

Microforum Inc.

CONSOLIDATED FINANCIAL STATEMENTS February 28, 1998

May 22, 1998

AUDITORS' REPORT

***To the Shareholders of
Microforum Inc.***

We have audited the consolidated balance sheets of **Microforum Inc.** as at February 28, 1998 and 1997 and the consolidated statements of operations and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at February 28, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Chartered Accountants

MICROFORUM INC.**CONSOLIDATED BALANCE SHEETS**

| | February 28 | |
|---|---------------------|---------------------|
| | 1998 | 1997 |
| Assets | | |
| Current assets | | |
| Cash in bank | \$ 2,222,386 | \$ - |
| Accounts receivable | 1,238,883 | 1,063,491 |
| Income taxes receivable | - | 58,332 |
| Inventories | 129,222 | 500,224 |
| Due from officers (Note 4) | 530,666 | - |
| Assets of discontinued software and hardware operations (Note 3) | 300,000 | 3,766,715 |
| Current portion of note receivable on sale of Microforum Italia (Note 2) | 100,000 | - |
| Prepaid expenses and other assets | 37,734 | 73,664 |
| | 4,558,891 | 5,462,426 |
| Capital assets (Note 4) | 3,217,562 | 4,163,726 |
| Note receivable on sale of Microforum Italia s.r.l. (Note 2) | 100,000 | - |
| Assets of discontinued subsidiary - Microforum Italia s.r.l. (Note 2) | - | 370,557 |
| | \$ 7,876,453 | \$ 9,996,709 |
| Liabilities | | |
| Current liabilities | | |
| Bank indebtedness (Note 6) | \$ - | \$ 1,359,168 |
| Accounts payable and accrued liabilities | 1,352,119 | 1,447,242 |
| Liabilities of discontinued software and hardware operations (Note 3) | 1,384,000 | 523,581 |
| Current portion of long-term debt (Note 7) | 643,794 | 1,217,437 |
| | 3,379,913 | 4,547,428 |
| Long-term debt (Note 7) | 1,086,225 | 3,448,545 |
| Liabilities of discontinued subsidiary - Microforum Italia s.r.l. (Note 2) | - | 399,939 |
| | 4,466,138 | 8,395,912 |
| Shareholders' Equity | | |
| Capital stock (Note 8) | 20,545,813 | 10,725,013 |
| Deficit | (17,135,498) | (9,124,216) |
| | 3,410,315 | 1,600,797 |
| | \$ 7,876,453 | \$ 9,996,709 |
| Approved by the Board _____ | Director | Director |

MICROFORUM INC.**CONSOLIDATED STATEMENTS OF OPERATIONS AND
DEFICIT**

| | Year ended February 28 | |
|--|------------------------|-----------------------|
| | 1998 | 1997 |
| Sales | \$ 5,230,268 | \$ 5,909,928 |
| Cost of sales | 2,741,383 | 5,347,289 |
| Gross profit | 2,488,885 | 562,639 |
| Operating expenses | | |
| General and administration | 3,686,126 | 4,412,365 |
| Sales and marketing | 1,551,911 | 1,299,182 |
| Research and development | 666,643 | 1,388,454 |
| Interest on long-term debt | 304,633 | 338,531 |
| | 6,209,313 | 7,438,532 |
| Loss, before loss from discontinued operations and subsidiary | (3,720,428) | (6,875,893) |
| Loss from discontinued software and hardware operations (Note 3) | (4,152,422) | (3,410,546) |
| Loss from discontinued subsidiary - Microforum Italia s.r.l. (Note 2) | (138,432) | (348,113) |
| Loss before income taxes | (8,011,282) | (10,634,552) |
| Income taxes (recovery) | - | (105,123) |
| Net loss for the year | (8,011,282) | (10,529,429) |
| Deficit, beginning of year | (9,124,216) | 1,405,213 |
| Deficit, end of year | \$ (17,135,498) | \$ (9,124,216) |
| Basic earnings (loss) per share (Note 8) | | |
| From continuing operations | \$ (0.47) | \$ (1.50) |
| From discontinued operations and subsidiary | (0.54) | (0.80) |
| | \$ (1.01) | \$ (2.30) |

