items, Reko's opening retained earnings on conversion to IFRS will change to reflect the cumulative impact of each of the above items; and,
- Amortization expense – on conversion to IFRS, Reko will revalue its capital assets. As a result of this revaluation, Reko's expected amortization expense will increase or decrease, in similar proportion and direction with the increase or decrease in the revaluation of its capital assets. As indicated in our discussion on capital assets, insufficient information is available to determine whether amortization expenses in the future will increase or decrease or whether it is by a material amount or not upon conversion to IFRS.

Going forward, management is concentrating on the quantification of the impact of the changes to the financial statements in preparation for our conversion to IFRS on August 1, 2011.

*This MD&A contains forward-looking information and forward-looking statements within the meaning of applicable securities laws. We use words such as "anticipate", "plan", "may", "will", "should", expect", "believe", "estimate" and similar expressions to identify forward-looking information and statements. Such forward-looking information and statements are based on assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments, as well as other factors we believe to be relevant and appropriate in the circumstances. Readers are cautioned not to place undue reliance on forward-looking information and statements, as there can be no assurance that the assumptions, plans, intentions or expectations upon which such statements are based will occur. Forward-looking information and statements are subject to known and unknown risks, uncertainties, assumptions and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed, implied or anticipated by such information and statements. These risks are described in the Company's MD&A included in our 2009 Annual Information Form, this MD&A and, from time to time, in other reports and filings made by the Company with securities regulators.*

*While the Company believes that the expectations expressed by such forward-looking information and statements are reasonable, there can be no assurance that such expectations and assumptions will prove to be correct. In evaluating forward-looking information and statements, readers should carefully consider the various factors, which could cause actual results or events to differ materially from those, indicated in the forward-looking information and statements. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the Company disclaims any obligations to update publicly or otherwise revise any such factors of any of the forward-looking information or statements contained herein to reflect subsequent information, events or developments, changes in risk factors or otherwise.*

## MANAGEMENT'S RESPONSIBILITY
## FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements and other financial information in this annual report were prepared by management of Reko International Group Inc., reviewed by the Audit Committee and approved by the Board of Directors.

Management is responsible for the consolidated financial statements and believes that they fairly present the Company's financial condition and results of operation in conformity with Canadian generally accepted accounting principles. Management has included in the Company's consolidated financial statements amounts based on estimates and judgments that it believes are reasonable, under the circumstances.

To discharge its responsibilities for financial reporting and safeguarding of assets, management believes that it has established appropriate systems of internal accounting control which provide reasonable assurance that the financial records are reliable and form a proper basis for the timely and accurate preparation of financial statements. Consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these controls should not exceed their expected benefits. Management further assures the quality of the financial records through careful selection and training of personnel and through the adoption and communication of financial and other relevant policies.

These financial statements have been audited by the shareholders' auditors, PricewaterhouseCoopers LLP, and their report is presented herein.

**"Diane St. John"**

Diane St. John, B.Comm
Chief Executive Officer
September 23, 2010

**"Carl A. Merton"**

Carl A. Merton, CA, CBV
Chief Financial Officer

## *Auditor's Report*

**To the Shareholders of**
**Reko International Group Inc.**

We have audited the consolidated balance sheet of Reko International Group Inc. as at July 31, 2010 and the consolidated statement of income (loss), comprehensive income (loss) and retained earnings and the consolidated statement of cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at July 31, 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at July 31, 2009 and for the year then ended were audited by another firm of chartered accountants who expressed an opinion without reservation on those statements in their report dated September 24, 2009.

**"PricewaterhouseCoopers LLP"**

Chartered Accountants
Licensed Public Accountants

London, Ontario
September 23, 2010

**REKO INTERNATIONAL GROUP INC.**
**CONSOLIDATED STATEMENTS OF INCOME (LOSS), COMPREHENSIVE INCOME (LOSS) AND RETAINED EARNINGS**

***Years ended July 31,***
(in $000's, except for loss per common share)

| | 2010 | 2009 |
|---|---|---|
| Sales | $ 40,151 | $ 55,171 |
| Costs and Expenses | | |
| Cost of sales | 36,040 | 41,670 |
| Selling and administrative | 5,990 | 7,101 |
| Amortization | 5,058 | 4,615 |
| | 47,088 | 53,386 |
| Income (loss) before the following | (6,937) | 1,785 |
| (Gain) loss on sale of capital assets | (24) | 116 |
| Unrealized foreign exchange loss (gain) on foreign tax losses | 119 | (109) |
| Interest on long-term debt | 1,026 | 1,000 |
| Interest on other interest bearing obligations, net | 449 | 488 |
| | 1,570 | 1,495 |
| Income (loss) before income taxes | (8,507) | 290 |
| Income taxes (recovered) (Note 6) | | |
| Current | -- | 8 |
| Future | (1,038) | 83 |
| Net (loss) income and comprehensive (loss) income | $ (7,469) | 199 |
| Retained earnings, beginning of year | $ 23,103 | $ 22,904 |
| Net income (loss) | (7,469) | 199 |
| Retained earnings, end of year | 15,634 | $ 23,103 |
| Earnings (loss) per common share (Note 13) | | |
| Basic | $ (1.16) | $ 0.03 |
| Diluted | $ (1.16) | $ 0.03 |

**REKO INTERNATIONAL GROUP INC.**
**CONSOLIDATED BALANCE SHEETS**

***As at July 31,***
(in $000's)

| | 2010 | 2009 |
|---|---|---|
| **ASSETS (Notes 9 and 10)** | | |
| Current | | |
| Cash and cash equivalents | $ 1,303 | $ 3,084 |
| Accounts receivable (Note 3) | 10,657 | 17,959 |
| Other receivables | 367 | 204 |
| Non-hedging financial derivatives (Note 4) | 591 | 1,522 |
| Income taxes receivable | 22 | 24 |
| Work-in-progress (Note 5) | 19,826 | 14,852 |
| Prepaid expenses and deposits | 536 | 572 |
| Future income taxes (Note 6) | -- | 12 |
| | 33,302 | 38,229 |
| Capital assets (Note 8) | 32,825 | 37,512 |
| Future income taxes (Note 6) | 2,814 | 3,074 |
| SR & ED tax credits (Note 7) | 4,460 | 4,685 |
| | $ 73,401 | $ 83,500 |
| **LIABILITIES** | | |
| Current | | |
| Bank indebtedness (Note 9) | $ 14,292 | $ 12,500 |
| Accounts payable and accrued liabilities | 6,201 | 6,148 |
| Current portion of long-term debt (Note 10) | 12,678 | 2,640 |
| | 33,171 | 21,288 |
| Long-term debt (Note 10) | 1,925 | 15,181 |
| Future income taxes (Note 6) | 2,149 | 3,414 |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital (Note 11) | 18,772 | 18,772 |
| Contributed surplus (Note 12) | 1,750 | 1,742 |
| Retained earnings | 15,634 | 23,103 |
| | 36,156 | 43,617 |
| | $ 73,401 | $ 83,500 |

