

# **microforum**

Second Quarter Report  
August 31, 2001

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

## SECOND QUARTER FISCAL 2002 COMPARED TO SECOND QUARTER FISCAL 2001

### Results of Continuing Operations

The Company reported a loss from continuing operations of \$3.7 million (\$0.08 per share) for the three-month period ended August 31, 2001 ("second quarter fiscal 2002") compared to a loss from continuing operations of \$3.9 million (\$0.10 per share) for the three-month period ended August 31, 2000 ("second quarter fiscal 2001"). Of that loss for the second quarter fiscal 2002, \$1.8 million (\$3.1 million for the second quarter of 2001) was represented by non-cash charges relating to the amortization and write-down of capital assets and amortization and impairment of goodwill.

### Revenues

Revenues for the second quarter fiscal 2002 were \$7.7 million compared to \$10.0 million for the comparative quarter of fiscal 2001, a decrease of 23% reflecting the closure of the Company's New York and Halifax operations, and the current market realities contrasted with the surging marketplace of one year ago for Internet products and solutions.

### Gross Profit

Overall gross profit and gross profit percentage decreased from \$4.8 million (48%) in the second quarter fiscal 2001 to \$2.8 million (37%) in the second quarter fiscal 2002. The decline in 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. The imbalance in headcount was primarily due to the various acquisitions completed during the early part of fiscal 2001 as well as additional hiring made to meet the Company's increased activities in

the surging markets during the period of March 2000 to July 2000. This imbalance was the principal cause of the deterioration in gross profit percentage, as resources were not reduced at as rapid a rate as revenues. In an effort to restore gross profit percentage, the Company, in late June 2001 and early August 2001, eliminated certain resources and re-assigned others to areas where they would be more highly utilized. Management continues to focus on actions to improve gross profit percentage.

### Operating Expenses

Operating expenses, excluding amortization and write-down of capital assets and amortization and impairment of goodwill and income taxes, decreased by \$1.1 million in the second quarter fiscal 2002 to \$4.4 million from the \$5.5 million incurred in the second quarter fiscal 2001. This reduction resulted from:

- a decrease in selling, general and administrative expenses of \$1.6 million from \$6.0 million incurred in the second quarter fiscal 2001 to \$4.4 million incurred in the second quarter fiscal 2002. The decrease reflects a decrease in compensation expenses resulting from an overall reduction in the total number of employees in the business, the elimination of overhead of non-profitable offices (New York, Seattle, Halifax) and an overall reduction in other expenses as the Company focuses on cash conservation.
- a reduction of \$0.5 million in investment income to \$0.1 million from \$0.6 million due to a combination of lower interest rates and a decrease in the amount of cash and cash equivalents throughout the second quarter fiscal 2002 compared to the second quarter fiscal 2001.

### **Amortization and Write-down of Capital Assets and Goodwill**

Amortization and write-down of capital assets increased by \$0.2 million to \$0.5 million in the second quarter fiscal 2002 from \$0.3 million in the second quarter fiscal 2001. This increase is due to the additional amortization of furniture, fixtures and leasehold improvements related to the new corporate facility occupied in December 2000.

Amortization and impairment of goodwill decreased by approximately \$1.5 million from \$2.9 million in the second quarter fiscal 2001 to \$1.4 million in the second quarter fiscal 2002. This reduction is the result of a lower base amount of goodwill following the impairments recorded in November 2000 and May 2001, offset by a further charge for impairment in the second quarter fiscal 2002 of \$0.9 million. The balance of goodwill as at August 31, 2001 will be amortized over the next five quarters.

### **Results of Discontinued Operations**

Discontinued operations reported a profit of \$0.02 million in the second quarter fiscal 2002 compared to a loss of \$4.7 million in the second quarter fiscal 2001. The operations of the strategic marketing business have benefited from cost reduction initiatives similar to those carried out in the Company's continuing operations. The results from discontinued operations for the second quarter fiscal 2002 have been applied against the November 30, 2000 accrual for discontinued operations.

