

1st Quarter Fiscal 2005 Report

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

Dear Shareholder,

The year is off to a great start with a further improvement in profitability over Q1 of last year and substantial revenue growth of 42% to \$5.3M. Improvements were made in most areas with several new accounts joining us and several major accounts going live on our new technology. Sales of our own licenses and services rose significantly. Allow me to share a few details.

All key financial indicators improved this quarter:

- Revenue increased to \$5.3M up from \$3.8M in the same quarter of last year.
- Product sales rose to \$1.8M from \$1.6M in the same quarter last year with sales of our own products increasing by 48%.
- Services revenue climbed significantly from \$2.0M in Q1 of last year to \$3.4M, an increase of 74%.
- Cash in the bank rose to \$9.2M, up from \$8.8M at the end of the prior quarter.
- Operating earnings increased by 67% and net earnings increased from \$10K to \$136K over Q1 of last year, making for our fifth consecutive profitable quarter.

You may recall that a company by the name of Simcona joined our customer base in Q4 of last year. In the first quarter, a supplier of theirs signed on as well. This new account is a designer and manufacturer/importer of connectors for the electronics industry, in fact, many of the connectors on the back of your PC could well be their products.

We are also pleased to say that we made some great gains in the healthcare space:

- a medical supplies distributor in Florida signed up for a complete implementation of our **EliteSeries** suite
- a high volume distributor of medical samples added on the rest of our suite after beginning with our Enterprise Transportation Management System
- a medical/surgical distributor signed a significant agreement with us to extend **EliteSeries** to new areas within their hospital network

Other new accounts included:

- a distributor of antique reproductions in Missouri
- a distributor of furniture and storage units in Ontario
- an importer-distributor of handmade items and tableware in British Columbia
- a wholesaler of medical supplies in New York
- a manufacturer and distributor of power tools in Minnesota
- a distributor of woodworking and gardening tools in New York

We saw a number of successful implementations in the quarter including:

- a distributor of pet supplies in Massachusetts
- a company in Calgary specializing in waste management upgrading to our Web-based technology
- a floral distributor in Illinois
- a distributor of home furnishings in Vancouver
- a frozen meat wholesaler in New York
- a designer and manufacturer of fashion watch brands in Ontario
- a gourmet gift food manufacturer in Quebec
- an automotive aftermarket products and industrial sealant distributor in Ohio

We were also delighted to see some real progress in Latin America with three new accounts joining us in that region and several customer upgrades.

In summary, this was a solid quarter. We continue to keep a tight lid on costs, while revenue improves. In the U.S. market, business capital spending seems to be on the rise and this bodes well for us. The players in our market continue to consolidate and this is opening up opportunities for those of us who continue to prosper. We are delighted to be able to say that our recently acquired PointForce division is doing well and meeting our expectations. We look forward to great returns for our shareholders.

Yours truly,

A handwritten signature in black ink, appearing to read 'Peter Brereton', with a long horizontal flourish extending to the right.

Peter Brereton
President and Co-CEO

Management's Discussion and Analysis of Financial Condition and Results of Operations dated September 3, 2004

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto, which are included in this document. This discussion and analysis should also be read in conjunction with the annual report for fiscal year 2004. The Company's first quarter for fiscal year 2005 ended on July 31, 2004.

These interim unaudited consolidated financial statements have not been reviewed by the Company's auditors.

The Company's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, and all financial data derived therefrom in this interim report are expressed in U.S. dollars. The Company's reporting currency is the U.S. dollar; and the functional currency is the Canadian dollar. Accordingly, the consolidated financial statements for the three-month periods ended July 31, 2004 and July 31, 2003 are translated into U.S. dollars using the current rate method. All gains and losses resulting from the translation of the consolidated financial statements into U.S. dollars are reflected in the cumulative translation adjustment in shareholders' equity.

In addition, the consolidated financial statements include a reconciliation of the significant measurement differences between Canadian and United States generally accepted accounting principles as they relate to the Company.

Business Combination

On December 31, 2003, the Company acquired 100% of the issued and outstanding shares of PointForce Inc. ("PointForce"), a company which develops, markets, and sells Supply Chain Management ("SCM") software for the giftware distribution, office products distribution, and high-growth import-to-retail distribution market segments. PointForce was wound-up into TECSYS Inc. on January 1, 2004 and the results of its operations have been included in the consolidated financial statements commencing January 1, 2004.