Contingencies (Note 20)

On behalf of the Board:

**"Diane St. John"**
Director

**"Andrew Szonyi"**
Director

**REKO INTERNATIONAL GROUP INC.**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

***Years ended July 31,***
(in $000's)

| | 2010 | 2009 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income (loss) | $ (7,469) | $ 199 |
| Adjustments for: | | |
| Amortization | 5,058 | 4,615 |
| Unrealized foreign exchange loss (gain) on foreign tax losses | 119 | (3) |
| Future income taxes | (1,038) | 83 |
| SR & ED tax credits | 151 | (706) |
| Gain (loss) on sale of capital assets | (24) | 116 |
| Stock option expense (Note 12) | 8 | 22 |
| | (3,195) | 4,326 |
| Net change in non-cash working capital (Note 17) | 3,187 | (683) |
| **CASH (USED) PROVIDED BY OPERATING ACTIVITIES** | (8) | 3,643 |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Net proceeds (payments) on bank indebtedness | 1,792 | (482) |
| Net payments on long-term debt | (3,218) | (2,453) |
| Net proceeds on issuance of long-term debt | -- | 3,000 |
| Cost of repurchase of shares | -- | (710) |
| **CASH (USED) PROVIDED BY FINANCING ACTIVITIES** | (1,426) | (645) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Investment in capital assets | (889) | (1,011) |
| Proceeds on sale of capital assets | 542 | 79 |
| Proceeds on sale of asset held for sale | -- | 1,018 |
| **CASH PROVIDED (USED) BY INVESTING ACTIVITIES** | (347) | 86 |
| Net change in cash and cash equivalents | (1,781) | 3,084 |
| Cash and cash equivalents, beginning of year | 3,084 | -- |
| Cash and cash equivalents, end of year | $ 1,303 | $ 3,084 |

Refer to Note 17 for supplemental cash flow information.

## 1. SIGNIFICANT ACCOUNTING POLICIES

*Nature of operations*

The Company, incorporated under the laws of Ontario, has several subsidiaries, which operate in Canada and the State of Michigan in the United States.

The Company's revenue is primarily generated from the sales of manufacturing molds, automation and large custom machining mainly for the automotive sector.

*Basis of presentation*

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

*Principles of consolidation*

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, Reko Tool & Mould (1987) Inc., Reko International Sales, Inc. and Reko International Holdings, Inc. All material inter-company accounts and transactions have been eliminated on consolidation.

During the year, the Company dissolved, wound up the affairs, liquidated and terminated the remaining interests in Novi Laser Inc. and ABC Plastics, Inc. (f/k/a Superior Plastics, Inc.). These actions were completed without a material financial impact to these consolidated financial statements.

During the prior year, the Company dissolved, wound up the affairs, liquidated and terminated the remaining interests in Proto-Techniques, Inc., ABC Mold Company and ABC Decorating and Finishing, Inc. These actions were completed without a material financial impact to these consolidated financial statements.

*Use of significant accounting estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. Significant estimates used in the preparation of these financial statements include the allowance for doubtful accounts, percentage of completion of work-in-progress, net realizable value of inventory, inventory reserves, inventory overhead allocation, useful lives of capital assets, impairment of capital assets, fair value of financial instruments, valuation of stock options, realizable value of Scientific, Research & Experimental Development ("SR&ED") tax credits and valuation of future income taxes.

*Revenue recognition*

The Company deals primarily in contracts with a period of completion over several months. Revenue is recognized based on the percentage of completion method, provided the contract has progressed to the point where total costs can be reasonably estimated. The percentage of completion is determined by relating the actual cost of work performed to date to the current estimated total cost for each contract. Any projected loss is recognized immediately. The Company considers all jobs, which have completed all aspects of engineering and design (approximately 15% to 25% complete), to have progressed to the point where total costs could be reasonably estimated.

*Foreign currency translation*

The Company translates monetary assets and liabilities denominated in foreign currencies at the exchange rate as at the balance sheet date. Revenues and expenses are translated at rates prevailing on the date of the transaction. Gain of $268 (2009: Losses of $1,510) arising on translation are included in the statements of income (loss).

The financial statements of U.S. subsidiaries, which are considered integrated foreign operations, are translated such that monetary amounts and liabilities are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at average rates for the year except for amortization, which is translated at historical rates. Translation gains or losses are included in income.

The Company hedges its exposure to foreign currency fluctuations by purchasing forward exchange contracts and options (see Note 15).

*Financial instruments*

The Company utilizes derivative instruments in the management of its foreign currency exposure by economically hedging its foreign exchange exposure on anticipated net cash inflows in U.S. dollars through the use of U.S. dollar denominated debt, forward contracts and options.

Financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose, for which the financial instruments were acquired or issued, their characteristics and the Company's designation of such instruments. Settlement date accounting is used.

**Classification**

| | |
|---|---|
| Cash and cash equivalents | Held for trading |
| Non-hedging financial derivatives | Held for trading |
| Accounts receivable | Loans and receivables |
| Bank indebtedness | Held for trading |
| Accounts payable and accrued liabilities | Other financial liabilities |
| Long-term debt | Other financial liabilities |

**Held for trading**

Held for trading financial assets are financial assets typically acquired for resale prior to maturity or that are designated as held for trading. They are measured at fair value at the balance sheet date. Fair value fluctuations including interest earned, interest accrued, gains and losses realized on disposal and unrealized gains and losses are included in sales. Financial liabilities designated as held for trading are those non-derivative financial liabilities that the Company elects to designate on initial recognition as instruments that it will measure at fair value through other interest expense. These are accounted for in the same manner as held for trading assets.

**Held-to-maturity**

Held-to-maturity financial assets are non-derivative financial assets with fixed or determinable payments and a fixed maturity, other than loans and receivables that an entity has the positive intention and ability to hold to maturity. These financial assets are measured at amortized cost using the effective interest method. The Company has not designated any non-derivative financial assets as held to maturity.

