

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**YEAR END REPORT**  
for the year ended June 30, 2010

**Management Discussion & Analysis**

**Date of Report – October 7, 2010**

**Description of Business**

International Barrier Technology Inc. (Barrier) manufactures and sells fire-rated building materials. Barrier's primary business is in the United States but through distribution partnerships is endeavoring to enter building products markets in Australia, Europe, and South America. Barrier has a patented fire resistive material (Pyrotite™) and manufacturing process that is applied to building materials to greatly improve their respective fire resistant properties. Many of the top multifamily and wood frame commercial builders in the United States utilize Barrier's fire-rated structural panels in areas where the building code requires the use of a fire-rated building panel.

Barrier manufactures a private label fire rated sheathing product under contract for both LP® Building Products, Inc. (LP) and MuleHide Products, Inc. (MuleHide). LP has introduced a fire rated OSB trademarked LP® Flameblock® Fire-Rated OSB Sheathing (LP® FlameBlock®) and MuleHide has been selling MuleHide FR Deck Panel™ (FR Deck Panel) to commercial modular building manufacturers since 2004.

**Discussion of Operations**

Barrier's financial statements are filed with both the SEC (USA) and SEDAR (Canada) and are disclosed in US dollars utilizing US generally accepted accounting principles. Barrier's filings with the SEC consist of quarterly reviewed financial statements on Form 10-Q and annual audited financial statements on Form 10-K. Barrier continues to file the above financial statements with SEDAR in Canada.

**Sales** revenue reported for the fiscal year ending June 30, 2010 was \$2,606,254. Total sales volume, as measured by surface volume of product shipped, was 5,002,600 sq.ft. During the same period in the previous year, Barrier shipped 5,780,032 sq.ft. with sales revenue of \$4,091,647.

Shipments into the Commercial Modular Market during the fiscal year were 3,034,100 sq. ft. (vs. 4,182,900 sq. ft. in 2009) Sales into the Residential Roof Deck Market Sector this year were 1,936,400 sq. ft. (a 25% increase over the 1,552,300 sq. ft. in previous year) which was split between the Mid-Atlantic region at 904,100 sq. ft., the South at 421,500 sq. ft., the West at 297,600 sq. ft., the Midwest at 166,000 sq. ft., and a special project in Alaska at 147,200 sq. ft. There were 32,100 sq. ft. of shipments in the Structural Insulated Panel market during this period.

On January 19, 2010 Barrier entered into an exclusive Supply Agreement with LP, the largest producer of Oriented Strand Board (OSB) in the world. The agreement gives LP the exclusive right to sell Pyrotite treated panel products in North America under their brand name LP® FlameBlock® Fire-Rated OSB Sheathing. While this agreement is expected to dramatically improve sales volume and financial performance for Barrier, sales revenue reported will be influenced in a negative direction since LP will be providing their own OSB, with no pass

through charges for Barrier on the substrate or inbound and outbound freight. Barrier's margin will be on the treatment of the OSB only.

**Gross profit** for Fiscal 2010 was \$75,622 vs. \$577,154 in the previous year. The gross margin, as a percentage of sales revenue, was 3% in comparison to 14% in the prior year. Gross margins are affected dramatically by sales volume because as the fixed cost portion of Barrier's business is factored over a larger sales volume the cost per sq.ft. of sales goes down dramatically. The larger the volume shipped, the smaller the cost per sq.ft. of fixed costs and the costs of sales and administrative services. We anticipate larger gross margins as sales volumes rise.

**Cost of sales** decreased to \$2,530,632 from \$3,514,493 in Fiscal 2009. The decrease is attributable to the continuation of improvements in efficiency of operations and the fact that less volume is being produced. The gain in efficiency is reflected in the decreased year-to-date average cost per sq.ft. of production of \$0.51 in comparison to \$0.61 in the comparable period.

Substrate cost and materials/labor were the major expenses in this category. Substrate accounted for \$744,065 for the fiscal year versus \$1,354,082 in the same period last year. Materials and labor accounted for an additional \$953,068 in the twelve month period in 2010 versus \$1,084,898 in 2009.

R&D expenses and activity has generally been limited to those areas allowing LP to introduce LP<sup>®</sup> FlameBlock<sup>®</sup> into targeted markets such as the Wildland Urban Interface (WUI) zoned properties in California and for fire rated wall assemblies in wood framed commercial buildings. Barrier's International Code Council Evaluations Services Report (ICC-ES 1365) has been updated and it now includes LP Building Products, Inc. as an "additional listee". This allows LP to sell their LP<sup>®</sup> FlameBlock<sup>®</sup> product in any application originally certified for Blazeguard<sup>®</sup>, Barrier's original fire rated sheathing product.

