

3rd Quarter

Fiscal 2004 Report

*Prepared in Accordance with Canadian
Generally Accepted Accounting Principles*

Dear Shareholder,

Twenty-seven percent growth, and approximately half of that organic! Needless to say, we are very pleased with the quarter, and yet we recognize that we are still in a challenging business climate that remains somewhat cautious, with a Canadian dollar that continues to be expensive. Let me run through the highlights for you:

- Revenue grew by 27% to \$4.2M, and gross margin increased to 53% of revenue compared to 43% in Q3 of fiscal 2003.
- We completed the acquisition of PointForce.
- We won three new customer accounts.
- Loss from operations dropped dramatically to \$110,000 compared to a net operating loss of \$3.5M in Q3 of fiscal 2003 (loss last year included non-recurring expenses totaling \$2.9M).
- Net income was \$20,000 compared to a net loss of \$3.6M.
- For the reporting nine months, net income was \$382,000 prior to loss on exchange. Net income was \$54,000 after loss on exchange.

When considering the comparable quarter revenue, it is important to note that roughly half of this 27% growth was organic and the other half was due to the acquisition of PointForce. One month of PointForce results is included in our 3rd quarter results.

Our backlog was \$9.7M at the end of the quarter compared to \$7M at the end of the prior quarter. We ended Q3 of this year with \$9.2M in cash, down from \$12.8M in the prior quarter primarily due to the acquisition of PointForce.

Our PointForce acquisition closed on December 31st, 2003, and we are pleased with what we are seeing as we come to understand the PointForce operations better. Focused on the giftware distribution market, PointForce has a target market of about 1,500 businesses that fit its product and services offering. In this market, PointForce has become a household word. Although the business only holds about 5% of this market today, that number is up from 2% two years ago. PointForce is clearly the number one supplier to this segment and continues to gain momentum.

On the *EliteSeries* side of the business, we continued to focus on both healthcare distribution/logistics and general wholesale distribution. Activity increased in the healthcare segment although we did not actually sign any new healthcare accounts in the quarter. This is a cautious, but well funded, industry and we continue to be pleased with the progress we are seeing. Of the new accounts we did sign, one was signed as a rental agreement. This does not permit us to recognize much revenue in the signing quarter, but does add to our on-going revenue stream. On the product development side, we were pleased to be able to ship the first ever German language version of our product. This, along with our English, French and Spanish versions, positions us well for pursuit of more international business.

Finally, allow me to summarize our view of the business for you. We now have three solid profitable quarters behind us. We have stabilized the business, re-established technology leadership in our market, and the results are showing in both our revenue and backlog numbers. Although, the rising Canadian dollar has negatively impacted our bottom line by approximately \$800K, the bulk of that impact is simply absorbed into our expenses, since most of our salaries and leases are paid in CDN funds. We still have some work to do, but given what we have accomplished over the last three quarters, we believe we have a solid platform for significant growth and profitability.

Yours truly,

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

Peter Brereton

President and Co-CEO

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto, which are included in this document. These statements should also be read in conjunction with the annual report for fiscal year 2003. The Corporation's third quarter for fiscal year 2004 ended on January 31, 2004.

The Corporation'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 Corporation's reporting currency is the U.S. dollar; and the functional currency is the Canadian dollar. Accordingly, the consolidated financial statements for the three and nine month periods ended January 31, 2004 and January 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 specific measurement differences between Canadian and United States generally accepted accounting principles as they relate to the Corporation.

Results of Operations

Three and nine months ended January 31, 2004 compared to three and nine months ended January 31, 2003

Business Combination

On December 31, 2003, the Corporation acquired 100% of the issued and outstanding shares of PointForce Inc. ("PointForce"), a company which develops, markets, and sells distribution software products primarily to the gift and home decor market. Please see note 9 of the unaudited consolidated financial statements

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.

Revenue

Total revenue increased 27% to \$4.2 million in the third quarter of fiscal 2004 compared to \$3.3 million in the third quarter of fiscal 2003. Products revenue increased 19% to \$1.3 million in the third quarter of fiscal 2004 compared to \$1.1 million for the same period last year due primarily to increases of third-party products revenue. Services revenue increased 33% to \$2.7 million during the third quarter of fiscal 2004 compared to \$2.0 million in the same period last year. As a proportion of total revenue, products accounted for 32% and services 65% in the third quarter of fiscal 2004 compared to 34% and 62%, respectively, in the third quarter of fiscal 2003. The revenue figures above include revenues from PointForce in the amount of \$446,000 representing revenues for the month of January 2004.

