
Versatile Systems Inc.
Management Discussion and Analysis
Six months ended December 31, 2005

The following management's discussion and analysis of the consolidated results of operations and financial condition of Versatile Systems Inc. (the "Company" or "Versatile") on the unaudited consolidated financial statements and notes for the six months ended December 31, 2005 is made as of January 19, 2006 and should be read in conjunction with the audited consolidated financial statements and notes for the year ended June 30, 2005. 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.

Forward-Looking Statements

This document may contain forward-looking statements relating to Versatile's operations or to the environment in which it operates, which are based on Versatile's 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's 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 disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

EBITDA

EBITDA is defined by the Company as net earnings before interest expense, income taxes, depreciation and amortization. The Company has included information concerning EBITDA because it believes that it may be used by certain investors as one measure of the Company's financial performance. EBITDA is not a measure of financial performance under Canadian GAAP and is not necessarily comparable to similarly titled measures

used by other companies. EBITDA should not be construed as an alternative to operating income or to cash flows from operating activities (as determined in accordance with Canadian GAAP) as a measure of liquidity.

Overview

The Company's core business is developing solutions that solve customer's problems in the storage, security, transmission and collection of mission critical data. The Company's proprietary software applications, the Mobiquity™ Solution Suite, are a key component of this solution. This enables companies to improve the sales, marketing and distribution of their products. The Company delivers wireless/wired solutions to the consumer packaged goods, retail, financial, pharmaceutical, healthcare, and logistics verticals through an integrated combination of licensed software, professional services, and the re-sale of mobile-computing devices and related hardware. The Company also offers maintenance and support via a 24 hour call centre.

Acquisition of the Perfect Order business

In the fourth quarter of the 2005 fiscal year the Company acquired all of the issued and outstanding shares of two privately held companies Perfect Order, Inc. and Perfect Order Manufacturing, Inc. (collectively "Perfect Order"), which were under common control (the "Acquisition"). Perfect Order is based in Mechanicsburg, Pennsylvania. The transaction was conducted through the company's newly incorporated subsidiary, Versatile Acquisition Corporation, formerly Perfect Order Acquisition Corporation ("VAC") and for accounting purposes, are included in the consolidated financial statements from April 26, 2005.

On closing, the company paid the vendors cash consideration of \$2,488,000 (U.S. \$2,000,000), issued unsecured promissory notes to pay \$1,244,000 (U.S. \$1,000,000), which at the time were due on June 30, 2005 (the "VAC Notes"), issued secured promissory notes to pay \$5,244,800 (U.S. \$4,200,000) on April 25, 2006 (the "Promissory Notes") and agreed to make four quarterly payments of \$85,525 (U.S. \$68,750) on June 10, 2005, September 10, 2005, December 10, 2005 and March 10, 2006. The quarterly payments for June, September and December have been paid as well as all of the VAC Notes.

The Promissory Notes bear interest at the rate of 3.1% per annum and the Vendors may convert up to one-half of their Promissory Notes on or before February 25, 2006, into shares of Versatile at the rate of one common share for each \$0.425 (U.S. \$0.34) of the Promissory Note. In addition, the company issued 750,000 Common Share purchase warrants to the Vendors on the closing. One Warrant entitles the holder thereof to purchase one common share at \$0.345 per share on or before April 25, 2007.

Highlights for the quarter

Highlights of the Company's operations for the second quarter included:

- Revenue of \$17,765,850 a record for the Company and up 620% over the same period last year.
- Net earnings of \$754,444, or \$0.01 per share, compared to a Net loss of \$495,184 over the same period last year.
- EBITDA for the quarter was \$233,349 compared to an EBITDA for the previous quarter of \$622 and an EBITDA loss of \$435,689 for the same quarter last year
- Cash generated from operations for the quarter amounted to \$186,964 compared to a deficiency of \$433,250 for the same quarter last year.
- General and administrative and Selling and marketing expenses, as a percentage of sales, are at the lowest levels in the history of the Company
- Deferred revenue is at an all time high of \$7,336,915. Of that, \$6,706,221, together with the associated costs in deferred contract costs, are expected to be realized over the next four quarters.
- Partnering with Team Rahal Solutions to launch *Versatile AutoStore™*
- Becoming a certified partner of Computer Associates.

Highlights for the first half of the 2006 fiscal year

Highlights of the Company's operations for the six months ended December 31, 2005 included:

- Revenue of \$34,549,159 for the period compared to \$6,677,220 an increase of 517% over the same period last year
- Net earnings of \$713,401 for the period compared to a Net loss of \$1,137,281 for the same period last year
- Working capital has increased by \$901,318 from the June 30, 2005 year-end.
- Launch of *Mobiquity Transaction Engine 3.0™* and setup of demonstration/validation lab to show the correlation of disparate data feeds from the following:
 - RFID
 - Identity management system
 - Security systems
 - Digital video
 - Financial transactions

to increase business intelligence by leveraging the customer's existing IT infrastructure, which currently collects data from multiple business processes. By way of example, the *Mobiquity Transaction Engine 3.0™* enables the integration of RFID and Video Surveillance to provide real time monitoring of physical asset movement.