Depreciation on plant and equipment is included in cost of sales category. Depreciation, which has non-cash impact on Barrier's actual cash flow, decreased slightly from \$264,122 in 2009 to \$264,101. The expense reflects scheduled depreciation of the new manufacturing line equipment and building expansion. Amortization, another non-cash category of reporting, of the worldwide Pyrotite technology (including patents, technical know-how, and trademarks) began when Barrier purchased it in 2004 and will continue at existing rates until it is fully depreciated (eight years).

Barrier and Pyrotite Corporation successfully negotiated the termination of an agreement that had assigned the technology rights of integrally treated (non-coated boards) OSB to Pyrotite Corporation Late in March 2010. To date, no additional amortization amounts or schedule has been added to Barrier's financial statement in this reporting period, both because it happened so late in the quarter and the added value of the additional technology has not been fully assessed. Further discussion of this transaction will occur in subsequent financial reports from Barrier.

**Administrative expenses** for the Fiscal 2010 increased to \$1,393,570 from \$1,159,294 in the prior year. During this period, stock options were issued to key management employees as well as the Board of Directors as a part of Barrier's shareholder approved stock-based incentive program. Most of the options issued prior to this period had expired and a major part of this issuance was to replace and provide this incentive where deemed appropriate. During the twelve months ended June 30, 2010, a compensation charge included in administrative expenses was \$500,900 versus \$9,820 in the same period in 2009.

Administrative costs (including stock-based compensation of \$500,900 (2009: \$9,800)) per square foot, was \$0.28 in the fiscal year ending June 30, 2010. In the same period in the previous year administrative costs per square foot were \$0.20. Over this time volume dropped from 5,780,032 sq.ft. to 5,002,600 sq. ft. Barrier continued to focus on holding expenses at a minimum during this transition period. Increasing volumes will generally cause a reduction in the average cost of administrative expense per sq.ft. Barrier expects the reduction in the average cost of administration to have a significant impact on bottom line performance in future reporting periods as sales volumes rise with an improving economy.

**Accounting and Audit Fees** increased from \$74,537 to \$84,173. This is attributed to complicated accounting matters related to financial instruments issued by the Company during the year.

**Insurance costs** have increased to \$71,936 in comparison to \$62,399 the previous year. The difference is due to annually adjusted premiums.

**Legal fees** increased to \$80,422 for the annual period ending June 30, 2010. For the same period in the prior year, legal fees were \$73,631. Legal fees were expended on a the development of a Supply Agreement with LP for Barrier to provide fire treatment services for LP's oriented strand board (OSB) panel products as well as for help in the drafting and review of certain business correspondence. In March, 2010 Barrier was awarded sole ownership to the worldwide rights from Pyrotite Corporation (holder of the integral treatment Pyrotite patent) through a mediation hearing. The rights, in addition to a lump sum payment, were agreed upon to settle amounts due to Barrier per the royalty payments due for receipts Pyrotite Corporation received over the past few years related to integral Pyrotite technology.

Barrier believes protecting its technology and trademarks is an important step in positioning itself to develop strategic partners and potential technology licensees. Barrier received the final patent approval on the manufacturing process in late October, 2009.

**Sales, marketing, and investor relations** increased for the twelve month period (\$79,569 vs. \$66,876). Barrier is intent upon developing markets where exterior wall designs are required to accommodate both strength and fire considerations; this is inherently the case in the wild-fire prone areas of the west coast where building for earthquake risks is code mandated. Sales expenses, therefore, are expected to grow during Fiscal 2010 with the development of both the northern and southern California territories, Oregon, and Colorado – the Northern Pacific region. While Barrier has always planned business travel to accommodate only “necessary” trips, all business travel is will continue to be pre-approved by a cash flow committee in addition to approval by Barrier's CEO.

**Loss Before Other items** Loss before other items of (\$1,317,948) is being reported for the fiscal period ending June 30, 2010, whereas in the same period in 2009, a net loss of (\$582,140) was reported.

The net reported loss for Fiscal 2010 was heavily impacted by the non-cash charge for stock options. The net loss, however, was also impacted by the lower volume of sales and shipments experienced in this twelve month period as compared both to 2009 and 2008.