**Available-for-sale**

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale, or that are not classified as loans and receivables, held-to-maturity or held-for-trading investments. Available-for-sale financial assets are carried at fair value with unrealized gains and losses included in accumulated other comprehensive income until realized when the cumulative gain or loss is transferred to income. Available-for-sale financial assets that do not have quoted market prices in an active market are recorded at cost. Interest on interest-bearing available-for-sale financial assets is calculated using the effective interest method. The Company has not designated any non-derivative financial assets as available for sale.

**Loans and receivables**

Loans and receivables are accounted for at amortized cost using the effective interest method.

**Other financial liabilities**

Other financial liabilities are recorded at amortized cost using the effective interest method and include all financial liabilities, other than bank indebtedness and derivative instruments.

**Transaction costs**

Transaction costs related to held for trading financial assets are expensed as incurred. Transaction costs related to available-for-sale financial assets, held-to-maturity financial assets, other liabilities and loans and receivables are netted against the carrying value of the asset or liability and are then recognized over the expected life of the instrument using the effective interest method.

**Effective interest method**

The Company uses the effective interest method to recognize interest income or expense, which includes transaction costs or fees, premiums or discounts, earned or incurred for financial instruments.

*Cash and cash equivalents*

Cash and cash equivalents include cash on hand and balances with maturities less than 90 days.

*Work-in-progress*

Work-in-progress includes unbilled contract revenue and inventory. Costs incurred on contracts where the criteria for revenue recognition have not been met are shown as inventory. Domestic and outsourced tooling inventory is valued at the lower of cost and net realizable value. Cost includes the cost of materials, direct labour applied to the product and the applicable share of manufacturing overhead. The results reported under the percentage of completion method are based on management's estimates. Actual results could differ from these estimates.

*Capital assets and amortization*

Capital assets are stated at cost. Amortization of capital assets is calculated on the straight-line basis over the estimated economic lives of the assets at the following rates:

| | |
|---|---|
| Buildings | 4% |
| Machinery and equipment | 5 – 20% |
| Computer hardware | 33% |
| Computer software | 50% |
| Leasehold improvement | 20% |
| Equipment under capital lease | 5 – 10% |

*SR & ED tax credits*

SR & ED costs are expensed as incurred. SR & ED tax credits are recorded when there is reasonable assurance of receiving them. SR & ED tax credits are recorded as part of cost of sales.

During the year, management determined that, based on the past history of successful claims, it was appropriate to accrue $304 (2009: $819) of the current year's estimated SR & ED tax credits since reasonable assurance exists for recovering them.

*Impairment of long-lived assets and basis of valuation*

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value and is included in amortization of capital assets.

*Income taxes*

The Company follows the liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using enacted and substantively enacted income tax rates for the years in which differences are expected to reverse. A valuation allowance is recognized to the extent management determines the Company's ability to realize on its future income tax asset, on a more likely than not basis, cannot be met. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period that the change occurs.

*Stock based compensation*

The Company estimates the fair value of stock options at the grant date using the Black-Scholes option-pricing model. This model requires the input of a number of assumptions, including expected dividend yields, expected stock volatility, expected time until exercise and risk-free interest rates. Although the assumptions used reflect management's best estimates, they involve inherent uncertainties based on market conditions generally outside the Company's control. If other assumptions are used, stock-based compensation expense could be significantly impacted. As stock options are exercised, the proceeds received on exercise, in addition to the portion of the contributed surplus balance related to those stock options, is credited to share capital and contributed surplus is reduced accordingly.

*Earnings per share*

Basic earnings per share are calculated on net income using the weighted average number of common shares outstanding during the year.

Diluted earnings per share are calculated on the weighted average number of common shares that would have been outstanding during the year had all "in the money" stock options outstanding been exercised and converted into common shares using the treasury method.

*Government assistance*

The Company makes periodic applications for financial assistance under available government assistance programs in the various jurisdictions that the Company operates. Grants and tax credits relating to capital expenditures are reflected as a reduction of the cost of the related assets. Grants and tax credits relating to current operating expenditures are generally recorded as a reduction of the related expense at the time the eligible expenses are incurred.

*Consideration given to customers*

Cash consideration given by the Company to a customer, such as cash discounts and rebates, are presumed to be a reduction of the selling prices of the Company's products or services and are, therefore, accounted for as a reduction of revenue when recognized in the statement of income.

*Future accounting changes*

The Canadian Institute of Chartered Accountants ("CICA") has announced the following accounting changes scheduled to become effective for the Company between August 1, 2010 and August 1, 2012:

**Multiple deliverable revenue arrangements**

In December 2009, the Emerging Issues Committee ("EIC") issued a new abstract concerning multiple deliverable revenue arrangements, EIC 175, "Multiple Deliverable Revenue Arrangements" ("EIC 175") which amended, "Revenue Arrangements with Multiple Deliverables" ("EIC 142"). The objective of issuing this abstract is to harmonize EIC 132 with amendments made to US generally accepted accounting principles. These amendments require a vendor to allocate arrangement consideration at the inception of the arrangement to all deliverables using the relative selling method, thereby eliminating the use of the residual value method. The amendments also change the level of evidence of the standalone selling price required to separate deliverables when more objective evidence of the selling price is not available. EIC 175 should be adopted prospectively to revenue arrangements entered into or materially modified in the first annual period beginning on or after January 1, 2011, with early adoption permitted. EIC 142 continues to be effective until that date. The Company will adopt the new EIC, without a material impact on its consolidated financial statements, in the first quarter of fiscal 2012.

**Business combinations, Consolidated financial statements & Non-controlling interests**

In October 2008, the CICA issued Sections 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements" and Section 1602, "Non-Controlling Interests". Section 1582 establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. Section 1601 carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition on other than non-controlling

interests. Section 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards are effective for the Company in the first quarter of fiscal 2012 with earlier adoption permitted. The Company will adopt the new Standards, without a material impact on its consolidated financial statements, in the first quarter of 2012.

**International financial reporting standards ("IFRS")**

In March 2008, the CICA confirmed its intent to replace GAAP with IFRS. As a publicly accountable enterprise, the Company must convert to IFRS no later than its first quarter of fiscal 2012, although earlier adoption may be available.

## 2. CHANGES IN ACCOUNTING POLICIES

During the year, the Company adopted the following recommendations of the CICA Handbook:

a) *Section 3064, Goodwill and intangible assets*. The CICA issued a new accounting standard, Section 3064 "Goodwill and intangible assets", which establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The Company adopted this new recommendation without restatement of prior periods.

