
Versatile Mobile Systems (Canada) Inc.
Management Discussion and Analysis
Six months ended December 31, 2004

The following management's discussion and analysis of the consolidated results of operations and financial condition of Versatile Mobile Systems (Canada) Inc. (the "Company") as at and for the three months and six months ended December 31, 2004 is made as of February 28, 2005 and should be read in conjunction with the audited consolidated financial statements and notes for the year ended June 30, 2004. The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The consolidated financial statements and management's discussion and analysis have been reviewed by the Company's Audit Committee and approved by the Company's Board of Directors and are presented in Canadian dollars unless otherwise specified.

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions, which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

Overview:

The Company's core business is developing mobile business solutions that enable companies to improve the sales, marketing and distribution of their products by extending the supply chain beyond the traditional enterprise. The Company delivers wireless mobile solutions to the consumer packaged goods (CPG) and logistics industries through an integrated combination of licensed software, professional services, and the re-sale of mobile-computing devices and related hardware.

The Company offers software applications as a key area of the mobile business solution. These software applications are in the Supply Chain Management and mobile Customer Relationship Management areas operating in a wired or wireless environment.

Review of operations:

Revenue for the six months ended December 31, 2004 was \$6,677,220 compared to \$10,265,242 for the same period last year. The Net Loss for the six-month period was \$1,137,281 (\$0.01 per share) compared to Net Earnings of \$148,744 (\$0.00 per share) in the same period last year. The Net Earnings (Loss) is after non-cash charges for amortization of capital assets and intangible assets is of \$127,805 compared to \$167,933 for the same period last year.

Revenue for the quarter ended December 31, 2004 was \$2,865,311 compared to \$5,039,522 for the same quarter last year. The Net Loss for the quarter was \$495,184 (\$0.01 per share) compared to Net Earnings of \$4,780 (\$0.00 per share) in the same quarter last year. The Net Earnings (Loss) is after non-cash charges for amortization of capital assets and intangible assets of \$58,736 for the quarter compared to \$81,905 for the same quarter last year.

Revenue decreased 35% over the comparable six-month period last year as a result of several major customers delaying their spending decisions.

A significant amount of management time has been diverted from the core business of the Company to deal with the negotiation, financial analysis and due diligence surrounding the Company's recent acquisition activity. This activity has negatively impacted the last two quarters, however, it is anticipated that the benefits will be realized by the end of this quarter.

Cost of sales for the six month period ended December 31, 2004 was \$4,938,802 yielding a gross margin of 26.0% as compared to \$6,919,350 or a gross margin of 32.6% in the same period last year. Cost of sales for the quarter was \$2,002,512 yielding a gross margin of 30.1% as compared to \$3,515,070 or a gross margin of 30.2% in the same quarter last year. The decrease in the cost of sales percentage compared to last year can be attributed to the fact that the sales were primarily related to lower margin hardware and systems integration services.

General and administrative costs were \$1,166,230 for the six-month period ended December 31, 2004 compared to \$1,299,242 for the same period last year. General and administrative costs were \$481,396 for the quarter as compared to \$587,247 for the same quarter last year. Salary costs were lower in the current period due to the staff reductions that have been made over the past year, which along with reductions in professional fees and premise costs have resulted in a significant reduction in the general and administrative expenses.

Research and development costs were \$342,288 for the six-month period ended December 31, 2004 as compared to \$547,785 for the same period last year. Research and development costs were \$175,128 for the quarter as compared to \$303,995 for the same quarter last year. The level of in house activity in research and development has decreased as the company has the Company has completed several research and development initiatives. Staffing levels were reduced over the course of the prior year and the Company will continue to monitor these costs for the remainder of the fiscal year.

Selling and marketing costs for the six-month period ended December 31, 2004 amounted to \$1,231,969 compared to \$1,278,709 for the same period last year. Selling and marketing costs for the quarter were \$639,560 compared to \$643,046 for the same quarter last year. The investment in sales and marketing has not yet yielded a corresponding increase in revenues. It is anticipated that the benefit of these activities will be realized at a future date.

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

Financial position:

Working capital at December 31, 2004 was \$2,297,160 compared to \$3,620,261 at June 30, 2004. Cash and cash equivalents at December 31, 2004 amounted to \$828,194. 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 for the company to meet all of its current obligations as they become due.

During the six months ended December 31, 2004, there was a significant reduction in accounts receivable of \$1,850,267 and accounts payable of \$1,970,253. These changes can be mainly attributed to the decline in activity.

Cash used in operating activities for the three month period ended December 31, 2004 was \$730,542 compared to \$757,538 for the same period last year and for the six month period ended December 31, 2004 was \$1,186,914 compared to \$1,024,493 for the same period last year.

Cash required for capital expenditures for the six-month period ended December 31, 2004 amounted to \$15,378 versus \$69,587 for the same period last year. In addition, capital lease obligations were reduced by \$6,429 for the six-month period ended December 31, 2004.

Share Capital:

During the quarter, 66,666 common shares were issued for exercised stock options.

