microforum

Annual Report 2001

CONTENTS

message to shareholders

LAST YEAR WAS INTENSELY CHALLENGING. It's hard to imagine any business sector suffering a year of greater turmoil. Demand in the technology sector dropped dramatically in the second half of calendar 2000. Today there are fewer customers, and they take longer in their buying decisions, and demand more for their money. As a result, your Company, along with many other technology companies, has surplus capacity – capacity acquired over the past two years to meet extraordinary demand.

This industry-wide deterioration is apparent in our financial results. While revenue from continuing operations during fiscal 2001 increased 68 percent to $26.7 million from $15.9 million the year before, the loss was $73.6 million or $1.79 per share compared to $0.08 per share in fiscal 2000, a 96 percent change. Losses included several non-recurring items, including a $4-million bad debt provision, arising primarily from Internet start-ups and other new economy clients, $4.5 million associated with refocusing the business, approximately $30.4 million in depreciated goodwill, and a loss from discontinued operations of $19.7 million.

OUR INDUSTRY UNDER PRESSURE

Microforum is not alone in turning in poor financial results during this period. Most technology companies suffered dramatic setbacks over the past year. Many are in far worse condition than Microforum. However, this does not make our poor financial performance any more acceptable, to our shareholders, the Board or management. We all want to take pride in the Company's successes.

The economic forces impacting our industry are not pleasant; however, we intend to emerge a winner from this recessionary market situation. We are confident that your Company will emerge stronger, with a pressure-tested business model.

THE NEED TO TAKE ACTION

To get there, we have been forced to make some hard decisions and to take some difficult steps to turn around the Company's financial performance. However, we have much in our favour. Our balance sheet remains strong. We have excellent core technologies. We have top people who are able to build on those core technologies. And there is ongoing demand for our core products in the marketplace. In short, we have the will as well as the tools to make Microforum a winner in the new reality of the technology sector.

LOOKING BACK IS PAINFUL

Like so many other companies during 2000, Microforum was driven by tremendous market opportunity. Virtually everyone believed we were witnessing a paradigm shift of unprecedented proportions. Management believed that if we didn't capture market share in the galloping field of Internet solutions, others would. To stake a position and meet client demand, the Company made acquisitions and investments that have proven difficult to sustain since the market has deteriorated.

Microforum's year began with high optimism in February 2000 when we completed a private placement of over $43 million. That was followed in June with Microforum's Nasdaq filing, intended to provide

We are operating under a very tightly controlled cash conservation program. We want to ensure that not one dollar is wasted. Our cash needs to be spent repositioning profitable businesses in the go-forward Company.

greater liquidity for shareholders and the ability to trade alongside the world's fastest-growing technology companies. In that same month Microforum was named "Fastest Growing Technology Company in Canada" by *Canadian Business* magazine.

However, storm clouds quickly gathered thereafter. The collapse of the technology market began in the summer and had worsened by fall. Microforum's sales fell dramatically and bad debts from Internet start-ups and other new economy clients grew. Concurrently, the Company suffered a rash of negative publicity and an abrupt senior management change.

REVITALIZED MANAGEMENT

While our poor financial performance is entirely logical under current market conditions, it is nevertheless unacceptable to all of us at Microforum, and certainly to our shareholders. Because of our results, we have taken action to accelerate our return to profitability.

In February, I was appointed Chairman of the Board. With an extensive background in international finance, most recently with Newcourt Credit Group and AT&T Capital, I bring to the Company some gray hair and many years of management experience, particularly in situations where a solid business plan and internal management disciplines are required to improve performance.

I am currently working with a very talented and dedicated team of Microforum managers to develop that plan. Two fellow Board members share with me the day-to-day management of the Company: David Shaw, former CEO of Pepsi Cola Canada and a very able business leader, and Dr. Steven Small, a very successful venture capitalist and the founding investor in Newcourt. We look forward to presenting our plan to you at the Annual General Meeting on August 2, at the TSE Conference Centre.

FOCUSING OUR BUSINESS

In January and February of 2001, we began reducing costs and divesting the Company of non-core assets, specifically the Company's advertising, public relations, and strategic marketing businesses. Marshall Fenn Communications and Two Door Communications were sold. We have signed a non-binding letter of intent for the sale of PPL Marketing. We intend to complete this transaction by August of this year.

In May 2001, we announced a cost-reduction plan that included the closure of our New York office as well as the reduction of our total workforce by 30 percent before the end of July 2001. These reductions are directly related to the fundamental changes in demand in the sector and the surplus capacity acquired over the past two years. On an annualized basis, these measures alone are expected to reduce our costs by approximately $8 million. We plan to do more, and if market conditions demand it, we will take tougher actions promptly.

We are operating under a very tightly controlled cash conservation program. We want to ensure that not one dollar is wasted. Our cash needs to be spent only in divesting unprofitable businesses and repositioning profitable businesses in the go-forward Company.

STRICTLY PROFIT-FOCUSED

There is a great deal more work to do. However, one of the reasons I joined Microforum is that I believe this Company is able to do that work, to turn itself around and return to profitability.

We have four critical advantages in support of our return to profitability: strong intellectual property, talented people, excellent customers and the financial resources to succeed.

STRONG INTELLECTUAL PROPERTY

The first advantage is the quality of our intellectual property. Microforum owns some of the most robust, adaptable software in the industry. It is used by some very discriminating customers for mission-critical applications. I have had personal experience with CALMS (Credit Adjudication and Lending Management System), and know it is an outstanding credit decision and administration system. It is currently being used by some excellent customers such as Ford Credit, Case New Holland and Fair, Isaac & Co. CALMS is web-based, rapidly deployable, and extremely scalable. It facilitates the flow of credit information to allow for more efficient decision-making. At Newcourt, many of our in-house loan origination and administration systems and those we developed for many high-profile clients were based on CALMS.

TALENTED PEOPLE

The high quality of our people is another great advantage. Despite the Company's challenges, almost all our key people are still with us. They're energetic. They're smart. They are driven. They know our products. They understand our customers, have a history of anticipating customer needs and take great pleasure in satisfying their needs.

The skills of our people span credit adjudication, content management, online help functions, and wireless applications – all essential applications for businesses seeking to enhance revenues or reduce costs.

The passion, dedication and hard work of our people over the next few years is essential for returning this Company to profitability. Accordingly, we are proposing a number of initiatives to our shareholders at the Annual General Meeting designed to protect these assets.

EXCELLENT CUSTOMERS

We have the kind of customers that every company wants – ones with high expectations that never settle for second best. Serving tough customers is not a job for the inexperienced or the insecure. It requires agility to anticipate needs before they are voiced. And it requires horsepower to turn around solutions on time and on budget.

We recognize that "nobody ever got fired for buying IBM", or so the saying goes. The superior way IBM markets and scopes its projects is what Microforum aims to emulate. However, our goal is not to pattern our service delivery after Big Blue. We want to continue executing our contract work just as Microforum always has. It works, and is our competitive advantage. Our blue chip clients rely on Microforum due to our ability to perform quickly, cost-effectively and reliably. We put unsurpassed brainpower and energy against the needs of our customers. This we never want to change, as the satisfaction of our customers is our first objective.

FINANCIAL RESOURCES TO SUCCEED

Our fourth advantage is our balance sheet. We remain liquid, with little debt. That liquid position, against which we have already taken some charges, is well within reach of what it will take to restore Microforum's financial health. We are fortunate to have the cash to reposition the Company.

REDUCING COSTS AND DRIVING GROWTH

Times are tough, and tough actions are required.

We believe in our business, and we are developing a clear plan for the future, based on deep "back-to-basics" analytical thinking.