## 3. ACCOUNTS RECEIVABLE

During the year, the Company recorded the following transactions with respect to its allowance for doubtful accounts:

| | 2010 | 2009 |
|---|---|---|
| Opening allowance for doubtful accounts | $ 885 | $ 993 |
| Less: write-off of allowance and receivables | (368) | (371) |
| Plus: bad debt expense | 193 | 263 |
| Less: effect of foreign exchange on U.S. denominated balances | (31) | - |
| | $ 679 | $ 885 |

## 4. NON-HEDGING FINANCIAL DERIVATIVES

Non-hedging financial derivatives is comprised of:

| | 2010 | 2009 |
|---|---|---|
| Fair value of forward exchange contracts | $ 591 | $ 1,620 |
| Fair value of U.S. dollar call options | -- | 168 |
| Fair value of U.S. dollar put options | -- | (266) |
| | $ 591 | $ 1,522 |

Based on the average spot market value of U.S. dollars for the year ended July 31, 2010 and the forward exchange contracts and United States put and call options outstanding during the year, the Company generated foreign exchange gains of $268 (2009: losses of $1,510), recognized in sales.

## 5. WORK-IN-PROGRESS

Work-in-progress is comprised of:

| | 2010 | 2009 |
|---|---|---|
| Unbilled contract revenue | $ 19,336 | $ 14,118 |
| Inventory | 490 | 734 |
| | $ 19,826 | $ 14,852 |

Unbilled contract revenue represents the costs incurred under long-term tooling contracts in excess of amounts billed and paid by the customer or billed and included in accounts receivable.

## 6. INCOME TAXES

| | 2010 | 2009 |
|---|---|---|
| The provision for income taxes reflects an effective tax rate which differs from the combined Federal and Provincial rate for the following reasons: | | |
| Combined Federal and Provincial rate | 31.8% | 33.2% |
| Manufacturing and processing deduction | (2.0%) | (2.0%) |
| Increase in valuation allowance | (18.2%) | --% |
| Decrease in substantively enacted tax rates on future tax assets and liabilities | (0.7%) | --% |
| Permanent and other differences | 1.3% | 0.2% |
| Effective rate | 12.2% | 31.4% |

The tax effects of temporary differences that give rise to significant portions of current and long-term future income tax assets and liabilities are as follows:

| | 2010 | 2009 |
|---|---|---|
| **Current portion of future tax asset** | | |
| Unbilled contract revenue | $ -- | $ 388 |
| Unrealized foreign exchange adjustments | -- | (445) |
| Other | -- | 69 |
| | -- | $ 12 |
| **Long-term future tax asset** | | |
| Non-capital loss carry-forwards – United States | 3,730 | 3,916 |
| Valuation allowance | (916) | (842) |
| | $ 2,814 | $ 3,074 |
| **Long-term future tax liability** | | |
| Capital assets | $ 2,177 | $ 3,749 |
| Tax impact of SR & ED tax credits | 1,274 | 1,224 |
| Other | (98) | (305) |
| | 3,353 | 4,668 |
| Undeducted SR & ED expenditures | 1,715 | 1,574 |
| Unbilled contract revenue | 1,056 | -- |
| Valuation allowance | (1,568) | (320) |
| | 1,203 | 1,254 |
| | $ 2,149 | $ 3,414 |

The ultimate realization of the future income tax assets is dependent upon the generation of future taxable income during the years in which the temporary differences become deductible.

The valuation allowance for future income taxes as at July 31, 2010 is $916 (2009: $842). In assessing the realizability of future tax assets, management considers whether it is more likely or not that some portion or all of the future tax assets will be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the years in which these temporary differences and loss carry forwards are deductible. Management considers the scheduled reversal of future tax liabilities, the character of future income tax assets and available tax planning strategies in making this assessment.

At July 31, 2010, the Company had net operating losses of $10,971 (2009: $10,494) in the United States, which expire between 2022 and 2029. These losses have been recognized in these consolidated financial statements, net of a valuation allowance.

## 7. SR & ED TAX CREDITS

The tax effect of SR & ED tax credits is:

| | 2010 | 2009 |
|---|---|---|
| SR & ED tax credits | $ 4,877 | $ 4,992 |
| Valuation allowance | (417) | (307) |
| | $ 4,460 | $ 4,685 |

The valuation allowance for SR & ED tax credits as at July 31, 2010 is $417 (2009: $307). In assessing the realizability of SR & ED tax credits, management considers whether there is reasonable assurance that some portion or all of the SR & ED tax credits will be realized. The ultimate realization of SR & ED tax credits is dependent upon the generation of future taxable income. Management considers the scheduled reversal of future tax liabilities, the character of future tax assets and available tax planning strategies in making this assessment.

## 8. CAPITAL ASSETS

Capital assets are comprised of:

| | | 2010 | |
|---|---|---|---|
| | **Cost** | **Accumulated Amortization** | **Net Book Value** |
| Land | **$ 1,287** | **$ --** | **$ 1,287** |
| Buildings | **16,280** | **8,098** | **8,182** |
| Machinery and equipment | **74,903** | **53,893** | **21,010** |
| Leasehold improvements | **80** | **51** | **29** |
| Equipment under capital lease | **3,434** | **1,512** | **1,922** |
| Equipment under construction | **395** | **--** | **395** |
| | **$ 96,379** | **$ 63,554** | **$ 32,825** |

| | | 2009 | |
|---|---|---|---|
| | **Cost** | **Accumulated Amortization** | **Net Book Value** |
| Land | $ 1,369 | $ -- | $ 1,369 |
| Buildings | 17,085 | 8,227 | 8,858 |
| Machinery and equipment | 72,400 | 50,588 | 21,812 |
| Leasehold improvements | 73 | 64 | 9 |
| Equipment under capital lease | 7,094 | 2,319 | 4,775 |
| Equipment under construction | 689 | -- | 689 |
| | $ 98,710 | $ 61,198 | $ 37,512 |

In fiscal 2009, the Company sold assets for net proceeds of $1,018, related to the land and building at a previously closed facility located in the United States. The proceeds were used to reduce the Company's bank indebtedness.