- Substantially completed the product integration and the rebranding of the Company and its products

- Being named one of Canada's fastest growing technology companies in the 2005 Deloitte Canadian Technology Fast 50 Program.
- The launch of a new website www.versatile.com

Review of operations

Revenue for the six months ended December 31, 2005 was \$34,549,159 compared to \$6,677,220 for the same period last year, an increase of 517%.

Net earnings for the six months ended December 31, 2005 was \$713,401, or \$0.01 per share, compared to a Net Loss of \$1,137,281 (\$0.01 per share) for the comparable Period last year. The Net Earnings include a future income tax benefit of \$1,445,346, as well as non-cash expenses related to a stock based compensation charge, amortization of capital assets and amortization of intangible assets for the quarter of \$818,252 compared to non-cash expenses of \$134,201 for the same period last year.

During the first six months of this year the Company incurred costs of approximately \$150,000 relating to integration, branding, new website and other transitional costs.

The EBITDA for the first six months was \$234,011 compared to an EBITDA loss of \$1,006,814 for the same period last year.

Cost of sales for the six month period ended December 31, 2005 was \$27,689,673 yielding a gross margin of 19.9% compared to \$4,938,802 yielding a gross margin of 26.0% in the same period last year.

Technology Investment

Over the past five years the Company has invested in excess of \$10 million in the form of expense to advance the abilities of its technology and resulting service offering. This investment does not contribute directly to revenues during the period that the research and development expenses are incurred.

Research and development expense for the six months ended December 31, 2005 amounted to \$959,658 compared to \$342,288 for the same period last year. As a percentage of sales the research and development expenses are 2.8% in the period compared to 5.1% in the same period last year. The significant expense item in this category is salary and benefit costs.

During the six months ended December 31, 2005 the Company had many new product initiatives, along with feature improvements to current product lines including:

- Enhancements to the *Mobiquity Reporting Engine™* to deliver audit and logging functionality to cover security requirements.
- Creation of additional Adapters for the *Mobiquity Transaction Engine 3.0™* to integrate technologies such as device automation leveraging X10, IP based video to the H.323 standard and ISO 7811 Magnetic Stripe Card Readers.

- Continued development, testing and qualification of the *Versatile Port™*.
- Launch of *Mobiquity Transaction Engine 3.0™* and setup of demonstration/validation lab to show the correlation of disparate data feeds from the following:
 - RFID
 - Identity management system
 - Security systems
 - Digital video
 - Financial transactions

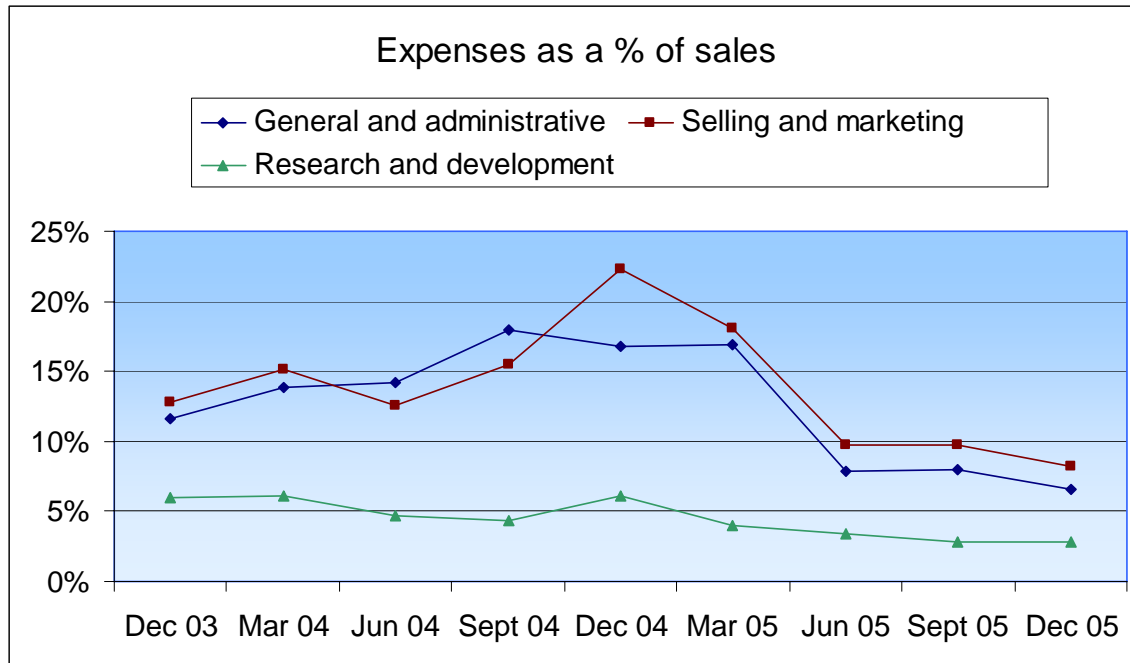
to increase business intelligence by leveraging the customer's existing IT infrastructure, which currently collects data from multiple business processes. By way of example, the *Mobiquity Transaction Engine 3.0™* enables the integration of RFID and Video Surveillance to provide real time monitoring of physical asset movement.

