

microforum

Third Quarter Report
November 30, 2001

management's discussion and analysis of financial condition and results of operations

THIRD QUARTER FISCAL 2002 COMPARED TO THIRD QUARTER FISCAL 2001

Results of Continuing Operations

The Company reported a loss from continuing operations of \$9.4 million (\$0.22 per share) for the three-month period ended November 30, 2001 compared to a loss from continuing operations of \$33.5 million (\$0.79 per share) for the three-month period ended November 30, 2000. Of that loss for the third quarter fiscal 2002, \$3.2 million (third quarter fiscal 2001 – \$26.3 million) was represented by non-cash charges relating to the amortization and write-down of capital assets and intellectual property and amortization and impairment of goodwill.

Revenues

Revenues for the third quarter fiscal 2002 were \$3.2 million compared to \$7.1 million for the comparative quarter of fiscal 2001, a decrease of 55% reflecting the closure of the Company's New York and Halifax operations (\$2.0 million) and a reduction in business activities and demand for the Company's products and services (\$1.9 million).

Gross Profit

Overall gross profit and gross profit percentage decreased from \$0.3 million (4%) in the third quarter fiscal 2001 to a loss of \$1.1 million (34%) in the third quarter fiscal 2002. This decline in gross profit and gross profit percentage was due to the combination of the cancellation of a contract whereby the Company had to write down its related work-in-progress (\$0.5 million) and the requirement to take a provision in expectation of a cost overrun on a fixed-fee contract (\$0.7 million) and other (\$0.2 million).

Operating Expenses

Operating expenses, excluding amortization and write-down of capital assets and intellectual property and amortization and impairment of goodwill and income taxes, decreased by \$2.3 million in the third

quarter fiscal 2002 to \$5.2 million from the \$7.5 million reported for the same period of fiscal 2001.

This reduction is attributed to:

- An increase in selling, general and administrative expense of \$1.2 million resulting from the higher rent at our new corporate office facility (\$0.4 million), severance expenses incurred for workforce reduction (\$0.4 million), a one-time expense related to the termination of the long-term incentive plan (\$0.2 million) and other expenses (\$0.3 million)
- A reduction in bad debt expense of \$3.7 million reflecting the large one-time expense incurred in the period ending November 30, 2000
- A decrease in investment income of \$0.2 million resulting from lower available cash during the period.

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

Amortization and write-down of capital assets and intellectual property increased by \$0.9 million to \$1.6 million in the third quarter fiscal 2002 from the \$0.7 million reported in the third quarter fiscal 2001. This increase was due to the additional write-down taken on computer equipment and leasehold improvements related to the new corporate facility, both of which resulted from the reduced workforce and level of activities.

Amortization and impairment of goodwill decreased by \$24.0 million from the \$25.6 million reported in the third quarter 2001 to \$1.6 million in the third quarter fiscal 2002. This reduction was the result of a lower base amount of goodwill following the impairment recorded in November 2000, May 2001 and August 2001, further increased by a charge for impairment in this third quarter of fiscal 2002 for \$1.3 million which effectively eliminated all goodwill from the

Company's balance sheet at the end of the third quarter of fiscal 2002.

Results of Discontinued Operations

Discontinued operations reported a profit of \$0.7 million in the third quarter fiscal 2002 compared to a loss of \$13.7 million during the same period one year prior. The operations of the strategic marketing business, which represents the only operation being reported as discontinued operations during this third quarter of fiscal 2002, benefited from cost reduction initiatives similar to those carried out in the Company's continuing operations and from a large one-time contract that accounted for 95% of the reported profit generated during this quarter. The results from discontinued operations for the third quarter fiscal 2002 have been applied against the November 30, 2000 accrual for discontinued operations. During the third quarter of fiscal 2002, the Company restated and reduced its accrual for accrued loss from discontinued operations by \$0.6 million.

NINE MONTHS OF FISCAL 2002 COMPARED TO NINE MONTHS OF FISCAL 2001

Results of Continuing Operations

The Company reported a loss from continuing operations of \$21.3 million (\$0.49 per share) for the nine-month period ended November 30, 2001 compared to a loss from continuing operations of \$37.7 million (\$0.93 per share) for the nine-month period ended November 30, 2000. Of that loss for the nine-month period fiscal 2002, \$8.1 million (nine-month period fiscal 2001 – \$31.0 million) was represented by non-cash charges relating to the amortization and write-down of capital assets and intellectual property and amortization and impairment of goodwill.