Results of Operations

Three months ended July 31, 2004 compared to three months ended July 31, 2003

Revenue

Total revenue increased by \$1.6 million or 42% to \$5.3 million in the first quarter of fiscal 2005 compared to \$3.8 million in the first quarter of fiscal 2004. PointForce contributed most of the revenue increase during the first quarter of fiscal 2005 amounting to \$1.5 million.

Products revenue increased 10% or \$157,000 to \$1.8 million in the first quarter of fiscal 2005 compared to \$1.6 million for the same period in the previous fiscal year. PointForce contributed \$397,000 of products revenue. Excluding PointForce, products revenue decreased \$240,000 or 15% due exclusively to decreases of third-party products revenue. In the first quarter of fiscal 2004, there were a few large shipments of third-party products to a few significant customers.

Services revenue increased 74% or \$1.5 million to \$3.4 million during the first quarter of fiscal 2005 compared to \$2.0 million for the same fiscal period last year. PointForce contributed \$1.1 million in services revenue during the first quarter of fiscal 2005. Excluding PointForce, services revenues increased by \$402,000 or 21% in comparison to the same three-month period last year representing primarily increased activity for consulting and products adaptations in some key account implementations, whereas support revenues remained relatively flat.

As a percentage of total revenue, products accounted for 33% and services 64% in the first quarter of fiscal 2005 compared to 42% and 52%, respectively, in the first quarter of fiscal 2004. The increased services percentage of revenue is primarily a result of the PointForce acquisition.

The Canadian dollar has strengthened approximately 1.5% vis-à-vis the US dollar for the first three months of fiscal 2005 as compared to the same period in fiscal 2004. The US dollar to Canadian dollar exchange rates for the three-month period ended July 31, 2004 have averaged 1.3526 in comparison to 1.3728 for the first three months of the previous fiscal year. Consequently, exchange rate impacts for revenues and expenses in comparing the first three months of fiscal 2005 to the first three months of fiscal 2004 will not be material.

Cost of Revenue

Total cost of revenue in the first quarter of fiscal 2005 was \$2.4 million representing an increase of \$782,000 or 47% compared to \$1.7 million for the same period last year. PointForce's cost of revenue for the three-month period ended July 31, 2004 accounted for \$708,000 of the increase.

Services costs increased by \$646,000 or 58% to \$1.8 million for the first quarter of fiscal 2005 compared to \$1.1 million for the comparable period of the previous fiscal year, reflecting primarily the impacts of the PointForce addition to the TECSYS group. Excluding PointForce, the impact of accounting for stock-based compensation at fair value (US\$15,000 in Q1 FY2005), and the reduction in tax credits, gross services expenses remained flat at \$1.3 million for the first quarter of fiscal 2005 compared to the previous fiscal year. The total cost of services also includes multimedia tax credits of \$132,000 for the first quarter of fiscal 2005 compared to \$166,000 for the same period in the previous fiscal year.

The cost of third-party products increased by \$166,000 or 49% to \$504,000 for the first quarter of fiscal 2005 in comparison to the same three-month period for the previous fiscal year reflecting primarily the addition of PointForce to the TECSYS group. Excluding the PointForce impact, fiscal 2005 costs increased 14% or \$46,000 for the first quarter of fiscal 2005 in comparison to fiscal 2004.

Gross Margin

The gross margin increased by \$797,000 or 38% to \$2.9 million for the first quarter of fiscal 2005 in comparison to \$2.1 million for the same fiscal period last year. Total gross margin percentage in the first quarter of fiscal 2005 was 54% compared to 56% in the same period of fiscal 2004. This decline in overall gross margin is due to a higher ratio of revenue derived from services, 64% in the first quarter of fiscal 2005 in comparison to 52% in the first quarter of fiscal 2004, which carries a lower margin compared to products as well as lower product margins.

Services gross margin was considerably higher at 48% in the first quarter of fiscal 2005 compared to 43% in the same period last year. Excluding PointForce, the services gross margin increased to 49% primarily as a result of the increase in the consultation and product adaptations revenue despite the fact that the cost base and the number of resources remained relatively flat. PointForce's service margin equally came in at 48% for the first quarter of fiscal 2005. Product margins decreased to 71% for the first quarter of fiscal 2005 compared to 79% for the same fiscal period last year. PointForce's product margin attained 70% in the first quarter of fiscal 2005.

