

WORKBRAIN CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

SELECTED CONSOLIDATED FINANCIAL INFORMATION

The following table sets out selected consolidated financial information for the years ended December 31, 2003, 2002 and 2001 and as at those dates. The selected consolidated financial information has been derived from our audited consolidated financial statements. You should read the following selected consolidated financial information in conjunction with our audited consolidated financial statements and the notes thereto and with Management's Discussion and Analysis.

	Year Ended December 31,		
	2003	2002	2001
	(Amounts In U.S. Dollars, In Thousands, Except Per Share Data)		
Consolidated Statement of Operations Data:			
Revenue:			
Licence	\$ 10,361	\$ 4,320	\$ 1,181
Service, maintenance and other	23,456	12,529	2,557
Net revenue	33,817	16,849	3,738
Cost of revenue:			
Licence	318	83	-
Service, maintenance and other	17,061	8,623	1,170
Cost of revenue accruals (recoveries), net	(561)	(359)	972
Total cost of revenue	16,818	8,347	2,142
Gross profit	16,999	8,502	1,596
Gross margin (%)	50.3%	50.5%	42.7%
Operating expenses:			
Sales and marketing	8,804	5,905	4,989
Research and development	5,153	3,456	3,366
General and administrative	1,614	2,215	1,783
Amortization of acquisition-related intangibles	336	-	-
Amortization of stock-based compensation	84	268	711
Total operating expenses	15,991	11,844	10,849
Income (loss) from operations	1,008	(3,342)	(9,253)
Interest income, net	232	260	476
Accretion on preferred shares	-	-	(529)
Net income (loss)	\$ 1,240	\$ (3,082)	\$ (9,306)
Net income (loss) per share:			
Basic	\$ 0.09	\$ (0.24)	\$ (0.76)
Basic weighted average number of common shares outstanding	13,249	12,589	11,618
Diluted	\$ 0.09	\$ (0.24)	\$ (0.76)
Diluted weighted average number of common shares outstanding	13,949	12,589	11,618

	Year Ended December 31,		
	2003	2002	2001
	(Amounts In U.S. Dollars, In Thousands)		
Consolidated Balance Sheet Data:			
Cash and cash equivalents and short-term investments	\$ 46,693	\$ 15,301	\$ 13,490
Working capital	41,443	8,968	12,215
Total assets	61,865	24,023	16,753
Deferred revenue	9,232	10,390	2,649
Long-term liabilities	125	99	139
Total shareholders' equity	46,929	10,184	12,884

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You should read the following discussion in conjunction with the selected consolidated financial information and with our audited consolidated financial statements and the notes thereto.

Forward-looking Statements

Certain statements included in this document constitute forward-looking statements, including those identified by the expressions *anticipate, believe, plan, estimate, expect, intend* and similar expressions to the extent they relate to us or our management. The forward-looking statements are not historical facts but reflect our current expectations regarding future results or events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations, including the matters discussed under *Risk Factors*.

Overview

Workbrain develops, markets, implements, and supports software that helps large organizations optimally deploy and manage their workforces. Our solutions automate workforce management processes such as labour forecasting, employee schedule optimization, time and attendance, workforce analytics and employee self-service. We market and sell our products through both direct and indirect channels to maximize market coverage in a cost-effective manner. We have a direct sales force that sells our software in North America and Europe. Our sales channels are supported through marketing and implementation relationships with leading systems integrators such as Accenture, IBM and BearingPoint, Business Process Outsourcers (BPOs) such as Exult and FESCO and resellers such as Fujitsu HST.

Revenue and Expenses

We generate revenue from licensing our software products and providing related services, including implementation, consulting, training, hosting and post-contract customer support (PCS). Licences for our products are typically perpetual licences for a specified number of users. In addition, customers often purchase implementation services from us to help them configure our software to meet their specific needs, which is typically billed on a time and materials basis. Customers generally enter into renewable annual maintenance contracts that provide for software updates and product support services. Our revenue has grown each quarter for the past ten fiscal quarters. We have grown our revenue through sales to new customers as well as through sales of additional products and services to our existing customers.

Cost of licence revenue consists primarily of the cost of third-party software we have licensed. Cost of service, maintenance and other revenue consists primarily of personnel and related costs incurred in providing implementation, consulting, training, hosting and PCS services. Cost of revenue accruals (recoveries), net consists of accruals and recoveries of zero-profit provisions.

Sales and marketing expenses consist primarily of personnel and related costs associated with our sales and marketing functions as well as commissions, seminars, trade shows, advertising and other promotional expenses. Research and development expenses consist primarily of personnel and related costs associated with the development of our software product. General and administrative expenses consist primarily of personnel and related costs associated with our administrative and finance functions, as well as professional fees and other general corporate expenses. Amortization of stock-based compensation relates primarily to charges on stock options granted to consultants.

Interest Income

Our interest income is related to our invested cash and short-term investments. We invest our excess cash in short-term investment-grade interest-bearing securities. Interest income fluctuates based upon the amount of funds available for investment and prevailing interest rates.