We have the will and the tools to be a winner in our industry. As I write this, our focus is on cost-cutting and realignment. Our job is to evaluate and protect Microforum's most valuable core assets, then rationalize intelligently around them, reducing costs quickly. That will give way to growing our top-line revenue.

We expect the year ahead to be one of transition. With the greatest speed possible, we intend to achieve satisfactory returns on the capital we have been entrusted by you. Given a fair measure of market stability during the coming year, we intend to transform Microforum into the company we know it can be.

We have the will and the tools to be a winner in our industry. Our job is to evaluate and protect Microforum's most valuable core assets, then rationalize intelligently around them.

Sincerely,

DAVID BANKS
Chairman of the Board

management's discussion and analysis

FISCAL 2001 COMPARED TO FISCAL 2000

Results of continuing operations

The Company reported a loss from continuing operations of $53.9 million for the fiscal year ended February 28, 2001 compared to a loss from continuing operations of $2.2 million for the fiscal year ended February 29, 2000. The major portion of the loss for the fiscal year 2001 was represented by non-cash charges relating to the amortization and write-down of capital assets and intellectual property, amortization and impairment of goodwill, and write-down of investment. These charges aggregated $36.1 million. Additionally, the loss for the fiscal year 2001 included a $4.0 million provision for bad debts and a $4.5 million charge for severance and other costs relating to actions planned in fiscal 2001 to refocus the Company's business.

Revenues

The following table provides a comparative breakdown of revenues by lines of business for the years ended February 28, 2001 and February 29, 2000:

	February 28, 2001		February 29, 2000		**Change**	
	$	**%**	$	%	**$**	**%**
Internet services	**11,038**	**41%**	7,590	48%	**3,448**	**45%**
Media Replication Services	**4,014**	**15%**	4,089	25%	**(75)**	**-2%**
Deployed Consulting Services	**6,062**	**23%**	781	5%	**5,281**	**676%**
Enterprise Solutions Group	**3,904**	**15%**	2,264	14%	**1,640**	**72%**
CALMS	**1,689**	**6%**	1,216	8%	**473**	**39%**
	26,707	**100%**	15,940	100%	**10,767**	**68%**

Internet services revenues, comprised of consulting, licensing and customization services, increased approximately $3.4 million for the 2001 fiscal year over the comparable period in 2000. Approximately $2.8 million of this increase was attributable to revenues generated by the operations of Blue Hypermedia, Inc., which was acquired on June 30, 2000, and the remainder to organic growth fueled by the then surging new economy marketplace in the first half of the fiscal year. Revenues of this business fell dramatically from September 2000 through to February 28, 2001 with the significant contraction of the new economy marketplace.

Deployed Consulting Services' revenues were derived from the operations of Relational Solutions Inc., acquired on December 1, 1999. The increase of $5.3 million for fiscal 2001 over fiscal 2000 is the combined result of 12 months of revenues in fiscal 2001 compared with 3 months in fiscal 2000 and an increase in revenues from existing and new clients, primarily in the public sector.

Revenues from the Enterprise Solutions Group were derived from the acquisition of Q-Inter Applications Inc. on June 1, 1999. The increase of $1.6 million over fiscal 2000 is the combined result of 12 months of revenues in fiscal 2001 compared with 9 months in fiscal 2000 and an increase in revenues from increased client implementations of Navision software in the marketplace. This product is well accepted. The Enterprise Solutions Group is now also the reseller of two new products: Changepoint and Seibel.

Recognized revenues from the Credit Adjudication and Lending Management System (CALMS) of $1.7 million increased by $0.5 million in fiscal 2001 over fiscal 2000. Deferred revenues on the balance sheet at February 28, 2001 includes $3.3 million (2000 – $0) relating to CALMS projects that were at various stages of completion as at February 28, 2001. These revenues are excluded from recognized revenue as the Company's revenue recognition policy does not recognize income until such time as the projects are complete. The increase in both recognized and deferred revenues is attributable to increasing customer demand for this solution.

Gross Profit

	February 28 2001	February 29 2000
Overall gross profit %	**31%**	62%

Overall gross profit and gross profit percentage decreased from $9.9 million in fiscal 2000 (62%) to $8.4 million in fiscal 2001 (31%), reflecting the impact of increased billable headcount in relation to revenues in the current fiscal year. The increase in headcount occurred primarily due to the various acquisitions during the early part of the year as well as hiring due to the Company's increased activities in the surging new economy markets in the period March 2000 to July 2000. Markets for certain of the Company's businesses began to quickly erode in the last half of fiscal 2001, with the decline accelerating rapidly in the last quarter of fiscal 2001. This caused the deterioration in gross profit and the gross profit percentage, as billable resources were not reduced so rapidly.

Operating Expenses

Operating expenses, excluding amortization and write-down of capital assets and intellectual property, write-down of investment, amortization and impairment of goodwill and income taxes, increased approximately $16.2 million in fiscal 2001 to $26.0 million from $9.8 million in fiscal 2000 and include:

- an increase in selling, general and administrative expenses of approximately $8.9 million from $10.6 million for fiscal 2000 to $19.5 million fiscal 2001. The increase reflects wages and staff compensation expenses due to an increase in total personnel resulting from acquisitions and the growth in the Company's business and the Company's newly expanded facilities. Also, sales and marketing expenses were higher for fiscal 2001 due to an increase in sales.
- an increase in bad debts expense of $4.2 million for fiscal 2001 as a result of the rapid downturn in the new economy marketplace and the consequent inability of the Company to recover amounts billed to certain customers in that sector.
- a charge of $4.5 million for fiscal 2001 for a program undertaken by the Company to adjust its business in light of rapidly changing circumstances, fix its cost structure and strengthen the management team. As part of this program, in February 2001, management decided to shut down its New York and Seattle operations and to reduce its Canadian workforce, all due to the downturn in its markets. The Company also decided to offer for sublet certain of its Head Office premises. In total, the charge represents $2.8 million of severance covering approximately 113 employees, $0.9 million of costs relating to the decision not to use certain of the leased premises of the Company, and $0.8 million of professional and other costs.

Amortization and Write-down of Capital Assets, Intellectual Property and Goodwill

Amortization and write-down of capital assets and intellectual property increased by approximately $4.6 million from $0.7 million in fiscal 2000 to $5.4 million in fiscal 2001. Amortization and write-down of capital assets and intellectual property for fiscal year 2001 includes a charge of approximately $3.3 million reflecting the amortization and write-off of intellectual property relating to the acquisitions of Flashcast Communications, Corp. and P2P3 Systems Inc. The remaining increase of approximately $1.4 million reflects the amortization of capital assets acquired during fiscal 2001 in connection with acquisitions during the year and relating to the new Head Office premises.

Amortization and impairment of goodwill increased by approximately $28.7 million from $1.7 million for the fiscal year 2000 to $30.4 million for the year ended February 2001. During fiscal 2001 the evaluation of the carrying value of the goodwill led management to a determination that due to the significant downturn in the emerging new economy, the market for certain products and services of the Company was significantly curtailed, which resulted in an impairment in the goodwill related to certain businesses which were acquired during fiscal years 2001 and 2000. Consequently, at November 30, 2000 a write-down of $23.2 million was taken on the goodwill relating to these businesses to reduce the balance at that date to $5 million. The remaining increase of approximately $5.6 million related to the amortization of goodwill on the acquisitions made in early fiscal 2001, prior to the charge for impairment and to amortization of the $5 million balance for the quarter ended February 28, 2001. The balance of goodwill as at February 28, 2001 will be amortized over the next seven quarters.

