

**WORKBRAIN CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002**

**SELECTED CONSOLIDATED ANNUAL FINANCIAL INFORMATION**

The following table sets out selected consolidated financial information for the years ended December 31, 2004, 2003 and 2002 and as at those dates. The selected consolidated financial information has been derived from our audited consolidated financial statements which are prepared in accordance with Canadian GAAP. 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.

|  | Years Ended December 31,                                       |           |            |
|--|--|-----------|------------|
|  | 2004   | 2003      | 2002       |
|  | (Amounts In U.S. Dollars, In Thousands, Except Per Share Data) |           |            |
| <b>Consolidated Statement of Operations Data:</b>                  |  |           |            |
| Revenue:   |  |           |            |
| Licence .....  | \$ 16,340  | \$ 10,361 | \$ 4,320   |
| Service, maintenance and other .....                               | 40,663   | 23,456    | 12,529     |
| Net revenue .....  | 57,003   | 33,817    | 16,849     |
| Cost of revenue:   |  |           |            |
| Licence .....  | 294  | 318       | 83         |
| Service, maintenance and other .....                               | 28,202   | 17,061    | 8,623      |
| Cost of revenue accruals (recoveries), net .....                   | (168)  | (561)     | (359)      |
| Total cost of revenue .....  | 28,328   | 16,818    | 8,347      |
| Gross profit .....   | 28,675   | 16,999    | 8,502      |
| Gross margin (%) .....   | 50.3%  | 50.3%     | 50.5%      |
| Operating expenses:  |  |           |            |
| Sales and marketing .....  | 13,847   | 8,804     | 5,905      |
| Research and development .....                                     | 9,650  | 5,153     | 3,456      |
| General and administrative .....                                   | 5,039  | 1,614     | 2,215      |
| Amortization of acquisition-related intangibles .....              | 367  | 336       | -          |
| Amortization of stock-based compensation .....                     | 1,237  | 84        | 268        |
| Total operating expenses .....                                     | 30,140   | 15,991    | 11,844     |
| Income (loss) from operations .....                                | (1,465)  | 1,008     | (3,342)    |
| Interest income, net .....   | 910  | 232       | 260        |
| Net income (loss) .....  | \$ (555)   | \$ 1,240  | \$ (3,082) |
| Net income (loss) per share:                                       |  |           |            |
| Basic .....  | \$ (0.03)  | \$ 0.09   | \$ (0.24)  |
| Basic weighted average number of common shares outstanding .....   | 16,871   | 13,249    | 12,589     |
| Diluted .....  | \$ (0.03)  | \$ 0.09   | \$ (0.24)  |
| Diluted weighted average number of common shares outstanding ..... | 16,871   | 13,949    | 12,589     |
|  | December 31,   |           |            |
|  | 2004   | 2003      | 2002       |
|  | (Amounts In U.S. Dollars, In Thousands)                        |           |            |
| <b>Consolidated Balance Sheet Data:</b>                            |  |           |            |
| Cash and cash equivalents and short-term investments .....         | \$ 51,077  | \$ 46,693 | \$ 15,301  |
| Working capital .....  | 45,943   | 41,443    | 8,968      |
| Total assets .....   | 72,926   | 61,865    | 24,023     |
| Deferred revenue .....   | 12,852   | 9,232     | 10,390     |
| Long-term liabilities .....  | 1,088  | 125       | 99         |
| Total shareholders' equity .....                                   | 50,514   | 46,929    | 10,184     |

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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. Additional information relating to Workbrain Corporation ("we", "us" or "Workbrain"), including our most recent annual information form, is available on SEDAR at [www.sedar.com](http://www.sedar.com). This management's discussion and analysis is prepared as of February 17, 2005.*

**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. These forward-looking statements are not facts, promises or guarantees; rather, they reflect our current expectations regarding future results or events. These forward-looking statements are subject to a number of known and unknown risks and uncertainties that could cause actual results, activities, performance or events to differ materially from current expectations. These risks include risks related to our revenue growth, operating results, industry, products, and litigation, as well as the matters discussed under *Risk Factors*. Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date on which they were made. We disclaim any obligation to publicly update or revise any such statements to reflect any change in our expectations or in events, conditions or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those set forth in the forward-looking statements.