## 9. BANK INDEBTEDNESS

The bank indebtedness is payable over various maturities, not exceeding 90 days, with interest at various amounts ranging from LIBOR plus a premium to bank prime plus a premium, as follows:

| | 2010 | 2009 |
|---|---|---|
| Canadian dollar bankers' acceptances – bearing interest at rates ranging from 4.74% to 4.79% (2009: 4.39% to 4.42%), due in less than 30 days | $ 2,000 | $ 12,500 |
| Canadian dollar bankers' acceptances – bearing interest at rates ranging from 4.87% to 4.89% (2009: Nil) due in less than 60 days | 3,300 | -- |
| Canadian dollar bankers' acceptances – bearing interest 4.90% (2009: Nil) due in less than 90 days | 2,000 | -- |
| U. S. dollar LIBORs – bearing interest at rates ranging from 4.39% to 4.50%, due in less than 30 days | 6,992 | -- |
| | $ 14,292 | $ 12,500 |

The bank indebtedness is secured by a general assignment of book debts and work-in-progress together with a second collateral mortgage of $85,000 on all land and buildings. At July 31, 2010, the Company had available operating lines of credit totaling $20,000 (2009: $20,000).

## 10. LONG-TERM DEBT

The long-term debt is comprised of:

| | 2010 | 2009 |
|---|---|---|
| Mortgage payable – 6.26% repayable $111 monthly including interest, due in full July 2011, secured by land and buildings and a second position on a general assignment of book debts and work-in-progress | **$ 10,030** | $ 11,264 |
| Mortgage payable – 6.52% repayable $15 monthly including interest, due in full July 2011, secured by land and buildings and a second position on a general assignment of book debts and work-in-progress | **1,409** | 1,495 |
| Loan payable – 5.90% repayable $14 monthly including interest due in full April 2012 secured by equipment | **282** | 429 |
| Loan payable – 7.25% repayable $63 monthly plus interest due in full July 2013, secured by equipment and a third position on a general assignment of book debts and work-in-progress | **2,312** | 3,000 |
| Obligations under capital leases payable $30 monthly including interest, bearing interest at 6.09% expiring in March 2012 (2009: February 2010 and March 2012) | **570** | 1,633 |
| | **14,603** | 17,821 |
| Deduct - principal portion included in current liabilities | **12,678** | 2,640 |
| Long-term portion | **$ 1,925** | $ 15,181 |

Obligations under capital leases are secured by the specific leased assets and certain of the obligations maintain a second or third position on a general assignment of book debts and work-in-progress.

Total bank credit facilities and minimum lease payments are as follows:

| Year | Bank Credit Facilities | Capital Leases | Total |
|---|---|---|---|
| 2011 | $ 12,346 | $ 362 | $ 12,708 |
| 2012 | 874 | 239 | 1,113 |
| 2013 | 750 | -- | 750 |
| 2014 | 63 | -- | 63 |
| 2015 | 0 | 0 | 0 |
| | 14,033 | 601 | 14,634 |
| Amount representing interest | -- | 31 | 31 |
| Balance of obligation | $ 14,033 | $ 570 | $ 14,603 |

## 11. SHARE CAPITAL

Share capital is comprised of:

| | Authorized | Issued Shares | Amount |
|---|---|---|---|
| Class A preference shares | Unlimited | Nil | -- |
| Class B preference shares | Unlimited | Nil | -- |
| Common shares | Unlimited | 6,420,920 | $ 18,772 |

Share capital transactions during the year were as follows:

| | **2010** | | 2009 | |
|---|---|---|---|---|
| | **Shares** | **Amount** | Shares | Amount |
| Outstanding, beginning of year | 6,420,920 | $ 18,772 | 7,113,992 | $ 20,798 |
| Re-purchase in respect to normal course issuer bid | -- | -- | (693,072) | 2,026 |
| Outstanding, end of year | 6,420,920 | $ 18,772 | 6,420,920 | $ 18,772 |

The following table presents the maximum number of shares that would be outstanding if all the dilutive "in the money" instruments outstanding, as at July 31, 2010 were exercised:

| | |
|---|---|
| Common shares outstanding at July 31, 2010 | 6,420,920 |
| Stock options (Note 14) | -- |
| | 6,420,920 |

## 12. CONTRIBUTED SURPLUS

Contributed surplus is comprised of:

| | **2010** | 2009 |
|---|---|---|
| Balance, beginning of year | **$ 1,742** | $ 406 |
| Re-purchase of shares in respect of the normal course issuer bid | **--** | 1,314 |
| Amounts charged to contributed surplus in respect of stock based compensation | **8** | 22 |
| Balance, end of year | **$ 1,750** | $ 1,742 |

## 13. EARNINGS PER SHARE

Earnings (loss) per share is computed as follows:

| | **2010** | 2009 |
|---|---|---|
| **Basic earnings (loss) per share:** | | |
| Net income (loss) | **$ (7,469)** | $ 199 |
| Average number of common shares outstanding during the year | **6,420,920** | 6,932,704 |
| Basic earnings (loss) per share | **$ (1.16)** | $ 0.03 |
| | | |
| **Diluted earnings (loss) per share:** | | |
| Net income (loss) | **$ (7,469)** | $ 199 |
| | | |
| Average number of common shares outstanding during the year | **6,420,920** | 6,932,704 |
| Weighted 'In the money' stock options outstanding during the year | **--** | -- |
| | **6,420,920** | 6,932,704 |
| Diluted earnings (loss) per share | **$ (1.16)** | $ 0.03 |

Diluted earnings per share exclude 117,000 (2009: 121,000) common shares issuable under the Company's stock option plan because these options were not 'in the money'.

## 14. STOCK BASED COMPENSATION

The Company has established a stock option plan for directors, officers, and key employees. The terms of the plan state that the aggregate number of shares, which may be issued and sold, will not exceed 10% of the issued and outstanding common shares of the Company on a non-diluted basis. The issue price of the shares shall be determined at the time of grant based on the closing market price of the shares on the specified date of issue. Options shall be granted for a period of five years with equal cumulative vesting over that period and 20% being exercisable immediately upon issue. Options given to outside directors vest immediately and can be exercised immediately. Effective September 24, 2002, amendments to the plan include a vesting progression of 30% in the year of grant, 30% in the second year, and 40% in the third year with the term still being 5 years.