**CONSOLIDATED STATEMENTS OF CHANGES
IN FINANCIAL POSITION**

| | Year ended February 28 | |
|--|------------------------|-----------------------|
| | 1998 | 1997 |
| Cash provided by (used in) | | |
| <i>Operating activities</i> | | |
| Net loss for the year from continuing operations | \$ (3,720,428) | \$ (6,875,893) |
| Item not affecting cash | | |
| Amortization of capital assets | 909,154 | 1,743,171 |
| Changes in non-cash working capital | | |
| Accounts receivable | (175,391) | 260,182 |
| Inventories | 371,002 | 1,337,913 |
| Prepaid expenses and other assets | 35,930 | 117,680 |
| Accounts payable and accrued liabilities | (95,123) | 223,367 |
| | (2,674,856) | (3,193,580) |
| <i>Financing activities</i> | | |
| Proceeds on issue of common shares, net | 9,452,587 | 5,472,279 |
| Long-term debt, net of repayments | (1,126,164) | 2,329,250 |
| Conversion of long-term debt to common shares | (1,809,800) | - |
| Due from officers | (530,666) | - |
| Common shares issued on exercise of stock options | 368,213 | - |
| Repayment of loans payable | - | (100,000) |
| | 6,354,170 | 7,701,529 |
| <i>Investment activity</i> | | |
| Sale (purchase) of fixed assets, net | 37,010 | (3,203,302) |
| Increase in cash attributable to continuing operations | 3,716,324 | 1,304,647 |
| Increase (decrease) in cash attributable to discontinued software and hardware operations | 233,004 | (2,900,042) |
| Decrease in cash attributable to discontinued subsidiary | (367,774) | (118,956) |
| | 3,581,554 | (1,714,351) |
| Cash (bank indebtedness) from continuing operations, beginning of year | (1,359,168) | 355,183 |
| Cash (bank indebtedness) from continuing operations, end of year | \$ 2,222,386 | \$ (1,359,168) |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

February 28, 1998

Nature of operations

Microforum Inc. (the "Company" or the "Corporation") is an integrated Internet applications and marketing communications company. The Company and its subsidiaries (Note 11) provide contract advertising, public relations direct marketing and multimedia services to major corporations in North America. Additionally, the Company is an Internet online magazine ("ezine") publisher, engaged in OnLine Electronic Commerce while selling interactive consumer software over the Internet.

1 Significant accounting policies

Consolidation

These consolidated financial statements include the accounts of the Company and its subsidiary, Internet Frontier Inc., a wholly-owned subsidiary of the Company which was incorporated and started business on June 6, 1996.

Inventories

Inventories are valued at the lower of cost and net realizable value. Cost is determined generally on a first-in, first-out basis.

Capital assets

Capital assets are recorded at cost. Amortization is provided on computer equipment and software, duplication and packaging equipment, and furniture and office equipment using the diminishing-balance basis at rates of 20% - 30% per annum. Leasehold improvements are amortized using the straight-line basis over the terms of the respective leases.

Revenue recognition

Revenue from product sales is recognized upon shipment of the product to the customer and is net of discounts and allowances for estimated future returns. Revenue from sale of services is recognized as the services are performed under the terms of the contract. Revenue from the sale of computer software licenses is recognized once remaining obligations under the sales agreements are considered insignificant.