Total revenue increased 7% to \$12.1 million for the first three quarters of fiscal 2004 compared to \$11.3 million during the same period in fiscal 2003. Products revenue increased by 30% to \$4.8 million compared to \$3.7 million for the same period last year. The increase in product revenues is mainly due to increases of third-party products revenue of \$858,000 related to the significant number of new contracts signed in the past twelve months. Services revenue decreased by 5% to \$6.8 million during the first three quarters of fiscal 2004 compared to \$7.2 million for the same period last year reflecting lower consulting and product adaptations. During the first nine months of fiscal 2003, significant services revenue was generated as a result of a number of major accounts going live. This compares to a lesser number of go-lives during the comparable period of fiscal 2004. As a proportion of total revenue, products accounted for 39% and services 57% in the first nine months of fiscal 2004 compared to 32% and 63%, respectively, in the same period last year.

As a result of the strengthening of the Canadian dollar vis-à-vis the U.S. dollar for the first nine months of fiscal 2004 as compared to the same period in fiscal 2003, the nine-month revenues for fiscal 2004 have been favorably impacted by approximately \$400,000. Similarly, the strengthening Canadian dollar has affected services expenses and operating expenses adversely for approximately \$1.2 million. U.S. dollar to Canadian dollar exchange rates for the nine-month period ended January 31, 2004 have averaged 1.3467 in comparison to 1.5567 for the first nine months of the previous fiscal year (Q3 fiscal 2004 - 1.3071, Q3 fiscal 2003 - 1.5572).

Cost of Revenue

Total cost of revenue in the third quarter of fiscal 2004 was \$2.0 million representing an increase of 5% compared to \$1.9 million for the same period last year. Cost of services remained flat at \$1.3 million during the third quarter of fiscal 2004, including PointForce's services cost of \$189,000. Excluding PointForce, services costs were lower by \$168,000 mainly due to lower personnel costs and overhead. Average services personnel count, excluding PointForce, was 81 in the third quarter of fiscal 2004 compared to 99 in the same period last year representing a decrease of 18%. PointForce's services personnel was 34 for the month of January 2004. Total cost of revenue was net of multimedia tax credits of \$119,000 in the third quarter of fiscal 2004 compared to \$145,000 in third quarter of fiscal 2003.

For the first nine months of fiscal 2004, the total cost of revenue declined by 10% to \$5.5 million compared to \$6.2 million in the first nine months of fiscal 2003. Cost of third-party products remained flat at \$1.4 million for the first nine months of fiscal 2004 compared to the previous fiscal year despite an increase of third-party product revenues. This is due primarily to better product mix and better negotiated costs from suppliers. Cost of services decreased by 15% to \$3.6 million for the first nine months of fiscal 2004 compared to \$4.3 million for the same period in fiscal 2003. This decrease is attributable mainly to lower average service personnel of 83 in the first nine months of fiscal 2004 compared to 107 for the same period last year. The cost of revenues are net of multimedia tax credits of \$422,000 in the first nine months of fiscal 2004 compared to \$588,000 for the comparable period of fiscal 2003.

As a result of the strengthening of the Canadian dollar vis-à-vis the U.S. dollar for the first nine months of fiscal 2004 as compared to the same period in fiscal 2003, the nine-month services expenses for fiscal 2004 have been unfavorably impacted by approximately \$400,000.

Gross Margin

Total gross margin in the third quarter of fiscal 2004 was 53% compared to 43% in the same period of fiscal 2003. This increase is due primarily to slightly higher product margins of 61% in the third quarter of fiscal 2004 compared to 60% for the comparable period of fiscal 2003. Services gross margin was considerably higher at 51% in the third quarter of fiscal 2004 compared to 36% in the same period last year mainly due to the lower personnel and overhead costs.

During the first nine months of fiscal 2004, the total gross margin was 54% compared to 45% for the same period of fiscal 2003. The increase is due primarily to a higher proportion of product revenues, which also generated higher margins of 70% in the first nine months of fiscal 2004 compared to 62% for the same period in the previous fiscal period. This is due primarily to better product mix and better negotiated costs from suppliers. Services margin increased in the first nine months of fiscal 2004 to 47% compared to 40% for the same period last year primarily due to lower headcount.

Operating Expenses

Total operating expenses decreased 53% to \$2.3 million in the third quarter of fiscal 2004 compared to \$4.9 million in the third quarter of fiscal 2003. The third quarter of fiscal 2003 included non-recurring charges; the impairment loss on intangible assets regarding acquired technology from a business combination effected in July 2000 and sub-licensing rights acquired in May 2000 amounting to \$1.1 million, restructuring charges related to the sublease of one floor at one of its facilities amounting to \$1.2 million, as well as the write-off of non-refundable tax credits for \$610,000. PointForce's operating expenses for January 2004 amounted to \$199,000. Total operating expenses, excluding these non-recurring charges and newly acquired PointForce, increased by 4% in the third quarter of fiscal 2004 to \$2.1 million compared to fiscal 2003 of \$2.0 million. Approximately \$330,000 of increased operating expenses can be attributed to a strengthened Canadian dollar against the U.S. dollar for the same period in the prior fiscal year.

During the first nine months of fiscal 2004, operating expenses decreased by 35% to \$6.3 million in comparison to \$9.7 million for the same period of fiscal 2003.

