

Consolidated Financial Statements of

MICROFORUM INC.

Years ended February 29, 2000 and February 28, 1999



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AUDITORS' REPORT

To the Shareholders of Microforum Inc.

We have audited the consolidated balance sheet of Microforum Inc. as at February 29, 2000 and the consolidated statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian 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 29, 2000 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Canadian generally accepted accounting principles vary in certain significant respects from accounting principles generally accepted in the United States. Application of accounting principles generally accepted in the United States would have affected results of operations for the year ended February 29, 2000 and shareholders' equity at February 29, 2000 to the extent summarized in note 16 to the consolidated financial statements.

The consolidated financial statements of the Company as of and for the year ended February 28, 1999 were reported on by another firm of Chartered Accountants who issued an unqualified auditors' report dated May 10, 1999.

Chartered Accountants

Toronto, Canada

April 14, 2000

MICROFORUM INC.

Consolidated Balance Sheets

February 29, 2000 and February 28, 1999

	2000	1999
Assets		
Current assets:		
Cash	\$ 1,847,453	\$ —
Marketable securities	50,536,929	—
Accounts receivable	14,816,804	6,859,997
Work in progress	1,592,351	1,378,225
Assets of discontinued software and hardware operations (note 3(a))	—	150,000
Note receivable on sale of Microforum Italia s.r.l. (note 3(b))	—	100,000
Prepaid expenses and other assets	952,068	215,449
	<u>69,745,605</u>	<u>8,703,671</u>
Capital assets (note 5)	3,841,560	3,120,531
Investment in Quartet Service Corporation	300,000	—
Goodwill (notes 2 and 6)	19,487,016	6,272,830
Due from related parties (note 15)	—	519,124
	<u>\$ 93,374,181</u>	<u>\$ 18,616,156</u>

Liabilities and Shareholders' Equity

Current liabilities:		
Bank indebtedness (note 7)	\$ —	\$ 1,354,554
Accounts payable and accrued liabilities	9,903,590	5,021,827
Deferred revenue	110,730	106,587
Liabilities of discontinued software and hardware operations (note 3(a))	—	299,860
Due to shareholder (note 15)	252,500	—
Current portion of long-term debt (note 8)	497,708	694,655
	<u>10,764,528</u>	<u>7,477,483</u>
Long-term debt (note 8)	—	474,330
Due to shareholder (note 15)	—	771,624
Shareholders' equity:		
Capital stock (note 9)	105,497,595	30,390,852
Loans to officers (note 4)	—	(512,167)
Deficit	(22,887,942)	(19,985,966)
	<u>82,609,653</u>	<u>9,892,719</u>
	<u>\$ 93,374,181</u>	<u>\$ 18,616,156</u>

Commitments (note 12)

Canadian and United States accounting policy differences (note 16)

See accompanying notes to consolidated financial statements.

On behalf of the Board:

“J. Efrim Boritz” _____ Director

“Donald W. Paterson” _____ Director

MICROFORUM INC.

Consolidated Statements of Operations and Deficit

Years ended February 29, 2000 and February 28, 1999

	2000	1999
Sales (note 13)	\$ 47,806,569	\$ 29,148,575
Cost of sales	29,534,767	19,615,902
Gross profit	18,271,802	9,532,673
Operating expenses (income):		
General and administration	13,703,082	7,661,256
Sales and marketing	4,453,073	2,783,977
Interest on long-term debt	96,949	270,635
Investment income	(734,420)	—
	17,518,684	10,715,868
Income (loss) from continuing operations before the undernoted	753,118	(1,183,195)
Gain on settlement of note receivable on sale of Microforum Italia s.r.l.	205,792	—
Cost of shares issued on renegotiation of acquisition of PPL Marketing Services Inc. (note 2(b))	—	(1,104,000)
Provision for write-down of shares pledged for loans to officers (note 4)	—	(366,667)
Gain on sale of Gamesmania (note 3(c))	—	407,700
Income (loss) from continuing operations before amortization of capital assets and goodwill and income taxes	958,910	(2,246,162)
Amortization of capital assets	1,044,934	1,204,157
Loss from continuing operations before income taxes and amortization of goodwill	(86,024)	(3,450,319)
Income taxes (note 11)	166,000	—
Loss from continuing operations before amortization of goodwill	(252,024)	(3,450,319)
Amortization of goodwill	2,451,175	330,149
Loss from continuing operations	(2,703,199)	(3,780,468)
Recovery from discontinued software and hardware operations (note 3(a))	111,714	930,000
Loss for the year	(2,591,485)	(2,850,468)
Deficit, beginning of year	(19,985,966)	(17,135,498)
Premium on redemption of common shares	(310,491)	—
Deficit, end of year	\$ (22,887,942)	\$ (19,985,966)
Basic earnings (loss) per share (note 9(b)):		
From continuing operations	\$ (0.09)	\$ (0.23)
From discontinued operations and discontinued subsidiary	0.01	0.06
	\$ (0.08)	\$ (0.17)

See accompanying notes to consolidated financial statements.