**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, Europe and Australia. Our sales channels are supported through marketing and implementation relationships with systems integrators and business process outsourcing.

**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), and from providing certain hardware related to our software offerings. 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 also 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 fourteen 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 licenced. Cost of service, maintenance and other revenue consists primarily of personnel and related costs incurred in providing implementation, consulting, training, hosting and PCS services, as well as the cost of data collection devices. "Cost of revenue accruals (recoveries), net" consists of accruals and recoveries of zero-profit provisions, which are further described under "Significant Accounting Policies", below.

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 after December 31, 2003 relates primarily to charges on stock options granted to employees whereas amortization of stock-based compensation prior to that date related primarily to charges on stock options granted to consultants.

**Interest Income**

Our interest income is derived from our invested cash and short-term investments. We invest our excess cash in short-term investment-grade interest-bearing securities. Interest income fluctuates primarily as a result of changes in the amount of funds available for investment and prevailing interest rates.

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**Significant Accounting Policies**

**Revenue Recognition.** Our revenue is derived primarily from licence fees and service fees. We licence 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 2001 and 2000, 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.

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 due from customers with respect to fees 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 sheets.

**Research and Development Costs.** Research and development costs, net of investment tax credits, are charged to the consolidated statements 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 statements 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 carry-forward 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 statements of operations and reductions of the related asset cost for items capitalized on the consolidated balance sheets.

**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. 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 business and economic conditions in the future period over which the receivables are collectible. We have estimated the useful life of our intangibles taking into account the risk of 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

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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) that we have established on our licence and service elements is 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.** Effective January 1, 2004, Canadian GAAP required us to estimate the fair value of stock-based compensation to employees and to expense the fair value over the estimated vesting period of the stock options. In accordance with the transition rules, the fair value of stock options granted to employees since January 1, 2002 was determined using the Black-Scholes option pricing model, and we recorded an adjustment to opening deficit at January 1, 2004 in the amount of \$498,000, representing the expense for the 2002 and 2003 fiscal years. The offset to deficit is an increase in contributed surplus. The financial statements for periods prior to January 1, 2004 have not been restated.

**Financial Instruments.** In January 2005, the CICA issued Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, Section 1530, *Comprehensive Income*, and Section 3865, *Hedges*. The new standards will be effective for interim and annual financial statements commencing in 2007. Earlier adoption is permitted. Most significantly for us, the new standards will require presentation of a separate statement of comprehensive income. Derivative financial instruments will be recorded in the balance sheet at fair value and the changes in fair value of derivatives designated as cash flow hedges will be reported in comprehensive income. The existing hedging principles of Accounting Guideline AcG-13, *Hedging Relationships*, will be maintained. We are assessing the impact of the new standards.

**Overall Performance & Results of Operations**

The following table sets out, as a percentage of net revenue, selected consolidated financial information for the years ended December 31, 2004, 2003 and 2002:

|   | Years Ended December 31,    |       |         |
|---|-----------------------------|-------|---------|
|   | 2004                        | 2003  | 2002    |
|   | (Percentage of Net Revenue) |       |         |
| <b>Consolidated Statement of Operations Data:</b>     |                             |       |         |
| Revenue:  |                             |       |         |
| Licence .....   | 28.7%                       | 30.6% | 25.6%   |
| Service, maintenance and other .....                  | 71.3                        | 69.4  | 74.4    |
| Net revenue .....                                     | 100.0                       | 100.0 | 100.0   |
| Cost of revenue:                                      |                             |       |         |
| Licence .....   | 0.5                         | 0.9   | 0.5     |
| Service, maintenance and other .....                  | 49.5                        | 50.5  | 51.1    |
| Cost of revenue accruals (recoveries), net .....      | (0.3)                       | (1.7) | (2.1)   |
| Total cost of revenue .....                           | 49.7                        | 49.7  | 49.5    |
| Gross margin .....                                    | 50.3                        | 50.3  | 50.5    |
| Operating expenses:                                   |                             |       |         |
| Sales and marketing .....                             | 24.3                        | 26.0  | 35.0    |
| Research and development .....                        | 16.9                        | 15.3  | 20.5    |
| General and administrative .....                      | 8.8                         | 4.8   | 13.2    |
| Amortization of acquisition-related intangibles ..... | 0.7                         | 1.0   | –       |
| Amortization of stock-based compensation .....        | 2.2                         | 0.2   | 1.6     |
| Total operating expenses .....                        | 52.9                        | 47.3  | 70.3    |
| Income (loss) from operations .....                   | (2.6)                       | 3.0   | (19.8)  |
| Interest income, net .....                            | 1.6                         | 0.7   | 1.5     |
| Net income (loss) .....                               | (1.0)%                      | 3.7%  | (18.3)% |

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**Comparison of Years Ended December 31, 2004 and 2003**

**Revenue:**

*Licence revenue* increased 57.7% to \$16.3 million in the year ended December 31, 2004 compared with \$10.4 million in the year ended December 31, 2003. The growth was substantially attributable to an increase in the cumulative number of new customers to 90 at December 31, 2004 compared with 57 at December 31, 2003. The growth was indirectly attributable to 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 as we expect to continue to add new customers, enhance our current products and develop new products, and continue to invest in sales and marketing infrastructure in future periods. Licence revenue as a percentage of net revenue declined to 28.7% in the year ended December 31, 2004 compared with 30.6% in the year ended December 31, 2003, as a result of faster growth in service, maintenance and other revenue.

*Service, maintenance and other revenue* increased 73.4% to \$40.7 million in the year ended December 31, 2004 compared with \$23.5 million in the year ended December 31, 2003. The increase was primarily attributable to additional product implementation projects related to new customers as well as our growing installed base, which has continued to purchase services.

**Cost of revenue:**

*Cost of licence revenue* decreased 7.5% to \$294,000 in the year ended December 31, 2004 compared with \$318,000 in the year ended December 31, 2003, and represented 1.8% and 3.1% of licence revenue for each year, respectively. The decrease in the dollar amount and as a percentage of licence revenue of the cost of licence revenue reflected the sale of a smaller number of third-party software licences in the year ended December 31, 2004 compared with the prior year.

*Cost of service, maintenance and other revenue* increased 65.3% to \$28.2 million in the year ended December 31, 2004 compared with \$17.1 million in the year ended December 31, 2003, and represented 69.4% and 72.7% of service, maintenance and other revenue for each year, respectively. The increase in the cost of service, maintenance and other revenue in dollar amount in the year ended December 31, 2004 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 214 in the year ended December 31, 2004 compared with 129 in the year ended December 31, 2003. The decrease in the cost of service, maintenance and other revenue as a percentage of service, maintenance and other revenue in the year ended December 31, 2004 related primarily to increased operating efficiencies of our services operations, especially professional services. We expect the cost of service, maintenance and other revenue to increase in dollar amounts in future periods as we expect to add personnel to service new customers and our growing customer base.

*Cost of revenue accruals (recoveries), net* was \$(168,000) in the year ended December 31, 2004 compared with \$(561,000) in the year ended December 31, 2003, and represented (0.3)% and (1.7)% of net revenue for each year, respectively. The cost of revenue accruals (recoveries), net, in the year ended December 31, 2004 results from the reversal, during 2004, of zero-profit provisions made in 2003 related to projects that were completed during 2004. 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 and 2001 related to projects that were completed during 2003. 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, 2004.