Barrier needs to maintain a higher level of sales to support a viable business in the building products industry. Barrier believes that the new strategic partnership with LP coupled with the

MuleHide agreement will support a much larger sales volume as the economy improves. As LP customers become more aware of LP's entry into the fire-rated sheathing market, shifts will occur in product mix that will improve Barrier's market share in targeted applications. The revenue generated by the private placement of shares, including the warrants which may be exercised at later dates, will serve to fund the business and cover operating losses that may ensue as the transition to higher volumes occurs over the next few months.

**Other items** include income and costs not directly related to business operations. Other income items reported during the period herein include \$3,017 in interest income and (\$30,615) in foreign exchange loss. To compare, for the same reporting period last year, interest income was \$7,521 and foreign exchange was a negative (\$58,088) year-to-date.

Barrier and the Seattle based Pyrotite Corporation successfully negotiated the termination of a technology agreement that had assigned the rights to integrally treated (non-coated) OSB to Pyrotite Corporation. With the assignment of the integrally treated OSB (IPOSB) technology to Pyrotite Corporation an obligation to pay a royalty to Barrier ensued; Pyrotite has been providing quarterly statements for these royalty fees and paying them to Barrier on occasion. The termination of this agreement resulted in a final royalty payment to Barrier of \$90,000 which was accounted for as other income during the period.

Interest on Long Term Debt has decreased from \$85,838 to \$79,921 for the year-to-date reporting period as overall long-term debt continues to decrease.

The regulatory agencies that oversee the reporting functions of publicly traded companies regulate how companies report the costs and revenue associated with the sale of equity (stock) in the company. In March, 2010, Barrier issued, and sold in a private placement, 15 million shares of stock at the price of \$0.10 CDN per share. In addition, the purchasers of the shares were awarded the right to buy an additional share (warrant) at \$0.15 CDN. As a result of this transaction Barrier is required to report a cost of \$935,700 representing a change in the fair value of derivative liabilities in this reporting period (See Note 5).

**.Summary of Quarterly Results.** The following is a summary of the Company's financial results for the nine most recently completed quarters:

	June 30 2010	Mar 31 2010	Dec 31 2009	Sept 30 2009	Jun 30 2009	Mar 31 2009	Dec 31 2008	Sept 30 2008	June 30 2008
Volume shipped (MSF)	1,496	1,261	1,343	903	1,011	1,085	1,578	2,106	1,891
Total Revenues (000)	\$574	\$660	\$791	\$581	\$618	\$764	\$1,123	\$1,587	\$1,349
Operating Income (000)	(\$370)	(\$652)	(\$101)	(\$195)	(\$277)	(\$211)	(\$94)	(\$0)	(\$143)
Net income (loss) (000)	(\$117)	(\$1,883)	(\$124)	(\$206)	(\$346)	(\$215)	(\$164)	\$6	(\$134)
EPS (Loss) Per Share	(\$0.00)	(\$0.06)	(\$0.00)	(\$0.01)	(\$0.00)	(\$0.01)	(\$0.01)	\$0.00	(\$0.01)

### **Selected Annual Information**

The following financial data is for the three most recent years ended June 30:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Total Revenue	\$2,606.3	\$4,092.0	\$4,878.0
Net income (loss)	(2,330.0)	(719.0)	(808.0)
Per share	(0.07)	(0.02)	(0.03)
Per share, fully diluted	(0.07)	(0.02)	(0.03)
Total assets	5,002.0	4,849.0	5,738.0
Total long-term financial liabilities	774.0	1,205.0	1,145.0
Cash dividends declared per share	Nil	Nil	Nil

### **New product and market development**

New product and market development activities have been curtailed over the past year as a result of reduced sales volume. Barrier anticipates that as the economy improves and strategic partnerships develop, an increase in this activity will transpire.

New product and market development activity during this period has generally been limited to those areas which will allow LP to introduce LP<sup>®</sup> FlameBlock<sup>®</sup> into targeted markets such as the Wildland Urban Interface (WUI) zoned properties in California and for fire rated wall assemblies in wood framed commercial buildings. Barrier's International Code Council Evaluations Services Report (ICC-ES 1365) has been updated and it now includes LP Building Products, Inc. as an "additional listee". This allows LP to sell their LP<sup>®</sup> FlameBlock<sup>®</sup> product in any application originally certified for Blazeguard<sup>®</sup>, Barrier's original fire rated sheathing product.

### **Global licensing opportunities**

Barrier has begun exploring opportunities for both Pyrotite technology licensing and distribution of US manufactured products as a part of the LP Building Products agreement. LP is active internationally and has offered to potentially extend their influence in Europe, Australia, and South America if the opportunity seems mutually beneficial. In addition, Barrier continues to explore the opportunity for developing fire resistive panels for the emerging Structural Insulated Panel (SIP) market in Australia with an American company currently doing SIP business there. More information will be presented on these opportunities in subsequent reports as it develops.

