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**Versatile Mobile Systems (Canada) Inc.**  
**Management Discussion and Analysis**  
**Nine Months Ended March 31, 2004**

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The company is primarily engaged in software development and sales of computer software, hardware and systems integration services related to wired and wireless mobile business solutions.

**Highlights for the third quarter included:**

- Versatile's VM DEX Server product was chosen by Kellogg Company for implementation in over 50 distribution centers throughout the U.S.A. and VM DEX 3.1 mobile client software was selected for deployment to 1000 Kellogg Direct Store Delivery route drivers.
- Versatile strengthened its sales team adding a senior person in New York.
- Versatile launched an in house telemarketing department.
- Versatile strengthened the balance sheet with a brokered private placement of \$2,220,000 at a price of \$0.27 per unit.

**Financial Highlights:**

The following are the financial highlights for the nine-month period ending March 31, 2004:

- Gross profit for the nine-months ended March 31, 2004 increased by 2.6% to \$4,829,894 compared to \$4,708,700 for the same period last year.
- Net earnings for the nine-month period were \$72,110 (\$0.00 per share) compared to a loss of \$1,966,813 (\$0.02 per share) in the same period last year.
- Cash flow generated from continuing operations for the nine-month period amounted to \$269,257 compared to a cash flow deficiency of \$1,776,827 for the comparable period last year.
- The Company completed two private placements for gross proceeds of \$3,090,000.
- Over the past nine months working capital has increased by \$3,050,922 to \$4,208,513.

- The decline in the translation rate of the U.S. dollar to 1.3379 in this period compared to 1.5129 for the last fiscal year has had a significant impact on the current year's financial statements compared to the comparable period last year as most of the company's operations are in the U.S.

### **Review of operations:**

Revenue for the nine months ended March 31, 2004 was \$14,733,209 compared to \$16,301,038 for the same period last year. Net Earnings for the nine-month period was \$72,110 (\$0.00 per share) compared to a loss of \$1,966,813 (\$0.02 per share) in the same period last year. Amortization of goodwill and intangible assets for the nine months ended March 31, 2004 was \$247,649 compared to \$312,914 for the same period last year.

Revenue for the quarter ended March 31, 2004 was \$4,467,967 compared to \$7,710,548 for the same quarter last year. The loss for the quarter was \$76,634 (\$0.00 per share) compared to a loss of \$116,617 (\$0.00 per share) in the same quarter last year. Amortization of goodwill and intangible assets for the quarter ended March 31, 2004 was \$79,716 compared to \$78,280 for the quarter last year.

Revenue decreased in the first nine months over the comparable period last year, as deferred revenue of \$3,718,904 was recognized in the comparable period, as a result of projects that were completed in the third quarter of last year. While revenue decreased, the actual gross profit increased by \$121,194.

Cost of sales for the nine-month period ended March 31, 2004 was \$9,903,315 resulting in a gross profit of 32.8% compared to \$11,592,338 or a gross profit of 28.9% in the same period last year. Cost of sales for the quarter was \$2,983,965 resulting in a gross profit of 33.2% compared to \$5,587,276 or a gross profit of 27.5% in the same quarter last year. The increase in the gross profit percentage compared to last year can be attributed to the fact that sales in the prior year were primarily related to lower margin hardware and systems integration services. Also, in the quarter ended March 31, 2003, the Company had substantially completed the implementation of a new inventory management system as well as an extensive review of its inventory and recorded an inventory provision of \$134,600, which was included in cost of sales.

General and administrative costs were \$1,906,855 for the nine-month period ended March 31, 2004 as compared to \$2,703,177 for the same period last year. General and administrative costs were \$613,644 for the quarter as compared to \$963,028 for the same quarter last year. Salary costs, premises and professional expenses have all been substantially reduced in the current fiscal year compared to the prior period.

Research and development costs were \$822,294 for the nine-month period ended March 31, 2004 as compared to \$1,422,535 for the same period last year. Research and development costs were \$274,509 for the quarter as compared to \$228,196 for the same quarter last year. The level of in house activity in research and development has been reduced over the course of the year as the Company focuses its resources on marketing its

completed products and solutions. Consequently staffing levels have declined and consulting costs have been reduced this year compared to last year. The company will monitor these costs and will continue to ensure that the cost structure is aligned with revenues and gross margins.

Selling and marketing costs for the nine-month period ended March 31, 2004 were \$1,952,821 compared to \$2,251,413 for the same period last year. Selling and marketing costs for the quarter were \$674,112 compared to \$951,570 for the same quarter last year. The decrease in the nine-month period is primarily attributable to lower salaries and commission costs. The company will monitor these costs and will continue to ensure that the cost structure is aligned with revenues and gross margins.

During the quarter the Company recorded \$7,970 for the stock-based compensation charge. The CICA Accounting Standards Board has amended Handbook Section 3870 to require entities to account for employee stock options using the fair value based method, beginning January 1, 2004. The Company has adopted the fair value method on a prospective basis for all grants made subsequent to June 30, 2003. Under the fair value based method, compensation cost is measured at fair value at the date of each grant and is expensed over the award's vesting period. The Company has applied the fair value based method to all employee stock options granted on or after July 1, 2003. The previous quarterly results will not be amended, as the amounts are insignificant as the total expense for the 2004 fiscal year is estimated to be \$31,686.