**Operating expenses:**

*Sales and marketing expenses* increased 57.3% to \$13.8 million in the year ended December 31, 2004 compared with \$8.8 million in the year ended December 31, 2003, and represented 24.3% and 26.0% 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 65 personnel in the year ended December 31, 2004 compared with an average of 50 in the year ended December 31, 2003, 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 our marketing activities.

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**Research and development expenses** increased 87.3% to \$9.7 million in the year ended December 31, 2004 compared with \$5.2 million in the year ended December 31, 2003, and represented 16.9% and 15.3% of net revenue for each year, respectively. The increase in dollar amount in the year ended December 31, 2004 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 97 in the year ended December 31, 2004 compared with 62 in the year ended December 31, 2003. The increase in research and development expenses was offset by investment tax credits of \$149,000 realized in the year ended December 31, 2004 compared with \$540,000 realized in the year ended December 31, 2003. Up to December 31, 2004, 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 product functionality.

**General and administrative expenses** increased 212.2% to \$5.0 million in the year ended December 31, 2004 compared with \$1.6 million in the year ended December 31, 2003, and represented 8.8% and 4.8% of net revenue for each year, respectively. The increase in dollar amount was primarily the result of the inclusion of a lower foreign exchange gain of \$339,000 in the year ended December 31, 2004 compared with the inclusion a foreign exchange gain of \$1.7 million in the year ended December 31, 2003. In addition, the average number of administrative and financial personnel grew to 41 in the year ended December 31, 2004 compared with 25 in the year ended December 31, 2003. The lower foreign exchange gain more than offset the efficiencies in general and administrative expenses we have experienced as our revenue grows. We anticipate that general and administrative expenses will increase in dollar amount in future periods due in part to the increasing costs associated with being a public company.

**Amortization of acquisition-related intangibles** relates to intangible assets acquired from Workforce Logistics Inc. during 2003 and increased 9.2% to \$367,000 in the year ended December 31, 2004, compared with \$336,000 in the year ended December 31, 2003, and represented 0.7% and 1.0% of net revenue for each year, respectively. The increase is primarily attributable to only a partial year's amortization being included in the year ended December 31, 2003, since the acquisition was completed effective April 1, 2003. We expect this charge to decrease in future periods as a portion of the intangibles were fully amortized by December 31, 2004.

**Amortization of stock-based compensation** increased to \$1.2 million for the year ended December 31, 2004 compared with \$84,000 in the year ended December 31, 2003 and represented 2.2% and 0.2% of net revenue, respectively. The increase in dollar amount and as a percentage of net revenue was the result of the adoption of a new accounting standard that, beginning on January 1, 2004, required us to expense the fair value of stock options granted to employees since January 1, 2002 over the estimated vesting period of the stock options.

**Interest income, net** increased to \$910,000 in the year ended December 31, 2004 compared with \$232,000 in the year ended December 31, 2003, primarily due to an increase in the amount of funds available for investment in the year ended December 31, 2004 compared with the prior year.

**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.

**Foreign exchange.** We maintain a Canadian dollar denominated treasury to fund our Canadian denominated operating expenses, in addition to our U.S. dollar-denominated treasury. As a result, we are subject to gains and losses due to fluctuations in the exchange rate between the U.S. and Canadian dollars. We recorded a net foreign exchange gain of approximately \$400,000 for the year ended December 31, 2004, compared with a net foreign exchange gain of \$2.0 million included in the year ended December 31, 2003. The gain included in the year ended December 31, 2004 was primarily as a result of an appreciation in the value of the Canadian dollar over the period (from 0.77 U.S. dollars at December 31, 2003 to 0.83 U.S. dollars at December 31, 2004). As we continue to expand our operations internationally, we will be subjected to additional potential gains and losses against currencies other than the U.S. dollar, in addition to our exposure to the Canadian dollar.