Results of Discontinued Operations

The loss from discontinued operations was $19.7 million compared to a loss of $0.4 million in fiscal year 2000. The Company initiated plans in fiscal 2001 to discontinue the Strategic Marketing and Advertising and Public Relations businesses and focus the remaining operations on the e-Business Solutions marketplace. The dispositions of the Advertising and Public Relations businesses to certain former principals, effective November 30, 2000, was completed on February 12, 2001. The disposition of the Strategic Marketing business is expected to be completed by August 31, 2001. The results from discontinued operations have been reported separately in the financial statements and include the operating losses to the measurement date of November 30, 2000, the write-off of remaining goodwill relating to the acquisition of these businesses and a provision for loss to the expected disposal date of the Strategic Marketing business.

LIQUIDITY AND CAPITAL RESOURCES

The Company reported a positive working capital of $14.7 million at February 28, 2001 compared with a positive working capital of $59.0 million at February 29, 2000, representing a decrease of $44.3 million. The decrease in working capital during fiscal 2001 chiefly reflects the use of $29.1 million of marketable securities to fund $10.1 million for acquisitions, $5.7 million for the acquisition of capital assets, and the remainder being used to finance continuing and discontinued operations.

At February 28, 2001, the Company had cash and marketable securities of $21.8 million compared with cash and marketable securities of $52.4 million at February 29, 2000, representing a decrease of $30.6 million.

Accounts receivable, work in progress and other current assets at February 2001 decreased $4.5 million from February 2000. Trade accounts receivable decreased $4.2 million, work in progress inventory increased $0.3 million, and prepaid and other expenses decreased $0.6 million. Trade receivables decreased due to a decline in sales of the Strategic Marketing business, the collection of the November 30, 2000 receivables of the Advertising and Public Relations businesses and a strong collection effort. Work in progress increased in line with the increase in deferred revenues. Accounts payable and other current liabilities at February 28, 2001 increased $9.2 million over February 29, 2000. Accounts payable and accrued liabilities increased $0.1 million, a provision was made for severance and other costs of $3.1 million, a loss was accrued on discontinued operations of $2.2 million and deferred revenue increased $4.2 million, offset by small reductions in other current liabilities. The increase in deferred revenues relates principally to the deferral of revenues on ongoing CALMS projects.

For the 12 months ended February 28, 2001, the Company raised $0.8 million from proceeds on issue of common shares and shares issued as director compensation, repaid $0.7 million under its long-term debt obligations and reduced net amounts due from related parties by $0.3 million.

RISK FACTORS

Management is confident of the Company's future, but recognizes the risk factors and uncertainties it faces, including:

- Rapid changes in technology
- Dependence on proprietary technology
- Competition
- Attracting, hiring and retaining key personnel

In addition, at this time, the Company is faced with the general economic weakness in the North American marketplace.

OUTLOOK

The following comments are based on the Company's current expectations of its future. Actual results could differ from the comments below.

Our plan for the future is to retain only those businesses that are currently profitable or that can be made profitable very quickly and to invest in these businesses as required and as financially justified to sustain their growth.

CALMS is well received in the marketplace and the Company will expand this business as its core business. This business offers high margins and is directed at financially strong customers. Independent research indicates that the market for this product is strong.

The Company's Deployed Consulting Services business offers reasonable gross margins in providing services primarily to provincial governments. This business will expand the offering of its services to the federal and municipal governments as well.

The Enterprise Solutions Group is becoming recognized as a leading reseller and implementer of the Navision financial software. This group has also recently become a reseller of Changepoint – a practice management suite and Seibel – a sales tracking suite.

The Media Replication Services business offers consistent margins and profits.

The Internet Services Group is currently being evaluated with a view to determining whether it can return to profitability and then sustain its profitability into the future.

The Company has implemented a cost reduction program that will result in annualized costs savings of at least $8 million. This program included the closure of the Company's New York operations, the offer for sublet of certain of its Head Office space and a reduction of the Company's workforce by more than 30 per cent of the 295 employees in the continuing operations.

The Company will continue to tightly manage its cash and will identify further cost savings both at the corporate cost centre level as well as the strategic business unit level. The Company expects to identify further cost savings in the range of $2 million. It is likely that the actions taken to generate these savings will result in further charges against earnings in early fiscal 2002.

management's report to shareholders

The management of Microforum Inc. is responsible for the accompanying consolidated financial statements and other information included in the annual report. The financial statements have been prepared in conformity with Canadian generally accepted accounting principles using best estimates and judgements of management, where appropriate. Information presented elsewhere in this annual report is consistent with that in the financial statements.

Management is also responsible for a system of internal control which is designed to provide reasonable assurance that assets are safeguarded, liabilities are recognized and that accounting systems provide timely and accurate financial reports.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities in respect of financial reporting and internal control. The Audit Committee of the Board of Directors meets periodically with management and the Company's independent auditors to discuss auditing matters and financial reporting issues. In addition, the Audit Committee reviews the annual consolidated financial statements and annually recommends to the Board of Directors the appointment of the independent auditors.

DAVID BANKS
Chairman of the Board

OWEN MENZEL
Chief Financial Officer

April 17, 2001

auditors' report to shareholders

We have audited the consolidated balance sheets of Microforum Inc. as at February 28, 2001 and February 29, 2000 and the consolidated statements of operations and deficit and cash flows 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 financial statements based on our audits.

We conducted our audits 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 28, 2001 and February 29, 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

CHARTERED ACCOUNTANTS

Toronto, Canada
April 17, 2001

Consolidated balance sheets

	FEBRUARY 28 2001	FEBRUARY 29 2000
ASSETS		
Current assets		
Cash *(note 6)*	**$ 367,304**	$ 1,847,453
Marketable securities	**21,454,781**	50,536,929
Accounts receivable	**10,565,001**	14,816,804
Work in progress	**1,867,209**	1,592,351
Prepaid expenses and other assets	**321,939**	952,068
	34,576,234	69,745,605
Capital assets *(note 4)*	**8,937,967**	3,841,560
Investment	**–**	300,000
Goodwill *(note 5(a))*	**4,375,000**	19,487,016
	$ 47,889,201	$ 93,374,181
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	**$ 9,994,237**	$ 9,903,590
Accrued severance and other costs *(note 10)*	**3,078,477**	–
Accrued loss from discontinued operations *(note 3)*	**2,170,097**	–
Deferred revenue	**4,309,798**	110,730
Due to shareholder *(note 14)*	**–**	252,500
Current portion of long-term debt *(note 7)*	**367,799**	497,708
	19,920,408	10,764,528
Long-term debt *(note 7)*	**683,410**	–
Shareholders' equity		
Capital stock *(note 8)*	**100,086,796**	105,497,595
Shares to be issued on acquisition *(note 2(a)(i))*	**253,911**	–
Contributed surplus	**521,847**	–
Deficit	**(73,577,171)**	(22,887,942)
	27,285,383	82,609,653
Commitments *(note 12)*		
	$ 47,889,201	$ 93,374,181

See accompanying notes to consolidated financial statements.