Excluding the non-recurring charges and PointForce's operating expenses, operating expenses decreased 11% for the first nine months of fiscal 2004 compared to the same period for 2003. This reduction in operating expenses has been a direct result of the Corporation's continuing efforts to adjust its operating model to be in line with revenue expectations.

As a result of the strengthening of the Canadian dollar vis-à-vis the U.S. dollar for the first nine months of fiscal 2004 as compared to the same period in fiscal 2003, the nine-month operating expenses for fiscal 2004 have been unfavorably impacted by approximately \$800,000.

Sales and Marketing

Expenses increased 5% or \$44,000 in the third quarter of fiscal 2004 to \$953,000 compared to the same period last year mainly due to the acquisition of PointForce. For the first nine months of fiscal 2004, expenses decreased slightly by 1% or \$35,000 to \$2.7 million. The average number of employees in sales and marketing during the first nine months of fiscal 2004 was 23 compared to 26 in fiscal 2003.

General and Administration

Expenses increased 17% in the third quarter of fiscal 2004 to \$399,000 compared to \$340,000 for the comparable period last year mainly due to the acquisition of PointForce. During the first nine months of fiscal 2004, general and administration expenses decreased 1% or \$15,000 to \$1.1 million compared to the same period of the previous fiscal year.

Research and Development (R&D)

Gross R&D expenses increased 15% in the third quarter of fiscal 2004 to \$887,000 compared to \$770,000 for the comparable period last year (\$758,000 and \$598,000 respectively, net of tax credits) primarily due to the strengthening of the Canadian dollar against the U.S. dollar. During the first nine months of fiscal 2004, gross R&D expenses decreased 12% to \$2.4 million compared to \$2.7 million for the same period in fiscal 2003 (\$1.9 million and \$2.2 million respectively, net of tax credits). The decrease is primarily due to lower salaries and benefits expenses resulting from lower average number of employees in the first nine months of fiscal 2004 of 45 compared to 59 in the same period last year.

During the third quarter of fiscal 2004, the Corporation continued to focus on moving the flagship *EliteSeries* product to a state-of-the-art Web-browser user interface with integrated Web Services capability. In the third quarter of fiscal 2004, gross R&D expenses were 21% of revenue compared to 23% in the same period last year. Gross R&D expenses for the first nine months of fiscal 2004 were 20% of revenues compared to 24% for the comparable period last year.

Amortization of Intangible Assets

The acquisition of PointForce in the third quarter of fiscal 2004 included identified intangible assets for core technology and customer relationships amounting to \$1.0 million. Please see the business combination note 9 accompanying the financial statements.

During the third quarter of fiscal 2003, the Corporation adopted retroactive to May 1, 2002, the new recommendations of the CICA regarding impairment of long lived assets and reassessed the carrying value, under these new rules, resulting in a write-off of \$1.1 million of acquired technology from a business combination effected in July 2000 and sublicensing rights acquired in May 2000.

Amortization of intangible assets increased 56% or \$18,000 to 50,000 in the third quarter of fiscal 2004 in comparison to the same period in the previous fiscal year due to the newly acquired intangible assets of PointForce. For the first nine months of fiscal 2004, amortization of intangible assets decreased 63% to \$114,000 as compared to \$305,000 for the first nine months of fiscal 2003 primarily due to the reduced asset base resulting from the fiscal 2003 write-off described above.

Other Income and Expenses

Interest income decreased 12% to \$63,000 in the third quarter of fiscal 2004 compared to \$71,000 for the same period in fiscal 2003 (\$228,000 and \$173,000 respectively for the first nine months of the year) due primarily to lower interest rates currently in effect. The favorable differential for the nine-month periods can be attributed mainly to more funds being available for investment in fiscal 2004.

Interest expense decreased 37% to \$17,000 in the third quarter of fiscal 2004 compared to \$27,000 for the same period last year (\$63,000 and \$102,000 respectively for the first nine months of the year). The reduction in interest expense is attributable to the reduction of long-term debt and capital lease obligations.

During the third quarter of fiscal 2004, the company recorded an exchange gain of \$84,000 compared to an exchange loss of \$163,000 for the same period in the previous fiscal year. The exchange gain in the quarter is due primarily because of the weakening Canadian dollar against the U.S. dollar considering the exchange rate at the beginning of the quarter (\$1 US = \$1.3197 CA) as well as the average exchange rate during the quarter (\$1 US = \$1.3071 CA). The exchange rate at January 31, 2004 was \$1 US = \$1.3248 CA.

For the first nine month period in fiscal 2004, as a result of the strengthening of the Canadian dollar against the U.S. dollar, the Corporation incurred an exchange loss of \$328,000 compared to an exchange loss of \$217,000 for the same period in fiscal 2003 primarily as a result of carrying a net asset position in U.S. dollars.