### **SIX MONTHS OF FISCAL 2002 COMPARED TO SIX MONTHS OF FISCAL 2001**

#### **Results of Continuing Operations**

The Company reported a loss from continuing operations of \$11.9 million (\$0.27 per share) for the six-month period ended August 31, 2001 ("first half fiscal 2002") compared to a loss from continuing operations of \$4.2 million (\$0.10 per share) for the six-month period ended August 31, 2000 ("first half fiscal 2001"). A major portion of the loss for the first

half fiscal 2002 was represented by non-cash charges relating to the amortization and write-down of capital assets and amortization and impairment of goodwill totalling \$5.0 million. In addition, the loss for the first half 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**

Revenues for the first half fiscal 2002 were \$12.5 million compared to \$16.8 million for the first half fiscal 2001, a decrease of 26%, reflecting the closure of the Company's Seattle office during the first quarter fiscal 2002 and of the New York and Halifax operations during the second quarter fiscal 2002, and the current market realities compared with the surging marketplace for Internet products and solutions of one year ago.

### **Gross Profit**

Overall gross profit and gross profit percentage decreased to \$4.3 million (34%) in the first half fiscal 2002 from \$9.3 million (55%) in the first half fiscal 2001. The decline in 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. The imbalance in headcount was primarily due to the various acquisitions completed during the early part of fiscal 2001 as well as hiring made 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 fiscal 2001, with the decline accelerating rapidly in the fourth quarter fiscal 2001 and continuing into fiscal 2002. This imbalance was the principal cause of the deterioration in gross profit percentage, as resources were not reduced at as rapid a rate as revenues. In an effort to restore gross profit percentage, the Company, in late June 2001 and early August 2001, eliminated certain resources and reassigned others 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 by \$2.3 million in the first half fiscal 2002 to \$10.9 million from \$8.6 million in the first half fiscal 2001 and include:

- a decrease in selling, general and administrative expenses of \$1.1 million to \$8.7 million in the first half fiscal 2002 from \$9.8 million in the first half fiscal 2001. The decrease reflects a decrease in compensation expenses resulting from a reduction in total personnel in the business in May and June 2001, the elimination of the overhead of non-profitable offices (New York – May 17, 2001, Seattle – March 31, 2001, Halifax – August 1, 2001) and an overall reduction in other expenses as the Company focuses on cash conservation.
- a reduction of \$1.0 million in investment income from \$1.2 million to \$0.2 million due to a combination of lower interest rates and a decrease in the amount of cash and cash equivalents throughout the first quarter fiscal 2002 compared to the first quarter fiscal 2001.
- a charge of \$2.3 million taken during the first quarter fiscal 2002 for a program undertaken by the Company to adjust its business in light of rapidly changing circumstances and to align its cost structure. As part of this program, in May 2001 management decided to discontinue its Halifax operations and to reduce its billable and corporate workforce, due to the downturn in the markets the Company serves. The charge consisted of \$1.2 million for 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 \$1.5 million from \$0.6 million in the first half fiscal 2001 to \$2.1 million in the first half fiscal 2002. Amortization and write-down of capital assets for the first half fiscal 2002 include 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 \$0.3 million reflects the amortization of capital assets acquired for the new head office premises.

Amortization and impairment of goodwill decreased by \$1.4 million from \$4.2 million for the first half fiscal 2001 to \$2.8 million for the first half fiscal 2002. This reduction is the result of a lower goodwill base amount following the impairments recorded in November 2000 offset by the impairment recorded in the first and second quarters fiscal 2002 relating to certain previously acquired companies.

### Results of Discontinued Operations

The loss from discontinued operations was \$0.5 million for the first half fiscal 2002 compared to a loss of \$6.0 million for the first half fiscal 2001. The results from discontinued operations for the first half fiscal 2002 have been charged against the accrued loss for discontinued operations.

### Liquidity and Capital Resources

The Company reported positive working capital of \$7.1 million at August 31, 2001 compared with positive working capital of \$14.7 million at February 28, 2001, representing a decrease of \$7.6 million.

At August 31, 2001, the Company had cash and cash equivalents of \$10.9 million compared with cash and cash equivalents of \$21.8 million at February 28, 2001, representing a decrease of \$10.9 million. The decrease in cash and cash equivalents reflects the use of \$0.6 million for the acquisition of capital assets, \$2.0 million to repay bank debt, \$0.2 million to repay capital lease obligations and \$3.2 million to pay down accrued severance and other costs, with the remainder being used to finance continuing and discontinued operations.

Accounts receivable, work in progress and other current assets at August 31, 2001 decreased \$2.2 million compared to February 28, 2001. Trade accounts receivable decreased \$2.9 million, work in progress increased \$0.5 million and prepaid and other expenses increased by \$0.2 million. Trade receivables decreased due to a decline in sales of the Company's continuing and discontinued businesses and as a result of a continuing strong collection effort. Work in progress increased as many projects were further advanced at August 31, 2001.