On behalf of the Board

DAVID BANKS
Chairman of the Board

J. EFRIM BORITZ
Director

Consolidated statements of operations and deficit

	FEBRUARY 28 2001	FEBRUARY 29 2000
Sales	**$ 26,706,648**	$ 15,939,813
Cost of sales	**18,339,005**	6,000,879
Gross profit	**8,367,643**	9,938,934
Operating expenses (income)		
Selling, general and administrative	**19,491,405**	10,604,844
Interest on long-term debt	**125,493**	94,336
Bad debts	**3,998,218**	(157,379)
Severance and other costs *(note 10)*	**4,466,868**	–
Investment income	**(2,045,204)**	(734,420)
	26,036,780	9,807,381
Income (loss) from continuing operations before the undernoted	**(17,669,137)**	131,553
Gain on settlement of note receivable on sale of Microforum Italia s.r.l. *(note 3(b))*	**–**	205,792
Amortization and write-down of capital assets and intellectual property *(note 5(b))*	**5,387,777**	743,855
Write-down of investment	**339,490**	–
Loss from continuing operations before amortization and impairment of goodwill and income taxes	**(23,396,404)**	(406,510)
Income taxes *(note 11)*	**79,921**	166,000
Loss from continuing operations before amortization and impairment of goodwill	**(23,476,325)**	(572,510)
Amortization and impairment of goodwill *(note 5(a))*	**30,376,960**	1,664,729
Loss from continuing operations	**(53,853,285)**	(2,237,239)
Loss from discontinued operations *(note 3)*	**(19,723,886)**	(354,246)
Loss for the year	**(73,577,171)**	(2,591,485)
Deficit, beginning of year	**(22,887,942)**	(19,985,966)
Reduction of stated capital *(note 8(b))*	**22,887,942**	–
Premium on redemption of common shares	**–**	(310,491)
Deficit, end of year	**$ (73,577,171)**	$ (22,887,942)
Basic loss per share *(note 8(d))*:		
From continuing operations before amortization and impairment of goodwill	**$ 0.57**	$ 0.02
From continuing operations	**$ 1.31**	$ 0.07
From discontinued operations	**0.48**	0.01
Loss for the year	**$ 1.79**	$ 0.08

See accompanying notes to consolidated financial statements.

Consolidated statements of cash flows

	FEBRUARY 28 2001	FEBRUARY 29 2000
Cash provided by (used in):		
Operating activities		
Loss from continuing operations	**$ (53,853,285)**	$ (2,237,239)
Items not affecting cash:		
Amortization and write-down of capital assets and intellectual property	**5,387,777**	743,855
Write-down of investment	**339,490**	–
Amortization and impairment of goodwill	**30,376,960**	1,664,729
Non-cash director compensation	**20,903**	20,435
Non-cash compensation expense	**253,911**	–
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	**2,075,683**	(1,626,252)
Work in progress	**(525,927)**	585,424
Prepaid expenses and other assets	**728,631**	(813,194)
Accounts payable and accrued liabilities	**2,527,049**	696,560
Accrued severance and other costs	**3,078,477**	–
Deferred revenue	**3,551,916**	(960,350)
	(6,038,415)	(2,131,824)
Financing activities		
Proceeds on issue of common shares, net	**770,000**	1,663,777
Proceeds on issue of special warrants	**–**	65,597,756
Long-term debt, net of repayments	**(706,476)**	(902,520)
Proceeds from officer loan repayment	**–**	512,167
Decrease in due to shareholder	**(252,500)**	(877,373)
Due to related parties	**–**	115,900
	(188,976)	66,109,707
Investing activities		
Sale (purchase) of marketable securities	**29,082,148**	(50,536,929)
Acquisition of capital assets, net	**(5,737,461)**	(538,483)
Acquisition of subsidiaries, net of cash acquired	**(10,116,715)**	(7,174,204)
Proceeds on settlement of note receivable on sale of Microforum Italia s.r.l.	**–**	305,792
Increase in investments	**(39,490)**	(300,000)
	13,188,482	(58,243,824)
Increase in cash attributable to continuing operations	**6,961,091**	5,734,059
Decrease in cash attributable to discontinued operations	**(8,441,240)**	(2,532,052)
Increase (decrease) in cash	**(1,480,149)**	3,202,007
Cash (bank indebtedness), beginning of year	**1,847,453**	(1,354,554)
Cash, end of year	**$ 367,304**	$ 1,847,453

Supplemental cash flow information (note 15)
See accompanying notes to consolidated financial statements.

Notes to consolidated financial statements

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation.

Investments where the Company is unable to exercise significant influence are recorded at cost and are written down only when there is evidence that a decline in value that is other than temporary has occurred.

(b) Work in progress

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

(c) Capital assets

Capital assets are stated at cost, net of accumulated amortization. Amortization is provided using the following bases and annual 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

The Company regularly reviews the carrying value of its capital assets for potential impairment in value. An impairment loss would be recognized when undiscounted future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. If such assets are considered impaired, the amount of the impairment loss recognized is measured as the amount by which the carrying value of the asset exceeds the fair value of the asset, fair value being determined based upon undiscounted cash flows or appraised values, depending on the nature of the asset. Any impairment in the carrying value of capital assets is charged to the statement of operations and deficit in the period such impairment is determined.

(d) Intellectual property

Intellectual property represents assets acquired from Flashcast Communications, Corp. and P2P3 Systems Inc. These assets are being amortized on a straight-line basis over three years.

The Company regularly reviews the carrying value of its intellectual property for potential impairment in value. An impairment loss would be recognized when estimated undiscounted cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. If such assets are considered impaired, the amount of the impairment loss recognized is measured as the amount by which the carrying value of the asset exceeds the fair value of the asset, fair value being determined based upon undiscounted cash flows or appraised values, depending on the nature of the asset. Any impairment in the carrying value of intellectual property is charged to the statement of operations and deficit in the period such impairment is determined.

(e) Revenue recognition

The Company's revenue is derived from the following sources:

(i) Software and services

Revenue from software license agreements is recognized upon delivery of software if persuasive evidence of an arrangement exists, collection is probable, the fee is fixed or determinable, vendor-specific objective evidence exists to allocate the total fee to elements of the arrangement and significant customization of the licensed software is not required. If an acceptance period is required, revenue is recognized upon the earlier of customer acceptance or the expiration of the acceptance period. The Company's agreements with its customers and resellers do not contain product return rights.

Revenue related to software customization, where significant customization is required, is recognized on the earlier of customer acceptance or the expiration of the acceptance period.

Revenue related to software customization, where such customization is not significant or could be offered by other vendors, is recognized as services are provided. Provision for estimated losses on contracts is recorded when identifiable.

Revenue that has been invoiced but does not yet qualify for recognition under the Company's policies is reflected as deferred revenue.

(ii) Consulting services

Revenue related to consulting services is recognized as services are provided.

(iii) Maintenance and support

Revenue related to maintenance agreements for supporting and maintaining the Company's products is recognized rateably over the term of the agreement, generally one year.

(iv) Royalties

Revenue related to royalties is recognized on the accrual basis, in accordance with the terms of the relevant agreement.

(f) Foreign currency translation

The Company's foreign subsidiary is considered to be a self-sustaining operation. Accordingly, the Company utilizes the current rate method to translate the financial statements of this subsidiary into Canadian dollars. Under the current rate method, the assets and liabilities of the subsidiary are translated at the rate of exchange in effect at the balance sheet date and revenue and expenses at the weighted average rate for the year. Exchange gains or losses arising from the translation of the financial statements of the self-sustaining foreign operation is deferred and included in cumulative translation adjustments as a separate component of shareholders' equity.

Other foreign currency transactions included in these consolidated financial statements are translated into Canadian dollars at the rate of exchange in effect at the balance sheet date in the case of monetary assets and liabilities and at the rate of exchange in effect on the date of transaction in the case of non-monetary assets and income and expenses. All gains and losses on translation of these foreign currency transactions are included in income.

(g) Goodwill

Goodwill represents the excess of the purchase price over the fair values of net assets acquired, and is being amortized on a straight-line basis over three years (2000 – three to ten years).

