

microforum

First Quarter Report

May 31, 2001

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

FIRST QUARTER FISCAL 2002 COMPARED TO FIRST QUARTER FISCAL 2001

RESULTS OF CONTINUING OPERATIONS

The Company reported a loss from continuing operations of \$8.2 million (\$0.19 per share) for the three-month period ended May 31, 2001 ("first quarter fiscal 2002") compared to a loss from continuing operations of \$0.3 million (\$0.01 per share) for the three-month period ended May 31, 2000 ("first quarter fiscal 2001"). A major portion of the loss for the first quarter fiscal 2002 was represented by non-cash charges relating to the amortization and write-down of capital assets and amortization and impairment of goodwill. These charges totalled \$3.1 million. In addition, the loss for the first quarter fiscal 2002 included a \$2.3 million charge for severance and other costs relating to actions taken or planned for fiscal 2002 to refocus the Company's business.

Revenues

Recognized revenues for the first quarter fiscal 2002 were \$4.8 million compared to \$6.8 million for the comparative quarter of fiscal 2001, a decrease of 29%. Invoiced sales for the first quarter fiscal 2002 were \$6.7 million compared to \$6.8 million for the comparative period in fiscal 2001. Consequently, deferred revenues increased in the first quarter fiscal 2002 by \$1.9 million compared to no change in the comparative period. Invoiced sales declined for the Company's CALMS solutions, deployed consulting and Internet services areas in line with the overall decline in the market in which the Company operates. The decline was mostly offset in the current period by revenues from the unprofitable New York and Halifax operations, for which there were lower comparative revenues in the period a year earlier due to the dates of acquisition of those operations.

Deployed consulting services revenues declined because of the change in focus of activities from managing and staffing major projects to providing resources for short- to longer-term contracts to the provincial governments. Internet services revenues declined because of the significant contraction in the new economy marketplace from the first half of fiscal 2001. While recognized revenues for CALMS declined in the three-month period ended May 31, 2001, invoiced revenues were approximately the same. At the end of May 2001, the Company was engaged in six CALMS installations compared to only two such installations at May 31, 2000. Both the recording of recognized revenue and deferred revenues depend upon when significant milestones are achieved in the CALMS projects and thus, despite activity levels, recognized and deferred revenues can swing widely on a quarter by quarter basis.

Gross Profit

Overall gross profit and gross profit percentage decreased from \$4.5 million (66%) in the first quarter fiscal 2001 to \$1.4 million (30%) in the first quarter fiscal 2002, reflecting the impact of increased billable headcount in relation to revenues in the current fiscal year. The increase in headcount was primarily due to the various acquisitions completed during the early part of fiscal 2001 as well as hiring to meet the Company's increased activities in the surging new economy markets during the March 2000 to July 2000 period. 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 at as rapid a rate. In late June 2001, certain resources were terminated and others were reassigned to areas where they would be more highly utilized.

Operating Expenses

Operating expenses, excluding amortization and write-down of capital assets and amortization and impairment of goodwill and income taxes, increased approximately \$3.3 million in the first quarter fiscal 2002 to \$6.5 million from \$3.2 million in the first quarter fiscal 2001 and include:

- an increase in selling, general and administrative expenses of approximately \$0.5 million from \$3.8 million for the first quarter fiscal 2001 to \$4.3 million for the first quarter fiscal 2002. The increase reflects wages and staff compensation expenses resulting from an increase in total personnel from acquisitions, the growth in the Company's business and the expanded facilities. In late June 2001, certain excess resources were terminated;
- a \$0.5 million reduction in interest income due to lower interest rates and a decrease in the amount of cash and marketable securities throughout the first quarter fiscal 2002 compared to those amounts in the first quarter fiscal 2001;
- a charge of \$2.3 million during the first quarter fiscal 2002 for a program undertaken by the Company to adjust its business and fix its cost structure in light of rapidly changing circumstances. As part of this program, in May 2001 management decided to discontinue its Halifax operation, if it could not be sold, and to reduce its billable and corporate workforce, all due to the downturn in the markets the Company serves. In total, the charge represents \$1.2 million of severance covering approximately 30 employees, \$0.9 million of costs relating to the decision not to use certain of the leased premises of the Company, and \$0.2 million of professional and other costs.