As at July 31, 2010, the following options and warrants were outstanding:

| Number of Options | Exercise Price | Expiry |
|---|---|---|
| 10,000 | $2.75 | 2011 |
| 10,000 | $2.50 | 2011 |
| 10,000 | $2.80 | 2011 |
| 11,000 | $3.27 | 2012 |
| 33,000 | $1.50 | 2014 |
| 43,000 | $1.16 | 2014 |

The weighted average exercise price of the options is as follows:

| | **2010** | | **2009** | |
|---|---|---|---|---|
| | **Number of Options** | **Weighted Average Exercise Price** | **Number of Options** | **Weighted Average Exercise Price** |
| Outstanding at the beginning of the year | **121,000** | **$ 1.83** | 165,918 | $ 2.74 |
| Granted during the year | **--** | **--** | 80,000 | 1.31 |
| Expired during the year | **--** | **--** | (124,918) | 2.71 |
| Exercised during the year | **--** | **--** | -- | -- |
| Cancelled during the year | **(4,000)** | **1.33** | -- | -- |
| Outstanding at the end of the year | **117,000** | **$ 1.85** | 121,000 | $ 1.83 |
| Exercisable at the end of the year | **98,000** | **$ 1.96** | 86,000 | $ 2.04 |

The significant assumptions used during the year to estimate the fair values of options is as follows:

| | **2010** | 2009 |
|---|---|---|
| Expected life | **5 years** | 5 years |
| Expected dividends | **$ Nil** | $ Nil |
| Expected volatility | **40.25%** | 38.61% |
| Risk free rate of return | **3.43%** | 2.70% |
| Total compensation cost recognized in income for stock-based employee compensation awards | **$ 8** | $ 22 |

## 15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

*Categories of financial assets and liabilities*

Under Canadian GAAP, financial instruments are classified into one of the following five categories: held for trading; held to maturity investments; loans and receivables; available-for-sale financial assets; and, other financial liabilities. The carrying values of the Company's financial instruments are classified into the following categories:

| **Held for trading financial assets** | **2010** | 2009 |
|---|---|---|
| Cash and cash equivalents | $ 1,303 | $ 3,084 |
| Non-hedging financial derivatives | 591 | 1,522 |
| | $ 1,894 | $ 4,606 |
| **Held for trading financial liabilities** | | |
| Bank indebtedness | $ 14,292 | $ 12,500 |
| | $ 14,292 | $ 12,500 |
| **Loans and receivables** | | |
| Accounts receivable | $ 10,657 | $ 17,959 |
| **Other financial liabilities** | | |
| Accounts payable and accrued liabilities | $ 6,201 | $ 6,148 |
| Current portion of long-term debt | 12,678 | 2,640 |
| Long-term debt | 1,925 | 15,181 |
| | $ 20,804 | $ 23,969 |

The Company has determined the estimated fair value of its financial instruments based on appropriate valuation methodologies; however, considerable judgment is required to develop these estimates. The fair values of the Company's financial instruments are not materially different from their carrying value, with the exception of the Company's long-term debt of $14,603 (2009: $17,821). Based on current interest rates for debt with similar terms and maturities, the fair value of the long-term debt is estimated to be $14,962 (2009: $18,547).

**Risks arising from financial instruments and risk management**

The Company's activities expose it to a variety of financial risks: market risk (including foreign exchange and interest rate), credit risk and liquidity risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance from quarter to quarter. The Company uses derivative financial instruments to achieve this objective. The Company does not purchase any derivative financial instruments for speculative purposes.

***Foreign exchange risk***

The Company operates in Canada and its functional and reporting currency is Canadian dollars, however a significant portion of its sales are denominated in U.S. dollars. Foreign exchange risk arises because the amount of the receivable or payable for transactions denominated in a foreign currency may vary due to changes in exchange rates ("transaction exposures") and because certain long-term contractual arrangements denominated in a foreign currency may vary due to changes in exchange rates ("translation exposures").

The Company's balance sheet includes U.S. dollar denominated cash and cash equivalents, accounts receivable, work-in-progress, capital assets, future income taxes, bank indebtedness and accounts payable and accrued liabilities. The Company is required to revalue these U.S. dollar denominated items to their current Canadian dollar value at each period end.

The objective of the Company's foreign exchange risk management activities is to minimize translation exposures and the resulting volatility of the Company's earnings. The Company manages this risk by entering into foreign exchange option contracts.

Based on the Company's foreign currency exposures, as at July 31, 2010, a change in the U.S. dollar/Canadian dollar foreign exchange rate to reflect a 100 basis point strengthening of the U.S. dollar for the month of July would, assuming all other variables remain constant, have increased net income by $13, (2009: $39) with an equal but opposite effect for an assumed 100 basis point weakening of the U.S. dollar. We caution that this sensitivity is based on an assumed net U.S. dollar denominated asset or liability balance at a point in time. The net U.S. dollar denominated asset or liability position changes on a daily basis, sometimes materially.

The Company utilizes financial instruments to manage the risk associated with fluctuations in foreign exchange. At July 31, 2010, the Company had entered into foreign exchange contracts to sell an aggregate amount of $24,800 (USD). These contracts hedge our expected exposure to U.S. dollar denominated net assets and mature at the latest on January 16, 2012, at an average exchange rate of $1.0538 Canadian.

| **As at July 31, 2010** | **Maturity** | **Notional Value** | **Average Rate** | **Notional USD equivalent** | **Carrying & fair value asset (liability)** |
|---|---|---|---|---|---|
| **Sell USD / buy CAD** | **0 – 6 months** | **$ 11,216** | **$ 1.0640** | **$ 10,800** | **$ 416** |
| **Sell USD / buy CAD** | **7 – 12 months** | **7,199** | **1.0590** | **7,000** | **198** |
| **Sell USD / buy CAD** | **13 – 18 months** | **6,976** | **1.0340** | **7,000** | **(23)** |
| | | **$ 25,391** | **$ 1.0538** | **$ 24,800** | **$ 591** |

| **As at July 31, 2009** | **Maturity** | **Notional Value** | **Average Rate** | **Notional USD equivalent** | **Carrying & fair value asset (liability)** |
|---|---|---|---|---|---|
| Sell USD / buy CAD | 0 – 6 months | $ 9,465 | $ 1.1921 | $ 8,500 | $ 965 |
| Sell USD / buy CAD | 7 – 12 months | 7,955 | 1.1683 | 7,300 | 655 |
| USD call / CAD put | 0 – 6 months | 9,768 | 1.0775 | 9,600 | 168 |
| CAD call / USD put | 0 – 6 months | 9,334 | 1.0580 | 9,600 | (266) |
| Elimination of conjoined put / calls | | (9,600) | 1.0856 | (9,600) | -- |
| | | $ 26,922 | $ 1.1386 | $ 25,400 | $ 1,522 |

***Interest rate risk***

The Company's interest rate risk primarily arises from its floating rate debt, in particular its bank indebtedness. At July 31, 2010, $14,292 (2009: $12,500) of the Company's total debt portfolio is subject to movements in floating interest rates.

Based on the value of interest-bearing financial instruments subject to movements in floating interest rates, as at July 31, 2010, an assumed 0.5 percentage point increase in the interest rate on all variable interest rate debt on the first day of the year would, assuming all other variables remain constant, have decreased net income by $71, (2009: $63) with an equal but opposite effect for an assumed 0.5 percentage point decrease.