Revenues

Revenues for the nine-month period of the current fiscal year were \$15.7 million compared to \$24.3 million for the comparative period of fiscal 2001, a decrease of 35% reflecting the closure of the Company's New York and Halifax operations (\$4.2 million) and a reduction in business activities and demand for the Company's products and services reflecting current market realities compared to

the surging marketplace for Internet products and solutions of one year ago.

Gross Profit

Overall gross profit and gross profit percentage decreased from \$9.5 million (39%) in the first nine months of fiscal 2001 to \$3.1 million (20%) in the same period of fiscal 2002. This decline in gross profit and gross profit percentage was due to an imbalance in headcount in relation to billable revenues, combined with project overruns in certain fixed-fee contracts and installations and the cancellation of a contract for which the Company was unable to recover its investment. The imbalance in headcount was primarily due to the various acquisitions completed during the early part of fiscal 2001 as well as expansion of the workforce to meet the Company's increased activities in the surging markets during the March 2000 to July 2000 period. Markets for the Company's services began to quickly erode in the second half of fiscal 2001, with the decline accelerating rapidly in the fourth quarter of fiscal 2001 and continuing into fiscal 2002. This imbalance was in large part responsible for the deterioration in gross profit percentage, as resources were not reduced as rapidly as revenues. In an effort to restore gross profit percentages, the Company, in late June 2001, early August 2001 and November 2001, eliminated certain resources and reassigned others to areas where they would be better utilized.

Operating Expenses

Operating expenses, excluding amortization and write-down of capital assets and intellectual property and amortization and impairment of goodwill and income taxes, remained unchanged from the first three quarters of fiscal 2001 to the first three quarters of fiscal 2002. However, the following off-setting transactions should be mentioned:

- Severance and other related expenses increased by \$2.3 million during the nine-month period of fiscal 2002 compared to the same period of the previous year, reflecting the provision of \$2.3 million made by the Company to account for impairment on its office facility as a result of lower occupancy following reductions in its workforce
- Investment income was reduced by \$1.3 million, reflecting lower average available cash balance
- A reduction in bad debt expense of \$3.6 million,

reflecting the large one-time expense in the previous year.

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

Amortization and write-down of capital assets increased by \$2.5 million to \$3.7 million for the nine months ended November 30, 2001 from the \$1.2 million reported for the nine months ended November 30, 2000. Amortization and write-down of capital assets and intellectual property for the nine-month period of fiscal 2002 included a charge of approximately \$1.3 million to write off leasehold improvements on the unoccupied space at the Company's facility, the write-down of capital assets in connection with the closure of the Halifax office (\$0.4 million), the write-down of capital assets in connection with the disposition of the Media Replication operation (\$0.4 million) and the write-down of other unutilized equipment (\$0.4 million).

Results of Discontinued Operations

The Company's discontinued operations reported a gain of \$0.6 million for the first nine months of fiscal 2002 compared to a loss of \$19.7 million for the same period in fiscal 2001. The results from discontinued operations for the nine-month period of fiscal 2002 have been charged against the accrued loss from discontinued operations. During the third quarter of fiscal 2002, the Company re-stated and reduced its accrual for accrued loss from discontinued operations by \$0.6 million.

Liquidity and Capital Resources

The Company reported positive working capital of \$2.1 million at November 30, 2001 compared with positive working capital of \$14.7 million at February 28, 2001, representing a decrease of \$12.6 million.

At November 30, 2001, the Company had cash and cash equivalents of \$9.7 million compared with cash and cash equivalents of \$21.8 million at February 28, 2001, representing a decrease of \$12.1 million. The decrease in cash and cash equivalents reflects the use of \$0.1 million for the acquisition of capital assets, \$2.0 million to repay bank debt, \$0.3 million to repay capital lease obligations and \$3.4 million to pay down accrued severance and other costs, with

the remainder being used to finance continuing net of discontinued operations.

Accounts receivable, work in progress and other current assets at November 30, 2001 decreased by \$6.4 million compared to February 28, 2001. Trade accounts receivable decreased by \$6.1 million, work in progress decreased by \$0.3 million and prepaid and other expenses remained unchanged. Trade receivables decreased as a result of reduced activities and increased collection activities. The decrease in work in progress reflects current project status.