MICROFORUM INC.

Consolidated Statements of Cash Flows

Years ended February 29, 2000 and February 28, 1999

	2000	1999
Cash provided by (used in):		
Operating activities:		
Loss from continuing operations	\$ (2,703,199)	\$ (3,780,468)
Items not affecting cash:		
Amortization of capital assets	1,044,934	1,204,157
Amortization of goodwill	2,451,175	330,149
Provision for shares issued on renegotiation of acquisition of PPL Marketing Services Inc.	-	1,104,000
Provision for write-down of shares pledged for loans to officers	-	366,667
Gain on settlement of note receivable on sale of Microforum Italia s.r.l.	(205,792)	-
Change in non-cash operating working capital:		
Accounts receivable	(4,756,646)	(1,552,158)
Work in progress	574,289	(370,625)
Prepaid expenses	(670,664)	202,070
Accounts payable and accrued liabilities	1,950,946	701,106
Deferred revenue	(959,207)	(118,398)
	(3,274,164)	(1,913,500)
Financing activities:		
Proceeds on issue of common shares, net	1,663,777	2,482,989
Proceeds on issue of special warrants	65,597,756	1,695,000
Long-term debt, net of repayments	(929,114)	(704,006)
Shares issued as director compensation	20,435	22,050
Decrease in due to shareholder	(877,373)	(516,416)
Due to related parties	115,900	(171,145)
Proceeds from officer loan repayment	512,167	(1,452,168)
	66,103,548	1,356,304
Investing activities:		
Purchase of marketable securities	(50,536,929)	-
Acquisition of capital assets, net	(868,733)	(194,560)
Acquisition of subsidiaries	(8,189,361)	(2,821,044)
Proceeds on settlement of note receivable on sale of Microforum Italia s.r.l.	305,792	-
Acquisition of interest in Quartet Service Corporation	(300,000)	-
	(59,589,231)	(3,015,604)
Increase (decrease) in cash attributable to continuing operations	3,240,153	(3,572,800)
Decrease in cash attributable to discontinued software and hardware operations	(38,146)	(4,140)
Increase (decrease) in cash	3,202,007	(3,576,940)
Cash (bank indebtedness), beginning of year	(1,354,554)	2,222,386
Cash (bank indebtedness), end of year	\$ 1,847,453	\$ (1,354,554)

MICROFORUM INC.

Consolidated Statements of Cash Flows (continued)

Years ended February 29, 2000 and February 28, 1999

	2000	1999
Supplemental cash flow information:		
Interest paid	\$ 110,528	\$ 340,211
Income taxes paid	15,224	-
Supplemental disclosure of non-cash investing and financing activities:		
Common shares received in consideration of the note receivable on sale of Microforum Italia s.r.l.	-	100,000
Common shares issued on conversion of accounts payable	-	50,000
Common shares issued in connection with acquisition of subsidiaries	7,917,508	5,695,000
Note payable issued in connection with acquisition of subsidiaries	-	252,500

See accompanying notes to consolidated financial statements.

MICROFORUM INC.

Notes to Consolidated to Financial Statements

Years ended February 29, 2000 and February 28, 1999

1. Significant accounting policies:

(a) Basis of consolidation:

These consolidated financial statements include the accounts of the Company and its subsidiaries, Internet Frontier Inc., the PPL Group of Companies (the "PPL Group"), Two Door Communications Inc., Frameworks Communications Inc. and Relational Solutions Inc.

(b) Work-in-progress inventory:

Work-in-progress inventory is recorded at cost, which comprises billable labour production and creative material costs for ongoing projects.

(c) Capital assets:

Capital assets are recorded at cost. Amortization is provided using the following bases and rates:

Assets	Basis	Rate
Computer equipment and software	Declining balance	20 - 30%
Duplication and packaging equipment	Declining balance	20 - 30%
Furniture, automotive and office equipment	Declining balance	20 - 30%
Leasehold improvements	Straight line	Over term of lease

(d) Revenue recognition:

Revenue from sale of multimedia services, internet content and internet services is recognized as the services are performed under the terms of the contract.