The objective of the Company's interest rate risk management activities is to minimize the volatility of the Company's earnings. Since the Company's exposure to floating interest rates is limited to its bank indebtedness, the Company's ability to effectively manage the volatility of interest rates is limited to locking portions of the Company's bank indebtedness into fixed rates for relatively short periods of time, usually 30 or 90 days.

***Credit risk***

Credit risk arises from cash and cash equivalents held with banks and financial institutions, derivative financial instruments as well as credit exposure to clients, including outstanding accounts receivable and unbilled contract revenue. The maximum exposure to credit risk is equal to the carrying value of the financial assets.

The objective of managing counterparty credit risk is to prevent losses in financial assets. The Company assesses the credit quality of the counterparties, taking into consideration their financial position, past experience and other factors. Management also monitors the utilization of credit limits regularly. In cases where credit quality of a client does not meet the Company's requirements sales opportunities may be terminated, progress payments may be required or continuing security interests in our products may be required.

In the normal course of business, the Company is exposed to credit risk from its customers, the majority of whom are in the automotive industry. While these accounts receivable are subject to normal industry credit risks, the ultimate source of funds to pay our accounts receivable balances may come from the Detroit 3 original equipment manufacturers, which are currently rated below investment grade by credit rating agencies, two of whom left United States bankruptcy protection in the past year and in the event that they are unable to satisfy their financial obligations or seek further protection from their creditors, the Company may incur additional expenses as a result of such credit exposure. The Company may be able to mitigate a portion of this credit risk through the use of accounts receivable insurance, when and if available for individual customers.

For the year ended July 31, 2010, sales to the Company's three largest customers represented 43.4% (2009: 25.6%) of its total sales. These same customers represent approximately 43.4% (2009: 27.9%) of its accounts receivable, as at July 31, 2010.

***Liquidity risk and relationship with primary lender***

Liquidity risk arises through an excess of financial obligations over available financial assets due at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements at any point in time. The Company achieves this by maintaining sufficient cash and cash equivalents and through the availability of funding from credit facilities. As at July 31, 2010, the Company has undrawn lines of credit available to it of approximately $6,798 (2009: $10,584); however, under its current margining provisions with its lender, the maximum it can draw on its available undrawn lines of credit is limited to $6,381 (2009: $10,584).

During the third quarter, the Company renegotiated its Debt Service Coverage Ratio with its primary lender. For an as yet undefined period of time, our primary lender has agreed to replace our quarterly Debt Service Coverage Ratio covenant with a minimum monthly EBITDA (earnings before interest, taxes, depreciation, amortization and non-cash charges, all as defined by our primary lender) covenant. The Company's current forecasts suggest that it will earn sufficient levels of EBITDA to meet its minimum monthly EBITDA covenant for the first quarter of fiscal 2011, the only period for which the covenant is already set. Despite the Company's current forecasts suggesting the Company will achieve its replaced financial covenant, the Company is exposed to a number of risks that could prevent it from achieving its primary lender defined monthly minimum EBITDA covenant.

## 16. MANAGEMENT OF CAPITAL

The Company's objective in managing capital is to ensure sufficient liquidity to pursue its organic growth strategy, while at the same time taking a conservative approach to financial leverage and management of financial risk. The Company's capital is composed of net debt and shareholders' equity. Net debt consists of interest-bearing debt less cash and cash equivalents. The Company's primary uses of capital are to finance increases in non-cash working capital and capital expenditures for capacity expansion. The Company currently funds these requirements out of its internally generated cash flows and when internally generated cash flow is insufficient, its revolving bank credit facility.

The primary measure used by the Company to monitor its financial leverage is its ratio of net debt to shareholders' equity, which it aims to maintain at less than 1.0:1. As at July 31, 2010, these capital management criteria can be illustrated as follows:

| | **2010** | 2009 |
|---|---|---|
| **Net debt** | | |
| Bank indebtedness | $ 14,292 | $ 12,500 |
| Current portion of long-term debt | 12,678 | 2,640 |
| Long-term debt | 1,925 | 15,181 |
| Less: cash and cash equivalents | (898) | (3,084) |
| **Net debt** | $ 27,997 | $ 27,237 |
| **Shareholders' equity** | $ 36,156 | $ 43,617 |
| **Ratio** | 0.77 | 0.62 |

As part of existing debt agreements, the Company monitors and communicates, as required by the terms of credit agreements, on a monthly, quarterly or annual basis, depending on the covenant and the lender, by management to ensure compliance with the agreements. The annual covenant is a debt service coverage ratio – calculated as EBITDA less cash taxes (for the previous 52 weeks) divided by interest coverage plus repayments of long-term debt (based on the upcoming 52 weeks). The quarterly covenants are: i) debt to equity ratio – calculated as total debt, excluding future income taxes divided by shareholders' equity minus minority interest, if any; and (ii) current ratio – calculated as current assets divided by current liabilities. The monthly covenant is a minimum EBITDA target. For fiscal 2010 only, the Company's sole annual covenant was permanently waived.

The Company was in compliance with these covenants at all times during the year.

## 17. SUPPLEMENTAL CASH FLOW INFORMATION

Net change in non-cash working capital (exclusive of the current portion of future income taxes) is comprised of:

| | **2010** | 2009 |
|---|---|---|
| Accounts receivable | $ 7,302 | $ 11 |
| Other receivables | (163) | |
| Non-hedging financial derivatives | 931 | (1,086) |
| Work-in-progress | (4,974) | 752 |
| Income taxes | 2 | 20 |
| Prepaid expenses and deposits | 36 | 53 |
| Accounts payable and accrued liabilities | 53 | 287 |
| | $ 3,187 | $ (683) |

***Interest paid***

Interest paid during the year was $1,418 (2009: $1,497).

***Income taxes***

Income taxes paid during the year were $Nil (2009: $30).

## 18. SEGMENTED INFORMATION

*Geographic information*

The following information reflects the geographic breakdown of revenues and capital assets based on the physical location of the Company's various operating segments. The Company does not track revenues based on 'ship to' locations.

| | **2010** | |
|---|---|---|
| | **Revenues** | **Capital assets** |
| Canada | $ 40,151 | $ 32,805 |
| United States | -- | 20 |
| | $ 40,151 | $ 32,825 |

| | **2009** | |
|---|---|---|
| | **Revenues** | **Capital Assets** |
| Canada | $ 55,050 | $ 37,485 |
| United States | -- | 27 |
| | $ 55,050 | $ 37,512 |

## 19. RELATED PARTY TRANSACTIONS

During the current year, the Company did not engage in any material related party transactions. At year-end, there were no amounts outstanding with respect to related party transactions (2009 - $Nil).