Amortization and Write-down of Capital Assets and Goodwill

Amortization and write-down of capital assets increased by approximately \$1.4 million from \$0.3 million in the first quarter fiscal 2001 to \$1.7 million in the first quarter fiscal 2002. Amortization and write-down of capital assets for the first quarter fiscal 2002 includes a charge of approximately \$0.8 million to write off the leasehold improvement on the additional Head Office floor offered for sublet, and \$0.4 million relating to the capital assets of the Halifax office. The remaining increase of approximately \$0.2 million reflects the amortization of capital assets acquired for the new Head Office premises.

Amortization and impairment of goodwill increased by approximately \$0.2 million from \$1.3 million for the first quarter fiscal 2001 to \$1.5 million for the first quarter fiscal 2002. During the first quarter fiscal 2002 the evaluation of the carrying value of the goodwill led management to a determination that the significant changes in the functionality and design of the CALMS solution acquired from Software Guaranty Inc. that have taken place and will escalate in fiscal 2002 have resulted in an impairment in the goodwill relating to that business, which was acquired during fiscal 2000. Consequently, at May 31, 2001 a write-down of \$0.8 million was taken on the goodwill relating to that business to reduce the goodwill on that acquisition to nil. This increase was offset by a decrease of approximately \$0.6 million in regular amortization because of the significantly reduced goodwill amount that was established at November 30, 2000. The balance of goodwill as at May 31, 2001 will be amortized over the next six quarters.

RESULTS OF DISCONTINUED OPERATIONS

The loss from discontinued operations was \$0.5 million for the first quarter fiscal 2002 compared to a loss of \$1.2 million for the first quarter fiscal 2001. The results from discontinued operations for the first quarter fiscal 2002 have been charged against the accrued loss for discontinued operations.

LIQUIDITY AND CAPITAL RESOURCES

The Company reported positive working capital of \$8.9 million at May 31, 2001 compared with positive working capital of \$14.7 million at February 28, 2001, representing a decrease of \$5.8 million. The decrease in working capital during the first quarter fiscal 2002 chiefly reflects the use of \$7.3 million of marketable securities to fund \$0.6 million for the acquisition of capital assets, with the remainder being used to finance continuing and discontinued operations.

At May 31, 2001, the Company had cash and marketable securities of \$15.8 million compared with cash and marketable securities of \$21.8 million at February 28, 2001, representing a decrease of \$6.0 million.

Accounts receivable, work in progress and other current assets at May 31, 2001 decreased \$0.8 million compared to February 28, 2001. Trade accounts receivable decreased \$2.8 million, work in progress inventory increased \$1.9 million and prepaid and other expenses increased \$0.1 million. Trade receivables decreased due to a decline in sales of both the continuing and discontinued businesses and as a result of a continuing strong collection effort. Work in progress was higher as the number of projects in process over quarter end for CALMS and Internet services increased from the fiscal 2001 year end. Accounts payable and other current liabilities at May 31, 2001 decreased \$1.0 million compared to February 28, 2001. This was a result of decreases in accounts payable and accrued liabilities and severance and other costs of \$1.9 million, a decline in the accrued loss on discontinued operations of \$0.5 million and an increase in deferred revenue of \$1.4 million. The decrease in accounts payable and accrued charges relates primarily to the payment of older trade payables since year end, a reduction of amounts being added to accounts payable as the business pace lessens and payments of severance and other costs. The increase in deferred revenue relates principally to the deferral of revenues on ongoing CALMS projects.

For the three months ended May 31, 2001, the Company repaid \$0.1 million under its long-term debt obligations.

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
- Dependence on key customers
- Future capital needs and uncertainty of additional financing
- Limited profitability

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.

The Company implemented cost reduction programs in February 2001 and May 2001 that will result in annualized cost savings of at least \$10 million. These programs included the closure of the Company's New York and Seattle operations, the planned divestiture of the Halifax operation, the offer for sublet of two floors 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 at the strategic business unit level.