Marketing programs, distribution, advertising and public relations revenues are recognized on a completed contract basis.

(e) Foreign currency translation:

Monetary assets and liabilities are translated at year-end exchange rates. Revenue and expenses are translated at average rates of exchange during the year. Gains and losses on translation are included in the consolidated statements of operations.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

1. Significant accounting policies (continued):

(f) Goodwill:

The excess of the purchase price over the fair values of net assets acquired is recorded as goodwill and is amortized on a straight-line basis over three to 20 years. The Company evaluates the carrying values and amortization period of goodwill on an ongoing basis. In order to determine if a permanent impairment exists, the Company's management considers each subsidiary's financial condition and estimated fair values on an undiscounted basis. A permanent impairment in the value of goodwill is written off against earnings in the year such impairment is determined. During the year, the Company revised the original amortization period from 20 to 10 years for goodwill arising in the PPL Group acquisition and three years for all other acquisitions.

(g) Income taxes:

The Company follows the deferral method of accounting for income taxes.

In December 1997, the CICA Accounting Standards Board issued Section 3465, "Income Taxes," which adopts the liability approach based on the temporary differences method of accounting for income taxes. The standard is similar in many respects to the United States Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standard No. 109, and will be implemented by the Company in 2001.

(h) Financial instruments:

Fair values:

The carrying amounts reported in the balance sheets of cash, marketable securities, accounts receivable, note receivable, due from related parties, bank indebtedness, accounts payable and accrued liabilities and due to shareholder approximate fair values due to the short-term maturity of those instruments. The carrying values for capital leases and bank loans approximate fair values 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 values because they bear interest at variable rates.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

1. Significant accounting policies (continued):

Credit risk:

The Company's investment in marketable securities are subject to credit risk which is minimized as a result of the Company investing in high quality short-term interest-bearing securities.

(i) Stock-based compensation plans:

The Company has a stock option plan, which is described in note 10. No compensation expense is recognized for the plan when stock options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to capital stock.

(j) 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 revenue 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.

2. Acquisitions:

(a) Acquisitions during 2000 were as follows:

(i) Acquisition of Software Guaranty Inc.:

On March 9, 1999, the Company acquired all the issued and outstanding common shares of Software Guaranty Inc. The purchase price for the transaction was \$3,126,000 exclusive of expenses relating to the acquisition of \$62,629, of which \$2,250,000 was paid by way of cash and \$876,000 was paid by way of issue of 674,207 common shares of the Company. Effective February 21, 2000, 14,228 shares at a unit cost of \$1.30 were cancelled, reflecting the settlement of the final purchase price.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

2. Acquisitions (continued):

(ii) Acquisition of Q-Inter Applications Inc.:

Effective June 1, 1999, the Company acquired all the issued and outstanding common shares of Q-Inter Applications Inc. The purchase price for the transaction was \$1,310,000 exclusive of expenses relating to the acquisition of \$170,000, of which \$750,000 was paid by way of cash and \$560,000 was paid by way of issue of 86,153 common shares of the Company.

(iii) Acquisition of Two Door Communications Inc.:

Effective October 1, 1999, the Company acquired all the issued and outstanding common shares of Two Door Communications Inc. The purchase price for the transaction was \$2,000,000 exclusive of expenses relating to the acquisition of \$176,000, of which \$1,000,000 was paid by way of cash and \$1,000,000 was paid by way of issue of 150,830 common shares of the Company. As additional consideration, the Company has agreed to pay \$1.053 for each \$1.00 of pretax profit earned by Two Door Communications Inc. for the 12-month period ending September 30, 2000, up to a maximum of \$1,000,000. Any such additional consideration shall be in the form of common shares and shall be accounted for as goodwill.

(iv) Acquisition of Frameworks Communications Inc.:

Effective October 1, 1999, the Company acquired all the issued and outstanding common shares of Frameworks Communications Inc. The purchase price for the transaction was \$4,750,000 exclusive of expenses relating to the acquisition of \$245,000, of which \$2,750,000 was paid by way of cash and \$2,000,000 was paid by way of issue of 301,659 common shares of the Company.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

2. Acquisitions (continued):

(v) Acquisition of Relational Solutions Inc.:

Effective December 1, 1999, the Company acquired all the issued and outstanding common shares of Relational Solutions Inc. The purchase price for the transaction was \$4,275,204 exclusive of expenses relating to the acquisition of \$290,756, of which \$775,200 was paid by way of cash and \$3,500,004 was paid by way of issue of 465,426 common shares of the Company. As additional consideration, the Company has agreed to pay \$3.15 for each \$1.00 of earnings before interest, taxes, depreciation and amortization for the 12-month period ending November 30, 2000, up to a maximum of \$4,500,000. In addition, the Company has agreed to pay \$1,500,000 upon delivery of certain technology products. Any additional consideration shall be in the form of common shares and will be accounted for as additional goodwill in relation to the earnings before interest, taxes, depreciation and amortization payments and as software technology for the remainder.