## 20. CONTINGENCIES

The Company, in the course of its operations, is subject to environmental and other claims, lawsuits and contingencies. Accruals are made in instances where it is possible that liabilities can be reasonably estimated. The Company has no reason to believe that the ultimate outcome of these matters would have significant impact on its financial position, cash flows or results of operations.

## 21. COMPARATIVE FIGURES

Certain comparative figures have been reclassified in order to conform to the current year's presentation.

**REKO INTERNATIONAL GROUP INC.**
**SUMMARY OF INCOME (LOSS)**

***July 31, 2010 and 2009***
(in $000's, except for share amounts)

| | **2010** | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|---|---|---|
| Sales | **40,151** | $55,277 | $55,729 | $49,377 | $67,459 | $61,626 | $73,041 |
| Cost and expenses | | | | | | | |
| Cost of sales | **36,040** | 41,670 | 46,517 | 38,404 | 50,479 | 47,787 | 54,377 |
| Selling and administrative | **5,990** | 7,101 | 7,226 | 7,463 | 7,647 | 8,650 | 11,121 |
| Depreciation and amortization | **5,058** | 4,615 | 5,511 | 4,165 | 4,183 | 4,407 | 5,237 |
| | **47,088** | 53,386 | 59,254 | 50,032 | 62,309 | 60,844 | 70,735 |
| Income (loss) before the following | **(6,937)** | 1,891 | (3,525) | (655) | 5,150 | 782 | 2,306 |
| Loss (gain) on sale of capital assets | **(24)** | 116 | 15 | (54) | (146) | -- | -- |
| Unrealized foreign exchange (gain) loss on tax loss carryforwards | **119** | (3) | -- | -- | -- | -- | -- |
| Interest on long-term debt | **1,026** | 1,000 | 1,102 | 1,056 | 880 | 1,207 | 1,404 |
| Interest on other interest bearing instruments, net | **449** | 488 | 506 | 774 | 797 | 523 | 544 |
| | **1,570** | 1,601 | 1,623 | 1,776 | 1,531 | 1,730 | 1,948 |
| Income (loss) before income taxes | **(8,507)** | 290 | (5,148) | (2,431) | 3,619 | (948) | 348 |
| Income taxes (recovered) | | | | | | | |
| Current | **--** | 8 | 30 | (100) | 2,392 | 1,774 | 634 |
| Future | **(1,038)** | 83 | (1,649) | (779) | (2,004) | (1,853) | 36 |
| | **(1,038)** | 91 | (1,619) | (879) | 388 | (79) | 670 |
| Income (loss) before other equity adjustments | **(7,469)** | 199 | (3,529) | (1,552) | 3,231 | (869) | (312) |
| Net loss from discontinued operations | **--** | -- | -- | (2,072) | (2,303) | (3,645) | (1,002) |
| Net income (loss) for the year | **(7,469)** | $ 199 | $ (3,529) | $ (3,624) | $ 928 | $ (4,514) | $ (1,314) |
| Basic income (loss) per common share | **(1.16)** | $ 0.03 | $ (0.49) | $ (0.51) | $ 0.12 | $ (0.59) | $ (0.17) |

## STATISTICAL DATA
## COSTS AND EXPENSES AS
## A PERCENT OF SALES
## BASED ON CONTINUING OPERATIONS

| | **2010** | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|---|---|---|
| Costs and expenses | | | | | | | |
| Cost of sales | **90.0%** | 75.4% | 83.5% | 76.6% | 74.8% | 77.5% | 74.4% |
| Selling and administration | **14.9%** | 12.8% | 13.0% | 15.1% | 11.3% | 14.0% | 15.2% |
| Depreciation and amortization | **12.6%** | 8.3% | 9.8% | 8.4% | 6.2% | 7.2% | 7.2% |
| | **117.5%** | 96.5% | 106.3% | 100.1% | 92.3% | 98.7% | 96.8% |
| Gross margin contribution before selling and administration expenses | **(2.3%)** | 16.3% | 6.6% | 13.8% | 19.0% | 15.3% | 18.4% |
| Return on sales | **(18.6%)** | 0.4% | (6.3%) | (3.1%) | 4.8% | (1.4%) | (1.8%) |
| Effective tax rate | **12.2%** | (31.4%) | (31.4%) | (36.2%) | 10.7% | (8.3%) | 187.6% |

## DIRECTORS AND OFFICERS

**Diane St. John**
Chief Executive Officer, Secretary Treasurer and a Director and an Officer

**Gregory Henwood**
President and Chief Operating Officer and an Officer

**Carl A. Merton**
Chief Financial Officer and an Officer

**Jeffrey M. Slopen**
Director and a member of the Compensation Committee (Partner – Miller, Canfield, Paddock and Stone, LLP, Windsor, Ontario)

**John R. Halula Sr.**
Director and a member of the Audit Committee (Corporate Director, Worthington Custom Plastics)

**Stephen E. Myers**
Director and Chair of the Compensation Committee (Executive-in-Residence at the College of Business Administration at the University of Akron, Akron, Ohio)

**Dr. Andrew J. Szonyi**
Director and Chair of the Audit Committee (President, Andrew J. Szonyi & Associates, Toronto, Ontario)

**John Sartz**
Director and a member of the Audit Committee (President, Viking Capital Corp., Toronto, Ontario)

**Victor Neufeld**
Lead Director and a member of the Compensation Committee
(President and Chief Executive Officer, Jamieson Laboratories Ltd., Windsor, Ontario)

## CORPORATE DIRECTORY

**Corporate Officer**
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London, Ontario

**Bankers**
Bank of Montreal
Windsor, Ontario

Comerica Bank
Detroit, Michigan

**Counsel**
Miller, Canfield, Paddock and Stone LLP
Windsor, Ontario

**Transfer Agent**
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P.O. Box 7010 Adelaide Street Postal Station
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Chief Financial Officer
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Oldcastle, Ontario N0R 1L0
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## ANNUAL MEETING

The Annual Meeting of the Shareholders will be held at the Holiday Inn Select, 1855 Huron Church Rd., Windsor, Ontario on December 2, 2010 at 3:00 p.m.

## LISTING

The Common Shares of the Company are listed on the Toronto Stock Exchange (symbol: REK)

**Reko International Group**

**5390 Brendan Lane**

**Oldcastle, ON, Canada**

**N0R 1L0**

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