- Partnering with two major wireless technology providers to deliver consumer access to Broadband over Power Line (BPL) by leveraging wireless technologies the last mile capability for residential access to WiFi.
- The transition of its PHP portal solution to a JAVA platform, consolidating technology for the Versatile AutoStore and Versatile Retail solutions.

General and administrative costs were \$2,501,121 for the six-month period ended December 31, 2005 compared to \$1,164,579 for the same period last year. As a percentage of sales the general and administrative expenses are 7.2% in the period compared to 17.4% in the same period last year.

Selling and marketing costs for the six-month period ended December 31, 2005 amounted to \$3,092,336 compared to \$1,231,969 for the same period last year. As a percentage of sales the selling and marketing expenses are 9.0% in the period compared to 18.5% in the same period last year. The increase from last year is attributable to higher salaries, commissions, advertising and promotion costs. Selling and marketing expenses over the next year have been budgeted to continue at the current levels to support new sales initiatives with the expanded customer base resulting from the acquisition of Perfect Order.

As a percentage of sales, the general and administrative, selling and marketing and research and development expenditures are at their lowest levels since the Company's inception.



Summary of Quarterly Results

The table below provides 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 2004 Mar 04	Q4 2004 Jun 04	Q1 2005 Sept 04	Q2 2005 Dec 04	Q3 2005 Mar 05	Q4 2005 Jun 05	Q1 2006 Sept 05	Q2 2006 Dec 05
Revenue	4,467,967	4,711,896	3,811,909	2,865,311	3,232,765	16,214,945	16,783,309	17,765,850
Cost of Sales	2,983,965	3,935,788	2,936,290	2,002,512	2,402,800	12,358,507	13,320,024	14,369,649
Gross Profit	1,484,002	776,108	875,619	862,799	829,965	3,856,438	3,463,285	3,396,201
Expenses:								
General and administrative	621,012	671,429	683,977	480,602	543,958	1,266,114	1,329,984	1,171,137
Research and Development	274,509	219,871	167,160	175,128	129,403	553,486	467,040	492,618
Selling and Marketing	674,112	591,687	592,409	639,560	586,250	1,576,352	1,631,190	1,461,146
	1,471,993	1,417,894	1,443,546	1,295,290	1,259,611	3,395,952	3,428,214	3,124,901
Net (earnings) loss before other items	12,009	(641,786)	(567,927)	(432,491)	(429,646)	460,486	35,071	271,300
Amortization	79,716	58,257	69,069	58,736	31,105	228,996	391,566	354,326
Interest	957	905	857	794	730	127,148	132,513	71,161
Stock based compensation	7,970	23,854	3,198	3,198	3,199	128,367	34,409	37,951
Income taxes	-	-	1,046	(35)	(10)	(1)	(482,374)	(946,582)
Net Earnings (loss)	(76,634)	(724,802)	(642,097)	(495,184)	(464,670)	(24,024)	(41,043)	754,444
Per share, basic and diluted	(0.00)	(0.01)	(0.01)	(0.01)	(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.

Second Quarter results

Revenue for the three months ended December 31, 2005 was \$17,765,850 compared to \$2,865,311 for the same quarter last year, an increase of 620%.

Net Earnings for the quarter was \$754,444 or \$0.01 per share compared to a Net Loss of \$495,184 or (\$0.01) per share in the same quarter last year. The Net Earnings includes a future income tax benefit of \$959,757, as well as non-cash expenses related to stock based compensation, amortization of capital assets and intangible assets of \$392,277 compared to non-cash charges of \$61,934 for the same quarter last year.

The EBITDA for the quarter was \$233,349 compared to an EBITDA of \$662 for the previous quarter and an EBITDA loss of \$435,689 for the same quarter last year.

Cost of sales for the quarter was \$14,369,649 yielding a gross margin of 19.1% as compared to \$2,002,512 or a gross margin of 30.1% 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 \$1,171,137 for the quarter compared to \$480,602 for the same quarter last year. As a percentage of sales the general and administrative expenses are 6.6% in the quarter compared to 16.8% in the same quarter last year.

Research and development costs were \$492,618 for the quarter as compared to \$175,128 for the same quarter last year. As a percentage of sales the research and development expenses are 2.8% in the quarter compared to 6.1% in the same quarter last year.

Selling and marketing costs for the quarter were \$1,461,146 compared to \$639,560 for the same quarter last year. As a percentage of sales the selling and marketing expenses are 8.2% in the quarter compared to 22.3% in the same quarter last year. The increase from last year is attributable to higher salaries, commissions, advertising and promotion costs. Selling and marketing expenses over the next year have been budgeted to continue at the current levels to support new sales initiatives with the expanded customer base resulting from the acquisition of Perfect Order.