Related party transactions, which include expenses of \$116,088, for the nine-month period ended March 31, 2004 amounted to \$658,840 compared to \$621,423 (includes \$141,944 for expenses) for the same period last year.

During the quarter the Company realized savings of \$97,640 on its premise costs. These have been separately disclosed in the Statement of Operations.

### **Financial position:**

Cash and cash equivalents and marketable securities at March 31, 2004 amounted to \$2,524,988. Working capital at March 31, 2004 was \$4,208,513 compared to \$2,186,856 at December 31, 2003 and \$1,157,591 at June 30, 2003. The ability of the Company to continue operations on an ongoing basis will be dependent on its ability to continue to generate sales, maintain profitable operations, maintain margins and control operating expenses. The company has cash on hand and accounts receivable sufficient to meet all of its current obligations as they become due.

During the nine months ended March 31, 2004, there was a significant increase in the accounts receivable to \$2,829,931, which can be mainly attributed to the activity towards the end of the period. During the nine months ended March 31, 2003, there was a significant reduction in accounts receivable (\$3,455,519), inventory (\$2,428,283), accounts payable (\$1,725,274) and deferred revenue (\$3,718,904). These changes can be mainly attributable to focused collection activities, implementation of an inventory

management system and the completion of a number of sales milestones, in particular, the Books are Fun project, with the recognition of revenue relating to this project.

Cash generated from continuing operations for the nine-month period ended March 31, 2004 was \$269,257 compared to cash flow required to fund operations of \$1,776,827 for the same period last year. Cash required to fund non-cash working capital items amounted to \$1,678,221, compared to a surplus of \$541,581 for the same period last year.

Cash required for capital expenditures in the nine-month period ended March 31, 2004 amounted to \$87,274 versus \$111,377 for the same period last year. Cash required for capital expenditures in the quarter amounted to \$17,867 versus \$78,317 for the same quarter last year.

### **Share Capital:**

On December 4, 2003 the Company closed a non-brokered private placement for gross proceeds of \$870,000. The Company issued 2,485,713 Units at a price of \$0.35 per Unit. All of the officers and directors of the Company participated in this placement subscribing for 1,071,428 Units. Each Unit consisted of one common share and one common share purchase warrant. Each common share purchase warrant will entitle the subscriber to purchase one common share of the Company on or before December 4, 2004 at a price of \$0.40 per common share. For accounting purposes the price of \$0.35 per Unit has been allocated as to \$0.30 for each common share and \$0.05 for each share purchase warrant. The issued securities are subject to a hold period, with the hold period expiring on April 5, 2004.

On March 17, 2004 the Company closed a brokered private placement for gross proceeds of \$2,220,000. The Company issued 8,222,222 Units at a price of \$0.27 per Unit. Each Unit consisted of one common share and one-half of a common share purchase warrant. Each whole common share purchase warrant entitle the subscriber to purchase one common share of the Company on or before September 17, 2005 at a price of \$0.40 per common share. For accounting purposes the price of \$0.27 per Unit has been allocated as to \$0.25 per common share and \$0.02 to the one-half share purchase warrant. The Company paid the agent a cash commission of \$166,500 and issued 822,000 Brokers Warrants, which entitle the holder to purchase one common share of the Company on or before March 17, 2005 at a price of \$0.37 per common share. The Brokers Warrants were assigned a value of \$32,889, which has been recorded as a share issue cost. The issued securities are subject to a hold period, with the hold period expiring on July 18, 2004.

During the current quarter 10,000 stock options with an exercise price of \$0.32 per share were forfeited. During the previous quarter 66,666 stock options were exercised at \$0.10 per share.

On December 8, 2003, the Company granted employees and a director, incentive stock options to acquire a total of 145,000 common shares of the Company exercisable for a period of 4 years at a price of \$ 0.32 per share

On August 20, 2003, the Company granted employee incentive stock options to acquire a total of 275,000 common shares of the Company exercisable for a period of 4 years at a price of \$ 0.11 per share.

### **Foreign Exchange**

Foreign exchange rates for the U.S. dollar fell during the year as the Canadian dollar strengthened. The dosing rate was 1.3113 at March 31, 2004 and the average rate used for the nine months ended March 31, 2004 was 1.3379 and for the quarter was 1.3178 compared to 1.5129 for the year ended June 30, 2003. The decline in the foreign exchange rate in this period compared to the last fiscal year has a significant impact on the current year's financial statements compared to the comparable quarter last year as most of the company's operations are in the U.S., which operates its business in U.S. dollars, which are translated into Canadian dollars at the prevailing rate. Whereas a significant amount of the Company's expenses are in Canadian dollars so the decline of the U.S. dollar has had a negative impact on the net monetary position and the results for the quarter.

### **Forward-Looking Statements**

This document may contain forward-looking statements relating to Versatile Mobile Systems' operations or to the environment in which it operates, which are based on Versatile Mobile Systems' operations, estimates, forecasts and projections. These statements are not guarantees of future performance and involve risks and uncertainties that are difficult to predict or are beyond Versatile Mobile Systems' control. A number of important factors including those set forth in other public filings could cause actual outcomes and results to differ materially from those expressed in these forward looking statements. Consequently readers should not place any undue reliance on such forward-looking statements. In addition, these forward looking statements relate to the date on which they are made. Versatile Mobile Systems' disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.