Operating Expenses

Total operating expenses increased by \$743,000 or 37% to \$2.8 million in the first quarter of fiscal 2005 compared to \$2.0 million in the first quarter of fiscal 2004. PointForce's operating expenses for the first quarter of fiscal 2005 amounted to \$694,000. Total operating expenses, excluding newly acquired Pointforce, increased by \$49,000 or 2% in the first quarter of fiscal 2005 compared to the same period in fiscal 2004.

Excluding PointForce, the major variances for the operating expense increase in the first quarter of fiscal 2005 in comparison to the first quarter of fiscal 2004 are a \$71,000 unfavorable variance due to less investment tax credits applicable to the research and development activities offset by \$42,000 of favorable variances for the amortization of property, plant, and equipment and intangible assets.

The MD&A in the fiscal 2004 annual report indicated that the recent changes to the Quebec tax credit would have an adverse impact of approximately \$150,000 in the amount of tax credits to be claimed in fiscal year 2005 in comparison to fiscal year 2004.

Other Income and Expenses

Interest income decreased \$42,000 to \$43,000 in the first quarter of fiscal 2005 compared to \$85,000 for the same period in the previous fiscal year due primarily to lower short-term interest rates and less funds available for investment principally as a result of the purchase of PointForce and the repayment of a term loan and capital lease obligations subsequent to July 31, 2003.

Interest expense decreased \$16,000 to \$9,000 in the first quarter of fiscal 2005 compared to \$25,000 for the same period last year. The reduction in interest expense is attributable to the reduction of long-term debt including the repayment of a term loan and capital lease obligations during the fiscal 2004 year.

During the first quarter of fiscal 2005, the Company recorded an exchange loss of \$33,000 compared to an exchange loss of \$131,000 for the same period in the previous fiscal year. The exchange loss arises because the Company carries net monetary assets, primarily cash and accounts receivable, denominated in US dollars. The net US monetary assets are devalued due to the strengthened Canadian dollar vis-à-vis the US dollar. The exchange rate at April 30, 2004, the beginning of the quarter, was \$1 US = \$1.3707 CA. The exchange rate at July 31, 2004 was \$1 US = \$1.3292 CA. The exchange rate at April 30, 2003 was \$1 US = \$1.4335 CA and at July 31, 2003 the rate was \$1 US = \$1.4073 CA.

During the first quarter of fiscal 2005, the Company protected a portion of its net monetary assets by means of a forward exchange contract selling \$1.5 million US dollars forward at an average rate of \$1.3713. The contract matured before the end of the quarter. There were no foreign exchange contracts outstanding at the end of the quarter. The hedging strategy in the first quarter of fiscal 2005 resulted in the minimization of exchange losses for US\$48,000. No hedging strategy or foreign exchange contracts were in effect in the first quarter of fiscal 2004.

The consolidated financial statements for the three-month periods ended July 31, 2004 and July 31, 2003 are translated into U.S. dollars using the current rate method. All gains and losses resulting from the translation of the Canadian dollar consolidated financial statements into U.S. dollars are reflected in the cumulative translation adjustment in shareholders' equity.

The Company has recorded increases in the cumulative translation adjustment (CTA) account within the shareholder's equity of \$402,000 for the first quarter of fiscal 2005 compared to an increase of \$235,000 for the comparable period of fiscal 2004. The increases to CTA account represent exchange gains arising on the translation of the Canadian dollar financial statements into U.S. dollar financial statements where such exchange gains are posted directly into the shareholder's equity section rather than flowing through the statement of operations.

Net Earnings

The Company recorded net earnings of \$136,000 (\$0.01 per share) in the first quarter of fiscal 2005 compared to net earnings of \$10,000 (\$0.00 per share) for the same period last year.

Note 5 to the financial statements reflects that there are no material differences between the Company's reported net earnings and basic and diluted net earnings per share under Canadian GAAP as compared to U.S. GAAP for the three-month periods ended July 31, 2004 and 2003. However, under US GAAP, the cumulative translation adjustment (CTA) is an integral part of arriving at the comprehensive income. The comprehensive income for the first three months of fiscal 2005 under U.S. GAAP was \$538,000 compared to the comprehensive income of \$245,000 for the corresponding period in fiscal 2004.