Accounts payable and other current liabilities at August 31, 2001 decreased \$5.6 million compared to February 28, 2001. This was the combined result of decreases in accounts payable and accrued liabilities and severance and other costs of \$3.4 million, a decline in the accrued loss on discontinued operations of \$0.5 million and a decrease in deferred revenue of \$1.7 million. The decrease in accounts payable and accrued charges relates primarily to the payment of older trade payables since year end, the payment of severance and other costs, the favourable resolution of various accrued liabilities, a reduction of amounts being added to accounts payable as the business pace lessens and the reduction in costs resulting from the Company's focus on cash control. The provision for discontinued operations decreased as losses of and severances relating to the discontinued operations were charged against the provision.

## 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
- Dependence on key customers
- 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.*

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, Halifax and Seattle operations, the offer for sublet of two floors of its head office space and a reduction in the Company's workforce of approximately 32% of the 295 employees in the continuing operations. At August 31, 2001, the Company's workforce had been reduced to 200 employees and the Company's offices in New York, Seattle and Halifax had been closed, with leased space in New York having been taken back by the landlord and leased space in Halifax and Seattle having been sublet. The Company is actively pursuing opportunities to reduce its head office space obligations.

The Company continues to aggressively manage its financial position and to look at all aspects of its operations with the view of achieving cash equilibrium from continuing operations and a return to profitability.

**Interim consolidated balance sheet**

(unaudited)	AUGUST 31 2001	FEBRUARY 28 2001
<b>ASSETS</b>		
Cash and cash equivalents	\$ 10,904,291	\$ 21,822,085
Accounts receivable	7,698,931	10,565,001
Work in progress	2,332,962	1,867,209
Prepaid expenses	506,476	321,939
<b>Total current assets</b>	<b>\$ 21,442,660</b>	<b>\$ 34,576,234</b>
Capital assets, net	\$ 7,274,642	\$ 8,937,967
Deferred compensation	230,449	–
Goodwill, net	1,562,831	4,375,000
	<b>\$ 30,510,582</b>	<b>\$ 47,889,201</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Accounts payable and accrued liabilities	\$ 6,743,531	\$ 9,994,237
Accrued severance and other costs	2,971,893	3,078,477
Accrued loss from discontinued operations	1,703,434	2,170,097
Deferred revenue	2,588,305	4,309,798
Capital lease obligations	359,402	367,799
<b>Total current liabilities</b>	<b>\$ 14,366,565</b>	<b>\$ 19,920,408</b>
Capital lease obligations	499,397	683,410
<b>Total liabilities</b>	<b>\$ 14,865,962</b>	<b>\$ 20,603,818</b>
<b>Shareholders' equity</b>		
Capital stock	\$ 26,368,839	\$100,086,796
Shares to be issued	237,034	253,911
Contributed surplus	916,763	521,847
Deficit	(11,878,016)	(73,577,171)
	<b>\$ 15,644,620</b>	<b>\$ 27,285,383</b>
	<b>\$ 30,510,582</b>	<b>\$ 47,889,201</b>

See accompanying notes to interim consolidated financial statements.