Significant Accounting Policies

Revenue Recognition. Our revenue is derived primarily from licence fees and service fees. We license software under non-cancelable licence agreements and provide services, including implementation, consulting, training, hosting, and PCS to our customers. In certain cases, we also provide customers with hardware related to our software offerings. We recognize revenue in accordance with Canadian GAAP, which, in our circumstances, is consistent with the provisions of the American Institute of Certified Public Accountants' Statement of Position No. 97-2, *Software Revenue Recognition* and related provisions (SOP 97-2).

To date, most of our arrangements with customers have involved services that have been determined to be essential to the functionality of the software. Accordingly, the revenue from such arrangements has been recognized under contract accounting using the percentage of completion method to measure progress towards completion. We use either the completion of contractual milestones or the ratio of incurred costs to estimated total costs, as appropriate, as the measure of our progress on each contract. If a loss on a contract is considered probable, all of that loss will be recognized at the date determinable.

Under certain of our arrangements, entered into in 2000 and 2001, where estimating the final outcome of a contract was impractical, except to assure that no loss would be incurred, we used a zero estimate of profit until results could be estimated more precisely. Under this method, the portion of total contract revenue earned to date was determined by measuring progress towards completion. We then recorded an equal amount of costs against the revenue. Cost of revenue was adjusted to recognize the profit element from the arrangement once we were able to estimate total revenue and total costs, which, in our circumstances, was at the time of substantial contract completion. We do not anticipate using the zero-profit method in the future.

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Implementation, consulting, and training fees, when not essential to the functionality of the software, are recognized as delivered to the customer, based on the prices charged when these services are sold separately to customers.

Hosting fees are recognized monthly as hosting services are provided to the customer, based upon contractually-stated renewal prices provided to customers.

PCS fees are recognized ratably over the term of the support contract, which is generally one year in length, based on the contractually-stated renewal prices provided to our customers.

Hardware fees are recognized as hardware is delivered to our customers, once the risks and rewards of ownership have passed to the customer, based on the prices charged when hardware is sold separately to customers.

Accounts receivable reflected on the consolidated balance sheet represent amounts from fees that are due from customers for which revenue has previously been recognized. Fees that have been prepaid but do not yet qualify for recognition as revenue under our revenue recognition policy are reflected as deferred revenue on the consolidated balance sheet.

Research and Development Costs. Research and development costs, net of investment tax credits, are charged to the consolidated statement of operations in the year in which they are incurred unless the criteria for deferral are met, including the establishment of technological feasibility.

Based on our product development process, technological feasibility is established once a working model has been produced and tested. To date, development costs incurred between the completion of a working model and the point where a product is released have been insignificant. Accordingly, all research and development costs have been charged to the consolidated statement of operations in the year in which they were incurred, net of related investment tax credits.

We are entitled to certain Canadian investment tax credits for qualifying research and development activities performed in Canada. As a Canadian Controlled Private Corporation (CCPC), certain investment tax credits were refundable to us. As a public company, investment tax credits are non-refundable, but can be applied against our future income tax liabilities and are subject to a 10-year carryforward period. Investment tax credits are recognized once we have reasonable assurance that the amounts will be realized.

Investment tax credits have been accounted for as a reduction of the related expenditures for items expensed in the consolidated statement of operations and a reduction of the related asset cost for items capitalized on the consolidated balance sheet.

Significant Accounting Estimates

We have made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses to prepare our consolidated financial statements in conformity with Canadian GAAP. Actual results could differ from these estimates.

Significant estimates in our consolidated financial statements include the valuation of accounts receivable, intangibles and goodwill, and the determination of the amount and timing of revenue to be recognized. In our determination of the valuation of accounts receivable, including the allowance for doubtful accounts, we rely on current customer information and our planned course of action as well as assumptions about future business and economic conditions. We have estimated the useful life of our intangibles based upon rapidly changing industry trends and changes in our customers' businesses. In our determination of the amount and timing of revenue to be recognized, we rely on assumptions supporting our revenue recognition policy. Estimates of the percentage of completion for customer projects are based upon current actual and forecasted information and contractual terms. Vendor-specific objective evidence (VSOE) we have established on our licence and service elements are based upon the prices charged when we sell specific elements to customers separately or contractually-stated renewal prices. Changes in our business practices or sales arrangements may impact our ability to establish VSOE on current or newly offered elements, thereby changing the amount and timing of revenue recognized.

Recent Accounting Pronouncements

Stock-based Compensation. In September 2003, the Canadian Institute of Chartered Accountants (CICA) amended Handbook Section 3870, *Stock-based Compensation and other Stock-based Payments*, to require the recording of compensation expense on the granting of all stock-based compensation awards, including stock options to employees, calculated using the fair-value method. We will adopt this standard on January 1, 2004, retroactively without restatement, and, accordingly, will record a charge to our opening deficit on January 1, 2004 of \$537,000 related to stock options granted on or after January 1, 2002.