The consolidated financial statements for the three and nine month periods ended January 31, 2004 and January 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 Corporation has recorded increases in the cumulative translation adjustment (CTA) account within the shareholder's equity of \$1.0 million for the first nine months of fiscal 2004 compared to an increase of \$411,000 for the comparable period of fiscal 2003. 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 shareholders' equity section rather than flowing through the statement of operations.

Net Profit / Loss

The Corporation recorded a net profit of \$20,000 (\$0.00 per share) in the third quarter of fiscal 2004 compared to a net loss of \$3.6 million (\$0.24 per share) for the same period last year.

On a year to date basis, the net profit was \$54,000 (\$0.00 per share) compared to a net loss of \$4.8 million (\$0.32 per share) for the same period last year.

Note 8 to the financial statements reflects that there are no material differences between the Corporation's reported net profit (loss) and basic and diluted net profit (loss) per share under Canadian GAAP as compared to U.S. GAAP for the three and nine month periods ended January 31, 2004 and 2003. However, under U.S. GAAP, the cumulative translation adjustment (CTA) is an integral part of arriving at the comprehensive profit or loss. The comprehensive net profit for the first nine months of fiscal 2004 under U.S. GAAP was \$1.0 million compared to the comprehensive net loss of \$4.3 million for the corresponding period in fiscal 2003 (\$41,000 and \$3.3 million comprehensive loss respectively for the three months ended January 31).

Liquidity and Capital Resources

As of January 31, 2004, current assets totaled \$14.4 million compared to \$16.8 million at the end of fiscal 2003. Cash, restricted cash equivalents, and short-term and other investment securities decreased to \$9.2 million compared to \$12.7 million as at April 30, 2003 primarily as a result of the recent \$3.2 million disbursement related to the PointForce acquisition. Accounts receivable totaled \$4.6 million at the end of January 31, 2004 compared to \$3.2 million at the end of fiscal 2003. The increase in accounts receivable is attributable primarily to the acquisition of PointForce, which holds \$1.3 million of accounts receivable at the end of January 2004. The Corporation's DSO (days sales outstanding) was 81 days at the end of the third quarter of fiscal 2004 compared to 78 days at the end of fiscal 2003.

Current liabilities as at January 31, 2004 totaled \$5.8 million compared to \$6.2 million at the end of fiscal 2003. This is mainly due to the repayment, in full, of a term loan. Long-term debt and other long-term liabilities, excluding the current portion of long-term debt, decreased to \$1.1 million at the end of the third quarter of fiscal 2004 from \$1.2 million at the end of fiscal 2003 due mainly to the repayment of a term loan, mentioned above, as well as certain capital lease obligations.

During the first nine months of fiscal 2004, operating activities used funds of \$33,000 compared to \$2.6 million generated funds for the same period last year. During the first nine months of fiscal 2004, used funds were due primarily to increases in net working capital of \$810,000 offset by positive results in operating activities. The \$2.6 million generated for the first nine months of fiscal 2003 was due primarily to the reduction of net working capital items. Working capital at the end of January 2004 was \$8.6 million compared to \$10.6 million at the end of fiscal 2003. The reduction in working capital is due primarily to the differential of the cash consideration for the PointForce acquisition versus the net working capital acquired (please see the business combination note 9 accompanying the financial statements), the repayment of long-term debt and capital lease obligations, and the repurchase of common shares for cancellation. The Corporation believes that funds on hand at January 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.

During the first nine months of fiscal 2004, financing activities used funds of \$1.0 million compared to \$571,000 for the same period last year. Specifically, \$648,000 was used for the repayment of long-term debt and capital lease obligations in the first nine months of fiscal 2004 compared to \$423,000 for the same period of fiscal 2003. Additionally, during the first nine months of fiscal 2004, the Corporation purchased 327,700 of its outstanding common shares for cancellation at an average price of \$1.05 per share under a Normal Course Issuer Bid announced on July 15, 2002 and renewed on July 15, 2003. The total cost related to purchasing these shares, including other related costs, was \$360,000. During the first nine months of fiscal 2003, the Corporation purchased 187,200 of its outstanding common shares for cancellation at an average price of \$0.79 per share under the Normal Course Issuer Bid announced on July 15, 2002. The total cost related to the share purchase in the first nine months of fiscal 2003, including other related costs was \$148,000.

During the first nine months of fiscal 2004, funds generated by investing activities amounted to \$1.1 million as compared to \$2.7 million used for the period of fiscal 2003. During the first nine of fiscal 2004, the Corporation generated funds of \$4.4 million by reductions in short term investments and used \$3.2 million for the acquisition of PointForce as well as \$236,000 to acquire new property, plant and equipment. In the comparable period for fiscal 2003, the Corporation used \$2.8 million to increase short term investments and \$253,000 to acquire new property, plant and equipment. Additionally, in the first nine months of fiscal 2003, cash inflows of \$374,000 were generated from the proceeds on asset dispositions.