Liquidity and Capital Resources

As of July 31, 2004, current assets totaled \$14.9 million, the same amount as at the end of fiscal 2004. Cash, restricted cash equivalents, and short-term and other investment securities increased to \$9.2 million compared to \$8.8 million as at April 30, 2004. Accounts receivable totaled \$4.6 million at the end of July 31, 2004 compared to \$4.7 million at the end of fiscal 2004. The Company's DSO (days sales outstanding) remained flat at 78 days at the end of the first quarter of fiscal 2005 in comparison to the end of fiscal 2004.

Current liabilities as at July 31, 2004 totaled \$5.1 million compared to \$5.7 million at the end of fiscal 2004. Working capital increased to \$9.7 million at the end of the first quarter of fiscal 2005 compared to \$9.2 million at the end of fiscal year 2004.

During the first quarter of fiscal 2005, operating activities used funds of \$99,000 compared to \$476,000 for the same period last year. During the first quarter of fiscal 2005, used funds were due primarily to increase net non-cash working capital by \$498,000 offset by positive results in operating activities in comparison to the first quarter of fiscal 2004, where used funds were due primarily to increase net non-cash working capital by \$734,000 offset by positive results in operating activities.

The Company believes that funds on hand at July 31, 2004, together with short term investments and cash flow from operations will be sufficient to meet its needs for working capital, R&D, capital expenditures and debt repayment for at least the next twelve months.

Financing activities used funds of \$75,000 and \$117,000 respectively for the first quarter of fiscal 2005 and 2004 for the repayment of long-term debt and capital lease obligations. Additionally, during the first quarter of fiscal 2004, the Company purchased 320,100 of its outstanding common shares for cancellation at an average price of \$1.04 per share under a Normal Course Issuer Bid. The total cost related to purchasing these shares, including other related costs, was \$335,000.

During the first quarter of fiscal 2005, funds generated by investing activities amounted to \$573,000 as compared to \$932,000 for the first quarter of fiscal 2004. The Company generated funds of \$273,000 and \$992,000 respectively for the first quarter of fiscal 2005 and 2004 by reductions in short term investments. Funds of \$68,000 and \$60,000 were used for the first quarter of fiscal 2005 and 2004 respectively for the acquisition of property, plant, and equipment, and computer software for internal use (intangible assets). Additionally, in the first quarter of fiscal 2005, the company received funds of \$368,000 representing the purchase price adjustment from the former PointForce shareholders pursuant to the acquisition of PointForce.

Change in Accounting Policy

Stock-based compensation and other stock-based payments

The Company maintains a stock-based compensation plan, which is described in note 11(d) in the audited financial statements for the year ended April 30, 2004. Effective May 1, 2004, the Company has adopted the fair value based method of accounting for stock options and warrants granted to employees and directors and has elected to apply the new standard retroactively without restatement as prescribed by the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870, Stock-based Compensation and Other Stock-based Payments. Under the fair value based method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period with a corresponding credit to contributed surplus. The stock-based compensation expense is recorded in the financial statements for the three months ended July 31, 2004. Accordingly, for the three-month period ended July 31, 2003, the Company provides only pro forma disclosures of net earnings (loss) and net earnings (loss) per common share as if the fair value based method of accounting had been used to account for stock options and warrants granted to employees and directors.

No compensation cost is recognized when shares are issued to employees. Any consideration received from plan participants is credited to capital stock. Any stock-based compensation costs related to awards to individuals other than employees and directors are accounted for at fair value.

The change in accounting for the stock-based compensation has resulted in a restatement of the opening balance of the deficit for the current fiscal year of \$4.8 million, with a corresponding credit to contributed surplus, reflecting the prior periods' cost of options and warrants granted since inception, which occurred in the 1998 fiscal year.

Critical Accounting Policies

The Company's critical accounting policies are those that it believes are the most important in determining its financial condition and results. A summary of the Company's significant accounting policies, including the critical accounting policies discussed below, is set out in the notes to the consolidated financial statements in the annual report for year ended April 30, 2004.

Use of estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the reporting periods.