The amortization of capital assets and intangible assets for the quarter amounted to \$354,326 (December 31, 2004 - \$58,736), including amortization for the customers and purchased technology arising from the acquisition of Perfect Order. The amount of amortization expected to be recorded over the next five years, relating to the customers and purchased technology arising from the acquisition of Perfect Order is significant:

<u>Fiscal Year</u>	<u>Amortization expense</u>
2006	\$907,609
2007	\$907,609
2008	\$826,717
2009	\$422,253
2010	\$351,878

Future Income Tax Asset

Canadian GAAP requires a valuation allowance to be recorded against any future tax asset to the extent that it is *more likely than not* that the future income tax asset will not be realized. This is also the Company's stated accounting policy.

Historically, the Company has determined that it has not met this test so the Company has recorded a full valuation allowance against the potential value of all of its tax losses and deductions available to be taken against future years' income tax returns. As a result there has been no future income tax asset.

During the current fiscal year, the Company has determined that the U.S. subsidiaries are generating sufficient profits that it is *more likely than not* that a portion of the losses and deductions attributable to these U.S. subsidiaries will be used. Consequently, Canadian GAAP and the Company's stated policy requires that the valuation allowance be reduced accordingly. The difference between the total value of these tax benefits less the valuation allowance is the amount of the future income tax asset that is recorded by the Company.

During the quarter the Company recorded a \$959,757 non-cash income tax benefit related to the recognition of future income tax assets of its U.S. subsidiaries. In the first quarter the Company recorded a future income tax benefit of \$484,589.

Financial position

As at December 31, 2005 the Company had cash and cash equivalents of \$122,372, a decrease of \$61,226 over the balance at June 30, 2005, and the Company had an unused credit line of \$3,536,645 (U.S. \$2,982,844). The working capital deficiency at December 31, 2005 was \$8,492,034 an improvement of \$901,318 over the working capital deficiency of \$9,393,352 at June 30, 2005. This working capital deficiency includes the Promissory Notes due to the Vendors, relating to the acquisition of the Perfect Order business, of \$4,896,780 (U.S. \$4,200,000), which are due on or before April 25, 2006 and the Bank Term Loan of \$3,205,366 (U.S. \$2,749,263).

During the quarter the Company repaid Promissory Notes amounting to \$774,067 (U.S. \$666,667), which were due on November 30, 2005. The ability of the Company to continue operations on an ongoing basis will be dependent on its ability to continue to

generate sales at these levels, maintain profitable operations, maintain or increase margins, control operating expenses and pay its obligations as they become due.

At December 31, 2005 the Bank term loan amounted to \$3,205,366 (U.S. \$2,749,263). The term loan is repayable on April 26, 2006, bears interest at the State of New York prime rate plus 1% and is secured with a first charge on the Company's assets. Monthly repayments consist of interest only with the principal due at the end of the term.

The line of credit bears interest at the State of New York prime rate of lending and is secured with a first charge on the company's assets. As at December 31, 2005 the Company had used the line of credit for \$20,002 (U.S. \$17,156) compared to \$376,259 (U.S. \$307,000) at June 30, 2005 and had a bank overdraft of \$829,084 (June 30, 2005 - \$144,367).

At December 31, 2005 the Company had deferred revenue of \$7,336,915. The deferred revenue relates to service, support and maintenance contracts for periods ranging up to 36 months. The majority of the deferred revenue of \$6,706,221 is expected to be realized over the next four quarters. The associated costs relating to these service, support and maintenance contracts have been recorded as Deferred contract costs.

Share Capital

On August 10, 2005, the Company completed a non-brokered private placement for 1,646,000 Units at a price of \$0.25 per Unit for gross proceeds of \$411,500. Each Unit consisted of one common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to purchase one common share of the Company for a period of twenty-four months after the Closing Date at a price of \$0.30 per common share. The Company assigned a value of \$0.21 to each common share and \$0.04 to each warrant. The common shares and warrants are subject to a four-month hold period.

On August 19, 2005 Computershare Trust Company of Canada released the 690,000 common shares, held in trust for employees of VMS-Europe pursuant to a trust agreement dated in 1993, to the transfer agent who subsequently cancelled these shares, the effect of which reduces the issued common shares.

Stock Options

During the first quarter the Company granted employees, incentive stock options to acquire a total of 600,000 common shares of the Company. These incentive stock options have a vesting period ranging from 4 months to 28 months, and are exercisable for a period of up to 4 years with an exercise price of \$ 0.30 per share.

During the second quarter the Company granted employees, incentive stock options to acquire a total of 1,102,300 common shares of the Company. These incentive stock

options have a vesting period ranging from 4 months to one year, and are exercisable for a period of up to 4 years with an exercise price of \$0.25 per share.