The Company regularly reviews the carrying value of its goodwill for potential impairment in value. An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. If such assets are considered impaired, the amount of the impairment loss recognized is measured as the amount by which the carrying value of the asset exceeds the fair value of the asset, fair value being determined based upon each unit's financial condition and estimated fair values on an undiscounted basis. Any impairment in the carrying value of goodwill is charged to the statement of operations and deficit in the period such impairment is determined.

(h) Income taxes

Effective January 1, 2000, The Canadian Institute of Chartered Accountants ("CICA") changed the accounting standard relating to the accounting for income taxes. The new standard adopts the liability method of accounting for future income taxes. Under the liability method, future income tax assets and liabilities are determined based on differences between the accounting basis and the tax basis of the assets and liabilities, and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized. Income tax expense or benefit is the sum of the Company's provision for current income taxes and the difference between the opening and ending balances of the future income tax assets and liabilities.

Prior to adoption of this new accounting standard, income tax expense was determined using the deferral method. Under this method, deferred income tax expense was determined based on differences between the accounting and tax treatment of items of expense or income and was measured using the tax rates in effect in the year the differences originated. Certain deferred tax assets, such as the benefit of tax losses carried forward, were not recognized unless there was virtual certainty that they would be realized.

The Company has adopted the new income tax accounting standard retroactively, which did not have an impact on the current or prior periods.

(i) Financial instruments

Fair values

The carrying amounts reported in the balance sheets of marketable securities, accounts receivable, accounts payable and accrued liabilities, accrued loss from discontinued operations 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.

Credit risk

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

(j) Stock-based compensation plan

The Company has a stock option plan, which is described in note 9. 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.

(k) 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, particularly goodwill, and recorded values of liabilities including those relating to discontinued operations and severance and other costs. Actual results could differ from those estimates.

2. ACQUISITIONS

(a) Acquisitions during 2001 were as follows:

(i) Acquisition of Icom Alliance Incorporated

Effective May 1, 2000, the Company acquired all the issued and outstanding common shares of Icom Alliance Incorporated. The purchase price for the transaction was $1,000,000, exclusive of expenses relating to the acquisition of $72,417, of which $750,000 was paid by way of cash and $250,000 was paid by way of issue of 39,671 common shares, at a value of $6.30 per share, of the Company. As additional consideration, the Company has agreed to issue up to 396,736 common shares of the Company, over 30 months, upon the achievement of certain conditions. On January 21, 2001, the Company agreed to issue 396,736 common shares of the Company as settlement of the additional consideration provisions of the acquisition agreement that resulted in the recording of additional compensation expense of $253,911. On March 7, 2001, the Company issued 396,736 common shares.

(ii) Acquisition of Flashcast Communications, Corp.

Effective May 11, 2000, the Company acquired substantially all of the productive assets of Flashcast Communications, Corp. The purchase price for the transaction was US$2,000,000, exclusive of expenses relating to the acquisition of $55,521, of which US$500,000 was paid by way of cash and US$1,500,000 was paid by way of issue of 342,563 common shares, at a value of $6.51 per share, of the Company (note 5(b)).

(iii) Acquisition of Blue Hypermedia, Inc.

Effective June 30, 2000, the Company acquired all the issued and outstanding common shares of Blue Hypermedia, Inc. The purchase price for the transaction was US$14,000,000, exclusive of expenses relating to the acquisition of $1,695,178, of which US$4,900,000 was paid by way of cash and US$9,100,000 was paid by way of issue of 1,770,160 common shares, at a value of $7.62 per share, of the Company. Included in the expenses relating to the acquisition are commissions of US$409,500, which were satisfied by the issuance of 79,657 common shares, at a value of $7.62 per share, of the Company (notes 5 and 10).

(iv) Acquisition of the P2P3 Assets

Effective October 25, 2000, the Company acquired substantially all of the productive assets of P2P3 Systems Inc., The Unire Group Inc. and 1421376 Ontario Inc. (collectively, "P2P3 Assets"). The purchase price for the transaction was $200,000, exclusive of expenses relating to the acquisition of $21,000. As additional consideration, the Company has issued 300,000 warrants, subject to vesting (note 8(c)).

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

	Icom Alliance Incorporated	Flashcast Communications, Corp.	Blue Hypermedia, Inc.	P2P3 Assets
Cash and cash equivalents	$ –	$ –	$ 179,108	$ –
Current assets	430,440	–	1,267,124	–
Capital and other assets	26,627	–	478,064	–
Goodwill	1,123,400	–	20,795,616	–
Intellectual property *(note 5)*	–	3,069,392	–	221,000
	1,580,467	3,069,392	22,719,912	221,000
Bank indebtedness	(69,456)	–	–	–
Liabilities assumed	(438,594)	–	(286,565)	–
Net assets	$ 1,072,417	$ 3,069,392	$ 22,433,347	$ 221,000

(b) 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, at a value of $1.30 per share, 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.

(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, at a value of $6.50 per share, of the Company.

(iii) Acquisition of Two Door Communications Corporation

Effective October 1, 1999, the Company acquired all the issued and outstanding common shares of Two Door Communications Corporation. The purchase price for the transaction was $2,000,000, 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, at a value of $6.30 per share, of the Company subsequent to November 30, 1999. As additional consideration, the Company had agreed to pay $1.053 for each $1.00 of pre-tax profit earned by Two Door Communications Corporation for the 12-month period ending September 30, 2000, up to a maximum of $1,000,000. Any such additional consideration would be in the form of common shares and would be accounted for as goodwill. It has been determined that no additional consideration will be paid.

(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, at a value of $6.63 per share, of the Company.

(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, at a value of $7.52 per share, 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. During the year ended February 28, 2001, the Company issued 797,872 common shares as additional consideration.

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

	Software Guaranty Inc.	Q-Inter Applications Inc.	Two Door Comm. Corp.	Frameworks Comm. 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

3. DISCONTINUED OPERATIONS AND DISPOSALS

(a) Discontinued business segments

The Company initiated plans in fiscal 2001 to discontinue certain of its operations and restructure its remaining operations to concentrate on the e-Business Solutions segment. The Board of Directors has approved a formal plan to dispose of the Strategic Marketing and Advertising and Public Relations businesses. The disposition of the Strategic Marketing business is expected to be completed before the end of the third quarter of fiscal 2002. The dispositions of the Advertising and Public Relations businesses to certain former principals were supported by independent fairness opinions obtained by the Company and were completed on February 12, 2001. The results from discontinued operations have been reported separately in these financial statements and include the operating loss to the measurement date, November 30, 2000, and the expected costs of discontinuance, net of estimated proceeds, to the expected disposal dates as follows:

	2001	2000
Revenue	**$ 25,152,287**	$ 31,866,756
Operating expenses	**35,689,393**	32,221,002
Write-off of related goodwill	**6,586,780**	–
Loss to measurement date	**(17,123,886)**	(354,246)
Estimated loss from measurement date to disposal date	**(2,600,000)**	–
	$ (19,723,886)	$ (354,246)

The loss from discontinued operations from the measurement date of November 30, 2000 to February 28, 2001 was $429,903 which is included in the accrued loss from discontinued operations on the balance sheet.