Accounts payable and other current liabilities at November 30, 2001 decreased by \$5.9 million compared to February 28, 2001. This was the combined result of a decrease in accounts payable and accrued liabilities of \$3.5 million and a decrease in deferred revenue of \$2.5 million. The decrease in accounts payable and accrued liabilities relates primarily to the payment of older trade payables since year end and a reduction in amounts added to accounts payable as the business pace lessens and operating costs are reduced. The decrease in deferred revenue is due to the timing of completion of certain projects and the application of the related Company's revenue recognition policy.

Risk Factors

Management recognizes the risk factors and uncertainties it faces, including:

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

The Company has incurred significant operating losses over the past 24 months and its ability to continue as a going concern is dependent upon achieving and maintaining profitable operations and upon obtaining additional financing. The outcome of these matters cannot be predicted at this time.

Interim consolidated balance sheet

SEE NOTE 1 BASIS OF PRESENTATION (unaudited)	NOVEMBER 30 2001	FEBRUARY 28 2001
ASSETS		
Cash and cash equivalents	\$ 9,651,161	\$ 21,822,085
Accounts receivable, net	4,441,842	10,565,001
Work in progress	1,572,703	1,867,209
Prepaid expenses	395,851	321,939
Total current assets	\$ 16,061,557	\$ 34,576,234
Capital assets, net	\$ 5,261,177	\$ 8,937,967
Deferred compensation	—	—
Goodwill, net	—	4,375,000
	\$ 21,322,734	\$ 47,889,201
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable and accrued liabilities	\$ 6,420,694	\$ 9,994,237
Accrued severance and other costs	3,641,031	3,078,477
Accrued loss from discontinued operations	1,800,000	2,170,097
Deferred revenue	1,817,270	4,309,798
Capital lease obligations	303,871	367,799
Total current liabilities	\$ 13,982,866	\$ 19,920,408
Capital lease obligations	468,270	683,410
Total liabilities	\$ 14,451,136	\$ 20,603,818
Shareholders' equity		
Capital stock	\$ 26,569,741	\$100,086,796
Shares to be issued	—	253,911
Contributed surplus	916,544	521,847
Deficit	(20,614,687)	(73,577,171)
	\$ 6,871,598	\$ 27,285,383
	\$ 21,322,734	\$ 47,889,201

See accompanying notes to interim consolidated financial statements.

Interim consolidated statement of operations and deficit

(unaudited)	THREE MONTHS ENDED NOVEMBER 30 2001	NINE MONTHS ENDED NOVEMBER 30 2001	THREE MONTHS ENDED NOVEMBER 30 2000	NINE MONTHS ENDED NOVEMBER 30 2000
Sales	\$ 3,201,981	\$ 15,743,896	\$ 7,115,590	\$ 24,259,397
Cost of sales	4,347,937	12,614,161	6,832,698	14,711,227
Gross profit	\$ (1,145,956)	\$ 3,129,735	\$ 282,892	\$ 9,548,170
Operating expenses (income)				
Selling, general and administrative	\$ 3,755,198	\$ 12,428,794	\$ 2,610,847	\$ 12,406,865
Interest on long-term debt	70,067	133,583	21,819	112,105
Bad debts	75,008	75,501	3,717,460	3,717,460
Severance and other costs	1,561,950	3,908,005	1,624,641	1,624,641
Investment income	(222,162)	(382,103)	(464,858)	(1,709,477)
	\$ 5,240,061	\$ 16,163,780	\$ 7,509,909	\$ 16,151,594
Income (loss) from continuing operations before the undernoted	\$ (6,386,017)	\$ (13,034,045)	\$ (7,227,017)	\$ (6,603,424)
Amortization and write-down of capital assets and intellectual property	1,599,778	3,747,597	658,997	1,219,866
Income (loss) from continuing operations before amortization and impairment of goodwill and income taxes	\$ (7,985,795)	\$ (16,781,642)	\$ (7,886,014)	\$ (7,823,290)
Income taxes	(163,371)	106,629	40,000	80,000
Income (loss) from continuing operations before amortization and impairment of goodwill	\$ (7,822,424)	\$ (16,888,271)	\$ (7,926,014)	\$ (7,903,290)
Amortization and impairment of goodwill	1,562,831	4,375,000	25,553,347	29,751,962
Income (loss) from continuing operations	\$ (9,385,255)	\$ (21,263,271)	\$ (33,479,361)	\$ (37,655,252)
Income (loss) from discontinued operations	648,584	648,584	(13,739,222)	(19,723,886)
Net loss for the period	\$ (8,736,671)	\$ (20,614,687)	\$ (47,218,583)	\$ (57,379,138)
Deficit, beginning of period	(11,878,016)	(73,577,171)	(10,160,555)	(22,887,942)
Reduction of stated capital	-	73,577,171	-	22,887,942
Deficit, end of period	\$ (20,614,687)	\$ (20,614,687)	\$ (57,379,138)	\$ (57,379,138)
Basic income (loss) per share:				
From continuing operations	\$ (0.22)	\$ (0.49)	\$ (0.79)	\$ (0.93)
From discontinued operations	0.01	0.02	(0.33)	(0.49)
Loss for the period	\$ (0.21)	\$ (0.47)	\$ (1.12)	\$ (1.42)