Consolidated Balance Sheets

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

| (in thousands of U.S. dollars) | January 31, 2004 (unaudited) | April 30, 2003 |
|--|---|---------------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | 827 | 703 |
| Short-term investments | 7,467 | 10,954 |
| Accounts receivable (note 2) | 4,585 | 3,226 |
| Other accounts receivable | 282 | 36 |
| Tax credits receivable | 767 | 1,359 |
| Prepaid expenses | 494 | 478 |
| | <u>14,422</u> | <u>16,756</u> |
| Restricted cash equivalents and other investments | 869 | 1,046 |
| Property, plant and equipment | 2,234 | 2,153 |
| Intangible assets (note 9) | 1,332 | 349 |
| Goodwill (note 9) | 1,603 | - |
| | <u>20,460</u> | <u>20,304</u> |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities (note 4) | 3,688 | 3,635 |
| Current portion of long-term debt | 241 | 611 |
| Deferred revenue | 1,891 | 1,955 |
| | <u>5,820</u> | <u>6,201</u> |
| Long-term debt | 414 | 547 |
| Other long-term liabilities | 661 | 684 |
| | <u>6,895</u> | <u>7,432</u> |
| Shareholders' Equity | | |
| Capital stock (note 5) | 39,326 | 40,291 |
| Contributed surplus | 1,606 | 996 |
| Cumulative translation adjustment | 758 | (236) |
| Deficit | (28,125) | (28,179) |
| | <u>13,565</u> | <u>12,872</u> |
| | <u>20,460</u> | <u>20,304</u> |

Consolidated Statements of Deficit

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars)

| | Nine Months Ended January 31, 2004 (unaudited) | Nine Months Ended January 31, 2003 (unaudited) |
|---------------------------------------|---|---|
| Balance - Beginning of period | (28,179) | (21,227) |
| Transitional goodwill impairment loss | | (346) |
| Net profit (loss) for the period | 54 | (4,752) |
| Balance - End of period | <u>(28,125)</u> | <u>(26,325)</u> |

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 January 31, 2004 (unaudited) | Three Months Ended January 31, 2003 (unaudited) | Nine Months Ended January 31, 2004 (unaudited) | Nine Months Ended January 31, 2003 (unaudited) |
|---|--|--|---|---|
| Revenue | | | | |
| Products (note 7a) | 1,335 | 1,123 | 4,755 | 3,657 |
| Services | 2,712 | 2,044 | 6,837 | 7,162 |
| Reimbursable expenses | 128 | 127 | 496 | 491 |
| | <u>4,175</u> | <u>3,294</u> | <u>12,088</u> | <u>11,310</u> |
| Cost of revenue | | | | |
| Products | 516 | 452 | 1,406 | 1,389 |
| Services (note 7b) | 1,326 | 1,305 | 3,646 | 4,307 |
| Reimbursable expenses | 128 | 127 | 496 | 491 |
| | <u>1,970</u> | <u>1,884</u> | <u>5,548</u> | <u>6,187</u> |
| Gross margin | <u>2,205</u> | <u>1,410</u> | <u>6,540</u> | <u>5,123</u> |
| Operating expenses | | | | |
| Sales & marketing | 953 | 909 | 2,711 | 2,746 |
| General & administration | 399 | 340 | 1,113 | 1,128 |
| Gross research & development | 887 | 770 | 2,425 | 2,746 |
| Research & development tax credits | (129) | (172) | (490) | (578) |
| Write-off of non-refundable tax credits | - | 610 | - | 610 |
| Depreciation of property, plant and equipment | 155 | 162 | 450 | 512 |
| Impairment loss on intangible assets | - | 1,059 | - | 1,059 |
| Amortization of intangible assets | 50 | 32 | 114 | 305 |
| Restructuring charges | - | 1,201 | - | 1,201 |
| | <u>2,315</u> | <u>4,911</u> | <u>6,323</u> | <u>9,729</u> |
| Profit (loss) from operations | (110) | (3,501) | 217 | (4,606) |
| Interest income | 63 | 71 | 228 | 173 |
| Interest expense | (17) | (27) | (63) | (102) |
| Foreign exchange gains (losses) | 84 | (163) | (328) | (217) |
| Net profit (loss) for the period | <u>20</u> | <u>(3,620)</u> | <u>54</u> | <u>(4,752)</u> |
| Weighted average number of common shares outstanding | | | | |
| - basic | 14,161,789 | 14,840,623 | 14,229,344 | 14,928,335 |
| - diluted | 14,387,577 | 14,840,623 | 14,432,886 | 14,928,335 |
| Basic and diluted net profit (loss) per common share (in US dollars) | <u>\$ 0.00</u> | <u>\$ (0.24)</u> | <u>\$ 0.00</u> | <u>\$ (0.32)</u> |