Generally Accepted Accounting Principles. In July 2003, the CICA released Handbook Section 1100, *Generally Accepted Accounting Principles*. This Section establishes standards for financial reporting in accordance with Canadian GAAP, and describes what constitutes Canadian GAAP and its sources. This section also provides guidance on sources to consult when selecting accounting policies and determining appropriate disclosures, when a matter is not dealt with explicitly in the primary sources of GAAP. The new standard is effective on a prospective basis beginning January 1, 2004. We are currently evaluating the impact of the adoption of this standard on our consolidated financial statements.

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Consolidation of Variable Interest Entities. In June 2003, the CICA issued Accounting Guideline AcG-15, *Consolidation of Variable Interest Entities* (AcG-15). AcG-15 addresses the consolidation of variable interest entities (VIEs), which are entities which have insufficient equity at risk to finance their operations without additional subordinated financial support and/or entities whose equity investors lack one or more of the specified essential characteristics of a controlling financial interest. AcG-15 provides specific guidance for determining when an entity is a VIE and who, if anyone, should consolidate the VIE. AcG-15 will be applied in the Company's year beginning January 1, 2005. Enterprises with VIEs entities are required to provide certain disclosure related to their interests in the VIEs in periods beginning on or after January 1, 2004. We do not expect the adoption of this standard to have an impact on our consolidated financial statements.

Asset Retirement Obligations. In March 2003, the CICA issued Handbook Section 3110, *Asset Retirement Obligations*. This Section establishes standards for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated retirement costs. This Section applies to legal obligations associated with the retirement of a tangible long-lived asset that result from its acquisition, construction, development or normal operation. This Section covers the obligations of both lessors and lessees in connection with leased assets, whether imposed by a lease agreement or by a party other than the lessor, except for those obligations of a lessee that meet the definition of either minimum lease payments or contingent rentals in Section 3065, *Leases*, and are accounted for in accordance with that Section. This guideline is effective for our 2004 fiscal year, with early adoption encouraged. We do not expect the adoption of this standard to have an impact on our consolidated financial statements.

Results of Operations

The following table sets out, as a percentage of net revenue, selected consolidated financial information for the years ended December 31, 2003, 2002 and 2001:

	Year Ended December 31,		
	2003	2002	2001
	(Percentage of Net Revenue)		
Consolidated Statement of Operations Data:			
Revenue:			
Licence	30.6%	25.6%	31.6%
Service, maintenance and other	69.4	74.4	68.4
Net revenue	100.0	100.0	100.0
Cost of revenue:			
Licence	0.9	0.5	-
Service, maintenance and other	50.5	51.1	31.3
Cost of revenue accruals (recoveries), net	(1.7)	(2.1)	26.0
Total cost of revenue	49.7	49.5	57.3
Gross margin	50.3	50.5	42.7
Operating expenses:			
Sales and marketing	26.0	35.0	133.5
Research and development	15.3	20.5	90.0
General and administrative	4.8	13.2	47.7
Amortization of acquisition-related intangibles	1.0	-	-
Amortization of stock-based compensation	0.2	1.6	19.0
Total operating expenses	47.3	70.3	290.2
Income (loss) from operations	3.0	(19.8)	(247.5)
Interest income, net	0.7	1.5	12.7
Accretion on preferred shares	-	-	(14.2)
Net income (loss)	3.7%	(18.3)%	(249.0)%

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Comparison of Years Ended December 31, 2003 and 2002

Revenue:

Licence revenue increased 139.8% to \$10.4 million in the year ended December 31, 2003 compared with \$4.3 million in the year ended December 31, 2002. The growth was substantially attributable to an increase in the number of customers to 57 at December 31, 2003 compared to 32 at December 31, 2002. Growth was also a result of significant investments in sales infrastructure, primarily an increase in the number of direct sales personnel as well as a substantial expansion of marketing programs. We expect licence revenue to increase in dollar amounts and as a percentage of net revenue as we expect to continue to add new customers and continue to invest in sales infrastructure in future periods.

Service, maintenance and other revenue increased 87.2% to \$23.5 million in the year ended December 31, 2003 compared with \$12.5 million in the year ended December 31, 2002. The increase was primarily attributable to additional product implementation projects related to new customers as well as a growing installed base.

Cost of revenue:

Cost of licence revenue increased 283.1% to \$318,000 in the year ended December 31, 2003 compared with \$83,000 in the year ended December 31, 2002, and represented 3.1% and 1.9% of licence revenue for each year, respectively. The increase in the dollar amount and as a percentage of licence revenue of the cost of licence revenue reflected the sale of a greater number of third-party software licenses in the year ended December 31, 2003 compared with the prior year.

Cost of service, maintenance and other revenue increased 97.9% to \$17.1 million in the year ended December 31, 2003 compared with \$8.6 million in the year ended December 31, 2002, and represented 72.7% and 68.8% of service, maintenance and other revenue for each year, respectively. The increase in the cost of service, maintenance and other revenue in dollar amount and as a percentage of service, maintenance and other revenue in the year ended December 31, 2003, related primarily to the increase in the number of customer support, implementation and training personnel and related costs necessary to support our larger customer base and new product implementations. The average number of customer support, implementation and training personnel grew to 129 in the year ended December 31, 2003 compared to 54 in the year ended December 31, 2002. We expect the cost of service, maintenance and other revenue to increase in future periods as we expect to add personnel to service our growing customer base.