### **Financial position & financings**

Barrier ended the period with a working capital deficiency of (\$1,742,966), of which (\$2,519,600) is a required non-cash fair market value derivative liability related to the outstanding warrants issued during the period.

The Company generated negative operating cash flow for the twelve months ended June 30, 2010 of (\$366,392) in comparison to (\$318,979) for the twelve months ended June 30, 2009. The net cash outflow from operating activities for the current fiscal period ended was primarily a result of a net loss of (\$2,329,567), the non-cash items (stock-based compensation of \$500,900 and amortization of \$126,816), and an increase in inventory of \$58,172. The Company expects to fund short-term cash needs out of current operations and supplement other short-term needs with the funds raised in the recent private placement that was successfully completed to pay down debt and generate extra working capital.

Investing activities used \$23,068 during the year compared with a use of \$14,196 during the year ended June 30, 2009. The amount of capital expenditures incurred by the Company has decreased from past years. The Company does not expect any significant additional long-term

capital investments in the near future as they recently expanded manufacturing operations with a more efficient automated process that is projected to fulfill mid-term growth needs. Should a developing strategic alliance create the need for a quick ramp up of production and sales, however, some additional investments in working capital (e.g.; raw materials and finished good inventory) will be required. In addition, the company has identified some relatively small capital improvement projects specifically targeted on material storage and moving larger amounts of items through the shop on a timely basis. These funds are available, generated by the private placement of stock identified above.

Financing activities resulted in net cash inflow of \$1,041,858 in the current period compared to a net cash inflow of \$107,472 for the same period last year. Cash generated by financing activities is attributable to a private placement of 15,000,000 equity units undertaken during the year for which the Company raised \$1,461,626 (\$1,500,000 CDN).

There is no assurance that we will operate profitably or will generate positive cash flow in the future. In addition, our operating results in the future may be subject to significant fluctuations due to many factors not within our control, such as the unpredictability of when customers will order products, the size of customers' orders, the demand for our products, the level of competition or general economic conditions.

Although management believes that revenues will increase, management also expects an increase in operating costs. Consequently, the Company expects to incur operating losses and negative cash flow until our products gain market acceptance sufficient to generate a commercially viable and sustainable level of sales, and/or additional products are developed and commercially released and sales of such products made so that we are operating in a profitable manner.

### **Current and Future Financing Needs**

Having undertaken an equity financing during the year ended June 30, 2010, management of the Company believes it has sufficient cash to operate its business for the fiscal year ended June 30, 2011. At June 30, 2010, the current cash and cash equivalents total \$863,121 and there is currently no available funds to draw on the revolving credit facility. Over the next 12 months, the Company anticipates that the operation of business will produce an average negative monthly operating cash flow of approximately \$15,000 for a total of \$180,000 for the 2010 fiscal year. In addition, over the next 12 months, the Company is required to make payments totaling \$144,800 in respect of its long-term debt and capital lease obligations and \$370,000 in respect of accounts payable outstanding as at June 30, 2010 leaving a cash balance of \$168,000 at the end of the fiscal year.

The Company bases its estimate of future cash requirements on assumptions that may prove to be wrong and the requirements for cash are subject to factors, some of which are not within the control of the Company, including:

- Increased costs of general and administrative expenses
- Increased costs of raw materials and freight
- Costs associated with the research and development activities
- Costs associated with maintaining property, plant and equipment and intellectual property

## Related Party Transactions

During the fiscal period ended June 30, 2010 the Company incurred wages and management fees of \$594,064 (of which \$181,064 was wages and management fees and \$413,000 was share-based compensation) with directors of the Company or private companies with common directors. The Company paid \$173,717 in wages and management fees for the same prior year-to-date.

## Capitalization

Authorized: 100,000,000 common shares without par value.

Issued as of June 30, 2010: 44,414,926 common shares at \$15,457,697

Issued as of Sept 20, 2010: 44,414,926 common shares at \$15,457,697

Options outstanding:

The following summarizes information about the stock options outstanding at June 30, 2010:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
250,000	\$0.55	August 9, 2010
40,000	\$0.09	March 7, 2011
400,000	\$0.15 CDN	December 17, 2011
<u>3,640,000</u>	<u>\$0.12 CDN</u>	<u>March 18, 2012</u>
<u>4,330,000</u>		

During the twelve months ended June 30, 2010, a compensation charge included in Wages and Management Fees associated with the grant of stock options in the amount of \$500,900 (2009: \$9,820) was recognized in the financial statements.