**Interim consolidated statement of operations and deficit**

(unaudited)	THREE MONTHS ENDED AUGUST 31 2001	SIX MONTHS ENDED AUGUST 31 2001	THREE MONTHS ENDED AUGUST 31 2000	SIX MONTHS ENDED AUGUST 31 2000
<b>Sales</b>	<b>\$ 7,735,707</b>	<b>\$ 12,541,914</b>	\$ 9,970,159	\$ 16,811,052
Cost of sales	4,899,327	8,266,225	5,219,625	7,545,775
<b>Gross profit</b>	<b>\$ 2,836,380</b>	<b>\$ 4,275,689</b>	\$ 4,750,534	\$ 9,265,277
<b>Operating expenses (income)</b>				
Selling, general and administrative	\$ 4,429,720	\$ 8,674,088	\$ 5,998,351	\$ 9,796,018
Interest on long-term debt	44,800	63,516	71,448	90,285
Severance and other costs	–	2,346,055	–	–
Investment income	(34,165)	(159,942)	(605,620)	(1,244,619)
	<b>\$ 4,440,355</b>	<b>\$ 10,923,717</b>	\$ 5,464,179	\$ 8,641,684
Income (loss) from continuing operations before the undernoted	<b>\$ (1,603,975)</b>	<b>\$ (6,648,028)</b>	\$ (713,645)	\$ 623,593
Amortization and write-down of capital assets	470,312	2,147,819	296,645	560,869
Income (loss) from continuing operations before amortization and impairment of goodwill and income taxes	<b>\$ (2,074,287)</b>	<b>\$ (8,795,847)</b>	\$ (1,010,290)	\$ 62,724
Income taxes	250,000	270,000	–	40,000
Income (loss) from continuing operations before amortization and impairment of goodwill	<b>\$ (2,324,287)</b>	<b>\$ (9,065,847)</b>	\$ (1,010,290)	\$ 22,724
Amortization and impairment of goodwill	(1,355,070)	(2,812,169)	(2,851,354)	(4,198,615)
Loss from continuing operations	<b>\$ (3,679,357)</b>	<b>\$ (11,878,016)</b>	\$ (3,861,644)	\$ (4,175,891)
Loss from discontinued operations	–	–	(4,699,514)	(5,984,664)
<b>Net loss for the period</b>	<b>\$ (3,679,357)</b>	<b>\$ (11,878,016)</b>	\$ (8,561,158)	\$ (10,160,555)
<b>Deficit, beginning of period</b>	<b>(81,775,830)</b>	<b>(73,577,171)</b>	(24,487,339)	(22,887,942)
Reduction of stated capital	73,577,171	73,577,171	22,887,942	22,887,942
<b>Deficit, end of period</b>	<b>\$ (11,878,016)</b>	<b>\$ (11,878,016)</b>	\$ (10,160,555)	\$ (10,160,555)
Basic loss per share:				
From continuing operations	\$ (0.08)	\$ (0.27)	\$ (0.10)	\$ (0.10)
From discontinued operations	–	–	(0.12)	(0.16)
<b>Loss for the period</b>	<b>\$ (0.08)</b>	<b>\$ (0.27)</b>	\$ (0.22)	\$ (0.26)

See accompanying notes to interim consolidated financial statements.

**Interim consolidated statement of cash flows**

(unaudited)	THREE MONTHS ENDED AUGUST 31 2001	SIX MONTHS ENDED AUGUST 31 2001	THREE MONTHS ENDED AUGUST 31 2000	SIX MONTHS ENDED AUGUST 31 2000
<b>OPERATING ACTIVITIES</b>				
Loss from continuing operations	\$ (3,679,357)	\$ (11,878,015)	\$ (3,861,644)	\$ (4,175,891)
Items not affecting cash				
Amortization and write-down of capital assets	470,312	2,147,819	506,555	849,020
Gain on disposal of capital assets	–	(20,569)	–	–
Amortization and impairment of goodwill	1,355,070	2,812,169	2,851,354	4,198,615
Changes in non-cash operating working capital balances related to operations				
Accounts receivable	435,212	937,625	(2,770,455)	(7,939,077)
Work in progress	1,612,041	(201,803)	(1,190,038)	(634,280)
Prepaid expenses and deposits	(75,396)	(201,982)	(81,336)	(288,761)
Deferred compensation	(230,449)	(230,449)	–	–
Accounts payable and accrued liabilities	(1,720,678)	(3,289,989)	1,697,177	1,100,553
Deferred revenue	(3,791,656)	(2,165,045)	2,141,910	3,347,506
<b>Cash (used in) operating activities</b>	<b>\$ (5,624,901)</b>	<b>\$ (12,090,239)</b>	<b>\$ (706,477)</b>	<b>\$ (3,542,315)</b>
<b>FINANCING ACTIVITIES</b>				
Repayments under capital lease obligations	\$ (94,632)	\$ (192,406)	\$ (46,908)	\$ (375,038)
Increase in shares to be issued	237,034	237,034	–	–
Proceeds on issue of common shares	–	–	748,322	761,338
Proceeds on conversion of broker warrants	–	–	(433,071)	–
Due to shareholders	–	–	–	(252,500)
<b>Cash provided by (used in) financing activities</b>	<b>\$ 142,402</b>	<b>\$ 44,628</b>	<b>\$ 268,343</b>	<b>\$ 133,800</b>
<b>INVESTING ACTIVITIES</b>				
Acquisition of capital assets, net	\$ (41,874)	\$ (567,828)	\$ (1,574,471)	\$ (2,213,545)
Acquisition of subsidiary	–	–	(9,298,399)	(10,496,799)
Purchase of intellectual property	–	–	786,360	–
Increase in investments	–	–	60,510	(89,490)
<b>Cash (used in) investing activities</b>	<b>\$ (41,874)</b>	<b>\$ (567,828)</b>	<b>\$ (10,026,000)</b>	<b>\$ (12,799,834)</b>
Decrease in cash from continuing operations	\$ (5,524,373)	\$ (12,613,439)	\$ (10,464,134)	\$ (16,208,349)
Increase (decrease) in cash from discontinued operations	609,528	1,695,645	(13,134,709)	(12,098,948)
<b>Net decrease in cash during the period</b>	<b>\$ (4,914,845)</b>	<b>\$ (10,917,794)</b>	<b>\$ (23,598,843)</b>	<b>\$ (28,307,297)</b>
Cash, beginning of period	15,819,136	21,822,085	47,675,928	52,384,382
<b>Cash, end of period</b>	<b>\$ 10,904,291</b>	<b>\$ 10,904,291</b>	<b>\$ 24,077,085</b>	<b>\$ 24,077,085</b>