Consolidated Statements of Cash Flows

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars)

| | Three Months Ended January 31, 2004 (unaudited) | Three Months Ended January 31, 2003 (unaudited) | Nine Months Ended January 31, 2004 (unaudited) | Nine Months Ended January 31, 2003 (unaudited) |
|--|--|--|---|---|
| Cash flows from | | | | |
| Operating activities | | | | |
| Net profit (loss) for the period | 20 | (3,620) | 54 | (4,752) |
| Adjustments for | | | | |
| Write-off of non-refundable tax credits | - | 610 | - | 610 |
| Depreciation of property, plant and equipment | 155 | 162 | 450 | 512 |
| Impairment loss on intangible assets | - | 1,059 | - | 1,059 |
| Amortization of intangible assets | 50 | 32 | 114 | 305 |
| Unrealized foreign exchange (gains) losses | (23) | - | 159 | (7) |
| Restructuring charges | - | 1,015 | - | 1,015 |
| Changes in non-cash working capital items related to operations | | | | |
| Decrease (increase) in accounts receivable | (174) | 757 | 17 | 2,849 |
| Decrease (increase) in other accounts receivable | 33 | 61 | (199) | 335 |
| Decrease (increase) in tax credits receivable | (248) | (74) | 784 | 1,116 |
| Decrease in prepaid expenses | 138 | 37 | 135 | 148 |
| Decrease in accounts payable and accrued liabilities | (414) | (1) | (980) | (595) |
| Decrease in deferred revenue | (11) | (17) | (567) | (13) |
| | (474) | 21 | (33) | 2,582 |
| Financing activities | | | | |
| Repayment of long-term debt and capital lease obligations | (30) | (102) | (648) | (423) |
| Issuance of common shares | 5 | - | 5 | - |
| Purchase of common shares for cancellation | (25) | (139) | (360) | (145) |
| Share purchase costs | - | - | - | (3) |
| | (50) | (241) | (1,003) | (571) |
| Investing activities | | | | |
| Decrease (increase) in short-term and other investments | 4,459 | (211) | 4,442 | (2,843) |
| Acquisitions of property, plant and equipment | (69) | (108) | (236) | (253) |
| Proceeds on disposals of property, plant and equipment | - | 309 | - | 374 |
| Business combination, net of cash and cash equivalents acquired | (3,151) | - | (3,151) | - |
| | 1,239 | (10) | 1,055 | (2,722) |
| Effect of foreign exchange rate fluctuations on cash and cash equivalents | 43 | 35 | 105 | 47 |
| Change in cash and cash equivalents | 758 | (195) | 124 | (664) |
| Cash and cash equivalents - Beginning of Period | 69 | 1,031 | 703 | 1,500 |
| Cash and cash equivalents - End of Period | 827 | 836 | 827 | 836 |

1. *Interim Financial Information*

The interim financial statements for the three and nine month periods ended January 31, 2004 and for the three and nine month periods ended January 31, 2003 are unaudited. 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 and nine month periods ended January 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 annual financial statements for the year ended April 30, 2003. 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, 2003.

2. *Accounts Receivable*

Accounts receivable comprise the following:

| | <u>Jan. 31, 2004</u> | <u>Apr. 30, 2003</u> |
|---|----------------------|----------------------|
| Trade, net of an allowance for doubtful accounts of \$1,015 (April 30, 2003 – \$1,751) | 4,493 | 3,063 |
| Work in process | 92 | 163 |
| | <u>4,585</u> | <u>3,226</u> |

3. *Bank Advances*

- a) The Company renewed its banking agreement with the National Bank of Canada in January 2004. This agreement obliges the Company to respect certain covenants in the form of financial ratios, which have been respected as of January 31, 2004.
- b) Under the terms of the agreement, the Bank has agreed to provide a currency risk protection facility for a principle amount not exceeding CA\$750,000 (US\$566,000) which may be used to issue foreign exchange forward contracts for the sale or purchase of foreign currencies. There were no outstanding foreign exchange contracts at April 30, 2003. On January 31, 2004, one foreign exchange contract to sell \$2,000,000 US at a rate of 1.3149 on February 2, 2004 for Canadian currency was outstanding. The foreign exchange contract was a hedge of existing financial assets, specifically US cash and accounts receivable. There was an unrealized loss of \$14,946 US which was recognized as at January 31, 2004. The financial statements reflect the expected Canadian equivalent for this conversion.
- c) This facility also permits the issuance of letters of guarantee of up to a maximum of CA\$1,500,000 (US\$1,132,000). As of January 31, 2004, CA\$1,151,000 (US\$869,000) of this facility was used to obtain letters of guarantee. An amount of CA\$872,000 (US\$658,000) is in favor of one of the Company's landlords and must be renewed annually through fiscal 2010; and CA\$279,000 (US\$211,000) is for certain capital lease obligations and must be maintained through October 2004.
- d) Under the terms of this agreement, the Company also has available a three-year revolving term loan of up to CA\$500,000 (US\$377,000) to finance up to 50% of the net book value of property, plant and equipment at bank prime rate plus 1.75%. Advances under a prior agreement amounted to CA\$750,000 (US\$523,000) at April 30, 2003. CA\$125,000 and CA\$625,000 were repaid in the first and second quarter respectively of the current fiscal year.
- e) These facilities are secured by a first ranking general hypothec of CA\$2,000,000 (US\$1,510,000) on all present and future moveable assets.