Warrants:

During the quarter no warrants were issued or exercised. Warrants that were scheduled to expire on December 4, 2004 were extended to June 4, 2005. The details of the outstanding warrants at December 31, 2004 are as follows:

<u>Expiry Date</u>	<u>Exercise Price</u>	<u>Number</u>	<u>Amount</u>
June 4, 2005	0.40	2,485,713	\$ 124,286
March 17, 2005	0.37	822,222	164,444
September 17, 2005	0.40	4,111,110	32,889
		<u>7,419,045</u>	<u>\$ 321,619</u>

Stock Options:

During the quarter 60,000 options expired, 200,000 options were forfeited, no stock options were granted and 66,666 options were exercised. The details of the outstanding options at December 31, 2004 are as follows:

	Number of Shares	Exercise Price	Expiry Date
Directors	400,000	\$ 1.05	February 3, 2005
Director	75,000	1.50	March 1, 2005
Employee	250,000	2.50	March 9, 2005
Directors & Employees	1,385,000	0.50	April 11, 2005
Directors & Employees	3,141,668	0.10	April 17, 2007
Employees	275,000	0.18	August 18, 2007
Directors & Employees	135,000	0.32	December 6, 2007
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	5,661,668	0.40	

Foreign Exchange

Foreign exchange rates for the U.S. dollar fell during the quarter as the Canadian dollar strengthened. The closing rate was 1.2062 at December 31, 2004 compared to 1.3404 at June 30, 2004. The average rate for the three months ended December 31, 2004 was 1.2207 compared to 1.3071 for the three months ended September 30, 2004. The significant change in the rates had an impact on the current year's financial statements 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. The substantial change in the foreign exchange rate occurred in the fourth quarter and had a negative impact on the net monetary position and the results for the fourth quarter.

Related Party Transactions

Related party transactions, which include expenses, in the quarter amounted to \$201,859 compared to \$232,700 for the same quarter last year. Related party expenses, which are allocated to administration expense and selling and marketing expense, are for management services provided to the company by directors acting as officers of the company pursuant to employment or consulting service contracts. In addition the company reimburses expenses paid by the directors for reasonable travel and other costs incurred whilst undertaking company business.

Investor relations

During the period Equicom was engaged at a total cost of \$19,500 (2003 – Nil).

Pursuant to the requirements of National Instrument Policy 51-102F1 the Company is providing selected annual information as set forth in Section 1.3 and a summary of quarterly results as set forth in Section 1.5 of that Policy.

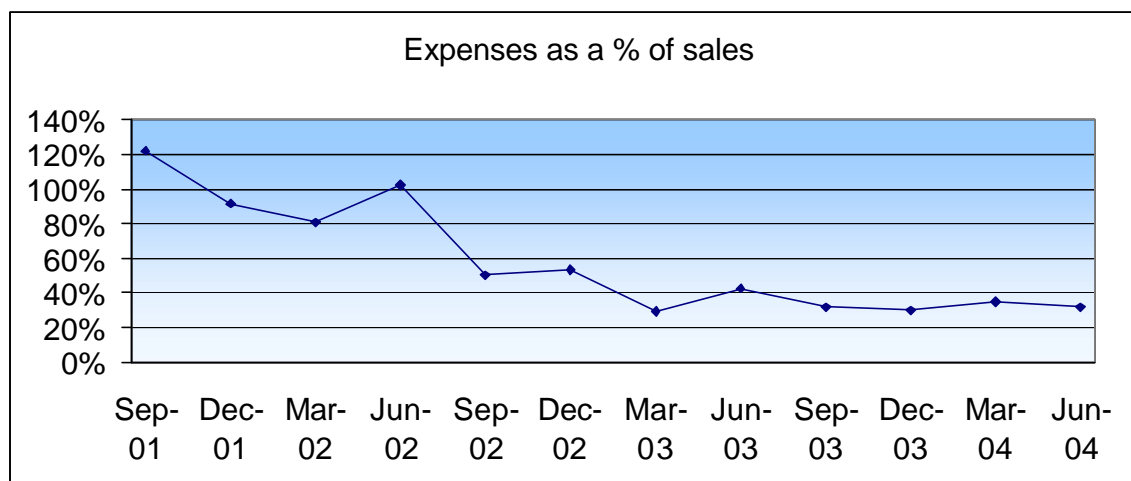
Section 1.3 Selected Financial Information - Annual

Below is a summary of certain selected financial information from the audited consolidated financial statements for the years ending June 30, 2004, 2003 and 2002:

	For the years ending June 30		
	2002	2003	2004
(a) Net Sales	\$ 16,033,453	\$ 20,596,215	\$ 19,445,105
(b) Income (loss) before discontinued operations and extraordinary items	(8,797,545)	(2,739,753)	(652,692)
and per share, basic and diluted	(0.11)	(0.03)	(0.01)
(c) Net income (loss)	(20,022,397)	(2,739,753)	(652,692)
and per share, basic and diluted	(0.12)	(0.03)	(0.01)
(d) Total assets	16,373,003	7,877,312	11,012,020
(e) Total long-term financial liabilities	242,640	30,016	22,563
(f) Cash Dividends declared per share	N/A	N/A	N/A

Revenue decreased by \$1,151,110 or 5.6% in 2004 over the 2003 fiscal year. In 2003 the company recognized as revenue invoiced amounts related to the Books are Fun project that were deferred in 2002. The invoiced amounts were recognized as revenue in the 2003 fiscal year as the company completed all of its contractual obligations.