	Number of options	Weighted average exercise price
Outstanding – June 30, 2005	7,271,668	0.21
Granted in the first quarter	600,000	0.30
Granted in the second quarter	1,102,300	0.25
Expired in the second quarter	<u>(850,000)</u>	0.10
Outstanding – December 31, 2005	<u>8,123,968</u>	0.23

Warrants:

During the first quarter 4,111,110 warrants expired, 1,646,000 warrants were issued and none were exercised. No warrants were issued, exercised or expired during the second quarter. The details of the outstanding warrants at December 31, 2005 are as follows:

Expiry date	Exercise Price	Number of Warrants	Amount
April 22, 2007	\$ 0.35	5,135,413	\$ 256,771
April 25, 2007	\$ 0.345	750,000	37,500
August 10, 2007	\$ 0.30	<u>1,646,000</u>	<u>65,840</u>
Balance - December 31, 2005		<u>7,531,413</u>	<u>\$ 360,111</u>

New Accounting Policies

In June 2003, the CICA issued Accounting Guideline 15, “Consolidation of Variable Interest Entities” (AsG 15), which clarifies the application of consolidation principles to certain entities that are subject to control on a basis other than ownership of voting interests.

The guideline which came into effect on November 1, 2004 has had no impact on the consolidated financial statements of the company.

Foreign Exchange

Foreign exchange rates for the U.S. dollar continued to fluctuate with the strengthening of the Canadian dollar in relation to the U.S. dollar. The closing rate at December 31, 2005 was 1.1659 and the average rate for the six months ended December 31, 2005 was 1.1873 compared to the closing rate at June 30, 2005 of 1.2256 (2004 - 1.3404) and the average rate for fiscal 2005 was 1.2497 (2004 - 1.3433). 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. The effect of this change in the average rate is that the sales, cost of sales and expenses are translated at a rate that is 5% less for the first six months of the 2006 fiscal year compared to the 2005 fiscal year.

Related Party Transactions

During the quarter, the Company paid consulting fees and salaries of \$182,061 (December 31, 2004 - \$201,859) to Directors and Officers of the Company.

On August 10, 2005 the Company closed a non-brokered private placement for gross proceeds of \$411,500. One of the officers of the Company participated in this placement subscribing for 1,000,000 Units at a price of \$0.25 per Unit. Each Unit consisted of one common share and one common share purchase warrant.

Management Changes

There were no management changes during the quarter.

Investor relations

During the quarter Equicom was engaged at a total cost of \$19,500 (December 31, 2004 – \$19,500).

Risk Factors

The securities of the Company should be considered a highly speculative investment and investors should carefully consider all of the information disclosed in this Management Discussion & Analysis prior to making an investment in the Company. In addition to the other information presented in this Management Discussion & Analysis, the following risk factors should be given special consideration when evaluating an investment in the Company's securities.

Operating History

The Company's predecessor company commenced operations in March 1987 to distribute and sell Maximizer products in European countries, as well as provide consulting services and CRM solutions to companies. In January 1997, the Company changed its focus to research and development of CRM software. The Company purchased Versatile U.S. on June 19, 2000 and Perfect Order, Inc. and Perfect Order Manufacturing, Inc. on April 26, 2005. The Company has a limited operating history as a merged entity, and faces many of the risks and uncertainties encountered by early-stage companies in rapidly evolving markets.

History of Losses

The Company has a history of losses and may incur losses in the future, and its losses may increase because of the Company's plan to increase operating expenses.

The Company has incurred net losses in each fiscal year since inception. For the year ended June 30, 2005, the Company had a net loss of approximately \$1.6 million and, at June 30, 2005, the Company had an accumulated deficit of \$54.7 million. Although the Company has reported net earnings and decreased its operating expenses in recent periods, the Company will need to maintain or generate greater revenues than it has to date to achieve in order to be profitable. The Company cannot be assured that revenues will increase. The Company's business strategies may not be successful and the Company may not be profitable in any future period.

The Company's operating results have varied in the past, and they may continue to fluctuate in the future. In addition, the Company's operating results may not follow any past trends.

No Certainty of Future Profitability

The Company's product revenues are not predictable with any significant degree of certainty and future product revenues may differ from historical patterns. If customers cancel or delay orders, it can have a material adverse impact on the Company's revenues and results of operations from quarter to quarter. Because the Company's results of operations may fluctuate from quarter to quarter, investors should not assume that results of operations in future periods can be predicted based on results of operations in past periods.

Even though the Company's revenues are difficult to predict, the Company's expense levels are based in part on future revenue projections. Many of the Company's expenses are fixed and, accordingly, the Company cannot quickly reduce spending if revenues are lower than expected. This could result in significantly lower income or greater loss for any given period.

Competitive Market

The market for the Company's software is intensely competitive, fragmented and rapidly changing. Some of the Company's actual and potential competitors are larger, established companies that have greater technical, financial and marketing resources. In addition, as the Company develops new products, particularly applications focused on electronic commerce or specific industries, it may begin competing with companies with whom it has not previously competed. It is also possible that new competitors will enter the market or that the Company's competitors will form alliances that may enable them to rapidly increase their market share.

Increased competition may result in price reductions, lower gross margins or loss of the Company's market share, any of which could materially adversely affect its business, financial condition and operating results.