Use of estimates

Financial statements prepared in conformity with generally accepted accounting principles require management to make estimates and assumptions about reported assets and liabilities, disclosure of contingent assets and liabilities and reported amounts of revenues and expenses. Management also makes estimates and judgements about future results of operations related to specific elements of the business and operating units in assessing recoverability of assets and recorded values of liabilities. Actual results could differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued
February 28, 1998

Financial instruments

The carrying amounts reported in the balance sheets for accounts receivable, accounts payable and accrued liabilities approximate fair values due to the short-term maturity of those instruments. The carrying value for capital leases and term loans approximate fair value because the rates available for similar types of borrowing arrangements have not changed significantly since the company executed those financing agreements. The carrying amounts for bank loans approximate fair value because they bear interest at variable rates.

2 Sale of Microforum Italia s.r.l.

In accordance with its restructuring strategy, on August 18, 1997 the Company concluded an agreement to sell its interest in its subsidiary, Microforum Italia s.r.l. to the Company's founding shareholders for \$200,000. Under the terms of the agreement, the purchasers shall tender to the company 200,000 common shares presently held in Microforum Inc. over a two year period expiring in September 1999. Price adjustment provisions apply in the event the purchasers elect to substitute cash in lieu of common shares otherwise due at the prescribed installment dates. The purchasers are also obliged to arrange for adequate refinancing such that a \$200,000 letter of credit issued by the Company in support of indebtedness incurred by Microforum Italia is released in full by June 1998. The purchasers acquired effective control of Microforum Italia s.r.l. and its subsidiary, Dreamware s.r.l., on July 1, 1997.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued
February 28, 1998

| | 4 months to June 30, 1997 | 12 months to February 28, 1997 |
|---|---------------------------------|--------------------------------------|
| Selected financial information: | | |
| Revenue | \$ 758,678 | \$ 592,013 |
| Cost of sales and operating expenses | 897,110 | 940,126 |
| Net loss from discontinued subsidiary | \$ (138,432) | \$ (348,113) |
| Summary of assets and liabilities | | |
| Assets | | |
| Trade accounts receivable, net of allowances | \$ - | \$ 163,016 |
| Inventories | - | 43,659 |
| Current portion of note receivable | 100,000 | - |
| | 100,000 | 206,675 |
| Non-current portion of note receivable | 100,000 | - |
| Capital assets | - | 163,882 |
| Total assets attributed to discontinued subsidiary | \$ 200,000 | \$ 370,557 |
| Liabilities | | |
| Bank indebtedness | \$ - | 273,094 |
| Accounts payable and accrued liabilities | - | 126,845 |
| Total liabilities attributed to discontinued subsidiary | \$ - | \$ 399,939 |

3 Discontinued software development / publishing and hardware distribution operations

In accordance with its restructuring strategy, the Company discontinued wholesale distribution of hardware equipment during the year. The Company ceased its internal development of software products June 30, 1997 and announced May 14, 1998 (the "measurement date") that it would discontinue all software publishing activities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued
February 28, 1998

Selected financial information:

| | 1998 | 1997 |
|---|-----------------------|----------------|
| Revenue | | |
| Software | \$ 4,925,409 | \$ 5,721,377 |
| Hardware distribution | 158,793 | 3,877,961 |
| | 5,084,202 | 9,599,338 |
| Cost of sales and operating expenses | 8,406,265 | 13,009,884 |
| Net loss from discontinued software development/ publishing and hardware distributions to February 28 | (3,322,063) | (3,410,546) |
| Estimated loss from discontinued software publishing to disposal date | (830,359) | - |
| Net loss from discontinued software development/ publishing and hardware distribution operations | \$ (4,152,422) | \$ (3,410,546) |

Summary of assets and liabilities

| | 1998 | 1997 |
|---|---------------------|--------------|
| Assets | | |
| Trade accounts receivable, net of allowances | \$ 300,000 | \$ 1,040,000 |
| Inventories | - | 1,282,545 |
| Current portion of investment tax credits receivable | - | 414,129 |
| Prepaid expenses and other assets | - | 55,053 |
| Current assets | 300,000 | 2,791,727 |
| Product development expenses | - | 974,988 |
| Total assets attributed to discontinued operations | \$ 300,000 | \$ 3,766,715 |
| Liabilities | | |
| Accounts payable - trade | \$ 470,000 | \$ 173,581 |
| Accrued liabilities | 914,000 | 350,000 |
| Total liabilities attributed to discontinued operations | \$ 1,384,000 | \$ 523,581 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued

February 28, 1998

4 Due from officers

| | 1998 | 1997 |
|----------------------|-------------------|------|
| Non-interest bearing | \$ 530,666 | \$ - |

In accordance with the terms of arrangements approved by the Company's shareholders March 24, 1998, the Company may provide financial assistance to allow certain senior officers to exercise options and acquire common shares of the Company up to an aggregate limit of \$2,000,000. Such loans are secured against by the common shares acquired or issued upon exercise of granted options and are repayable on the earlier of such date that the officer disposes of its shareholdings or ceases to act as an officer of the Company. As at February 27, 1998 the fair market value of shares held as security for these loans was approximately \$2,352,000.

5 Capital assets

| | 1998 | 1997 |
|--|---------------------|--------------|
| Cost | | |
| Computer equipment and software | \$ 4,468,691 | \$ 4,535,430 |
| Duplication and packaging equipment | 1,023,473 | 1,014,121 |
| Furniture, automotive and office equipment | 688,066 | 677,637 |
| Leasehold improvements | 809,753 | 799,762 |
| | 6,989,983 | 7,026,950 |
| Accumulated amortization | | |
| Computer equipment and software | 2,266,523 | 1,675,880 |
| Duplication and packaging equipment | 702,668 | 623,635 |
| Furniture, automotive and office equipment | 329,509 | 239,228 |
| Leasehold improvements | 473,721 | 324,481 |
| | 3,772,421 | 2,863,224 |
| | \$ 3,217,562 | \$ 4,163,726 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued

February 28, 1998

Included in the above capital assets are assets under capital lease with a cost of \$3,477,010 (1997 - \$3,528,010) and accumulated depreciation of \$2,017,536 (1997 - \$1,645,842). A write-down of \$750,000 in respect of computer equipment, reflecting an estimate for impairment in value, was recorded at February 28, 1997.

6 Bank line of credit

The Company has a revolving line of credit for borrowings up to \$2,500,000 and aggregate non-revolving loan facilities of \$354,472 at February 28, 1998 (\$746,445 at February 28, 1997). Advances under the non-revolving loans are repayable over three years. Bank indebtedness arising from the revolving line of credit and the non-revolving loan bear interest at prime plus 1.5% and prime plus 1%, respectively. Included in the security for bank indebtedness under the revolving line of credit and the bank debt described in Note 6 is a registered general assignment of book debts and a first fixed charge over the assets of the Company. The Company is subject to certain financial covenants under its loan arrangements with its banker.

7 Long-term debt

Future minimum payments under capital lease obligations and bank loans and the present value of the minimum lease payments are as follows:

| | Term loan | Capital leases | Bank loans | Total |
|------------------------|----------------------|---------------------------|-----------------------|--------------|
| 1999 | \$ - | \$ 510,581 | \$ 212,148 | \$ 722,729 |
| 2000 | - | 450,000 | 225,648 | 675,648 |
| 2001 | - | 374,323 | 74,176 | 448,499 |
| 2002 | - | - | 22,000 | 22,000 |
| Total payments due | - | 1,334,904 | 533,972 | 1,868,876 |
| Less: Imputed interest | - | 138,857 | - | 138,857 |
| | - | 1,196,047 | 533,972 | 1,730,019 |
| Less: Current portion | - | 431,646 | 212,148 | 643,794 |
| February 28, 1998 | \$ - | \$ 764,401 | \$ 321,824 | \$ 1,086,225 |
| February 28, 1997 | \$ 774,500 | \$ 1,882,272 | \$ 791,773 | \$ 3,448,545 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued

February 28, 1998

- (a) The term loan originated at February 28, 1997 on the conversion of trade accounts payable owing to a major supplier. On September 18, 1997, \$700,000 of the term loan was converted into 350,000 common shares of the Company (Note 8).
- (b) Capital lease obligations bear interest at rates varying from 8% to 20%. Security under capital lease obligations is provided by a first fixed charge over the related capital asset. On September 18, 1997, \$750,000 of capital lease obligations was converted into 375,000 common shares of the Company (Note 8).
- (c) In addition to the non-revolving loans (Note 6), included in bank loans is \$179,500 (1997 - \$378,000) which bears interest at 7.25%. On September 18, 1997, \$359,800 of bank loan obligations were converted into 179,900 common shares of the Company (Note 8).

8 Capital stock

| | 1998 | 1997 |
|---|----------------------|---------------|
| Authorized | | |
| Unlimited number of common shares | | |
| Unlimited number of preference shares | | |
| Issued capital | | |
| 15,610,324 (1997 - 5,705,000) common shares | \$ 20,545,813 | \$ 10,725,013 |

- (a) During the year ended February 28, 1997, the following capital transactions occurred:
 - (i) On September 11, 1996, the Company reduced its authorized capital by cancelling its non-cumulative redeemable nonvoting Class A, B, C, D and E special shares, non-cumulative redeemable retractable nonvoting Class F special shares and redeemable Class A common shares, and authorized an unlimited number of preference shares which may, from time to time, be issued in series by the board of directors of the Company who, upon issue, may specify the number, designation, preferences, rights, restrictions, conditions, limitations and priorities as to payment of dividends and/or distribution attaching to each such series.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued

February 28, 1998

- (ii) On September 12, 1996, the Company completed its initial public offering ("IPO"), pursuant to which it distributed 1,000,000 common shares at a price of \$6.50 per share. The IPO was made under the terms of a prospectus that was filed with the Ontario Securities Commission on August 28, 1996. The IPO prospectus also qualified the distribution of 1,100,000 common shares that were issued upon the exercise of special warrants and the distribution of common shares pursuant to option agreements. The Company has granted the underwriters options to purchase up to an aggregate of 100,000 additional common shares for a period of two years from closing of this offering at a price of \$6.50 per common share.

- (c) During the year ended February 28, 1998, the following capital transactions occurred:
 - (i) On September 18, 1997, the Company completed a private placement of 8,000,000 Special Warrants for gross proceeds of \$8,000,000 before deducting fees and expenses incurred of \$887,879. Under the terms of the offering, the Special Warrant holders acquired, without additional payment, an aggregate of 8,000,000 common shares of the Company upon issue of a receipt for the final prospectus from the Ontario Securities Commission on December 16, 1997. The Company granted the Agents' non-assignable Compensation Warrants, representing the right to acquire, for no additional consideration, Compensation Options. The Compensation Options entitle the Agents to subscribe for up to 800,000 Common Shares at an exercise price of \$1.05 per share at any time up to September 18, 1999.
 - (ii) On September 18, 1997, the Company concluded arrangements with various creditors under which an aggregate of \$1,809,800 of long-term debt was converted into 904,900 common shares at a conversion price of \$2.00 per share.
 - (iii) On October 14, 1997, the Company issued 450,000 common shares to the President and Chief Executive Officer of the Corporation for consideration of \$351,000. The consideration was a non-interest bearing loan (Note 4).
 - (iv) On December 12, 1997, the Company issued 20,000 common shares to the General Manger of the Corporation for consideration of \$25,000. The consideration was a non-interest bearing loan (Note 4).
 - (v) On December 30, 1997, the Company issued 150,000 common shares to the President and Chief Executive Officer of the Corporation for consideration of \$117,000. The consideration was a non-interest bearing loan (Note 4).
 - (vi) On January 5, 1998, the Company issued 33,333 common shares to the Chief financial Officer of the Corporation for consideration of \$37,666. The consideration was a non-interest bearing loan (Note 4).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued

February 28, 1998

- (vii) On January 14, 1998 and February 26, 1998, the Company issued 300,000 shares upon exercise of Compensation Options to the Agents for cash consideration of \$315,000.
- (viii) During the third quarter of the fiscal year, the Company issued 47,091 common shares to employees and service providers under the provisions of its Stock Option Plan for cash consideration of \$53,213.