See accompanying notes to interim consolidated financial statements.

Interim consolidated statement of cash flows

(unaudited)	THREE MONTHS ENDED NOVEMBER 30 2001	NINE MONTHS ENDED NOVEMBER 30 2001	THREE MONTHS ENDED NOVEMBER 30 2000	NINE MONTHS ENDED NOVEMBER 30 2000
OPERATING ACTIVITIES				
Loss from continuing operations	\$ (9,385,255)	\$(21,263,271)	\$(33,479,361)	\$(37,655,252)
Items not affecting cash				
Amortization and write-down of capital assets and intellectual property	1,599,778	3,747,597	658,997	1,219,866
Amortization and impairment of goodwill	1,562,831	4,375,000	25,553,347	29,751,962
Gain on disposal of capital assets	78,090	57,469	–	–
Changes in non-cash operating working capital balances related to operations				
Accounts receivable	1,614,725	2,552,350	3,258,959	697,759
Work in progress	16,068	(185,735)	301,842	391,127
Prepaid expenses and deposits	123,450	(78,532)	797,838	363,071
Deferred compensation	230,449	–	–	–
Accounts payable and accrued liabilities	274,187	(2,778,549)	1,984,424	947,099
Deferred revenue	(86,118)	(2,251,163)	(655,288)	523,659
Cash (used in) operating activities	\$ (3,971,795)	\$ (15,824,834)	\$ (1,579,242)	\$ (3,760,709)
FINANCING ACTIVITIES				
Repayments under capital lease obligations	\$ (86,658)	\$ (279,068)	\$ 868,240	\$ (532,561)
Increase in shares to be issued	–	–	638,298	–
Decrease in due to shareholders	–	–	–	(252,500)
Proceeds on issue of common shares	–	–	(45,972)	835,160
Cash provided by (used in) financing activities	\$ (86,658)	\$ (279,068)	\$ 1,460,566	\$ 50,099
INVESTING ACTIVITIES				
Sale of marketable securities	\$ –	\$ –	\$ 4,415,493	\$ 21,853,690
Lease inducement allowance receivable	–	–	(1,600,000)	(1,600,000)
Acquisition of subsidiaries, net of cash acquired	–	–	(638,298)	(10,398,285)
Disposition (acquisition) of capital assets, net	335,597	(128,276)	(2,579,240)	(2,875,403)
Cash provided by (used in) investing activities	\$ 335,597	\$ (128,276)	\$ (402,045)	\$ 6,980,002
Decrease in cash from continuing operations	\$ (3,722,856)	\$(16,232,178)	\$ (520,721)	\$ 3,269,392
Increase (decrease) in cash from discontinued operations	2,469,726	4,061,254	(2,223,683)	(9,319,831)
Net decrease in cash during the period	\$ (1,253,130)	\$ (12,170,924)	\$ (2,744,404)	\$ (6,050,439)
Cash, beginning of period	10,904,291	21,822,085	(1,458,582)	1,847,453
Cash, end of period	\$ 9,651,161	\$ 9,651,161	\$ (4,202,986)	\$ (4,202,986)

See accompanying notes to interim consolidated financial statements.

Notes to interim consolidated financial statements

NOVEMBER 30, 2001 (unaudited)

The unaudited interim financial statements for the three- and nine-month periods ended November 30, 2001 should be read in conjunction with the consolidated financial statements for the year ended February 28, 2001, as the interim financial statements do not conform in all respects to the note disclosure requirements of generally accepted accounting principles for annual financial statements.