Technological Change

The market for the Company's solutions is characterized by rapidly changing technology and evolving industry standards. The market is affected by changes in end user requirements and frequent new product introductions and enhancements. The Company's products embody complex technology and may not always be compatible with current and evolving technical standards and products, developed by others. Failure or delays by the Company to meet or comply with the requisite and evolving industry or user standards could have a material adverse effect on the Company's business, results of operations and financial condition. The Company's ability to anticipate changes in technology, technical standards and product offerings will be a significant factor in the Company's ability to compete. There can be no assurance that the Company will be successful in identifying, developing, manufacturing and marketing products that will respond to technological change, evolving standards or individual wireless communications service provider standards or requirements. The Company's business will be adversely affected if the Company incurs delays in developing new products or enhancements or if such products or enhancements do not gain market acceptance. In addition, there can be no assurance that products or technologies developed by others will not render the Company's products or technologies non-competitive or obsolete.

Limited Sales and Support Infrastructure

The Company's future revenue growth will depend in large part on its ability to successfully expand its direct sales force and its customer support capability. The Company may not be able to successfully manage the expansion of these functions or to recruit and train additional direct sales, consulting and customer support personnel.

If the Company is unable to hire and retain additional highly skilled direct sales personnel, it may not be able to increase its licence revenue to the extent necessary to achieve profitability. If the Company is unable to hire highly trained consulting and customer support personnel, it may be unable to meet customer demands. The Company is unlikely to be able to increase its revenues as planned if it fails to expand its direct sales force or its consulting and customer support staff. Even if the Company is successful in expanding its direct sales force and customer support capability, the expansion may not result in revenue growth.

Dependence on Business Alliances

A key element of the Company's business strategy is the formation of corporate alliances with leading companies. The Company is currently investing and plans to continue to invest significant resources to develop these relationships. The Company believes that its success in penetrating new markets for its products will depend in part on its ability to

maintain these relationships and to cultivate additional or alternative relationships. There can be no assurance that the Company will be able to develop additional corporate alliances with such companies, that existing relationships will continue or be successful in achieving their purposes or that such companies will not form competing arrangements.

Dependence on Key Personnel

The Company's success depends largely upon the continued service of its executive officers and other key management, sales and marketing and technical personnel. The loss of the services of one or more of the Company's executive officers or other key employees could have a material adverse effect on its business, results of operations or financial condition.

The Company's future success also depends on its ability to attract and retain highly qualified personnel. The competition for qualified personnel in the computer software and Internet markets is intense, and the Company may be unable to attract or retain highly qualified personnel in the future. In addition, due to intense competition for qualified employees, it may be necessary for the Company to increase the level of compensation paid to existing and new employees to the degree that operating expenses could be materially increased.

Management of Growth

The Company expects to experience a period of significant growth in the number of personnel that will place a strain upon its management systems and resources. The Company's future will depend in part on the ability of its officers and other key employees to implement and improve its financial and management controls, reporting systems and procedures on a timely basis and to expand, train and manage its employee workforce. There can be no assurance that the Company will be able to effectively manage such growth. The Company's failure to do so could have a material adverse effect upon the Company's business, prospects, results of operation and financial condition.

Integration of Newly Acquired Businesses or Technology

The Company may expand its operations through acquisitions of additional businesses or technology. There can be no assurance that the Company will be able to identify, acquire or profitably manage additional businesses or technology or successfully integrate acquired businesses or technology into the Company without substantial expense, delay or other operational or financial problems. Further, acquisitions may involve a number of additional risks, including diversion of management's attention, failure to retain key acquired personnel, unanticipated events or circumstances, legal liabilities and amortization of acquired intangible assets, some or all of which could have a material adverse effect on the Company's business, financial condition and results of operation. In addition, there can be no assurance that acquired businesses, if any, will achieve

anticipated revenues and earnings. The failure of the Company to manage its acquisition strategy successfully could have a material adverse effect on the Company's business, financial condition and results of operation.

Potential Fluctuations in Quarterly Financial Results

The Company's quarterly financial results may be affected by the timing of new releases of its products and/or substantial customer orders. The Company's operating expenses are based on anticipated revenue levels in the short term, are relatively fixed, and are incurred throughout the quarter. As a result, if expected revenues are not realized on a timely basis as anticipated, the Company's financial results could be materially and adversely affected. These or other factors, including possible delays in the shipment of new products, may influence quarterly financial results in the future. Accordingly, there may be significant variation in the Company's quarterly financial results.

International Sales

Sales outside of the United States currently represent less than 10% of the Company's total gross revenues. The Company believes that its continued growth and profitability will require additional expansion of its sales in international markets. To the extent that the Company is unable to expand international sales in a timely and cost effective manner, the Company's business, results of operations and financial condition could be materially and adversely affected. In addition, even with the successful recruitment of additional personnel and international resellers, there can be no assurance that the Company will be successful in maintaining or increasing international market demand for the Company's products.

Currency Exchange Rate Risk

The Company's results are reported in Canadian dollars. A substantial portion of the Company's revenues and a material portion of its expenses are denominated in US dollars. Any fluctuations in the value of the Canadian dollar relative to the US dollar may result in variations in the sales and earnings of the Company expressed in Canadian dollars as a result of the geographic mix of the Company's customers, and may have a material effect on the Company's business, results of operations and financial condition.