Net assets acquired for each of the above acquisitions were as follows:

	Software Guaranty Inc.	Q-Inter Applications Inc.	Two Door Communications Inc.	Frameworks Communications Inc.	Relational Solutions Inc.
Cash and cash equivalents	\$ 135,518	\$ 55,919	\$ 160,843	\$ -	\$ -
Current assets	1,476,696	381,351	888,474	672,627	652,241
Capital and other assets	296,922	274,360	26,753	277,674	21,521
Goodwill	2,434,040	1,226,188	1,952,870	4,782,604	5,269,659
	4,343,176	1,937,818	3,028,940	5,732,905	5,943,421
Bank indebtedness	-	-	-	(61,606)	(483,450)
Liabilities assumed	(946,043)	(457,818)	(852,940)	(676,299)	(894,011)
Net assets	\$ 3,397,133	\$ 1,480,000	\$ 2,176,000	\$ 4,995,000	\$ 4,565,960

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

2. Acquisitions (continued):

(b) Acquisition during 1999, was as follows:

Acquisition of PPL Group:

Effective March 1, 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., collectively, the PPL Group. The purchase price for the transaction was \$6,700,000 exclusive of expenses relating to the acquisition of \$354,683, 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 secured by a pledge of shares of PPL Marketing Services Inc. On January 20, 1999, the Company's shareholders approved arrangements under which \$250,000 of this short-term liability was converted into common shares at a conversion price of \$0.74 per share and the maturity date with respect to a further \$252,500 of this short-term liability was extended to March 31, 2000.

As a result of renegotiation of the terms of the original agreement to acquire the shares of PPL Marketing Services Inc., the Company has issued 1,500,000 common shares to the former controlling shareholder of the PPL Group and current President and Chief Executive Officer of the Company. A liability for the cost of 1,500,000 common shares issued of approximately \$1,104,000 has been accrued and charged to income during the 1999 fiscal year.

The fair value of the net assets acquired was:

Current assets	\$ 5,345,974
Capital and other assets	1,456,690
Goodwill	6,602,979
	<hr/>
	13,405,643
Bank indebtedness	(1,963,861)
Liabilities assumed	(4,387,099)
	<hr/>
Net assets	\$ 7,054,683

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

3. Discontinued operations and disposals:

(a) Discontinued software development/publishing and hardware distribution operations:

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

Selected financial information:

	2000	1999
Software revenue	\$ —	\$ 839,427
Cost of sales and operating expenses (income)	(85,951)	117,877
Income before undernoted	85,951	721,550
Royalty income	25,763	208,450
Income from discontinued software development/publishing and hardware distribution operations	\$ 111,714	\$ 930,000

	2000	1999
Assets:		
Accounts and sundry receivable, net of allowances	\$ —	\$ 150,000
Total assets attributed to discontinued operations	\$ —	\$ 150,000
Liabilities:		
Accrued liabilities	\$ —	\$ 299,860
Total liabilities attributed to discontinued operations	\$ —	\$ 299,860

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

3. Discontinued operations and disposals (continued):

(b) Sale of Microforum Italia s.r.l.:

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. Settlement adjustment provisions apply in the event the purchasers elect to substitute cash in lieu of common shares otherwise due to be tendered. The purchasers were 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 s.r.l. was released in full in June 1998. The purchasers acquired effective control of Microforum Italia s.r.l. and its subsidiary, Dreamware s.r.l., on July 1, 1997. During November 1998, the Company received 100,000 common shares of Microforum Inc. from the purchasers. In April 1999, the Company sold these shares for proceeds of \$213,900 (note 9(a)). On January 10, 2000, the Company received final settlement from the purchasers in the amount of \$305,792, resulting in a gain of \$205,792.

(c) Sale of Gamesmania:

On January 6, 1999, the Company concluded an agreement to sell its interest in its electronic magazine, Gamesmania, for approximately \$413,000. Under the terms of the agreement, the Company received cash consideration of approximately \$375,000 at closing, and a promissory note of approximately \$38,000, which was paid approximately 90 days after the closing of the transaction.