As the Company's software implementation period may typically span from six to twelve months, the most significant area requiring judgement and estimation is revenue recognition relating to multiple element arrangements, where the resulting revenue recognition per element and the related timing must be assessed in relation to contract terms, Statement of Position ("SOP") 97-2 criteria, future services, and other criteria as discussed later. The estimates and assumptions are based on past experience and other factors that the Company considers reasonable. As this involves varying degrees of judgement and uncertainty, actual results could differ from those estimates.

Goodwill represents the excess of the purchase price of businesses acquired over the fair value of the underlying net identifiable assets acquired or liabilities assumed. Goodwill related to business combinations initiated or completed prior to July 1, 2001 was amortized on a straight-line basis over the estimated useful life of five years. Following the adoption of the recommendations of the CICA Handbook Section 3062 on May 1, 2002, goodwill is not amortized, but rather is evaluated for impairment annually, or when events or changed circumstances indicate that an impairment may have occurred. In connection with the goodwill impairment test, if the carrying value of the Company's reporting unit to which goodwill relates exceeds its estimated fair value, the goodwill related to that reporting unit is tested for impairment. If the carrying value of such goodwill is determined to be in excess of its fair value, an impairment loss is recognized in the amount of the excess of the carrying value over the fair value. The goodwill impairment test entails the use of a number of estimates including future cash flows and involving varying degrees of judgement and uncertainty. Actual results will differ from those estimates.

The Company assesses the carrying value of its long-lived assets, which include property, plant and equipment and definite-life intangible assets, for future recoverability when events or changed circumstances indicate that the carrying value may not be recoverable. An impairment loss is recognized if the carrying value of a long-lived asset exceeds the sum of the estimated undiscounted future cash flows expected from its use. The amount of impairment loss, if any, is determined as the excess of the carrying value of the assets over their fair value. The long-lived assets impairment test entails the use of a number of estimates including future cash flows and involving varying degrees of judgement and uncertainty. Actual results will differ from those estimates.

Revenue Recognition

The Company licenses software under non-cancellable license agreements and provides services including training, installation, consulting and maintenance, which includes product support services and periodic updates. The Company recognizes revenue in accordance with the guidance set out in Statement of Position ("SOP") 97-2, "Software Revenue Recognition". Revenues generated by the Company include the following:

- **License Fees**

Revenues from licenses sold separately are recognized when a non-cancellable license agreement has been signed, the software product has been shipped, there are no uncertainties surrounding product acceptance, the fees are fixed or determinable, and collection is considered probable. Fees from multiple element arrangements are allocated to the various elements based on vendor-specific objective evidence of fair value provided that services, if any, are not essential to the functionality of the software. Revenues from licenses sold under multiple element arrangements are recognized upon shipment of the software product, provided that all of the above criteria have been met.

Where services are considered to be essential to the functionality of the software, fees from licenses and services are aggregated and recognized as revenue as the related services are performed using the percentage-of-completion method. The percentage of completion is generally determined based on the number of hours incurred to date in relation to the total expected hours of services. The cumulative impact of any revision in estimates of the percentage completed is reflected in the period in which the changes become known. Losses on such contracts in progress are recognized when known. Work in process is established for revenue based on the percentage completed in excess of progress billings as of the balance sheet date. Any excess of progress billings over revenue based on the percentage completed is deferred and included in deferred revenue. Generally, the terms of long-term contracts provide for progress billing based on completion of certain phases of work. Where acceptance criteria are tied to specific milestones, the percentage of completion up to that milestone is recognized upon acceptance.

- **Support Agreements**

Support agreements generally call for the Company to provide technical support and unspecified software updates to customers. Revenues from technical support and unspecified software update rights are recognized ratably over the term of the support agreement.

- **Consulting and Education Services**

The Company provides consulting and education services to its customers. Revenues from such services are recognized as the services are performed.

Related Party Transactions

The company has an unsecured subordinated loan for CA\$107,000 (US\$80,500) from a person related to certain shareholders, bearing interest at 12.67% with no specific terms of repayment. The same amount was outstanding as at July 31, 2004 and July 31, 2003. This loan originated in fiscal year 1989 and 1994.

Management has compiled the unaudited interim consolidated financial information of TECSYS Inc. consisting of the interim Consolidated Balance Sheet as at July 31, 2004 and the Consolidated Statements of Deficit, Operations, and Cash Flows for the three-month periods ended July 31, 2004 and July 31, 2003. An accounting firm has not reviewed or audited these interim consolidated financial statements.