The interim financial statements are prepared in accordance with the same accounting policies and their methods of application as the most recent annual financial statements.

1. BASIS OF PRESENTATION

These interim financial statements have been prepared on the “going concern” basis, which presumes that Microforum Inc. (the “Company”) will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Company has incurred significant operating losses over the past 24 months and its ability to continue as a going concern is dependent upon achieving and maintaining profitable operations and upon obtaining additional financing. The outcome of these matters cannot be predicted at this time. The financial statements have been prepared on a going concern basis and do not include any of the adjustments to the amounts and classifications of the assets and liabilities that might be necessary should the Company be unable to continue in business.

2. CHANGE IN ACCOUNTING POLICY

Effective March 1, 2001, the Company adopted the treasury stock method of calculating diluted earnings per share and applied it on a retroactive basis. Under this method, the exercise of options is assumed to have occurred at the beginning of the period and the related common shares are assumed to have been issued at that time. The proceeds from the exercise are assumed to have been used to purchase common shares of the Company for cancellation at the average market price during the period. The incremental shares (the difference between the number of shares assumed issued and the number of shares assumed purchased) are included in the denominator of the diluted earnings per share calculation. This new policy was applied retroactively and did not have an effect on the previously disclosed amounts.

3. DISCONTINUED OPERATIONS AND DISPOSALS

The Company initiated plans in fiscal 2001 to discontinue certain of its operations and restructure its remaining operations to concentrate on its Business Solutions segment. In fiscal 2001, the Board of Directors approved a formal plan to dispose of the Strategic Marketing, Advertising and Public Relations segments. The disposition of the Strategic Marketing segment is expected to be completed before the end of the fourth quarter of fiscal 2002. The dispositions of the Advertising and Public Relations segments 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. With respect to the Strategic Marketing, Advertising and Public Relations segments, the results include the operating loss occurring prior to the measurement date, November 30, 2000, as follows:

	THREE MONTHS ENDED NOVEMBER 30		NINE MONTHS ENDED NOVEMBER 30	
	2001	2000	2001	2000
Revenue	\$ 3,253,626	\$ 8,337,314	\$ 7,213,993	\$ 21,830,403
Operating expenses	2,446,297	19,476,536	6,188,058	32,367,509
Severance and other costs	62,179	—	747,448	6,586,780
Income (loss) to end of period	\$ 745,150	\$(11,139,222)	\$ 278,487	\$(17,123,886)
Amount charged against (added to) accrued loss from discontinued operations	(745,150)	(2,600,000)	(278,487)	(2,600,000)
Income (loss) from discontinued operations	\$ —	\$(13,739,222)	\$ —	\$(19,723,886)

At November 30, 2000, the Company accrued an amount of \$2.6 million for the expected costs of discontinuance of the Strategic Marketing, Advertising and Public Relations segments, net of estimated proceeds to the expected disposal dates. Charges against the provision from November 30, 2000 comprise:

Balance, November 30, 2000	\$ 2,600,000
Less:	
Loss from the measurement date of December 1, 2000 to February 28, 2001	(429,903)
Balance, February 28, 2001	\$ 2,170,097
Loss from March 1, 2001 to May 31, 2001	(483,566)
Income from June 1, 2001 to August 31, 2001	16,903
Balance, August 31, 2001	\$ 1,703,434
Add:	
Income from September 1, 2001 to November 30, 2001	745,150
Adjustment to restate accrual	(648,584)
Balance, November 30, 2001	\$ 1,800,000

Assets and liabilities included on the consolidated balance sheet relating to discontinued operations are as follows:

	NOVEMBER 30 2001	FEBRUARY 28 2001
Current assets		
Accounts receivable	\$ 2,392,600	\$ 5,963,409
Work in progress	469,914	950,155
Prepaid expenses and other assets	51,013	55,633
Total current assets	\$ 2,913,527	\$ 6,969,197
Capital assets	486,967	731,070
Total assets attributed to discontinued operations	\$ 3,400,494	\$ 7,700,267
Liabilities		
Accounts payable and accrued liabilities	\$ 1,940,490	\$ 1,972,028
Accrued loss from discontinued operations	1,800,000	2,170,097
Deferred revenue	385,677	627,042
Total liabilities attributed to discontinued operations	\$ 4,126,167	\$ 4,769,167

For the nine months ended November 30, 2001, the Company earned a significant portion of its revenue from discontinued operations from one (February 28, 2001 – three) customer(s). As at November 30, 2001, approximately 93% (February 28, 2001 – 72%) of the accounts receivable balance from discontinued operations and 91% (February 28, 2001 – 87%) of revenue from discontinued operations for the nine-month period then ended were derived from this customer.