From the 2002 fiscal year to the 2004 fiscal year the Company has seen a significant drop in the expenses in relation to revenue and improved cash flow from operations. During this period the loss from operations has dropped from 55% of revenue in the 2002 fiscal year to 3% of revenue in the 2004 fiscal year.



Finally, the cash required to fund operations has declined significantly as illustrated in the following table.

	2002	2003	2004
Cash flow from operations before non cash working capital items	(4,283,834)	(2,658,769)	(554,468)
Loss before discontinued operations	(8,797,545)	(2,739,753)	(652,692)
Amortization	5,357,730	440,300	329,760
Loss, net of amortization	(3,439,815)	(2,299,453)	(322,932)

Section 1.5 Summary of Quarterly Results

Below is a summary of certain selected unaudited financial information from the Consolidated Statements of Operations for the most recent eight fiscal quarters comprising the Company's preceding two years:

	Q3 2003 Mar 03	Q4 2003 Jun 03	Q1 2004 Sept 03	Q2 2004 Dec 03	Q3 2004 Mar 04	Q4 2004 Jun 04	Q1 2005 Sept 04	Q2 2005 Dec 04
Revenue	7,710,548	4,295,177	5,225,720	5,039,522	4,467,967	4,711,896	3,811,909	2,865,311
Cost of Sales	5,587,276	3,246,014	3,404,280	3,515,070	2,983,965	3,935,788	2,936,290	2,002,512
Gross Profit	2,123,272	1,049,163	1,821,440	1,524,452	1,484,002	776,108	875,619	862,799
Expenses:								
General and administrative	996,369	864,660	718,010	575,201	613,644	663,376	684,834	481,396
Research and Development	228,196	253,302	243,790	303,995	274,509	219,871	167,160	175,128
Selling and Marketing	951,570	481,479	635,663	643,046	674,112	591,687	592,409	639,560
Amortization	78,280	127,386	86,028	81,905	79,716	82,111	69,069	58,736
Other	(14,526)	95,276	(6,015)	(85,594)	(81,345)	(56,135)	3,198	3,198
Income taxes				1119			1,046	(35)
	2,239,889	1,822,103	1,677,476	1,519,672	1,560,636	1,500,910	1,517,716	1,357,983
Net Earnings (loss)	(116,617)	(772,940)	143,964	4,780	(76,634)	(724,802)	(642,097)	(495,184)
Per share, basic and diluted		(0.01)				(0.01)	(0.01)	(0.01)

The Company's revenues and earnings fluctuate from quarter to quarter. A number of factors can cause such fluctuations, including the timing of substantial orders, the timing of releases of new products, timing of the deployment of solutions and delays by customers. Because the Company's operating expenses are determined based on anticipated sales, are generally fixed and are incurred throughout each fiscal quarter, any of the factors listed above can cause significant variations in the Company's revenues and earnings in any given quarter. Thus, the Company's quarterly results are not necessarily indicative of the Company's overall business, results of operations and financial condition.

Foreign exchange rates for the U.S. dollar had a significant impact on operations as the Canadian dollar strengthened. The closing rate was 1.2062 at December 31, 2004 compared to 1.3404 at June 30, 2004. While the closing rate at June 30, 2004 of 1.3404

did not change significantly from the rate at June 30, 2003 of 1.3475 this was significantly down from the rate of 1.5162 at June 30, 2002. The average rate for the three months ended December 31, 2004 was 1.2207 compared to 1.3071 for the three months ended September 30, 2004. The average rate for fiscal 2004 was 1.3433 compared to 1.5129 for fiscal 2003. A significant change in the rates has an impact on the Company's financial statements as most of the company's operations are in the U.S., which operates its business in U.S. dollars and are translated into Canadian dollars at the prevailing rate.

During the 2004 fiscal year the company elected to prospectively adopt the Canadian Institute of Chartered Accountants Handbook Section 3870, Stock-Based Compensation and Other Stock-Based Payments recommendation relating to stock options granted to employees subsequent to June 30, 2003. The recommendations relating to stock-based payments to non-employees were adopted effective July 1, 2003. The standard requires the recognition of stock-based compensation expense for all employee and non-employee stock-based compensation transactions using a fair value based method. The adoption of this accounting policy resulted in the recognition of \$31,284 in compensation expense and additional contributed surplus for the year ended June 30, 2004 for stock options granted to employees.

In the 2003 fiscal year the Company adopted CICA Handbook Section 3062, Goodwill and Other Intangible Assets issued in August, 2001. The company was required to assess whether the intangible assets previously identified as part of the acquisition of the U.S. operations met the new definition of intangible assets. In performing this assessment, the company determined that the acquired workforce and developed technology no longer met the criteria of an intangible asset. As such, the company reclassified a net balance of \$2,222,498 from intangible assets to goodwill.

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.