Consolidated balance sheets

<i>(unaudited)</i>	MAY 31 2001	FEBRUARY 28 2001
ASSETS		
Current assets		
Cash	\$ 1,671,136	\$ 367,304
Marketable securities	14,148,000	21,454,781
Accounts receivable	7,813,560	10,565,001
Work in progress	3,750,447	1,867,209
Prepaid expenses and other assets	454,448	321,939
	27,837,591	34,576,234
Capital assets	7,838,689	8,937,967
Goodwill <i>(note 3)</i>	2,917,901	4,375,000
	\$ 38,594,181	\$ 47,889,201
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$ 6,643,360	\$ 9,994,237
Accrued severance and other costs <i>(note 5)</i>	4,540,806	3,078,477
Accrued loss from discontinued operations <i>(note 2)</i>	1,686,702	2,170,097
Deferred revenue	5,683,158	4,309,798
Current portion of long-term debt	381,931	367,799
	18,935,957	19,920,408
Long-term debt	571,500	683,410
Shareholders' equity		
Capital stock <i>(note 6)</i>	100,128,052	100,086,796
Shares to be issued on acquisition	-	253,911
Contributed surplus	734,502	521,847
Deficit	(81,775,830)	(73,577,171)
	19,086,724	27,285,383
	\$ 38,594,181	\$ 47,889,201

See accompanying notes to consolidated financial statements.

Consolidated statements of operations and deficit

THREE-MONTH PERIODS ENDED MAY 31, 2001 AND 2000

<i>(unaudited)</i>	MAY 31 2001	MAY 31 2000
Sales	\$ 4,806,207	\$ 6,840,893
Cost of sales	3,366,898	2,326,150
Gross profit	1,439,309	4,514,743
Operating expenses (income)		
Selling, general and administrative	4,244,368	3,797,667
Interest on long-term debt	18,716	18,837
Severance and other costs <i>(note 5)</i>	2,346,055	-
Investment income	(125,777)	(638,999)
	6,483,362	3,177,505
Income (loss) from continuing operations before the undernoted	(5,044,053)	1,337,238
Amortization and write-down of capital assets	1,677,507	264,224
Income (loss) from continuing operations before amortization and impairment of goodwill and income taxes	(6,721,560)	1,073,014
Income taxes	20,000	40,000
Income (loss) from continuing operations before amortization and impairment of goodwill	(6,741,560)	1,033,014
Amortization and impairment of goodwill <i>(note 3)</i>	1,457,099	1,347,261
Loss from continuing operations	(8,198,659)	(314,247)
Loss from discontinued operations <i>(note 2)</i>	-	(1,285,150)
Loss for the period	(8,198,659)	(1,599,397)
Deficit, beginning of period	(73,577,171)	(22,887,942)
Deficit, end of period	\$ (81,775,830)	\$ (24,487,339)
Basic loss per share <i>(note 6(c))</i> :		
From continuing operations	\$ (0.19)	\$ (0.01)
From discontinued operations	-	(0.03)
Loss for the period	\$ (0.19)	\$ (0.04)

See accompanying notes to consolidated financial statements.

Consolidated statements of cash flows

THREE-MONTH PERIODS ENDED MAY 31, 2001 AND 2000

<i>(unaudited)</i>	MAY 31 2001	MAY 31 2000
Cash provided by (used in):		
Operating activities		
Loss from continuing operations	\$ (8,198,659)	\$ (314,247)
Items not affecting cash:		
Amortization and write-down of capital assets	1,677,507	264,224
Gain on disposal of capital assets	(20,569)	-
Amortization and impairment of goodwill	1,457,099	1,347,261
Change in non-cash operating working capital:		
Accounts receivable	502,416	(2,127,666)
Work in progress	(1,813,844)	144,769
Prepaid expenses and other assets	(126,586)	(183,443)
Accounts payable and accrued liabilities	(3,031,593)	(2,134,205)
Accrued severance and other costs	1,462,329	-
Deferred revenue	1,626,610	(42,000)
	(6,465,290)	(3,045,307)
Financing activities		
Proceeds on issue of common shares, net	-	(52,155)
Proceeds on conversion of broker warrants	-	433,071
Long-term debt, net of repayments	(97,778)	(328,130)
Decrease in due to shareholder	-	(252,500)
	(97,778)	(199,714)
Investing activities		
Sale of marketable securities	7,306,781	2,861,001
Acquisition of capital assets, net	(609,702)	(544,514)
Purchase of intellectual property	-	(828,785)
Increase in investments	-	(150,000)
Acquisition of Icom Alliance Incorporated, net of cash acquired	-	(884,456)
	6,697,079	453,246
Increase (decrease) in cash from continuing operations	134,011	(2,791,775)
Increase (decrease) in cash from discontinued operations	1,169,821	(1,376,589)
Increase (decrease) in cash	1,303,832	(4,168,364)
Cash, beginning of period	367,304	1,847,456
Cash (bank indebtedness), end of period	\$ 1,671,136	\$ (2,320,911)
Supplemental cash flow information		
Interest paid	\$ 18,716	\$ 78,844
Income taxes paid	152,865	-
Supplemental disclosure of non-cash investing and financing activities		
Common shares issued in connection with acquisition of subsidiaries	-	250,000
Common shares issued in connection with acquisition of intellectual property	-	2,230,085