See accompanying notes to interim consolidated financial statements.

# Notes to interim consolidated financial statements

**AUGUST 31, 2001** (unaudited)

The unaudited interim financial statements for the three- and six-month periods ended August 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 their methods of application as the most recent annual financial statements.

## 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 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. The application of this new policy was applied retroactively and did not have an effect on the previously disclosed amounts.

## 2. 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 the e-Business Solutions segment. In fiscal 2001, 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. With respect to the Strategic Marketing and 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 AUGUST 31		SIX MONTHS ENDED AUGUST 31	
	2001	2000	2001	2000
Revenue	\$ 2,066,868	\$ 8,260,098	\$ 5,984,331	\$ 27,634,902
Operating expenses	2,049,965	12,959,553	5,703,546	33,619,566
Severances and other costs	–	–	747,448	–
Income (loss) to end of period	\$ 16,903	\$ (4,699,455)	\$ (466,663)	\$ (5,984,664)
Amount charged against (added to) accrued loss from discontinued operations	(16,903)	–	466,663	–
Loss from discontinued operations	\$ –	\$ (4,699,455)	\$ –	\$ (5,984,664)

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

Accrual, November 30, 2000	\$ 2,600,000
Less:	
Loss from the measurement date of December 1, 2000 to February 28, 2001	(429,903)
Loss from March 1, 2001 to May 31, 2001	(483,566)
Balance, May 31, 2001	\$ 1,686,531
Add:	
Income from June 1, 2001 to August 31, 2001	16,903
<b>Balance, August 31, 2001</b>	<b>\$ 1,703,434</b>

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

	AUGUST 31 2001	FEBRUARY 28 2001
<b>Current assets</b>		
Accounts receivable	\$ 4,034,964	\$ 5,963,409
Work in progress	1,214,105	950,155
Prepaid expenses and other assets	38,188	55,633
<b>Total current assets</b>	<b>\$ 5,287,257</b>	<b>\$ 6,969,197</b>
Capital assets	627,166	731,070
<b>Total assets attributed to discontinued operations</b>	<b>\$ 5,914,423</b>	<b>\$ 7,700,267</b>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	\$ 1,904,727	\$ 1,972,028
Accrued loss from discontinued operations	1,703,434	2,170,097
Deferred revenue	1,070,594	627,042
<b>Total liabilities attributed to discontinued operations</b>	<b>\$ 4,678,755</b>	<b>\$ 4,769,167</b>

For the second quarter fiscal 2002, the Company earned a significant portion of its revenue from discontinued operations from one customer (2001 – three customers). As at August 31, 2001, approximately 94% (2000 – 73%) of the accounts receivable balance from discontinued operations and 90% (2000 – 66%) of revenue from discontinued operations for the six-month period then ended were derived from this customer.

### 3. GOODWILL

	AUGUST 31 2001	FEBRUARY 28 2001
Cost	\$ 44,825,656	\$ 44,825,656
Less:		
Goodwill impairment on continuing operations	24,023,099	23,191,000
Goodwill impairment on discontinued operations	6,586,780	6,586,780
Accumulated amortization to May 31, 2001	11,297,876	10,672,876
Amortization for three months ended August 31, 2001	416,844	–
Goodwill impairment recorded on continuing operations for the three months ended August 31, 2001	938,226	–
<b>Goodwill, net, August 31, 2001</b>	<b>\$ 1,562,831</b>	<b>\$ 4,375,000</b>

During the period ended August 31, 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 quarter ended August 31, 2001, a write-down of \$938,226 (quarter ended May 31, 2001 – \$800,000) was taken on the goodwill relating to those businesses to reduce the goodwill on those acquisitions to nil. The balance of goodwill as at August 31, 2001 will be amortized over the next five quarters.