4. Loans to officers:

	2000	1999
Non-interest bearing loans	\$ —	\$ 1,868,169
Allowance for impairment in share value at valuation date	—	(366,667)
Loan repayments received	—	(306,000)
Settlement of loan by return of shares	—	(683,335)
Reduction in shareholders' equity	—	(512,167)
	\$ —	\$ —

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

4. Loans to officers (continued):

In fiscal 1999, the loans to officers were written down to fair value, resulting in a charge to income of \$366,667, and the balance of \$1,501,502 was reclassified as a reduction in shareholders' equity. Subsequent loan repayments of \$512,167 in 2000 and \$989,335 in 1999 resulted in corresponding increases in share capital.

5. Capital assets:

2000	Cost	Accumulated amortization	Net book value
Computer equipment and software	\$ 7,517,541	\$ 4,688,683	\$ 2,828,858
Duplication and packaging equipment	1,429,786	1,147,104	282,682
Furniture, automotive and office equipment	1,606,106	1,011,055	595,051
Leasehold improvements	1,184,222	1,049,253	134,969
	<u>\$ 11,737,655</u>	<u>\$ 7,896,095</u>	<u>\$ 3,841,560</u>

1999	Cost	Accumulated amortization	Net book value
Computer equipment and software	\$ 4,938,390	\$ 2,809,354	\$ 2,129,036
Duplication and packaging equipment	1,240,744	866,176	374,568
Furniture, automotive and office equipment	951,565	456,110	495,455
Leasehold improvements	966,410	844,938	121,472
	<u>\$ 8,097,109</u>	<u>\$ 4,976,578</u>	<u>\$ 3,120,531</u>

Included in the above capital assets are assets under capital lease with a cost of \$3,477,010 (1999 - \$3,477,010) and accumulated amortization of \$2,528,791 (1999 - \$2,309,684).

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

6. Goodwill:

	2000	1999
Cost	\$ 22,268,340	\$ 6,602,979
Less accumulated amortization	2,781,324	330,149
	<u>\$ 19,487,016</u>	<u>\$ 6,272,830</u>

7. Bank line of credit:

The Company has a revolving line of credit for borrowings up to \$3,000,000 and aggregate non-revolving loan facilities of \$122,955 at February 29, 2000 (1999 - \$267,083). Advances under the non-revolving loans are repayable over three years. Bank indebtedness arising from the revolving line of credit and the non-revolving loans 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 8 is a registered general assignment of book debts and a first fixed charge over the assets of the Company.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

8. 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:

2000	Capital leases	Bank loans	Total
2000	\$ 398,537	\$ 122,955	\$ 521,492
Less imputed interest	23,784	–	23,784
	374,753	122,955	497,708
Less current portion	374,753	122,955	497,708
	\$ –	\$ –	\$ –

1999	Capital leases	Bank loans	Total
2000	\$ 450,000	\$ 291,228	\$ 741,228
2001	374,323	88,355	462,478
2002	–	25,000	25,000
	824,323	404,583	1,228,906
Less imputed interest	59,921	–	59,921
	764,402	404,583	1,168,985
Less current portion	403,427	291,228	694,655
	\$ 360,975	\$ 113,355	\$ 474,330

(a) Capital lease obligations bear interest at an average rate of approximately 8%. Security under capital lease obligations is provided by a first fixed charge over the related capital asset.

(b) In addition to the non-revolving loans (note 7), included in bank loans is \$100,000 (1999 - \$137,500), which bears interest at 7.25%. The remaining amounts bear interest at prime plus 1%.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

9. Capital stock:

	2000	1999
Authorized:		
Unlimited preference shares		
Unlimited common shares		
Issued:		
33,946,924 common shares (1999 - 20,005,296)	\$ 65,054,235	\$ 28,695,852
4,334,400 special warrants (1999 - 4,000,000)	40,443,360	1,695,000
	<u>\$ 105,497,595</u>	<u>\$ 30,390,852</u>

(a) Common shares:

	Number of shares	Amount
Balance, February 28, 1998	15,610,324	\$ 20,545,813
Issued on acquisition of PPL Group (note 2)	1,627,143	5,695,000
Issued to senior officers for non-interest bearing loans, net of severance arrangements	500,000	654,168
Received in satisfaction of note receivable arising on sale of Microforum Italia s.r.l. (note 3(b))	(100,000)	(100,000)
Issued for cash under stock option arrangements	462,332	474,821
Issued to directors for services rendered	7,000	22,050
Issued on renegotiations of the terms of the original agreement to acquire PPL Marketing Services Inc. and settlement of promissory note (note 2)	1,839,674	1,354,000
Issued on conversion of trade accounts payable	58,823	50,000
Balance, February 28, 1999	20,005,296	28,695,852
Issued on conversion of special warrants	4,000,000	1,660,000
Issued on conversion of purchase warrants	7,841,739	22,389,132
Issued on acquisition of Software Guaranty Inc., net of price adjustment (note 2)	659,979	857,504
Conversion of warrants - broker	947,793	1,952,764
Conversion of options to service providers	450,000	1,207,500
Issued for cash under stock option arrangements	451,696	1,203,777
Sale of shares received in satisfaction of note receivable arising on the sale of Microforum Italia s.r.l. (note 3(b))	100,000	100,000
Issued on acquisition of Q-Inter Applications Inc. (note 2)	86,153	560,000
Issued on acquisition of Two Door Communications Inc. (note 2)	150,830	1,000,000
Issued on acquisition of Frameworks Communications Inc. (note 2)	301,659	2,000,000
Issued on acquisition of Relational Solutions Inc. (note 2)	465,426	3,500,004
Issued to directors for services rendered	8,696	20,435
Redemption of shares in consideration of amounts due from related parties	(44,370)	(92,733)
Balance, February 29, 2000	<u>35,424,897</u>	<u>\$ 65,054,235</u>

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

9. Capital stock (continued):

(b) Basic earnings (loss) per share:

Basic earnings (loss) per share are calculated using a weighted average number of outstanding shares of 31,227,793 (1999 - 16,690,528). Fully diluted earnings per share data are not presented as they are anti-dilutive.

10. Stock options:

Pursuant to a plan authorized by the directors on April 1, 1996, as amended, options were granted to directors, officers, employees and other service providers, entitling the holders to purchase an aggregate of 4,721,888 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.

A summary of the changes in the Company's option plan for the years ended February 29, 2000 and February 28, 1999 is as follows:

	2000		1999	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
Balance, beginning of year	2,539,567	\$ 2.46	1,628,605	\$ 2.95
Options granted	3,310,400	6.56	1,483,327	1.72
Options exercised	(451,696)	(2.66)	(509,164)	(1.85)
Cancelled	(676,383)	(3.00)	(63,201)	(2.77)
Balance, end of year	4,721,888	\$ 5.24	2,539,567	\$ 2.46
Exercisable, end of year	690,374	\$ 2.50	586,536	\$ 2.96

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

10. Stock options (continued):

The stock options expire at various dates between April 15, 2006 and January 12, 2010, and the weighted average remaining contractual lives of outstanding and exercisable options were as follows:

Range of exercise price	Outstanding, February 29, 2000	Weighted average remaining life	Weighted average exercise price	Exercisable, February 29, 2000	Weighted average exercise price
\$1.13 to \$6.50	62,000	6.5 yrs	\$ 5.89	62,000	\$ 5.89
\$1.13 to \$4.90	340,069	7.6 yrs	2.23	195,360	2.07
\$0.60 to \$3.50	1,009,419	8.4 yrs	1.86	308,014	2.12
\$2.45 to \$9.50	3,310,400	9.7 yrs	6.56	125,000	2.45

In addition, the Company has granted the following options, which are outstanding at February 29, 2000:

	Number of options	Exercise price	Expiry date
Compensation options	60,129	\$ 1.38	March 8, 2001
Compensation options	310,000	6.50	November 10, 2000
Compensation options	155,000	10.00	September 10, 2000

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

11. Income taxes:

Total income tax expense varies from the amount that would be computed by applying the effective income tax rate to the loss before income taxes for the following reasons:

	2000	1999
Effective income tax rate	44.6%	44.6%
Income tax recovery based on the loss		
before income taxes	\$ (1,082,000)	\$ (1,271,000)
Large Corporations Tax	166,000	—
Goodwill amortization	1,093,000	147,000
Deductible financing expenses	(303,000)	(303,000)
Non-taxable gains	—	(344,000)
Losses not tax-effected	247,000	2,007,000
Other	45,000	(236,000)
	\$ 166,000	\$ —

Significant components of the Company's deferred taxes as of February 29, 2000 and February 28, 1999 are as follows:

	2000	1999
Deferred tax assets:		
Tax loss carryforwards	\$ 10,376,000	\$ 10,129,000
Property and equipment	175,000	175,000
Deductible financing expenses	447,000	750,000
	10,998,000	11,054,000
Less valuation allowance	10,998,000	11,054,000
	\$ —	\$ —

The Company has established valuation allowances equal to the net deferred tax assets due to uncertainties regarding the realization of deferred tax assets based on the Company's lack of earnings history and the risk that taxable income may not be generated during the carryforward periods.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

11. Income taxes (continued):

As at February 29, 2000, the Company had approximately \$23,253,000 of unrecognized non-capital tax losses which may be carried forward to reduce future years' taxable income. These losses expire as follows:

2003	\$ 300,000
2004	8,600,000
2005	9,300,000
2006	4,500,000
2007	553,000
	<hr/>
	\$ 23,253,000

12. Operating lease commitments:

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

2001	\$ 2,275,000
2002	2,899,000
2003	2,935,000
2004	2,744,000
2005	2,319,000
Thereafter	7,984,000

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

13. Segmented information:

In 1999, the Company adopted CICA Section 1701, Segmented Disclosures. The accounting policies of the segments are described in note 1.