Assets and liabilities relating to discontinued operations are as follows:

	2001	2000
Current assets		
Accounts receivable	**$ 5,963,409**	$ 9,592,824
Work in progress	**950,155**	1,361,780
Prepaid expenses and other assets	**55,633**	40,844
	6,969,197	10,995,448
Capital assets	**731,070**	889,407
Goodwill	**–**	7,439,254
Total assets attributed to discontinued operations	**$ 7,700,267**	$ 19,324,109
Liabilities		
Accounts payable and accrued liabilities	**$ 1,972,028**	$ 4,855,749
Accrued loss from discontinued operations	**2,170,097**	–
Deferred revenue	**627,042**	107,730
Total liabilities attributed to discontinued operations	**$ 4,769,167**	$ 4,963,479

For the year ended February 28, 2001, the Company earned a significant portion of its revenue from discontinued operations from three (2000 – three) customers. As at February 28, 2001, approximately 72% (2000 – 53%) of the accounts receivable balance from discontinued operations and 87% (2000 – 77%) of revenue from discontinued operations for the year then ended were derived from these customers.

(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 expired in September 1999. Price adjustment provisions apply in the event the purchasers elect to substitute cash in lieu of common shares otherwise due to be tendered. 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. 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.

4. CAPITAL ASSETS

2001	Cost	Accumulated amortization	Net book value
Computer equipment and software	**$ 9,759,902**	**$ 5,508,333**	**$ 4,251,569**
Duplication and packaging equipment	**1,691,982**	**1,373,753**	**318,229**
Furniture, automotive and office equipment	**3,627,868**	**1,683,996**	**1,943,872**
Leasehold improvements	**3,566,950**	**1,142,653**	**2,424,297**
	$ 18,646,702	**$ 9,708,735**	**$ 8,937,967**

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
	$ 11,737,655	$ 7,896,095	$ 3,841,560

Amortization and write-down of capital assets amounted to $2,255,722 and $1,044,934 in 2001 and 2000, respectively.

Included in the above capital assets are assets under capital lease with a cost of $1,109,977 (2000 – $3,477,010) and accumulated amortization of $50,733 (2000 – $2,528,791).

5. GOODWILL AND INTELLECTUAL PROPERTY

(a) Goodwill:

	2001	2000
Cost	**$ 44,825,656**	$ 22,268,340
Less:		
Accumulated amortization	**10,672,876**	2,781,324
Goodwill impairment on continuing operations	**23,191,000**	–
Goodwill impairment on discontinued operations	**6,586,780**	–
	$ 4,375,000	$ 19,487,016

Amortization and write-down of goodwill amounted to $37,669,330 and $2,451,175 during 2001 and 2000, respectively.

During the year ended February 28, 2001, the evaluation of the carrying value of the goodwill led to a determination by management that due to the significant downturn in the emerging new economy, the market for certain products and services of the Company was significantly curtailed, resulting in a permanent impairment in certain amounts of goodwill. Consequently, during the year ended February 28, 2001, there was a write-down of $23,191,000 relating to certain businesses acquired and forming a part of continuing operations and an additional write-off relating to discontinued operations of $6,586,780, which is included in the loss from discontinued operations (note 3).

(b) Intellectual property

During the year ended February 28, 2001, for the reasons stated in (a) above, the Company amortized $469,514 and wrote down $2,820,878 of intellectual property relating to the acquisitions of Flashcast and the P2P3 Assets (notes 2(a)(ii) and 2(a)(iv)).

6. BANK LINE OF CREDIT

The Company has a revolving line of credit for borrowings of up to $6,000,000 (2000 – $3,000,000) and aggregate non-revolving loan facilities of $25,000 at February 28, 2001 (2000 – $122,955). 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 is $6,150,000 of marketable securities, a general security agreement covering all assets other than real property, a guarantee and postponement of claim in the amount of $4,000,000 and an assignment of insurance over real property. The Company also has a standby letter of credit in the amount of $175,000.

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:

2001	Capital leases	Bank loans	Total
2001	**$ 425,487**	**$ 25,000**	**$ 450,487**
2002	**425,487**	**–**	**425,487**
2003	**319,115**	**–**	**319,115**
	1,170,089	**25,000**	**1,195,089**
Less imputed interest	**143,880**	**–**	**143,880**
	1,026,209	**25,000**	**1,051,209**
Less current portion	**342,799**	**25,000**	**367,799**
	$ 683,410	**$ –**	**$ 683,410**

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
	$ –	$ –	$ –

(a) Capital lease obligations bear interest at a rate of approximately 9.5% (2000 – 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 6), included in bank loans is nil (2000 – $100,000, which bears interest at 7.25%, remaining amounts bear interest at prime plus 1%).

8. CAPITAL STOCK

	2001	2000
Authorized:		
Unlimited preference shares		
Unlimited common shares		
Issued:		
42,814,401 common shares (2000 – 35,424,897)	**$ 100,086,796**	$ 65,054,235
Nil special warrants (2000 – 4,334,400)	**–**	40,443,360
	$ 100,086,796	$ 105,497,595

(a) Common shares:

	Number of shares	Amount
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
Conversion of broker warrants	947,793	1,952,764
Conversion of options to service providers	450,000	1,207,500
Issued for cash under stock option agreements	451,696	1,203,777
Sale of shares received in satisfaction of note receivable arising on the sale of Microforum Italia s.r.l.	100,000	100,000
Issued on acquisition of Software Guaranty Inc., net of price adjustment	659,979	857,504
Issued on acquisition of Q-Inter Applications Inc.	86,153	560,000
Issued on acquisition of Two Door Communications Inc.	150,830	1,000,000
Issued on acquisition of Frameworks Communications Inc.	301,659	2,000,000
Issued on acquisition of Relational Solutions Inc.	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	35,424,897	65,054,235
Issued on conversion of special warrants	4,334,400	40,378,189
Conversion of broker warrants	129,961	684,946
Issued for cash under stock option arrangements	114,430	150,225
Issued on acquisition of Icom Alliance Incorporated	39,671	250,000
Issued on acquisition of certain assets of Flashcast Communications, Corp.	342,563	2,230,085
Issued on acquisition of Blue Hypermedia, Inc.	1,849,817	14,089,704
Issued as additional consideration on acquisition of Relational Solutions Inc.	797,872	638,298
Issued to directors for services rendered	5,724	20,903
Cancelled in satisfaction of agreement between the Company and a certain former senior officer of the Company	(224,934)	(521,847)
Reduction of stated capital	–	(22,887,942)
Balance, February 28, 2001	42,814,401	$ 100,086,796

(b) Stated capital reduction

On June 28, 2000, a special resolution was passed by the Company's shareholders to eliminate the deficit of the Company at February 29, 2000 by reducing the stated capital by $22,887,942. This deficit was accumulated in connection with the Company's historical operations and does not relate to the Company's current business mandate.

(c) Warrants

On October 25, 2000, in connection with the acquisition of certain assets of the P2P3 Assets (note 2(a)(iv)), the Company issued 300,000 warrants as partial consideration, in satisfaction of the purchase price. The warrants are exercisable without payment of additional consideration into options to purchase up to an aggregate of 300,000 common shares of the Company at an exercise price of $2.19. The Company has determined that the vesting conditions attached to these options will not be met.

(d) Basic loss per share

Basic loss per share is calculated using a weighted average number of outstanding shares of 41,065,080 (2000 – 31,227,793). Fully diluted loss per share data is not presented, as it is not dilutive.