Consolidated Balance Sheets

Prepared in Accordance with Canadian Generally Accepted Accounting Principles
(in thousands of U.S. dollars)

	July 31, 2004 (unaudited)	April 30, 2004
Assets		
Current assets		
Cash and cash equivalents	2,774	2,388
Short-term investments	5,607	5,665
Accounts receivable	4,605	4,705
Other accounts receivable	113	579
Tax credits receivable	1,330	1,056
Prepaid expenses	448	501
	<u>14,877</u>	<u>14,894</u>
Restricted cash equivalents and other investments	770	747
Long-term trade account receivable	33	-
Property, plant and equipment	2,039	2,059
Intangible assets	1,202	1,215
Goodwill	<u>1,282</u>	<u>1,242</u>
	<u>20,203</u>	<u>20,157</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	3,316	3,691
Current portion of long-term debt	103	175
Deferred revenue	1,711	1,809
	<u>5,130</u>	<u>5,675</u>
Long-term debt	413	401
Other long-term liabilities	603	613
	<u>6,146</u>	<u>6,689</u>
Shareholders' Equity		
Capital stock (note 2)	39,326	39,326
Contributed surplus (notes 1 and 3)	6,442	1,606
Cumulative translation adjustment	702	300
Deficit	<u>(32,413)</u>	<u>(27,764)</u>
	<u>14,057</u>	<u>13,468</u>
	<u>20,203</u>	<u>20,157</u>

Consolidated Statements of Deficit

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars)

	Three Months Ended July 31, 2004 (unaudited)	Three Months Ended July 31, 2003 (unaudited)
Balance - Beginning of period	(27,764)	(28,179)
Adjustment resulting from a change in accounting policy re: stock-based compensation (note 1)	(4,785)	-
Restated balance - Beginning of period	(32,549)	(28,179)
Net earnings for the period	136	10
Balance - End of period	(32,413)	(28,169)

Consolidated Statements of Operations

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars, except share and per share data)

	Three Months Ended July 31, 2004 (unaudited)	Three Months Ended July 31, 2003 (unaudited)
Revenue		
Products (note 4a)	1,753	1,596
Services	3,406	1,954
Reimbursable expenses	186	216
	<u>5,345</u>	<u>3,766</u>
Cost of revenue		
Products	504	338
Services (note 4b)	1,757	1,111
Reimbursable expenses	186	216
	<u>2,447</u>	<u>1,665</u>
Gross margin	<u>2,898</u>	<u>2,101</u>
Operating expenses		
Sales & marketing	1,190	865
General & administration	556	362
Gross research & development	916	784
Research & development tax credits	(101)	(172)
Amortization of property, plant and equipment	130	150
Amortization of intangible assets	72	31
	<u>2,763</u>	<u>2,020</u>
Earnings from operations	135	81
Interest income	43	85
Interest expense	(9)	(25)
Foreign exchange losses	(33)	(131)
Net earnings for the period	<u>136</u>	<u>10</u>
Weighted average number of common shares outstanding		
- basic	<u>14,158,797</u>	<u>14,363,595</u>
- diluted	<u>14,282,404</u>	<u>14,453,995</u>
Basic and diluted net earnings per common share (in US dollars)	<u>\$ 0.01</u>	<u>\$ 0.00</u>

Consolidated Statements of Cash Flows

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars)

	Three Months Ended July 31, 2004 (unaudited)	Three Months Ended July 31, 2003 (unaudited)
Cash flows from		
Operating activities		
Net earnings for the period	136	10
Adjustments for		
Amortization of property, plant and equipment	130	150
Amortization of intangible assets	72	31
Stock-based compensation costs	51	-
Unrealized foreign exchange losses	10	67
Changes in non-cash working capital items related to operations		
Decrease (increase) in accounts receivable	292	(236)
Decrease (increase) in other accounts receivable	109	(200)
Increase in tax credits receivable	(237)	(306)
Decrease in prepaid expenses	65	128
Increase in long-term accounts receivable	(34)	-
Decrease in accounts payable and accrued liabilities	(507)	(74)
Decrease in deferred revenue	(186)	(46)
	(99)	(476)
Financing activities		
Repayment of long-term debt and capital lease obligations	(75)	(117)
Purchase of common shares for cancellation	-	(335)
	(75)	(452)
Investing activities		
Decrease in short-term and other investments	273	992
Acquisitions of property, plant and equipment	(45)	(60)
Acquisitions of intangible assets	(23)	-
Business combination, purchase price adjustment	368	-
	573	932
Effect of foreign exchange rate fluctuations on cash and cash equivalents	(13)	52
Change in cash and cash equivalents	386	56
Cash and cash equivalents - Beginning of Period	2,388	703
Cash and cash equivalents - End of Period	2,774	759