See accompanying notes to consolidated financial statements.

Notes to consolidated financial statements

THREE-MONTH PERIOD FROM FEBRUARY 28, 2001 TO MAY 31, 2001 (unaudited)

The unaudited interim financial statements for the period ended May 31, 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 methods of their application as the most recent annual financial statements, except as described in note 1.

1. 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 purchased 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. The application of this new policy was applied retroactively for the three months ended May 31, 2000 and did not have an effect on the previously disclosed amounts.

2. DISCONTINUED OPERATIONS AND DISPOSALS

During fiscal 2001, the Company initiated plans to discontinue certain of its operations and restructure its remaining operations to concentrate on the e-Business Solutions segment. The Board of Directors approved a formal plan to dispose of the Strategic Marketing and Advertising and Public Relations segments. The disposition of the Strategic Marketing segment is expected to be completed before the end of the third quarter 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 and include the operating loss occurring prior to the measurement date, November 30, 2000, and the actual and expected costs of discontinuance, net of estimated proceeds, to the expected disposal dates as follows:

	Three months ended	
	2001	2000
Revenue	\$ 2,023,964	\$ 9,696,402
Operating expenses	2,163,611	10,981,552
Severance and other costs	343,919	-
Loss to end of period	(483,566)	(1,285,150)
Amount charged against accrued loss from discontinued operations	483,566	-
	\$ -	\$ (1,285,150)

At November 30, 2000, the Company accrued an amount of \$2,600,000 for the expected costs of discontinuance, net of estimated proceeds, to the expected disposal dates. At May 31, 2001, the remaining accrued loss from discontinued operations amounted to \$1,686,702. Charges against the accrued loss from discontinued operations from November 30, 2000 comprise:

Balance, November 30, 2000	\$ 2,600,000
Less loss from the measurement date of November 30, 2000 to February 28, 2001	429,903
Balance, February 28, 2001	2,170,097
Less loss from March 1, 2001 to May 31, 2001	483,595
Balance, May 31, 2001	\$ 1,686,702

Assets and liabilities relating to discontinued operations are as follows:

	MAY 31 2001	FEBRUARY 28 2001
Current assets		
Accounts receivable	\$ 3,714,384	\$ 5,963,409
Work in progress	1,019,549	950,155
Prepaid expenses and other assets	61,556	55,633
	4,795,489	6,969,197
Capital assets	679,028	731,070
Total assets attributed to discontinued operations	\$ 5,474,517	\$ 7,700,267
Liabilities		
Accounts payable and accrued liabilities	\$ 1,652,744	\$ 1,972,028
Accrued loss from discontinued operations	1,686,702	2,170,097
Deferred revenue	373,792	627,042
Total liabilities attributed to discontinued operations	\$ 3,713,238	\$ 4,769,167

For the first quarter fiscal 2002, the Company earned a significant portion of its revenue from discontinued operations from one customer (2001 – three customers). As at May 31, 2001, approximately 82% (February 28, 2001 – 72%) of the accounts receivable balance from discontinued operations and 99% (May 31, 2000 – 65%) of revenue from discontinued operations for the three months then ended were derived from this customer.