Cost of revenue accruals (recoveries), net was \$(561,000) in the year ended December 31, 2003 compared with \$(359,000) in the year ended December 31, 2002, and represented (1.7)% and (2.1)% of net revenue for each year, respectively. The cost of revenue accruals (recoveries), net, in the year ended December 31, 2003 results from the reversal, during 2003, of zero-profit provisions made in 2002 related to projects that were completed during 2003. The cost of revenue accruals (recoveries), net, in the year ended December 31, 2002 results from the reversal, during 2002, of zero-profit provisions made in 2000 and 2001 related to projects that were completed during 2002. We expect the amounts of any future accrual or recovery of zero-profit provisions to be minimal as substantially all projects where revenue was recognized using the zero-profit method were completed by December 31, 2003.

Operating expenses:

Sales and marketing expenses increased 49.1% to \$8.8 million in the year ended December 31, 2003 compared with \$5.9 million in the year ended December 31, 2002, and represented 26.0% and 35.0% of net revenue for each year, respectively. The increase in dollar amount was primarily attributable to the expansion of our sales and marketing workforce, which grew to an average of 50 personnel in the year ended December 31, 2003 compared to an average of 35 in the year ended December 31, 2002, increases in their related travel expenses in both North America and Europe and increased marketing activities, including trade shows and promotional expenses. The decrease as a percentage of net revenue is due to increased productivity as our sales and marketing workforce continues to grow. We expect sales and marketing expenses to increase in dollar amount in future periods as we expect to continue to add to our sales force and increase marketing activities.

Research and development expenses increased 49.1% to \$5.2 million in the year ended December 31, 2003 compared with \$3.5 million in the year ended December 31, 2002, and represented 15.3% and 20.5% of net revenue for each year, respectively. The increase in dollar amount in the year ended December 31, 2003 over the prior year was primarily attributable to increased staffing and associated support invested in order to expand and enhance our product offering. The average number of research and development personnel grew to 62 in the year ended December 31, 2003 compared to 45 in the year ended December 31, 2002. The increase in research and development expenses was offset by investment tax credits of \$540,000 realized in the year ended December 31, 2003 compared to \$144,000 realized in the year ended December 31, 2002. Up to December 31, 2003, all research and development costs have been expensed as incurred. We intend to increase research and development expenditures in dollar amount in future periods as we expect to continue to enhance our products and introduce new functionality.

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General and administrative expenses decreased 27.1% to \$1.6 million in the year ended December 31, 2003 compared with \$2.2 million in the year ended December 31, 2002, and represented 4.8% and 13.2% of net revenue for each year, respectively. The decrease in dollar amount was primarily the result of the inclusion of a foreign exchange gain of \$1.7 million in general and administrative expenses in the year ended December 31, 2003 which more than offset an increase in the number of administrative and financial personnel and increases in professional fees and other general corporate expenses necessary to manage and support our growth. The average number of administrative and financial personnel grew to 25 in the year ended December 31, 2003 compared to 20 in the year ended December 31, 2002. The decrease as a percentage of net revenue is partly due to efficiencies in general and administrative expenses as our revenue grows. We anticipate that general and administrative expenses will increase in dollar amount in future periods due in part to the increased costs associated with being a public company.

Amortization of stock-based compensation decreased 68.7% to \$84,000 for the year ended December 31, 2003 compared with \$268,000 in the year ended December 31, 2002 and represented 0.2% and 1.6% of net revenue, respectively. The decrease in dollar amount and as a percentage of net revenue is due to the fact that most options granted to consultants were fully vested and amortized by the beginning of 2003.

Interest income, net decreased to \$232,000 in the year ended December 31, 2003 compared with \$260,000 in the year ended December 31, 2002, primarily due to a decrease in prevailing interest rates in the year ended December 31, 2003 compared to the prior year. The increase in cash balances in the year ended December 31, 2003 is primarily attributable to cash provided by our public offering in December, 2003.

Income taxes. The differences between the effective tax rates and the statutory combined Canadian federal and provincial tax rates are explained in Note 14 of the notes to our audited consolidated financial statements.

Acquisition:

Effective April 1, 2003, we acquired the net operating assets of Workforce Logistics Inc., a provider of schedule optimization software. The acquisition enhanced our existing workforce management solution with additional schedule optimization functionality. Following this acquisition, we also began to recognize revenue from Workforce Logistics Inc.'s customers. Revenue attributable to the acquisition was less than \$1.2 million for the year ended December 31, 2003.

Amortization of acquisition-related intangibles relates to intangible assets acquired from Workforce Logistics Inc. and was \$336,000 for the year ended December 31, 2003.

We intend to continue to pursue selective strategic acquisitions that will expand and add functionality to our product offerings, augment our distribution channels, expand our market opportunity and broaden our customer base. We have no present agreements or commitments with respect to any prospective acquisition or investment.