1. Interim financial information

The interim financial statements for the three-month periods ended July 31, 2004 and July 31, 2003 are unaudited, nor have they been reviewed by the Company's auditors. In the opinion of management, all necessary adjustments were made to present fairly the results of these periods. The adjustments made were of a normal recurring nature. The results of operations for the three-month periods ended July 31, 2004 and 2003 are not necessarily indicative of the trends for the operating results for the full year.

The disclosures in these interim financial statements do not conform in all respects to the requirements of generally accepted accounting principles for annual financial statements; therefore these interim financial statements should be read in conjunction with the audited annual financial statements for the year ended April 30, 2004. These interim financial statements follow the same accounting policies and methods of their application as the annual financial statements for the year ended April 30, 2004, except for the change in accounting policy outlined below.

Change in Accounting Policy

Stock-based compensation and other stock-based payments

The Company maintains a stock-based compensation plan, which is described in note 11(d) in the audited financial statements for the year ended April 30, 2004. Effective May 1, 2004, the Company has adopted the fair value based method of accounting for stock options and warrants granted to employees and directors and has elected to apply the new standard retroactively without restatement as prescribed by the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870, Stock-based Compensation and Other Stock-based Payments. Under the fair value based method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period with a corresponding credit to contributed surplus. The stock-based compensation expense is recorded in the financial statements for the three months ended July 31, 2004. Accordingly, for the three-month period ended July 31, 2003, the Company provides only pro forma disclosures of net earnings (loss) and net earnings (loss) per common share as if the fair value based method of accounting had been used to account for stock options and warrants granted to employees and directors.

No compensation cost is recognized when shares are issued to employees. Any consideration received from plan participants is credited to capital stock. Any stock-based compensation costs related to awards to individuals other than employees and directors are accounted for at fair value.

The change in accounting for the stock-based compensation has resulted in a restatement of the opening balance of the deficit for the current fiscal year of \$4.8 million, with a corresponding credit to contributed surplus, reflecting the prior periods' cost of options and warrants granted since inception, which occurred in the 1998 fiscal year.

2. Capital stock

As at July 31, 2004, options to purchase 939,610 common shares at exercise prices ranging between CA\$0.99 and CA \$27.64 and warrants to purchase 30,000 common shares were outstanding. During the three-month period ended July 31, 2004, the Company granted options to purchase 1,000 common shares with an exercise price of CA \$1.70. Options to purchase 21,244 common shares at exercise prices ranging from CA\$0.99 to CA\$5.43 were either forfeited or expired. No options to purchase common shares were exercised during the three-month period ended July 31, 2004.

On July 15, 2004, the Company filed a one-year renewal with the Toronto Stock Exchange of the Notice of Intention to Make a Normal Course Issuer Bid (the "Notice"). The Notice stated the Company's intention to purchase on the open market at prevailing prices, through the facilities of the Toronto Stock Exchange, up to a maximum of 700,000 of its common shares, being approximately 5% of the 14,158,797 common shares outstanding as of June 30, 2004, but not more than 2% of such outstanding common shares as at June 30, 2004 in any 30-day period. Under the renewal, the Company may purchase common shares, if it considers it advisable, at any time, and from time to time for one year from the date of filing. The common shares will be purchased for cancellation.

During the three-month period ended July 31, 2004, the Company did not purchase any of its outstanding common shares for cancellation, whereas for the three-month period ended July 31, 2003, the Company

purchased 320,100 of its outstanding common shares for cancellation at an average price of \$1.04 per share under a Normal Course Issuer Bid. The total cost related to purchasing these shares, including other related costs, was \$335,000.