The Company is a digital transformation company providing a wide range of e-commerce, creative and database marketing services to recognized North American-based clients.

Areas of expertise include digital consulting, e-commerce application development, systems architecture, supply chain optimization, knowledge management, creative web design, video and digital design, strategic marketing, contest and incentive programs, special event management, customer response management, fulfillment and other tactical services, advertising, brand and public relations services. The Company delivers its integrated service offerings through three operating segments as reported below.

2000	e-Business Solutions	Strategic marketing	Advertising and public relations	Eliminations	Total
Sales	\$ 16,646,862	\$ 22,046,059	\$ 11,993,551	\$ (2,879,903)	\$ 47,806,569
Operating and other expenses	18,755,101	22,465,261	12,003,309	(2,879,903)	50,343,768
Loss from continuing operations	\$ (2,108,239)	\$ (419,202)	\$ (9,758)	\$ -	\$ (2,537,199)
Additions to capital assets	\$ 535,010	\$ 286,914	\$ 46,809	\$ -	\$ 868,733
Additions to goodwill	\$ 13,712,491	\$ -	\$ 1,952,870	\$ -	\$ 15,665,361
Identifiable assets from continuing operations	\$ 98,325,869	\$ 9,461,824	\$ 4,012,902	\$ (18,426,414)	\$ 93,374,181

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

13. Segmented information (continued):

1999	e-Business Solutions	Strategic marketing	Advertising and public relations	Eliminations	Total
Sales	\$ 5,380,551	\$ 15,641,192	\$ 8,470,673	\$ (343,841)	\$ 29,148,575
Operating and other expenses	7,998,219	16,684,692	8,589,973	(343,841)	32,929,043
Loss from continuing operations	\$ (2,617,668)	\$ (1,043,500)	\$ (119,300)	\$ -	\$ (3,780,468)
Additions to capital assets	\$ 53,918	\$ 139,256	\$ 1,386	\$ -	\$ 194,560
Additions to goodwill	\$ -	\$ 4,632,214	\$ 1,970,765	\$ -	\$ 6,602,979
Identifiable assets from continuing operations	\$ 4,270,615	\$ 6,965,628	\$ 2,387,267	\$ 4,742,646	\$ 18,366,156

The Company's predominant geographic segment is Canada.

14. Economic dependence:

For the year ended February 29, 2000, the Company earned a significant portion of its revenue from three (1999 - two) customers. As at February 29, 2000, approximately 35% (1999 - 51%) of the accounts receivable balance and 56% (1999 - 55%) of revenues for the year then ended were derived from these customers.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

15. Related party transactions:

Amounts due from/to related parties are detailed as follows:

	2000	1999
Due from related parties:		
Due from Elliot & Andrews Studios Inc. (a)	\$ —	\$ 370,000
Due from Tribco Communications Group Inc. (b)	—	149,124
	\$ —	\$ 519,124
Due to related party:		
Due to shareholder (c)	\$ 252,500	\$ 771,624

The companies in (a) and (b) are ultimately controlled by a former controlling shareholder of the PPL Group who is an officer, director and shareholder of the Company. All amounts were settled on February 29, 2000 by cancellation of 44,370 common shares at an average unit cost of \$2.09 pledged against amounts.

Amounts due to the shareholder in (c) are non-interest bearing and due on demand, except for \$252,500 (note 2), which matures March 31, 2000. Subsequent to February 29, 2000, the amount due to shareholder was repaid.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

16. United States accounting principles:

The consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles ("GAAP") as applied in Canada. In certain respects, GAAP as applied in the United States differs from that applied in Canada.