Comparison of Years Ended December 31, 2002 and 2001

Revenue:

Licence revenue increased 265.8% to \$4.3 million in the year ended December 31, 2002 compared with \$1.2 million in the year ended December 31, 2001. The growth was substantially attributable to an increase in the number of customers to 32 at December 31, 2002 compared to 11 at December 31, 2001, a result of significant investments in sales infrastructure, primarily an increase in the number of direct sales personnel as well as a substantial expansion of marketing programs.

Service, maintenance and other revenue increased 390.0% to \$12.5 million in the year ended December 31, 2002 compared with \$2.6 million in the year ended December 31, 2001. The increase was primarily attributable to additional product implementation projects related to new customers as well as a growing installed base.

Cost of revenue:

Cost of licence revenue increased to \$83,000 in the year ended December 31, 2002 compared with \$0 in the year ended December 31, 2001, and represented 1.9% and 0.0% of licence revenue for each period, respectively. The increase in the dollar amount and as a percentage of licence revenue of the cost of licence revenue reflected our first sales of third-party software licences in the year ended December 31, 2002.

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Cost of service, maintenance and other revenue increased 637.0% to \$8.6 million in the year ended December 31, 2002 compared with \$1.2 million in the year ended December 31, 2001, and represented 68.8% and 45.8% of service, maintenance and other revenue for each period, respectively. The increase in the cost of service, maintenance and other revenue in dollar amount and as a percentage of service, maintenance and other revenue in the year ended December 31, 2002, related primarily to the increase in the number of customer support, implementation and training personnel and related costs necessary to support a larger customer base and new product implementations. The average number of customer support, implementation and training personnel grew to 54 in the year ended December 31, 2002 compared to 25 in the year ended December 31, 2001.

Cost of revenue accruals (recoveries), net was \$(359,000) in the year ended December 31, 2002 compared with \$972,000 in the year ended December 31, 2001, and represented (2.1)% and 26.0% of net revenue for each period, respectively. The cost of revenue accruals (recoveries), net, in the year ended December 31, 2002 results from the reversal, during 2002, of zero-profit provisions made in 2000 and 2001 related to projects that were completed during 2002. The cost of revenue accruals (recoveries), net, in the year ended December 31, 2001 results from the accruals of zero-profit provisions related to progress during 2001 on on-going projects where the zero-profit method was applied.

Operating expenses:

Sales and marketing expenses increased 18.4% to \$5.9 million in the year ended December 31, 2002 compared with \$5.0 million in the year ended December 31, 2001, and represented 35.0% and 133.5% of net revenue for each period, respectively. The increase in dollar amount was primarily attributable to the expansion of our sales and marketing workforce, which grew to an average of 35 personnel in the year ended December 31, 2002 compared to an average of 30 in the year ended December 31, 2001, increases in their related travel expenses in North America and increased marketing activities, including trade shows and promotional expenses. The decrease as a percentage of net revenue was due to increased productivity as our sales and marketing workforce continued to grow.

Research and development expenses increased 2.7% to \$3.5 million in the year ended December 31, 2002 compared with \$3.4 million in the year ended December 31, 2001, and represented 20.5% and 90.0% of net revenue for each period, respectively. The increase in dollar amount in the year ended December 31, 2002 over the comparative period in the prior year was primarily attributable to increased staffing and associated support required to expand and enhance our product offering. The average number of research and development personnel grew to 45 in the year ended December 31, 2002 compared to 23 in the year ended December 31, 2001. The increase in research and development expenses was offset by investment tax credits of \$144,000 realized in the year ended December 31, 2002 compared to \$0 realized in the year ended December 31, 2001.

General and administrative expenses increased 24.2% to \$2.2 million in the year ended December 31, 2002 compared with \$1.8 million in the year ended December 31, 2001, and represented 13.2% and 47.7% of net revenue for each period, respectively. The increase in dollar amount was primarily the result of an increase in the number of administrative and financial personnel and increases in professional fees and other general corporate expenses necessary to manage and support our growth. The average number of administrative and financial personnel grew to 20 in the year ended December 31, 2002 compared to 15 in the year ended December 31, 2001.

Amortization of stock-based compensation decreased 62.3% to \$268,000 for the year ended December 31, 2002 compared with \$711,000 in the year ended December 31, 2001 and represented 1.6% and 19.0% of net revenue, respectively. The decrease in dollar amount and as a percentage of net revenue related to fully vested grants expensed in the year ended December 31, 2001.

Interest income, net decreased to \$260,000 in the year ended December 31, 2002 compared with \$476,000 in the year ended December 31, 2001, due to the combination of a decrease in average cash balances on hand and a decrease in prevailing interest rates in 2002 compared to 2001. The decrease in cash balances was primarily attributable to cash used in our operations.

Income taxes. The differences between the effective tax rates and the statutory combined Canadian federal and provincial tax rates are explained in Note 14 of the notes to our consolidated financial statements.