Basic earnings (loss) per share

Basic earnings (loss) per share is calculated using a weighted average number of outstanding shares of approximately 7,931,100 (1997 – 4,572,329). Fully diluted earnings per share data are not presented as they are anti-dilutive.

Stock options

Pursuant to a plan authorized by the directors on April 1, 1996 (the “ Stock Option Plan”), options were granted to directors, officers, employees and other service providers, entitling the holders to purchase an aggregate of 746,110 Common Shares from treasury, exercisable at a price equal to or greater than the market price on the day preceding the date of grant. These options vest over a three year period, commencing on the first anniversary of the date of grant and expire on or before the tenth anniversary of the date of grant.

In addition, the Company has also granted the following options: up to 500,000 Common Shares from treasury upon exercise of Compensation Options granted to the Agents under the terms of the Special Warrants financing described above, exercisable at \$1.05 per share, until September 19, 1999; and up to 300,000 common shares from treasury to a service provider, exercisable at \$3.60 per share, until September 18, 1999.

9 Income taxes

The Company’s effective income tax rate varies from the combined Canadian federal and provincial tax rates as follows:

| | 1998 | 1997 |
|--|----------------|----------------|
| Basic combined federal and provincial rate | 44.62% | 44.62% |
| Losses not recognized for accounting | (44.62) | (44.62) |
| Other | - | (1.06) |
| Total | -% | (1.06)% |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued

February 28, 1998

As of February 28, 1998, the Company had losses available to offset future taxable income of approximately \$15.7 million. If unutilized, these losses will expire in 2003 (\$1.1 million), 2004 (\$8.3 million) and 2005 (\$6.3 million). In addition, the Company has non-refundable tax credits of approximately \$200,000 that can be applied to reduce future income taxes payable. The benefit of these tax losses has not been recognized in these financial statements.

10 Commitments

The Company has entered into operating leases for premises and equipment with annual rentals as follows:

| | |
|------|------------|
| 1999 | \$ 246,000 |
| 2000 | 190,000 |
| 2001 | 6,000 |
| 2002 | 6,000 |
| 2003 | 6,000 |

11 Subsequent event

On April 6, 1998, the Company acquired directly and indirectly all the issued and outstanding common shares of PPL Marketing Services Inc., Marshall Fenn Communications Inc. and Poste Haste Systems Inc. The purchase price for the transaction was \$6,700,000, of which \$5,695,000 was paid by way of issue of 1,627,143 common shares of the Company, \$502,500 was paid by way of cash, and \$502,500 was paid by way of a non-interest bearing promissory note maturing six months after the closing of the transaction. Goodwill arising from the acquisition will be amortized on a straight-line basis over 20 years and amounted to approximately \$6,560,000 as follows:

| | |
|---|---------------------|
| Purchase price | \$ 6,700,000 |
| Fees and estimated expenses attributable to the acquisition | 315,000 |
| | <hr/> |
| Total costs of acquisition | \$ 7,015,000 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS ...continued
February 28, 1998

| | |
|---------------------------------|--------------|
| Net assets acquired | |
| Current assets | \$ 5,345,974 |
| Capital and other assets | 1,456,690 |
| | <hr/> |
| | 6,802,664 |
| Current liabilities | (5,716,300) |
| Long-term and other liabilities | (634,883) |
| | <hr/> |
| Net assets | \$ 451,481 |
| | <hr/> |
| Goodwill | \$ 6,563,519 |
| | <hr/> |

12 *Segmented Information*

Due to the effects of the discontinued operations (Notes 2 and 3), the company's continuing operations predominantly relate to one industry segment being multimedia services.