3. GOODWILL

	MAY 31 2001	FEBRUARY 28 2001
Cost	\$ 44,825,656	\$ 44,825,656
Less:		
Accumulated amortization	11,297,876	10,672,876
Goodwill impairment on continuing operations	24,023,099	23,191,000
Goodwill impairment on discontinued operations	6,586,780	6,586,780
	\$ 2,917,901	\$ 4,375,000

Amortization and write-down of goodwill amounted to \$1,457,099 and \$1,347,261 during the first quarter fiscal 2002 and the first quarter fiscal 2001, respectively.

During the period ended May 31, 2001, the evaluation of the carrying value of the goodwill led management to a determination that the significant changes in the functionality and design of the Credit Adjudication and Lending Management System solution acquired from Software Guaranty Inc. that have taken place and will escalate in fiscal 2002 have resulted in an impairment in the goodwill related to that business, which was acquired during fiscal 2000. Consequently, at May 31, 2001, a write-down of approximately \$800,000 was taken on the goodwill relating to that business to reduce the goodwill on that acquisition to nil. The balance of goodwill as at May 31, 2001 will be amortized over the next six quarters.

4. BANK LINE OF CREDIT

The Company has a revolving line of credit for borrowings of up to \$3,000,000. Advances under the non-revolving loans are repayable over three years. Bank indebtedness arising from the revolving line of credit bears interest at prime plus 1.5%. Included in the security for bank indebtedness under the revolving line of credit is \$4,000,000 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 \$150,000.

5. SEVERANCE AND OTHER COSTS

During the first quarter fiscal 2002, the Company recorded a charge of \$2,346,055 for the continuation of the 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 Halifax office in the absence of a buyer, reduce the Company's workforce and provide for certain further 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) Workforce reduction

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

(b) Leased premises

During the period ended May 31, 2001, the Company determined that a further 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	
			MAY 31	FEBRUARY 28
First quarter fiscal 2002 amounts:				
Severance	\$	1,303,530	\$	1,017,328
Lease and other contractual obligations		872,025		872,025
Other professional fees and costs		170,500		134,011
Fiscal 2001 amounts:				
Severance		-	1,488,045	\$ 1,943,250
Lease and other contractual obligations		-	839,630	892,504
Other professional fees and costs		-	189,767	242,723
	\$	2,346,055	\$	4,540,806
			\$	3,078,477

The major components of the fiscal 2001 and first quarter fiscal 2002 restructuring are estimated to be complete by the end of fiscal 2002.

With respect to the fiscal 2001 restructuring, severance of \$367,000 has been paid in respect of the closure of the Seattle office and \$88,205 in respect of the severance of certain former employees of the Canadian operations. Net rent paid of \$52,874 on the unused Head Office premises for the quarter ended May 31, 2001 has been charged against the provision for lease obligations. Various professional fees paid relating to the restructuring in the amount of \$52,956 have been charged against the provision for other professional fees. All amounts paid to date were in the amount provided for.

6. CAPITAL STOCK

	MAY 31 2001	FEBRUARY 28 2001
Authorized:		
Unlimited preference shares		
Unlimited common shares		
Issued:		
43,119,721 common shares (February 28, 2001 – 42,814,401)	\$ 100,128,052	\$ 100,086,796

(a) Common shares:

	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 certain former officer of the Company	(91,416)	(212,655)
Balance, May 31, 2001	43,119,721	\$ 100,128,052

(b) Cancellation of shares

By agreement between the Company and a certain former officer of the Company, 91,416 common shares were cancelled in connection with the acquisition of Flashcast Communications, Corp.

(c) Basic loss per share

The following is a reconciliation of the denominators of the basic and diluted loss per common share computations:

	Three months ended May 31	
	2001	2000
Weighted average number of common shares outstanding	43,126,637	37,952,733
Effect of dilutive stock options	-	-
Weighted average number of common shares outstanding – diluted	43,126,637	37,952,733

(d) Stock options

As at May 31, 2001, 5,544,338 (February 28, 2001 – 5,866,383) options are outstanding at a weighted average exercise price of \$3.41 (February 28, 2001 – \$3.61) of which 3,937,234 (February 28, 2001 – 2,796,288) are exercisable at a weighted average exercise price of \$3.22 (February 28, 2001 – \$3.29).

7. 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.*

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*

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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:

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