Liquidity and Capital Resources

We have historically financed our operations through the sale of shares and through the cash generated by our operations. In December 2003, we raised \$32.4 million, net of offering costs, through the sale of 3.3 million common shares in a public offering. In April 2001, we raised \$11.8 million, net of offering costs, through the sale of 3.0 million Class B preferred shares and we issued an additional 0.5 million Class B preferred shares at that time to the purchasers of the December 2000 Class B round of financing to reduce their effective per share price to be equivalent to that of the April 2001 Class B round. At December 31, 2003 we had cash and cash equivalents and short-term investments of \$46.7 million and working capital of \$41.4 million.

Cash provided by (used in) operating activities for the years ended December 31, 2003, 2002 and 2001 was \$2.2 million, \$2.9 million and (\$6.9 million), respectively. Cash provided by operations in the year ended December 31, 2003 was the result of our net income of \$1.2 million and non-cash charges for depreciation and amortization totaling \$1.9 million which was offset by a net increase in working capital

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requirements. Cash provided by operations in the year ended December 31, 2002 was primarily the result of a net decrease in working capital requirements, which included a significant increase in deferred revenue. Cash used in operations in the year ended December 31, 2001 was primarily the result of the net loss for the year, which was partially offset by a net decrease in working capital requirements, which included a significant increase in deferred revenue.

Our investing activities consist of the purchase and sale of short-term investments, the purchase of property and equipment and a business combination transaction. In the year ended December 31, 2003, we used cash of \$1.4 million in the acquisition of the net operating assets of Workforce Logistics Inc. In the years ended December 31, 2003, 2002 and 2001, we purchased property and equipment, principally computers and related software for our growing employee base, of \$2.3 million, \$1.1 million and \$433,000, respectively. We expect that our investment in property and equipment will continue to increase as our employee base continues to grow. In the year ended December 31, 2001, we purchased \$8.9 million in short-term investments, which were sold in early 2002. In the year ended December 31, 2002 we purchased \$8.9 million in short-term investments, which were sold in early 2003. In the year ended December 31, 2003, we purchased \$8.7 million in short-term investments.

Our financing activities consist primarily of the issuance of share capital. In the year ended December 31, 2003, 2002 and 2001, \$32.9 million, \$7,000 and \$11.9 million of cash was provided by our financing activities, respectively. In 2003, we raised \$32.4 million from the issuance common shares in a public offering and \$520,000 from stock options exercised during the year. In 2001, we raised \$11.8 million from the issuance of a round of Class B preferred shares.

We had cash, cash equivalents and short-term investments totaling \$46.7 million, \$15.3 million and \$13.5 million at December 31, 2003, 2002 and 2001, respectively. We believe that our current cash and short-term investments and anticipated cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for the foreseeable future.

Foreign Exchange Management

We enter into transactions in multiple currencies (primarily U.S. and Canadian dollars) and, therefore, we are subject to gains and losses due to fluctuations between those two currencies. We have, from time to time, entered into forward contracts intended to manage portions of this risk. Forward contracts are not recorded in our consolidated financial statements on their inception. Any unrealized or realized gains or losses from such financial instruments are recognized in our income or loss from operations in the year in which they are incurred.

To date, the majority of our cash inflows, primarily cash received from our customers, have been denominated in U.S. dollars. However, a significant portion of our operating cash outflows have been denominated in Canadian dollars. In addition, we have historically kept our excess cash in U.S. dollar denominated investments. To assist us in managing our U.S. and Canadian dollar denominated cash flows, during 2003, we entered into a series of forward contracts with our bank to sell U.S. dollars and buy Canadian dollars at set intervals to cover our expected Canadian dollar denominated operating expenses. We entered into contracts during 2003 to sell a total of U.S.\$18.0 million in exchange for Cdn\$27.7 million beginning in January 2003 and ending in June 2004. Of the contracts entered into during 2003, at December 31, 2003, contracts remained outstanding to sell U.S.\$3.7 million in exchange for Cdn\$5.2 million.

We recorded a realized foreign exchange gain of approximately U.S.\$1.3 million related to contracts completed within 2003. In addition, we recorded an unrealized foreign exchange gain of U.S.\$366,000 on the contracts that were still outstanding at December 31, 2003. These gains made up the majority of the \$2.0 million total foreign exchange gain that we recorded for the year ended December 31, 2003.

Since the proceeds we raised from our public offering in December 2003 were denominated in Canadian dollars, we no longer are required to sell U.S. dollars in order to fund our Canadian dollar denominated operating expenses. We now maintain a Canadian dollar treasury in addition to our U.S. treasury. We expect to use those funds to cover our future Canadian dollar denominated operating expenses. Despite this change in our treasury management practices, we are still subject to gains and losses due to fluctuations between the U.S. and Canadian dollars. As we continue to expand our operations internationally, we will be subjected to additional potential gains and losses against currencies in addition to our exposure to the Canadian dollar.

SELECTED CONSOLIDATED QUARTERLY FINANCIAL INFORMATION

The following table sets out unaudited selected consolidated financial information for each of the eight quarters for the periods ended up to December 31, 2003. In the opinion of management, this information has been presented on the same basis as the audited consolidated financial statements appearing elsewhere in this annual report, and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the unaudited quarterly results when read in conjunction with our audited consolidated financial statements and the notes thereto. The operating results for any quarter should not be relied upon as any indication of results for any future period.