Dependence on Proprietary Technology and Limited Patent and Trademark Protection

The Company relies on a combination of copyright and trademark laws, trade secret, confidentiality procedures and contractual provisions to protect its proprietary rights. The Company has yet to file any applications for patent protection and has not registered any trademarks or copyrights. Unauthorized parties may attempt to copy aspects of the Company's products or obtain and use information that the Company regards as proprietary. Policing unauthorized use of the Company's product is difficult, time-consuming and costly as is the pursuing of patents in each jurisdiction in which the Company carries on business. Although the Company is unable to determine the extent

to which piracy of its software product exists, software piracy is a possibility. In addition, the laws of certain countries in which the Company's products may be licensed do not protect its product and intellectual property rights to the same extent as the laws do in Canada or the United States. There is no assurance that the Company's means of protecting its proprietary rights will be adequate or the Company's competitors will not independently develop similar technology, the effect of either of which may be materially adverse to the Company's business, results of operations and financial condition.

Risk of Third Party Claims for Infringement

The Company is not aware that its product infringes the proprietary rights of third parties. There can be no assurance, however, that third parties will not claim such infringement by the Company or its licensees with respect to current or future products. The Company expects that software product developers will increasingly be subject to such claims as the number of products and competitors in the Company's industry segment grows and the functionality of products in different industry segments overlaps. Any such claims, with or without merit, could be time-consuming, result in costly litigation, cause product shipment delays or require the Company to enter into royalty or licensing agreements which, if required, may not be available on terms acceptable to the Company. Any of the foregoing could have a materially adverse effect on the Company's business, results of operations and financial condition.

Lengthy Sales and Implementation Cycle

The adoption of the Company's product generally involves a significant commitment of resources by potential customers. As a result, the Company's sales process is often subject to delays associated with lengthy approval processes by potential customers. For these and other reasons, the sales cycle associated with the license of the Company's product varies substantially from customer to customer and typically lasts between 6 to 12 months during which time the Company may devote significant time and resources to a prospective customer, including costs associated with multiple site visits, product demonstrations and feasibility studies, and experience a number of significant delays over which the Company has no control. Any significant or ongoing failure by the Company to ultimately achieve such sales could have a material adverse effect on the Company's business, results of operations and financial condition. In addition, following license sales, the implementation period is expected to involve a time period for customer training and integration with the customer's existing systems. A successful implementation program requires a close working relationship between the Company, the customer and, generally, third party consultants and system integrators who assist in the process. There can be no assurance that delays or difficulties in the implementation process for any given customer will not have a material adverse effect on the Company's business, results of operations and financial condition.

Risk of System Defects

System development involves the integration of the Company's proprietary software and software of others into the customer's operating systems. There can be no assurance that defects and errors will not be found in the Company's product when integrated with other products or systems. Any such defects and errors could result in adverse customer reactions, negative publicity regarding the Company and its product or damages. Consequently, there could be a material adverse effect on the Company's business, results of operations and financial condition.

Requirements for New Capital

As a growing business, the Company typically needs more capital than it has available to it or can expect to generate through the sale of its products. In the past, the Company has had to raise, by way of debt and equity financing, considerable funds to meet its capital needs. There is no guarantee that the Company will be able to continue to raise funds needed for its business. Failure to raise the necessary funds in a timely fashion will limit the Company's growth.

Critical Accounting Estimates

General

Unless otherwise specified in the discussion of the specific critical accounting estimates, the Company is not aware of trends, commitments, events, or uncertainties that it reasonably expects to materially affect the methodology or assumptions associated with the critical accounting estimates, subject to the circumstances identified above.

Changes are made to assumptions underlying all critical accounting estimates to reflect current economic conditions and updating of historical information used to develop the assumptions, where applicable. Unless otherwise specified in the discussion of the specific critical accounting estimates, it is expected that no material changes in overall financial performance and financial statement line items would arise either from reasonably likely changes in material assumptions underlying the estimate or within a valid range of estimates, from which the recorded estimate was selected.

All critical accounting estimates are uncertain at the time of making the estimate.

Accounts Receivable

Allowance for doubtful accounts

The Company considers the business area that gives rise to the accounts receivable, maintains procedures for granting credit terms on sales transactions and performs specific account identification when determining its allowance for doubtful accounts. This accounting estimate is in respect of the accounts receivable line item on the Company's

consolidated balance sheet comprising approximately 36% of total assets as at December 31, 2005. In the event the future results were to adversely differ from management's best estimate of the allowance for doubtful accounts, the Company could experience a bad debt charge in the future. Such a bad debt charge would not result in a cash outflow.

The estimate of the Company's allowance for doubtful accounts could materially change from period to period due to the allowance being a function of the balance and composition of accounts receivable, which can vary on a month-to-month basis. The variance in the balance of accounts receivable can arise from a variance in the amount and composition of operating revenues and from variances in accounts receivable collection performance.

Inventories

Provision for inventory obsolescence

The Company determines its provision for inventory obsolescence based upon historical experience, expected inventory turnover, inventory aging and current condition, and current and future expectations with respect to product offerings.