Subsequent to June 30, 2010; 250,000 stock options at \$0.55 expired unexercised.

At June 30 2010, the following share purchase warrants were outstanding entitling the holder to purchase one common share for each warrant held as follows:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
<u>15,000,000</u>	<u>\$0.15 CDN</u>	<u>March 18, 2012</u>
<u>15,000,000</u>		

## **Critical Accounting Estimates**

### **Stock-based Compensation Charge and Expense**

As described in Note 2 to the audited annual financial statements, the Company accounts for all stock-based payments and awards under the fair value based method. This fair value of the stock options is estimated at the date of the stock options are granted using the Black-Scholes option-pricing model. Stock-based payments to non-employees are periodically re-measured until counter-party performance is complete and any change is recognized over the life of the award. The Company accounts for share purchase options to employees by recording the fair value of the awards on the grant date and the related stock-based compensation expense is recognized over the period in which the options vest. In addition, this is a non-cash compensation charge and the cash flow effects are realized only at the time of exercise.

### **Fair Value Measurements**

The Company measures the fair value of its assets and liabilities using the fair value hierarchy under GAAP is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – observable inputs other than Level 1, quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and model-derived prices whose inputs are observable or whose significant value drivers are observable; and

Level 3 – assets and liabilities whose significant value drivers are unobservable by little or no market activity and that are significant to the fair value of the assets or liabilities.

During the year ended June 30, 2010, the Company determined that the warrants included in its offering of equity units during the year required bifurcation as derivative liabilities. The resulting derivative is required to be measured at their fair value each reporting period.

### **Internal Control and Financial Reporting Procedures**

The board of directors evaluates and maintains internal control procedures and financial reporting procedures to ensure the safeguarding of Barrier's assets as well as to ensure full, true, accurate and timely disclosure of Barrier's financial position for the twelve month period ended June 30, 2010, which would materially affect the accuracy of this financial report.

There has been no change in internal control procedures in the twelve month period ending June 30, 2010.

### **Other Matters**

As at June 30, 2010 the Company did not have any off-balance sheet arrangements to report.

During the reporting period, The Company paid \$225,000 on the revolving bank loan facility. In addition, a payment of \$80,000 was made to reduce the term debt.

On January 19, 2010, Barrier and LP<sup>®</sup> Building Products (LP) executed a 1-year Supply Agreement where Barrier has agreed to provide exclusive fire treatment services for LP on their oriented strand board panel product (OSB). LP is the largest producer of OSB in the world. LP will market and sell the fire treated OSB in North America under their own trade name LP<sup>®</sup> FlameBlock<sup>®</sup> Fire-Rated OSB Sheathing. Barrier has agreed not to market or sell Pyrotite<sup>™</sup> technology coated wood products under the registered trademark Blazeguard<sup>®</sup> for as long as the agreement is in place. Current Blazeguard customers, as of January 19, will be referred to LP customer service when they wish to place orders or arrange for shipping schedules. Barrier will provide technical support. Barrier will continue to supply MuleHide FR Deck Panel to MuleHide Products, Inc. under the existing Supply Agreement executed between Barrier and MuleHide in 2004.

LP studied available fire retardant technology for OSB for some time and after an exhaustive review of available technologies, selected Pyrotite<sup>™</sup>, Barrier's proprietary and patent protected technology. The Barrier/LP partnership is particularly powerful in that it links the raw manufacturing of the OSB substrate with the company that actually mixes and produces the fire retardant slurry. Barrier and LP believe that not only will LP<sup>®</sup> FlameBlock<sup>®</sup> be recognized as the premier fire rated sheathing in the marketplace; it will be priced competitively to alternative products. LP has a strong sales and distribution network all over North America and will be able to leverage this substantial support network in a way that Barrier was never able to do successfully with its relatively small size.

More descriptive details relating to the long-term relationship of LP and Barrier will be reported as they are developed. Presently, however, Barrier and LP agree that moving quickly to establish both a customer base of support and recognition of the product in the builder community is the number one priority. Establishing market share now, while the overall building market is slow, will enable LP<sup>®</sup> FlameBlock<sup>®</sup> sales to grow exponentially as the economy improves.

LP's number one market development priority will be roof and exterior wall applications in the wildfire prone areas of California. LP<sup>®</sup> FlameBlock<sup>®</sup>'s inherent attributes of strength enhancement coupled with superior fire protection will help position it as the premier choice for residential and commercial wood framed construction because along the west coast designing for both fire and earthquake protection is required.