4. GOODWILL

	NOVEMBER 30 2001	FEBRUARY 28 2001
Cost	\$ 13,277,551	\$ 44,825,656
Less:		
Accumulated amortization and impairment	13,277,551	40,450,656
Goodwill, net, November 30, 2001	\$ –	\$ 4,375,000

During the nine-month period ended November 30, 2001, the evaluation of the carrying value of the goodwill led management to a determination that the continuing weakness in their marketplace and lack of profitability of certain previously acquired operations resulted in an impairment in the goodwill related to those businesses, which were acquired during fiscal 2000. Consequently, for the nine months ended November 30, 2001, a write-down of approximately \$3 million was taken on the goodwill relating to those businesses to reduce the goodwill on those acquisitions to nil.

5. BANK LINE OF CREDIT/BANK INDEBTEDNESS

The Company has a revolving line of credit for borrowings of up to \$1 million. Bank indebtedness arising from the revolving line of credit bears interest at prime plus 1.5%. Included as security for bank indebtedness under the revolving line of credit is a cash collateral agreement in the amount of not less than \$1.5 million, a general security agreement constituting a first-ranking security interest in all personal property of the Company and a guarantee and postponement of claim in the amount of \$1.5 million. As at November 30, 2001, no amount was outstanding under this facility (February 28, 2001 – \$2.2 million). The Company also has a standby letter of credit in the amount of \$150,000.

6. SEVERANCE AND OTHER COSTS

The major components of the provision for severance and other costs are as follows:

	SEVERANCE	LEASES	OTHER	TOTAL
Additions, quarter ended November 30, 2000	\$ 1,086,027	\$ 110,000	\$ 428,614	\$ 1,624,641
Additions, quarter ended February 28, 2001	2,793,027	893,000	780,841	4,466,868
Charges applied, quarter ended February 28, 2001	(1,935,804)	(110,000)	(967,228)	(3,013,032)
Balance, February 28, 2001	\$ 1,943,250	\$ 893,000	\$ 242,227	\$ 3,078,477
Additions, quarter ended May 31, 2001	1,303,530	872,025	170,500	2,346,055
Charges applied, quarter ended May 31, 2001	(741,407)	(52,874)	(89,445)	(883,726)
Balance, May 31, 2001	\$ 2,505,373	\$ 1,712,151	\$ 323,282	\$ 4,540,806
Charges applied, quarter ended August 31, 2001	(1,400,112)	127,529	(296,330)	(1,568,913)
Balance, August 31, 2001	\$ 1,105,261	\$ 1,839,680	\$ 26,952	\$ 2,971,893
Additions, quarter ended November 30, 2001	–	1,561,950	–	1,561,950
Charges applied, quarter ended November 30, 2001	(675,591)	(208,854)	(8,366)	(892,811)
Balance, November 30, 2001	\$ 429,670	\$ 3,192,775	\$ 18,586	\$ 3,641,031

During the nine months ended November 30, 2001, the Company recorded a charge of \$3,908,005 for the continuation of the program undertaken by the Company to focus its business, align its cost structure and strengthen the management team. As part of this program, management closed its Halifax and New York offices, reduced the Company's workforce and made a provision 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.

7. CAPITAL STOCK

	NOVEMBER 30 2001	FEBRUARY 28 2001
Authorized:		
Unlimited preference shares		
Unlimited common shares		
Issued:		
43,732,345 common shares (February 28, 2001 – 42,814,401)	\$ 26,569,741	\$ 100,086,796

	NUMBER OF SHARES	AMOUNT
Balance, February 28, 2001	42,814,401	\$ 100,086,796
Issued on acquisition of Icom Alliance Incorporated	396,736	253,911
Cancelled in satisfaction of agreement between the Company and a former officer of the Company	(91,416)	(212,655)
Cancelled upon settlement with certain former principals of the Company	(23,890)	(182,042)
Reduction of stated capital	–	(73,577,171)
Issued upon surrender of warrants by former principals of P2P3	225,000	94,500
Issued under Outside Directors Compensation Plan	35,235	12,332
Issued under Restricted Share Plan	376,279	94,070
Balance, November 30, 2001	43,732,345	\$ 26,569,741