The total number of common shares outstanding at July 31, 2004 is 14,158,797.

3. Stock-based compensation costs

Commencing May 1, 2004, the company uses the fair value based method to record within its financial statements the stock-based compensation costs related to stock options and warrants granted to employees and directors for all stock options and warrants granted. The stock-based compensation expense recorded for the three months ended July 31, 2004 was CA\$67,000 (US\$51,000).

Stock-based compensation costs related to options and warrants are not reflected in the statement of operations for the three months ended July 31, 2003. Had the fair value based method been used to account for such stock-based compensation costs, the net earnings (loss) and related net earnings (loss) per common share figures would be as follows:

	Three months ended July 31, 2003
Net earnings for the period	10
Stock-based compensation costs	(97)
Pro forma loss for the period	(87)
Pro forma basic and diluted loss per common share	(\$0.01)

The fair value of options and warrants granted was estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

	Three months ended July 31, 2004	Three months ended July 31, 2003
Volatility	75%	75%
Risk-free interest rate	3.00%	3.00%
Dividend yield	nil	nil
Expected lives (in years)	3	3

Following is a summary of the weighted average grant date fair value of options and warrants granted during the three-month periods ended July 31, 2004 and 2003:

	Three months ended July 31, 2004	Three months ended July 31, 2003
Number of options & warrants	1,000	5,300
Weighted avg. exercise price US \$	1.26	0.99
Weighted avg. grant date FV US \$	0.64	0.50

4. Other Information

a) Products revenue

Products revenue is broken down as follows:

	Three months ended July 31, 2004	Three months ended July 31, 2003
Software products	1,091	739
Third-party hardware and software	662	857
	<u>1,753</u>	<u>1,596</u>

b) Cost of services consist of the following:

	Three months ended July 31, 2004	Three months ended July 31, 2003
Gross expenses	1,889	1,277
Refundable tax credits	(132)	(166)
	<u>1,757</u>	<u>1,111</u>

c) Earnings (loss) per share

Basic earnings (loss) per share is calculated using the weighted average number of shares outstanding during the period.

Diluted earnings per share is calculated based on the weighted average number of common shares outstanding during the period plus the effects of dilutive potential common shares outstanding during the period. This method requires that the dilutive effect of outstanding options and warrants be calculated using the treasury stock method, as if all dilutive options and warrants had been exercised at the later of the beginning of the reporting period or date of issuance, and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of the common shares during the period.

The diluted weighted average number of shares has been calculated as follows:

	Three months ended July 31, 2004	Three months ended July 31, 2003
Weighted average number of shares - basic	14,158,797	14,363,595
Additions to reflect the impacts of:		
Exercise of employee stock options and warrants	123,607	90,400
Weighted average number of shares -diluted	<u>14,282,404</u>	<u>14,453,995</u>

Options and warrants to purchase 320,616 common shares for the three months ended July 31, 2004 (three months ended July 31, 2003 – 575,869) have been excluded from the above calculations since they would have an anti-dilutive effect. There are no differences between basic and diluted per share figures.

5. Significant differences between Canadian and United States GAAP

The Company's financial statements are prepared in accordance with Canadian GAAP, which differs in some respects from U.S. GAAP. Significant measurement differences between Canadian GAAP and U.S. GAAP as they relate to the Company, are set forth below:

a) Statement of Operations

There are no differences between Canadian GAAP and U.S. GAAP affecting the net earnings or the basic and diluted net earnings per share for the three months ended July 31, 2004 and 2003. The following summary is a reconciliation of the net earnings to the comprehensive income for each period presented.

	Three months ended July 31, 2004	Three months ended July 31, 2003
Net earnings for the period in accordance with Canadian GAAP and U.S. GAAP	136	10
Other comprehensive income		
Foreign currency translation adjustments	402	235
Comprehensive income	538	245
Basic & diluted earnings per share	\$0.01	\$0.00

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The statements in this report relating to matters that are not historical fact are forward looking statements that are based on management's beliefs and assumptions. Such statements are not guarantees of future performance, and are subject to a number of uncertainties, including but not limited to future economic conditions, the markets that TECSYS Inc. serves, the actions of competitors, major new technological trends and other factors beyond the control of TECSYS Inc., which could cause actual results to differ materially from such statements.

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Printed in Canada 094114