If United States GAAP were employed, the loss for the year would be adjusted as follows:

	2000	1999
Loss for the year based on Canadian GAAP	\$ (2,591,485)	\$ (2,850,468)
Amortization of deferred expenses (a)	(142,331)	(215,800)
Provision for write-down of shares pledged for loans to officers (b)	—	366,667
Loss for the year based on United States GAAP	\$ (2,733,816)	\$ (2,699,601)
Loss per share based on United States GAAP:		
From continuing operations	\$ (0.09)	\$ (0.22)
From discontinued operations and discontinued subsidiary	—	0.06
	\$ (0.09)	\$ (0.16)

The areas of material difference between Canadian and United States GAAP and their impact on the consolidated financial statements are as follows:

(a) Stock-based compensation:

United States GAAP requires options issued to non-employees for services to be accounted for in accordance with FASB Statement of Financial Accounting Standards No.123 ("SFAS 123"), "Accounting for Stock-based Compensation." Deferred expense relates to the amortization of the fair value of options, based on the Black-Scholes model, over the period that the related services are rendered.

Stock options issued in relation to equity offerings have not been presented as the disclosure would be included in a separate component of shareholders' equity and there would be no net effect on shareholders' equity.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

16. United States accounting principles (continued):

(b) Loans to officers:

Under Canadian GAAP, the Company recorded a charge to operations which reflects the adjustment to fair value of the loans as of November 6, 1998 (the valuation date). Under United States GAAP, the Company netted the loans and resulting fair value adjustment directly against share capital.

There is no cumulative effect of these adjustments on the consolidated shareholders' equity of the Company.

Certain additional disclosures required under United States GAAP are as follows:

(a) Stock-based compensation:

Had compensation cost for stock option amounts issued to employees been determined under the provisions of the SFAS 123 which utilizes a fair value-based method, the Company's net income and earnings per share would have been reduced to the following pro forma amounts:

Amounts under United States GAAP	2000		1999	
	As reported	Pro forma	As reported	Pro forma
Net loss	\$ (2,733,816)	\$ (5,676,090)	\$ (2,699,601)	\$ (3,587,359)
Earnings (loss) per share:				
Basic:				
From continuing operations	\$ (0.09)	\$ (0.18)	\$ (0.22)	\$ (0.27)
From discontinued operations and discontinued subsidiary	—	—	0.06	0.06

For purposes of the pro forma disclosures, the fair value of each option grant is estimated on the date of grant with the following weighted average assumptions used for grants in 2000 and 1999, respectively: risk-free interest rates of 4.99% and 4.34%; expected volatility of 123% and 75%; expected dividend yields of 0% and 0%; and expected lives of three years and three years.

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

16. United States accounting principles (continued):

Under United States GAAP, certain additional disclosures with respect to stock options outstanding are required as follows:

	2000		1999	
	Weighted average deemed fair value for United States GAAP purposes	Weighted average exercise price	Weighted average deemed fair value for United States GAAP purposes	Weighted average exercise price
Options granted (exercise price equals deemed fair value for United States GAAP purposes of common shares at grant date)	\$ 5.08	\$ 6.56	\$ 0.60	\$ 1.72

(b) Disclosure of marketable securities:

Marketable securities represent short-term investments with maturities of less than 90 days. Under United States GAAP, these amounts would be classified as a component of cash for the purposes of the statement of cash flows. Under United States GAAP, the funds used in investing activities in 2000 would be decreased by \$50,536,929 (1999 - nil) and the increase in cash in 2000 and the amount of cash at February 29, 2000 would be increased by the same amount.

(c) Disclosure of allowance for doubtful accounts:

United States GAAP requires the disclosure of the allowance for doubtful accounts included in accounts receivable. The allowance for doubtful accounts at February 29, 2000 was \$908,920 (1999 - \$2,626,900).

(d) Disclosure of accrued liabilities:

United States GAAP requires the separate disclosure of accrued liabilities. As at February 29, 2000, accrued liabilities were \$4,172,876 (1999 - \$1,763,024).

MICROFORUM INC.

Notes to Consolidated Financial Statements (continued)

Years ended February 29, 2000 and February 28, 1999

16. United States accounting principles (continued):

(e) Disclosure of rent expense:

United States GAAP requires the disclosure of rent expense for the year. Rent expense was \$671,023 for 2000 (1999 - \$488,876).

(f) Future accounting pronouncements:

FASB has issued pronouncements entitled "Accounting for Derivative Instruments and Hedging Activities" which the Company would be required to adopt in the year ending February 28, 2002 were it reporting under United States GAAP. The Company has not determined the impact of this pronouncement on its consolidated financial statements.

The American Institute of Certified Public Accountants has issued Statements of Position entitled "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" and "Reporting the Costs of Start-up Activities" which the Company adopted in the year ended February 29, 2000. The adoption of these Statements of Position did not have a material effect on the consolidated financial statements.