4. *Accounts Payable and Accrued Liabilities*

Accounts payable and accrued liabilities comprise the following:

| | Jan. 31, 2004 | Apr. 30, 2003 |
|------------------------|---------------|---------------|
| Trade | 2,470 | 2,601 |
| Accrued employee costs | 969 | 848 |
| Other | 249 | 186 |
| | 3,688 | 3,635 |

5. *Capital Stock*

As at January 31, 2004, options and warrants to purchase 1,034,671 common shares at exercise prices ranging between CA\$0.99 and CA\$37.66 were outstanding. During the nine month period ended January 31, 2004, the Company granted options and warrants to purchase 398,800 common shares at exercise prices ranging from CA\$1.23 to CA\$2.03 and options to purchase 225,178 common shares at exercise prices ranging from CA\$1.13 to CA\$27.64 were either forfeited or expired. Options to purchase 3,750 common shares were exercised at CA\$1.70 during the nine-month period ended January 31, 2004.

On July 15, 2003 the Company filed a renewal with the Toronto Stock Exchange of a Notice of Intention to Make a Normal Course Issuer Bid (the "Notice"). In the Notice, the Company stated its intention to purchase on the open market at prevailing market prices, through the facilities of the Toronto Stock Exchange, up to a maximum of 910,000 of its common shares, being approximately 10% of the 9,118,157 common shares comprising the public float as of June 30, 2003, but not more than 2% of the outstanding common shares as at June 30, 2003 in any 30-day period. The Company may purchase common shares under the bid, if it considers it advisable, at any time and from time to time between July 17, 2003 and July 16, 2004. The common shares will be purchased for cancellation.

During the nine month period ended January 31, 2004, the Company purchased 327,700 of its outstanding common shares for cancellation at an average price of CA\$1.44 (US\$1.05) per share. The total cost related to purchasing these shares, including other related costs, was CA\$495,000 (US\$360,000). The excess of the net book value over the purchase price of these shares of CA\$844,000 (US\$610,000) has been credited to contributed surplus.

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

6. *Stock-based Compensation Costs*

During the 2003 fiscal year the Company adopted the new recommendations of the CICA regarding stock-based compensation costs (Handbook section 3870). In adopting this recommendation, the Company elected not to adopt the fair value based method of accounting for stock options and warrants granted to employees. Accordingly, the Company provides pro forma disclosures of net loss and net loss per common share as if the fair value based method of accounting had been used. For purposes of pro forma disclosures, the Company has applied these recommendations retroactively. Any stock-based compensation costs related to awards for individuals other than employees and directors, if any, continue to be accounted for at fair value.

If the fair value based method had been used to account for stock-based compensation costs related to stock options and warrants issued to employees, the net loss and related net loss per common share figures would be as follows:

| | Three months ended Jan. 31, 2004 | Three months ended Jan. 31, 2003 | Nine months ended Jan. 31, 2004 | Nine months ended Jan. 31, 2003 |
|---|--|--|---|---|
| Net loss for the period | (59) | (3,742) | (175) | (5,194) |
| Basic and diluted net loss per common share | \$0.00 | (\$0.25) | (\$0.01) | (\$0.35) |

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

The Black-Scholes options valuation model was developed for use in estimating the fair value of traded options. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

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

| | Three months ended Jan. 31, 2004 | Three months ended Jan. 31, 2003 | Nine months ended Jan. 31, 2004 | Nine months ended Jan. 31, 2003 |
|--------------------------------------|--|--|---|---|
| Number of options and warrants | 31,000 | 650 | 398,800 | 170,450 |
| Weighted average exercise price US\$ | 1.55 | 0.78 | 1.23 | 0.97 |
| Weighted average grant date FV US\$ | 0.88 | 0.40 | 0.63 | 0.49 |

7. Other Information

a) Products Revenue

Products revenue is broken down as follows:

| | Three months ended Jan. 31, 2004 | Three months ended Jan. 31, 2003 | Nine months ended Jan. 31, 2004 | Nine months ended Jan. 31, 2003 |
|-----------------------------------|--|--|---|---|
| Software products | 421 | 423 | 1,823 | 1,583 |
| Third-party hardware and software | 914 | 700 | 2,932 | 2,074 |
| | 1,335 | 1,123 | 4,755 | 3,657 |

b) Cost of Services

Cost of services consist of the following:

| | Three months ended Jan. 31, 2004 | Three months ended Jan. 31, 2003 | Nine months ended Jan. 31, 2004 | Nine months ended Jan. 31, 2003 |
|------------------------|--|--|---|---|
| Gross expenses | 1,445 | 1,450 | 4,068 | 4,895 |
| Refundable tax credits | (119) | (145) | (422) | (588) |
| | 1,326 | 1,305 | 3,646 | 4,307 |

c) Net Profit (Loss) Per Share

The net profit (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 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 Jan. 31, 2004 | Three months ended Jan. 31, 2003 | Nine months ended Jan. 31, 2004 | Nine months ended Jan. 31, 2003 |
|--|--|--|---|---|
| Weighted avg. number of shares – basic | 14,161,789 | 14,840,623 | 14,229,344 | 14,928,335 |
| Additions to reflect the impacts of: Exercise of employee stock options | 225,788 | 24,450 | 203,542 | 24,543 |
| Weighted avg. number of shares – diluted | 14,387,577 | 14,865,073 | 14,432,886 | 14,952,878 |