9. 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 8,250,000 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 28, 2001 and February 29, 2000 is as follows:

	Year ended February 28, 2001		Year ended February 29, 2000	
	Number of shares	**Weighted average exercise price**	Number of shares	Weighted average exercise price
Balance, beginning of period	**4,721,888**	**$ 5.24**	2,539,567	$ 2.46
Options granted	**3,245,500**	**2.58**	3,310,400	6.56
Options exercised	**(114,430)**	**(1.31)**	(451,696)	(2.66)
Options cancelled	**(1,986,575)**	**(4.32)**	(676,383)	(3.00)
Balance, end of period	**5,866,383**	**3.61**	4,721,888	5.24
Exercisable, end of period	**2,796,288**	**$ 3.29**	690,374	$ 2.50

Range of exercise prices	Number of options outstanding	Weighted average remaining life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
$ 0.55–1.13	1,946,061	9.67	$ 0.93	908,762	$ 0.94
1.24–1.35	294,513	7.15	1.27	317,452	1.28
1.98–2.45	613,401	8.59	2.28	319,069	2.43
3.15–4.55	488,967	8.27	4.03	292,968	3.35
4.90–7.10	1,830,939	8.86	5.50	594,703	5.50
8.00–8.20	692,502	8.76	8.02	363,334	8.01
$ 0.55–8.20	5,866,383	8.95	$ 3.61	2,796,288	$ 3.29

The Company has granted the following options, which are outstanding at February 28, 2001:

	Number of options		Exercise price	Expiry date
Compensation options	28,918	$	1.38	March 8, 2001
Compensation options	303,409		10.00	August 10, 2001

10. SEVERANCE AND OTHER COSTS

During the year ended February 28, 2001, the Company recorded a charge of $4,466,868 for a program undertaken by the Company to focus its business, fix its cost structure and strengthen the management team. As part of this program, management decided to close the operations of Blue Hypermedia, Inc., close the Seattle, USA office, reduce the Company's workforce and provide for certain leased premises which the Company will not use in the future. In addition, the Company incurred certain professional fees and other one-time costs in connection with the restructuring of its business.

(a) Closure of Blue Hypermedia, Inc.

In February 2001, the Company decided to close the operations of Blue Hypermedia, Inc. due to the downturn in the new economy marketplace. The Company's plans included an assessment to determine the most cost-effective method and timing of closure. The Company has accrued costs relating to severance, future rent costs, legal and other closure costs.

(b) Closure of Seattle, USA office

During January 2001, the Company approved the closure of the Seattle, USA office. In connection with this closure, the Company has provided for all required statutory and contractual severance obligations.

(c) Workforce reduction

During January 2001, the Company approved plans to reduce its workforce and has accrued the required statutory and contractual severance obligations.

(d) Lease premises

During February 2001, the Company determined that a portion of the current leased property will no longer be of benefit to its continuing operations. The provision represents management's best estimate as to the future net cash outflows relating to these premises.

		Severance and other costs		Amounts included in accrued severance and other costs
Severance	$	2,793,027	$	1,943,250
Lease and other contractual obligations		893,000		893,000
Other professional fees and costs		780,841		242,227
	$	4,466,868	$	3,078,477

The major components of the restructuring are estimated to be complete by the end of fiscal year 2002.

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 from continuing operations before income taxes for the following reasons:

	2001	2000
Effective income tax rate	**44.6%**	44.6%
Income tax recovery based on the loss from continuing operations before income taxes	**$ (23,983,000)**	$ (924,000)
Large Corporations Tax	**79,921**	166,000
Goodwill amortization and impairment	**13,548,000**	742,000
Deductible financing expenses	**(564,000)**	(303,000)
Losses not tax-effected	**10,865,000**	440,000
Other	**134,000**	45,000
	$ 79,921	$ 166,000

Significant components of the Company's future income taxes as of February 28, 2001 and February 29, 2000 are as follows:

	2001	2000
Future income tax assets:		
Tax loss carryforwards	**$ 26,781,000**	$ 10,376,000
Property and equipment	**175,000**	175,000
Deductible financing expenses	**1,357,000**	447,000
	28,313,000	10,998,000
Less valuation allowance	**28,313,000**	10,998,000
	$ –	$ –

The Company has established valuation allowances equal to the net future tax assets due to uncertainties regarding the realization of future 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.

As at February 28, 2001, the Company had approximately $60,046,000 of unrecognized non-capital tax losses, which may be carried forward to reduce future years' taxable income. These losses expire as follows:

2002	$ 300,000
2003	8,600,000
2004	9,300,000
2005	4,500,000
2006	553,000
2007	36,793,000
	$ 60,046,000

12. OPERATING LEASE COMMITMENTS

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

2002	$ 2,294,000
2003	2,204,000
2004	2,107,000
2005	1,797,000
2006	1,500,000
Thereafter	6,460,000

13. SEGMENTED INFORMATION

As a result of the planned discontinuation of operations of two of its three business segments (note 3), the Company operates in only one business segment. The Company's predominant geographic segment is Canada. Consequently, no additional information has been provided.

14. RELATED PARTY TRANSACTIONS

Amount due to shareholder is detailed as follows:

	2001	2000
Due to shareholder	**$ –**	$ 252,500

Amount due to shareholder is non-interest bearing and was repaid on its maturity date of March 31, 2000.

15. SUPPLEMENTAL CASH FLOW INFORMATION

	2001	2000
Supplemental cash flow information:		
Interest paid	**$ 212,672**	$ 110,528
Income taxes paid	**164,615**	15,224
Supplemental disclosure of non-cash investing and financing activities:		
Common shares issued in connection with acquisition of subsidiaries	**$ 17,461,998**	$ 7,917,508
Common shares issued in consideration for directors' compensation	**20,903**	20,435
Acquisition of capital assets financed by the assumption of a capital lease	**1,109,977**	–

16. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform with the presentation adopted in the current year.

board statement of corporate governance

Microforum operates in the technology industry. It's a sector that highly values creativity, which is essential to our business. However, if not properly managed, creativity can be nurtured at the expense of disciplined business processes. When this balance is out of equilibrium, the perils can be significant. As a consequence, Microforum strongly values and practices sensible governance. The Company relies upon its Board to ensure the energy of creativity and disciplined business processes are correctly balanced.

Microforum maintains a Board of Directors with the authority, independence and access to the information it requires to fulfill its duties. The members of the Board of Directors are carefully chosen for the broad business experience and values they provide. The Board's ability to execute its duties efficiently is central to generating shareholder value and securing a competitive advantage for Microforum. Because we believe our Board of Directors is a corporate asset, Microforum is committed to constantly improving its corporate governance standards.

The Company also recognizes that practices governing the roles and responsibilities of Board members and management need to be flexible to accommodate business realities. During the period of transition the Company currently faces, we intend to keep the Board smaller and more involved in the Company's business. Currently, management is being provided day-to-day guidance and direction from the Executive Office, a subcommittee of the Board temporarily formed to direct the Company's realignment process in the absence of a chief executive. The Executive Office is made up of three members of the Company's Board of Directors and will be disbanded upon the completion of the realignment process and the appointment of a new Chief Executive Officer.

The Company's goal is to continually enhance its corporate governance standards. This is a particularly important goal as the Company transitions through this period of turmoil. We have re-articulated our corporate governance guidelines as well as re-evaluated our compliance with these guidelines. The Company will add to the corporate governance guidelines whenever it determines that new initiatives will enhance shareholder value and afford Microforum a competitive advantage.

GENERAL GOVERNANCE

- Microforum's Board regards itself as fully responsible for the stewardship of the Company.
- The Board provides guidance on and approves the business plans proposed by the Company's Leadership Team and oversees the implementation of its strategic plans.
- The Chairman of the Board is responsible for the Company's general corporate governance, which includes but is not limited to reviewing the Company's approach to ethics, regulation, management processes and the performance of the Board and its Committees. As well, the Chairman monitors compliance with the Company's stated corporate governance policies.
- The Board ensures that the Leadership Team has considered the principal risks of the business and has plans for dealing with crises. The Board monitors those risks through regular reports prepared by the Leadership Team.
- The Board is committed to maintaining an effective corporate communications policy for the benefit of all the Company's stakeholders. This includes the adoption of a written disclosure policy, compliance with timely and continuous disclosure obligations applicable under law, and ensuring a designate of the Leadership Team is available to respond to inquiries from shareholders.