Effective October 25, 2000, the Company, directly and through a wholly-owned subsidiary, 1421376 Ontario Inc., acquired substantially all of the productive assets of P2P3 Systems Inc. and The Unire Group Inc. (collectively, "P2P3 Assets"). The purchase price for the transaction was \$200,000, exclusive of expenses of \$21,000 relating to the acquisition. As additional consideration, the Company issued 300,000 warrants, subject to vesting, at an exercise price of \$2.19 per share. On September 17, 2001, the Company entered into an agreement with the principals of P2P3 whereby the warrants were surrendered for cancellation and exchanged for an aggregate of 225,000 common shares of the Company. Under restrictions, these shares may not be resold in the marketplace until May 31, 2002.

Stated capital reduction

On August 2, 2001, a special resolution was passed by the shareholders of the Company to eliminate the deficit of the Company at February 28, 2001, by reducing the stated capital by \$73,577,171. This deficit was accumulated in connection with the Company's historical operations and does not relate to the Company's current business mandate.

On June 28, 2000, a special resolution was passed by the shareholders of the Company 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 did not relate to the Company's then current business mandate.

Earnings (loss) per share

Loss per share is based on the weighted average number of common shares outstanding. Fully diluted income per share information has not been provided as it is anti-dilutive. The following is a reconciliation of the denominators of the basic loss per common share computations:

	NINE MONTHS ENDED NOVEMBER 30		THREE MONTHS ENDED NOVEMBER 30	
	2001	2000	2001	2000
Weighted average number of common shares outstanding	43,210,849	40,466,224	43,393,411	42,229,284
Effect of diluted stock options	–	–	–	–
Weighted average number of common shares outstanding – diluted	43,210,849	40,466,224	43,393,411	42,229,284

8. COMPENSATION MATTERS**(a) Retention program**

On April 23, 2001, the Board of Directors approved the establishment of a long-term retention program for the benefit of certain key employees of the Company. Under each of the individual agreements entered into by the Company with 44 key employees, each such employee may deem his or her employment with the Company to be terminated within a period of eight (8) weeks following a change of control of the Company that takes place on or before April 22, 2002 and which is not approved by a minimum of two-thirds (2/3) majority vote of all directors eligible to vote on the approval of such change of control. Each employee who elects to treat the change of control as a deemed termination of employment is to receive, in addition to any severance payable under the terms of any employment agreements, termination benefits equal to a lump sum cash payment equivalent to a range of between 1.5 and 3 times 110% of his or her current annual base salary. In addition, upon such termination, any outstanding stock options granted to such employee shall immediately vest, subject to regulatory approval, and be exercisable for a period of twelve (12) months following the date of such deemed termination. As at November 30, 2001, the maximum amount payable under this program was \$6.4 million.

(b) Future employee compensation

On May 30, 2001, the Board of Directors approved the establishment of a Long Term Cash Incentive Plan for the benefit of certain key full-time employees of the Company, and for as long as such persons remain in the employ of the Company. Under the Plan, the Company was to establish a pool in the minimum amount of \$3 million and in the maximum amount of \$7.5 million provided the price of the common shares of the Company exceeded \$5.00 per share or such greater amount up to \$10.00 for any seven-day trading period during the 60-day trading period prior to May 30, 2004. The Company was required to fund the pool no later than 30 days from May 30, 2004.

In the event of a change of control of the Company, or in the event of liquidation, dissolution or reorganization of the Company, and in the absence of any successor entity's express assumption of the Company's obligations under this Plan, the Board would provide immediately prior thereto for a payment thereunder of \$3 million or such greater amount not to exceed \$7.5 million as may be deemed equitable by the Board, in its sole discretion, given the price of common shares at the time and the period of time remaining before May 30, 2004.

Subsequent to November 30, 2001 the Compensation Committee of the Board approved the dissolution of the Long Term Cash Incentive Plan. The Company has accrued \$200,000 as at November 30, 2001, representing the agreed aggregate amount accepted by the key full-time employee group in settlement of the Plan.

(c) Executive Office Compensation

On August 2, 2001, the Board of Directors approved a compensation package for the Executive Office of the Board consisting of a combination of a cash payment and stock options with a total value of \$750,000. As at November 30, 2001, an amount of \$250,000 representing the cash component of the compensation has been recorded as an expense by the Company. This latter amount was paid on January 3, 2002.