Options to purchase 398,821 common shares for the nine months ended January 31, 2004 (three months ended January 31, 2004 – 295,833, nine months ended January 31, 2003 – 767,894, three months ended January 31, 2003 – 767,894) have been excluded from the above calculations since they would have an anti-dilutive effect. Since the Company has recorded small net profits for the three and nine months ended January 31, 2004 and was in a loss position for the three and nine months ended January 31, 2003 there are no differences between basic and diluted per share figures.

8. Significant Differences Between Canadian and United States GAAP

The Company's financial statements were 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) Income Statements

There are no differences between Canadian GAAP and U.S. GAAP affecting the net profit (loss) or the basis and diluted net profit (loss) per share for the three and nine months ended January 31, 2004 and 2003. The following summary is a reconciliation of the net profit (loss) to the comprehensive profit (loss) for each period presented.

| | Three months ended Jan. 31, 2004 | Three months ended Jan. 31, 2003 | Nine months ended Jan. 31, 2004 | Nine months ended Jan. 31, 2003 |
|---|--|--|---|---|
| Net profit (loss) for the period in accordance with Canadian GAAP and U.S. GAAP | 20 | (3,620) | 54 | (4,752) |
| Other comprehensive profit (loss): | | | | |
| Foreign currency translation adjustments | (61) | 322 | 994 | 411 |
| Comprehensive profit (loss) | (41) | (3,298) | 1,048 | (4,341) |

b) Shareholders' Equity

The following summarizes the material differences between shareholders' equity accounts under Canadian GAAP versus U.S. GAAP:

Capital Stock

| | Jan. 31, 2004 | Apr. 30, 2003 |
|--|---------------|---------------|
| Capital stock in accordance with Canadian GAAP | 39,326 | 40,291 |
| Warrants forfeited during fiscal 2002 | 235 | 235 |
| Capital stock in accordance with U.S. GAAP | 39,561 | 40,526 |

Deficit

| | Jan. 31, 2004 | Apr. 30, 2003 |
|--|---------------|---------------|
| Deficit in accordance with Canadian GAAP | (28,125) | (28,179) |
| Goodwill impairment loss: | | |
| Cumulative effect of prior years | (235) | (235) |
| Deficit in accordance with U.S. GAAP | (28,360) | (28,414) |

9. Business Combination

a) PointForce Acquisition

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 distribution software products primarily to the gift and home decor market. The total purchase consideration of approximately CA\$4,200,000 (US\$3,250,000) consisted of cash and costs related to the acquisition. The purchase consideration is subject to potential adjustments based upon the final net asset position of PointForce as at December 31, 2003 and the results of its operations for the year then ended. Any adjustment to the purchase price as a result of the above is expected to be made, and reflected in the financial statements as an adjustment to goodwill, in the fourth quarter of fiscal 2004.

PointForce was wound-up into TECSYS Inc. on January 1, 2004 and the results of its operations are included in the accompanying financial statements commencing January 1, 2004.

This business combination was accounted for using the purchase method and resulted in goodwill of CA\$2,124,000 (US\$1,643,000), subject to the potential adjustments referred to above, and based on the following allocation of the purchase price to identifiable assets acquired and liabilities assumed:

| | CDN \$ | US \$ |
|---|---------------------|---------------------|
| Current assets | 1,802 | 1,395 |
| Core technology | 797 | 617 |
| Customer relationships | 557 | 431 |
| Other long-term assets | 224 | 173 |
| | <u>3,380</u> | <u>2,616</u> |
| Current liabilities | 1,232 | 953 |
| Obligations under capital leases | 72 | 56 |
| | <u>1,304</u> | <u>1,009</u> |
| Net identifiable assets | 2,076 | 1,607 |
| Goodwill | 2,124 | 1,643 |
| | <u>4,200</u> | <u>3,250</u> |
| Purchase price | 4,200 | 3,250 |
| | <u>128</u> | <u>99</u> |
| Less: cash and equivalents acquired | 128 | 99 |
| Investment, net of cash and cash equivalents | <u>4,072</u> | <u>3,151</u> |

b) PointForce Intangible Assets

The core technology and customer relationships intangible assets related to the PointForce acquisition are amortized on a straight-line basis over their estimated useful lives of five years.

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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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