COMMITTEES

- Each of the Audit Committee, Compensation Committee and Governance and Nominating Committee is comprised exclusively of unrelated Directors.
- The Audit Committee has the responsibility for ensuring the integrity of the Company's financial reporting, risk management and internal controls. The Committee has unrestricted access to the Company's personnel and documents, and has direct communication channels with the Auditors of the Company in order to discuss audit and related matters whenever appropriate. The Audit Committee receives and reviews the annual financial statements of the Company and makes recommendations thereon to the Board prior to their approval by the full Board. The Audit Committee also reviews the scope and planning of the external audit, the form of audit report and any correspondence from or comments by the Auditors of the Company regarding financial reporting and internal controls. In addition, the Audit Committee meets with the Auditors of the Company quarterly to discuss and receive the quarterly interim financial statements. The Audit

Committee is responsible for ensuring that the Leadership Team corrects weaknesses identified by the Auditors of the Company with respect to the internal control systems and for ensuring that the recommended corrections have been implemented.

- The Audit Committee reviews with the Leadership Team and the Auditors of the Company the ongoing sufficiency and integrity of the Company's internal controls, financial reporting and management information systems.
- The Compensation Committee recommends and reviews the compensation and human resources management policies of the Company. In addition to its monitoring role, the Committee proposes to the Board changes in the compensation policies of the Company, as it believes appropriate.
- The Compensation Committee reviews and recommends to the Board salary, benefits and bonus levels for the Company, salary and bonus actions for the Chief Executive Officer and the Leadership Team, and grants of share options for the Company. In addition, it ratifies on behalf of the Board allocations of option grants.
- The Governance and Nominating Committee recruits and reviews the nomination of new Directors to the Board. As well, the Committee considers governance matters as they arise, and assesses the quality of the Company's governance on an ongoing basis.
- The Governance and Nominating Committee appraises the standards of governance of the Board, ensures the independence of the Board and its actions and ensures that the Board acts within the ambit of the prevailing regulatory guidance and best practices.

INDEPENDENCE AND EFFECTIVENESS

- The Board of Microforum will be kept smaller during periods of high growth or transition to ensure active and meaningful participation by all Directors. The Board currently consists of seven Directors, and plans to expand to eight over the next twelve months.
- Over the next twelve months and following the dissolution of the Executive Office, the Board will consist of seven non-management or unrelated Directors and one management or related Director (namely the Chief Executive Officer). This proportion is well within the requirements of TSE guidelines.
- The Board reviews the factual circumstances and relevant relationships of each of the Directors, and will report any related party transactions in the management's discussion and analysis section of its annual filings.
- The Company maintains a bright line between the Board's oversight and the day-to-day management of the Company. However, the Board's unrelated Directors have direct access to the Leadership Team at Board meetings, the Chief Financial Officer in Audit Committee meetings, the Senior Director of Human Resources in the Compensation Committee meetings, and the General Counsel in the Governance and Nominating Committee meetings. As well, the Board's unrelated Directors have access to the Auditors of the Company.
- In appropriate circumstances, determined in the sole discretion of the Board, the Board may approve the engagement of an outside advisor at the expense of the Company. During the prior year, outside advisors were retained by the Compensation Committee to assist with the development of a compensation incentive framework for the Company.
- Periodically, the Board may, as it has in the past, form special committees to consider matters believed to require especially focused attention. These special committees may also engage outside advisors at the expense of the Company.

ACCOUNTABILITY AND COMPENSATION

- Directors are required to own shares in the Company.
- To further align Directors' compensation with the interests of shareholders, Directors are encouraged to receive their annual compensation in shares pursuant to the Outside Directors' Share Plan, which was approved by the Company's shareholders and the Toronto Stock Exchange. The plan enables Directors to receive shares as compensation for services rendered. As at the date hereof, all of the non-management Directors have elected to receive Common Shares as compensation for services to be rendered for the fiscal year 2001.
- The Chairman appraises each Director and each Committee annually in terms of effectiveness of performance, against the standards set when the Director was engaged. The Chairman takes into consideration level of commitment and quality of performance, as well as adherence to rules.
- Board policy requires that any Director who in any twelve-month period is absent from three or more meetings be removed from the Board.
- The Board is responsible for the assessment of the performance of, and the development of a succession plan for, the Chief Executive Officer. The Chief Executive Officer is charged with those same responsibilities in respect of the Leadership Team.
- The Board reviews the performance appraisals of the Leadership Team annually. These reviews form the basis of the granting of incentive compensation.
- The Chairman periodically reports his assessment of Board performance to the Governance and Nominating Committee as well as to the Auditors of the Company. No less often than annually, the whole Board considers these reports.
- The Company conducts an orientation program for new Directors to ensure they understand the Company as well as their responsibilities. In addition to orientation, the Board regularly invites the Leadership Team and periodically, members at the strategic management level to attend Board meetings to report on their respective business unit activities. Board meetings are periodically organized to include tours of the Company's facilities, which permits the Board to participate in a detailed first-hand review of the Company's activities.
- The Chairman of the Board together with the Chief Executive Officer reviews and approves the design and administration of all compensation and benefit plans and policies for the Company's Leadership Team and Board of Directors, and then makes recommendations to the Compensation Committee. The Compensation Committee then reviews and approves the design and administration of all compensation and benefit plans and policies for the Company's Leadership Team and Board compensation. Often these processes make use of surveys of the marketplace and reports made to the Company by outside consultants.

corporate information

BOARD OF DIRECTORS

David Banks
Chairman of the Board
Microforum Inc.

Dr. Steven Small
Founder
President and CEO
Capital Partners Corporation

François de Gaspé Beaubien
Chief Executive Officer
Telemedia Corp.

J. Efrim Boritz
Professor
School of Accountancy
University of Waterloo

Dwight Crane
Professor
Harvard Business School

Donald W. Paterson
President
Cavandale Corporation
(corporate consultant)

David R. Shaw
President
Yarra Ridge Investments

SENIOR MANAGEMENT/ LEADERSHIP TEAM

EXECUTIVE OFFICE:
David Banks
David Shaw
Dr. Steven Small

Owen Menzel
Chief Financial Officer

Jason Meretsky
Vice-President,
Corporate Affairs
General Counsel & Secretary

Michael Holland
Executive Vice-President,
Operations & Client Services

Martha Cass
Senior Director,
Corporate Communications

Andy Labute
Senior Director,
Human Resources

CORPORATE HEADQUARTERS

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M2P 2B8

REGISTRAR & TRANSFER AGENT

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151 Front Street
8th Floor
Toronto, Ontario
M5J 2N1

STOCK LISTING

The Company's common shares are traded on The Toronto Stock Exchange under the symbol MCF. Options on the Company's common shares are traded on The Montreal Exchange.

INVESTOR RELATIONS

Requests for a copy of the Annual Report or additional corporate materials should be directed to:

Investor Relations
150 Ferrand Drive
Suite 1200
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Direct: (416) 467-4055
Toll-free: (866) 467-4055
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or
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M5R 3K4

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Contact:
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msintzel@genoainc.com
at Microforum:
Tel: (416) 467-4039
megs@microforum.com

ANNUAL GENERAL MEETING

The Microforum Annual General Meeting will take place on August 2, 2001 at 3:00 pm at the TSE Conference Centre
The Exchange Tower
130 King Street West
Toronto, Ontario

microforum