#### 4. BANK LINE OF CREDIT/BANK INDEBTEDNESS

The Company has a revolving line of credit for borrowings of up to \$3 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 \$4 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 \$4 million. No amounts were outstanding under this facility as at August 31, 2001 (February 28, 2001 – \$2.2 million). The Company also has a standby letter of credit in the amount of \$150,000.

#### 5. SEVERANCE AND OTHER COSTS

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

	SEVERANCE	LEASES	OTHER	TOTAL
Additions, November 30, 2000	\$ 1,086,027	\$ 110,000	\$ 428,614	\$ 1,624,641
Additions, February 28, 2001	2,793,027	893,000	780,841	4,466,868
Charges applied, 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, May 31, 2001	1,303,530	872,025	170,500	2,346,055
Charges applied, 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, August 31, 2001	(1,400,112)	127,529	(296,330)	(1,568,913)
<b>Balance, August 31, 2001</b>	<b>\$ 1,105,261</b>	<b>\$ 1,839,680</b>	<b>\$ 26,952</b>	<b>\$ 2,971,893</b>

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, 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.

##### (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. This reduction took place as planned in June 2001 and August 2001.

##### (b) Leased premises

During the period ended May 31, 2001, the Company determined that a further portion of the current leased office premises will no longer be required for its continuing operations. The provision represents management's best estimate as to the future net cash outflows relating to these premises.

**6. CAPITAL STOCK**

	AUGUST 31 2001	FEBRUARY 28 2001
<b>Authorized:</b>		
Unlimited preference shares		
Unlimited common shares		
<b>Issued:</b>		
43,095,831 common shares (February 29, 2001 – 42,814,401)	<b>\$ 26,368,839</b>	<b>\$ 100,086,796</b>

	NUMBER OF SHARES	AMOUNT
<b>Balance, February 28, 2001</b>	<b>42,814,401</b>	<b>\$ 100,086,796</b>
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)
<b>Balance, August 31, 2001</b>	<b>43,095,831</b>	<b>\$ 26,368,839</b>

**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.

**Basic loss per share**

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

	2001	SIX MONTHS ENDED AUGUST 31 2000
Weighted average number of common shares outstanding	<b>43,212,736</b>	39,589,576
Effect of diluted stock options	–	–
Weighted average number of common shares outstanding – diluted	<b>43,212,736</b>	39,589,576

**Stock options**

As at August 31, 2001, 6,872,478 (February 28, 2001 – 5,866,383) options were outstanding at a weighted average exercise price of \$2.41 (February 28, 2001 – \$3.61), of which 1,429,575 (February 28, 2001 – 2,796,288) were exercisable at a weighted average exercise price of \$4.29 (February 28, 2001 – \$3.29).

## 7. 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 that 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 three 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 August 31, 2001, the maximum amount payable under this program was \$9 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 is 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 exceeds \$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 is 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 will provide immediately prior thereto for a payment thereunder of \$3 million or such greater amount not to exceed \$7.5 million as is 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.

### (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 August 31, 2001, an amount of \$250,000 representing the cash component of the compensation has been recorded as an expense by the Company.

### (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 August 31, 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 will deliver 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 Company has accrued an amount of \$237,034, which represents its best estimate of the value of the benefit to be granted. This amount will be amortized into income over the 36-month restriction period.

**8. CREDIT RISK**

As at August 31, 2001, one customer represented 66% (February 28, 2001 – three customers represented 46%; August 31, 2000 – three customers represented 44%) of the accounts receivable balance.

**9. SEGMENTED INFORMATION**

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

**10. SUBSEQUENT EVENTS**

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 until May 31, 2002.

**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

*Vice-President,  
Corporate Affairs  
General Counsel & Secretary*

### Martha Cass

*Senior Director,  
Corporate Communications*

### Andy Labute

*Senior Director,  
Human Resources*

## CORPORATE HEADQUARTERS

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M5K 1J7

## REGISTRAR & TRANSFER AGENT

Computershare Investor Services  
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:

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*or*

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