Assumptions underlying the provision for inventory obsolescence include the activity levels over previous fiscal years, and the expected inventory requirements and inventory composition necessary to support these future sales and offerings. The estimate of the Company's provision for inventory obsolescence could materially change from period to period due to changes in product offerings and consumer acceptance of those products.

This accounting estimate is in respect of the inventory line item on the Company's consolidated balance sheet comprising approximately 3% of total assets as at December 31, 2005. If the provision for inventory obsolescence was inadequate, the Company could experience a charge to direct cost of sales in the future. Such an inventory obsolescence charge would not result in a cash outflow.

Long-Lived Assets

The accounting estimates for long-lived assets that include capital assets, purchased technology, intellectual property, customer contracts and licenses, in aggregate, represent approximately 9% of the Company's total assets as at December 31, 2005, presented in its consolidated balance sheet. If the Company's estimated useful lives of assets were incorrect, the Company could experience increased or decreased charges for amortization in the future. If the future were to adversely differ from management's best estimate to recover the Company's investments in its long-lived assets, the Company could potentially experience future material impairment charges in respect of its long-lived assets.

Capital Assets

The estimated useful lives of capital assets are determined by a continuing program of asset life studies. The recoverability of capital assets is significantly impacted by the estimated useful lives. Assumptions underlying the estimated useful lives of capital assets include timing of technological obsolescence, competitive pressures and future infrastructure utilization plans. In the event management's best estimate of the useful lives of capital assets was adversely affected, the Company could potentially experience a charge to amortization expense in the future. Such a charge to amortization would not result in a cash outflow.

Purchased Technology

The recoverability of the Company's investment in purchased technology is determined by an ongoing analysis of the economic benefits attributed to the purchased technology. The Company estimates the future economic benefits attributed to the purchased technology and compares the results with the net book value of the asset. Assumptions underlying the estimated future economic benefits of purchased technology costs include future sales trends, product offerings, timing of technological obsolescence, competitive pressures and consumer acceptance of product offerings. If management's best estimate of the future economic benefits of purchased technology costs was adversely affected, the Company could potentially experience a charge to amortization expense in the future. Such a charge to amortization would not result in a cash outflow.

Customer Contracts

The recoverability of the Company's investment in customer contracts is determined by an ongoing analysis of the economic benefits attributed to the customer contracts in place at the date of the acquisition. The Company estimates the future economic benefits attributed to the customer contracts and compares the results with the net book value of the asset. Assumptions underlying the estimated future economic benefits of customer contracts include future sales trends, product offerings, timing of technological obsolescence, competitive pressures and consumer acceptance of product offerings. If management's best estimate of the future economic benefits of customer contracts was adversely affected, the Company could potentially experience a charge to amortization expense in the future. Such a charge to amortization would not result in a cash outflow.

Goodwill

The accounting estimates for goodwill represents approximately 32% of the Company's total assets as at December 31, 2005, presented in its consolidated balance sheet. If the Company's estimated fair value were incorrect, the Company could experience increased or decreased charges for changes to the estimated fair value in the future. If the future were to adversely differ from management's best estimate to recover the Company's investments in its goodwill, the Company could potentially experience future material impairment losses in respect of its goodwill. The impairment losses would be recognized

and presented as a separate line item in the consolidated statements of loss and deficit. Impairment losses to goodwill would not result in a cash outflow.

Evaluation and Effectiveness of Disclosure Controls and Procedures

The Company has established and maintains disclosure controls and procedures over financial reporting. The certifying officers have evaluated the effectiveness of the issuer's disclosure controls and procedures as of December 31, 2005 and have concluded that such procedures are adequate and effective to ensure accurate and complete disclosures in annual filings.

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

Section 1.3 Selected Financial Information - Annual

Below is a summary of certain selected financial information extracted from the audited consolidated financial statements for the years ending June 30, 2005, 2004 and 2003:

	2003	2004	2005
(a) Net Sales	\$ 20,596,215	\$ 19,445,105	\$ 26,124,930
(b) Income (loss) before discontinued operations and extraordinary items	\$ (2,739,753)	\$ (652,692)	\$ (1,625,975)
Income (loss) before discontinued operations and extraordinary items per share, basic and diluted	\$ (0.03)	\$ (0.01)	\$ (0.02)
(c) Net income (loss)	\$ (2,739,753)	\$ (652,692)	\$ (1,625,975)
Net income (loss) per share, basic and diluted	\$ (0.03)	\$ (0.01)	\$ (0.02)
(d) Total assets	\$ 7,877,312	\$ 11,012,020	\$ 36,948,401
(e) Total long-term financial liabilities	\$ 30,016	\$ 22,563	\$ 676,138
(f) Cash Dividends declared per share	N/A	N/A	N/A

Revenue increased by \$6,679,825 or 34.4% in 2005 over the 2004 fiscal year. The current year's increase related to the successful completion in the fourth quarter of a number of key initiatives.

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 2005 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 6% of revenue in the 2005 fiscal year.

Additional information relating to the Company can be found on the Canadian Securities Administrators System for Electronic Document Analysis and Retrieval (SEDAR), located at www.sedar.com