(d) Share Purchase Plan

On May 30, 2001, the Board of Directors approved the adoption and implementation of a Share Purchase Plan designed to provide directors, officers, employees and consultants of the Company and its affiliates with a financial incentive to acquire common shares of the Company and to encourage persons associated with the Company to maintain a long-term ownership interest in the Company. A maximum of 2,000,000 common shares have been reserved for issuance under this Plan.

Under the Plan, each director, employee and consultant of the Company and its affiliates may purchase that number of common shares with an aggregate value equal to or less than 50% of such eligible participant's annual base salary for the year, in the case of employees, officers and consultants, and 100% of their annual retainer, in the case of directors, in which the purchase is made. Unless otherwise amended by the regulations of this Plan, the shares may be purchased in any fiscal quarter for a period of 10 business days commencing 48 hours after the issuance of annual or quarterly financial statements, as the case may be, by the Company at a purchase price for each such period equal to the weighted average trading price on the five (5) consecutive trading days preceding the first day of the specified period. The purchase price for the shares has been set at a 15% discount, the maximum allowed under the Plan.

The common shares issued pursuant to this Plan must be paid for on a cash basis and are subject to a twelve (12) month restriction on resale commencing on the date of issuance. No common shares have been issued under this Plan as at November 30, 2001.

(e) Restricted Share Plan

On May 30, 2001, the Board of Directors approved the adoption and implementation of a Restricted Share Plan, which provides for the voluntary acquisition of common shares by certain employees, directors and consultants of the Company (each an "eligible RSP participant") who, as at the date of adoption of the Plan (August 2, 2001), hold stock options to purchase common shares pursuant to the Stock Option Plan at exercise prices that are greater than or equal to \$3.00 per common share. Following the determination of those holders of common shares who are eligible for the Plan, the maximum actual number of common shares that could be issued is 470,455.

In exchange for the voluntary surrender by each eligible RSP participant of all unexercised options with an exercise price greater than or equal to \$3.00 during the 60 business day period commencing on the date of the adoption of the Plan and ending on November 8, 2001, the Company delivered that number of common shares equal to 40% of the number of common shares which the eligible RSP participant would otherwise be entitled to subscribe for pursuant to the exercise of such options to be surrendered. Under the Plan, 50% of such options to be surrendered will be deemed cancelled and therefore become available for reissuance under the Company's Stock Option Plan.

All common shares issued pursuant to the Restricted Share Plan shall be subject to restrictions on resale commencing on their date of issuance and ending as to one-third of such common shares on each of February 2, 2002, August 2, 2003 and August 2, 2004, respectively.

The total number of restricted shares issued under the Plan was 376,279 at a share price of \$0.25. The cost of the shares issued was recorded as compensation expense.

9. CREDIT RISK

At November 30, 2001, one customer represented 73% (February 28, 2001 – three customers represented 39%) of the accounts receivable balance.

10. SEGMENTED INFORMATION

The Company is a global provider of business solutions and operates predominantly from its principal office in Canada. Consequently, no additional information has been provided.

11. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current period's financial statement presentation.

corporate information

BOARD OF DIRECTORS

David Banks

*Chairman of the Board
Microforum Inc.*

François de Gaspé Beaubien

*Chief Executive Officer
Telemedia Corp.*

J. Efrim Boritz

*Professor
School of Accountancy
University of Waterloo*

Donald W. Paterson

*President
Cavandale Corporation
(corporate consultant)*

Steven H. Schofield

*President & Chief Executive Officer
Microforum Inc.*

David R. Shaw

*President & Chief Executive Officer
Knightsbridge Human Capital
Management Inc.*

Dr. Steven Small

*Founder
President & Chief Executive Officer
Capital Partners Corporation*

SENIOR MANAGEMENT/ LEADERSHIP TEAM

Steven H. Schofield

President & Chief Executive Officer

Michel Beland

Chief Financial Officer

Michael Holland

Chief Operating Officer

Jason Meretsky

General Counsel & Secretary

Andy Labute

*Senior Director,
Human Resources*

CORPORATE HEADQUARTERS

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REGISTRAR & TRANSFER AGENT

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Toronto, Ontario
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STOCK LISTING

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

INVESTOR RELATIONS

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

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