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Quarter Ended							
2003				2002			
Dec 31, 2003	Sep 30, 2003	Jun 30, 2003	Mar 31, 2003	Dec 31, 2002	Sep 30, 2002	Jun 30, 2002	Mar 31, 2002

(Amounts In U.S. Dollars, In Thousands, Except Per Share Data, Unaudited)

Consolidated Statement of Operations Data:

Revenue:								
Licence	\$ 2,521	\$ 2,555	\$ 2,883	\$ 2,402	\$ 1,481	\$ 918	\$ 781	\$ 1,140
Service, maintenance and other	<u>6,975</u>	<u>6,400</u>	<u>5,402</u>	<u>4,679</u>	<u>4,095</u>	<u>3,694</u>	<u>2,647</u>	<u>2,093</u>
Net revenue	<u>9,496</u>	<u>8,955</u>	<u>8,285</u>	<u>7,081</u>	<u>5,576</u>	<u>4,612</u>	<u>3,428</u>	<u>3,233</u>
Cost of revenue:								
Licence	39	19	112	148	74	-	9	-
Service, maintenance and other	4,913	4,503	4,396	3,249	3,058	2,974	1,489	1,102
Cost of revenue accruals (recoveries), net	<u>(8)</u>	<u>(911)</u>	<u>112</u>	<u>246</u>	<u>77</u>	<u>(324)</u>	<u>(401)</u>	<u>289</u>
Total cost of revenue	<u>4,944</u>	<u>3,611</u>	<u>4,620</u>	<u>3,643</u>	<u>3,209</u>	<u>2,650</u>	<u>1,097</u>	<u>1,391</u>
Gross profit	<u>4,552</u>	<u>5,344</u>	<u>3,665</u>	<u>3,438</u>	<u>2,367</u>	<u>1,962</u>	<u>2,331</u>	<u>1,842</u>
Gross margin (%).....	47.9%	59.7%	44.2%	48.6%	42.4%	42.5%	68.0%	57.0%
Operating expenses:								
Sales and marketing	2,588	2,088	2,322	1,806	1,947	1,384	1,289	1,285
Research and development	1,711	1,369	1,323	750	1,209	930	754	563
General and administrative	293	319	445	557	782	499	555	379
Amortization of acquisition- related intangibles	125	127	84	-	-	-	-	-
Amortization of stock-based compensation	<u>81</u>	<u>-</u>	<u>2</u>	<u>1</u>	<u>9</u>	<u>41</u>	<u>107</u>	<u>111</u>
Total operating expenses	<u>4,798</u>	<u>3,903</u>	<u>4,176</u>	<u>3,114</u>	<u>3,947</u>	<u>2,854</u>	<u>2,705</u>	<u>2,338</u>
Income (loss) from operations	(246)	1,441	(511)	324	(1,580)	(892)	(374)	(496)
Interest income, net	<u>62</u>	<u>50</u>	<u>56</u>	<u>64</u>	<u>56</u>	<u>84</u>	<u>58</u>	<u>62</u>
Net income (loss)	<u>\$ (184)</u>	<u>\$ 1,491</u>	<u>\$ (455)</u>	<u>\$ 388</u>	<u>\$ (1,524)</u>	<u>\$ (808)</u>	<u>\$ (316)</u>	<u>\$ (434)</u>
Net income (loss) per share:								
Basic	<u>\$ (0.01)</u>	<u>\$ 0.11</u>	<u>\$ (0.04)</u>	<u>\$ 0.03</u>	<u>\$ (0.12)</u>	<u>\$ (0.06)</u>	<u>\$ (0.03)</u>	<u>\$ (0.03)</u>
Basic weighted average number of common shares outstanding	<u>14,039</u>	<u>13,299</u>	<u>12,955</u>	<u>12,687</u>	<u>12,591</u>	<u>12,591</u>	<u>12,590</u>	<u>12,586</u>
Diluted	<u>\$ (0.01)</u>	<u>\$ 0.11</u>	<u>\$ (0.04)</u>	<u>\$ 0.03</u>	<u>\$ (0.12)</u>	<u>\$ (0.06)</u>	<u>\$ (0.03)</u>	<u>\$ (0.03)</u>
Diluted weighted average number of common shares outstanding	<u>14,039</u>	<u>13,864</u>	<u>12,955</u>	<u>13,122</u>	<u>12,591</u>	<u>12,591</u>	<u>12,590</u>	<u>12,586</u>

Volatility of Operating Results

Our quarterly operating results have fluctuated in the past and may fluctuate significantly in the future depending on factors such as demand for our products, the size and timing of orders, progress on our implementation projects, the number, timing and significance of new product announcements by us and our competitors, our ability to develop, introduce and market new and enhanced versions of our products on a timely basis, the level of product and price competition, changes in operating expenses, changes in our sales incentive strategy, sales personnel changes, the mix of direct and indirect sales and general economic factors, among others.

A significant portion of our expenses are based on our expectations of future revenue and, therefore, are relatively fixed in the short-term. Accordingly, if revenue levels are below our expectations, our operating results are likely to be adversely affected. As a result, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as any indication of future performance.

Due to all of the foregoing factors, in some future quarter our operating results may be below the expectations of public market analysts and investors. In such event, the price of our common shares would likely be materially adversely affected. Although we have experienced growth in revenue in recent years, there can be no assurance that in the future we will sustain revenue growth or be profitable on a quarterly basis.

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RISK FACTORS

You should carefully consider the following risk factors in addition to the other information contained in this document. The risks and uncertainties below are not the only ones facing us. Additional risks and uncertainties also may impair our business operations, including those risk factors detailed in our disclosure documents filed with securities regulators, which risk factors are incorporated by reference into this document. If any of these risks actually occur, our business may be harmed and our financial condition and results of operations may suffer significantly.

Failure to manage our growth successfully may adversely impact our operating results.

The growth of our operations places a strain on managerial, financial and human resources. Our ability to manage future growth will depend in large part upon a number of factors, including the ability to rapidly:

- build and train sales and marketing staff to create an expanding presence in the evolving marketplace for our products, and to keep staff informed regarding the technical features, issues and key selling points of our products;
- attract and retain qualified technical personnel in order to continue to develop reliable and scalable products and services that respond to evolving customer needs;
- develop customer support capacity as sales increase, so that we can provide customer support without diverting resources from product development efforts; and
- expand our internal management and financial controls significantly, so that we can maintain control over our operations and provide support to other functional areas within Workbrain as the number of our personnel and our size increases.

Our quarterly revenue and operating results can be difficult to predict and can fluctuate substantially, which may harm our results of operations.

Our revenue is difficult to forecast and is likely to fluctuate significantly from quarter to quarter. In addition, our operating results may not follow any past trends. The factors affecting our revenue and results, many of which are outside of our control, include:

- competitive conditions in our industry, including new products, product announcements and special pricing offered by our competitors;
- market acceptance of our products;
- our ability to hire, train and retain sufficient sales and professional services staff;
- our ability to complete our service obligations related to product sales in a timely manner;
- varying size, timing and contractual terms of orders for our products, which may delay the recognition of revenue;
- our ability to maintain existing relationships and to create new relationships to assist with our sales and marketing efforts;
- the discretionary nature of our customers' purchase and budget cycles and changes in their budgets for, and timing of, software, implementation services and related purchases;
- the length and variability of the sales cycles for our products;
- strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments or changes in business strategy;
- general weakening of the economy resulting in a decrease in the overall demand for computer software and services or otherwise affecting our customers' capital investment levels in workforce management software;
- changes in our pricing policies and the pricing policies of our competitors;
- timing of product development and new product initiatives; and
- changes in the mix of revenue attributable to substantially lower-margin service revenue as opposed to higher-margin product licence revenue.

Because our quarterly revenue is dependent upon a relatively small number of transactions, even minor variations in the rate and timing of conversion of our sales prospects into revenue could cause us to plan or budget inaccurately, and those variations could adversely affect our financial results. Delays, reductions in the amount or cancellations of customers' purchases would adversely affect our revenue, results of operations and financial condition.

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We face intense competition from several software competitors. If we do not compete effectively with these competitors, our revenue may not grow and could decline.

We have experienced, and expect to continue to experience, intense competition from a number of software companies. Our competitors may announce new products, services or enhancements that better meet the needs of customers or changing industry standards. Increased competition may cause price reductions, reduced gross margins and loss of market share, any of which could have a material adverse effect on our business, results of operations and financial condition. Many of our competitors and potential competitors have significantly greater financial, technical, marketing and service resources than we have. Many of these companies also have a larger installed base of users, longer operating histories or greater name recognition than we have. Our competitors may also establish or strengthen co-operative relationships with systems integrators, third-party consulting firms or other parties with whom we have relationships, thereby limiting our ability to promote our products and limiting the number of consultants available to implement our software. Even if our competitors provide products with more limited workforce management system functionality than our products, these products may incorporate other capabilities of interest to some customers and may be appealing to some customers because they would reduce the number of different types of software used to run their business. Further, our competitors may be able to respond more quickly than we can to changes in customer requirements and devote greater resources to the enhancement, promotion and sale of their products.

If we are required to change our pricing models to compete successfully, our margins and operating results may be adversely affected.

The intensely competitive market in which we conduct our business may require us to reduce our prices. If our competitors offer deep discounts on certain products or services in an effort to recapture or gain market share or to sell other software products, we may be required to lower prices or offer other favourable terms to compete successfully. Any such changes would be likely to reduce our margins and could adversely affect our operating results. Some of our competitors may bundle software products that compete with ours for promotional purposes or as a long-term pricing strategy or provide guarantees of prices and product implementations. These practices could, over time, limit the prices that we can charge for our products. If we cannot offset price reductions with a corresponding increase in the number of sales or with lower spending, then the reduced software licence revenue resulting from lower prices would adversely affect our margins and operating results.