**Net income (loss)** decreased by \$1.8 million to a net loss of (\$555,000) in the year ended December 31, 2004 compared with net income of \$1.2 million in the year ended December 31, 2003. The decrease was partially related to the inclusion of a lower foreign exchange gain of \$400,000 in the year ended December 31, 2004, compared with a foreign exchange gain of \$2.0 million included in the year ended December 31, 2003. The decrease was also related to the inclusion of a stock-based compensation expense of \$1.2 million in the year ended December 31, 2004, compared with \$84,000 in the year ended December 31, 2003, due to the adoption of the new accounting standard described above.

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*Adjusted net income (loss)*, as defined below, increased by \$1.0 million to adjusted net income \$649,000 in the year ended December 31, 2004 compared with adjusted net loss of (\$366,000) in the year ended December 31, 2003. The increase in adjusted net income (loss) was due to an increase in gross margin (after adjusting for the effect of foreign exchange) as well as a decrease in operating expenses as a percentage of net revenue (after adjusting for the effect of foreign exchange).

Adjusted net income (loss) is a non-GAAP measure related to net income (loss) and is defined by us as net income (loss) excluding foreign exchange gains or losses, stock-based compensation charges and amortization of acquisition related intangibles. We believe that this measure enhances an overall understanding of our operational results by revealing trends in our core operating margins, while removing the effects of short-term fluctuations in foreign exchange rates, changes in non-cash stock-based compensation expenses which relate primarily to a recent accounting pronouncement, and non-cash expenses relating to acquisitions. Adjusted net income (loss) is a supplemental measure and should not be construed as an alternative to net income as defined under Canadian generally accepted accounting principles (Canadian GAAP) as a measure of profitability. Our method of measuring adjusted net income (loss) is unlikely to be comparable to similar measures provided by other companies. A reconciliation of the Canadian GAAP information to the adjusted information is provided in the following table (tabular amounts in thousands of U.S. dollars):

|   | Years ended December 31, |          |
|---|--------------------------|----------|
|   | 2004                     | 2003     |
| Net income (loss)                               | \$ (555)                 | \$ 1,240 |
| Add back:                                       |                          |          |
| Foreign exchange gain                           | (400)                    | (2,026)  |
| Amortization of stock-based compensation        | 1,237                    | 84       |
| Amortization of acquisition-related intangibles | 367                      | 336      |
| Adjusted net income (loss)                      | \$ 649                   | \$ (366) |

**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 cumulative number of new customers to 57 at December 31, 2003 compared with 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.

*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 licences 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 with 54 in the year ended December 31, 2002.

*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 related from the reversal, during 2002, of zero-profit provisions made in 2001 and 2000 related to projects that were completed during 2002.

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**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 with 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 was due to increased productivity as our sales and marketing workforce grew.

*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 with 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 with \$144,000 realized in the year ended December 31, 2002. Up to December 31, 2003, all research and development costs were expensed as incurred. Research and development expenses decreased as a percentage of net revenue as a result of an increase in the number of customers that have licenced our products.

*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 and as a percent of revenue 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 with 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 grew.

*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 the 2003 fiscal year.

*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 with the prior year and notwithstanding an increase in cash balances in the year ended December 31, 2003. 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.

*Foreign exchange.* We maintain a Canadian dollar denominated treasury to fund our Canadian denominated operating expenses, in addition to our U.S. dollar-denominated treasury. As a result, we are subject to gains and losses due to fluctuations in the exchange rate between the U.S. and Canadian dollars. We recorded a net foreign exchange gain of approximately \$2.0 million for the year ended December 31, 2003, compared with a foreign exchange loss of \$48,000 included in the year ended December 31, 2002. The gain included in the year ended December 31, 2003 was primarily as a result of forward exchange contracts entered into in 2003 at favourable rates, as more fully described under *Foreign Exchange Management* below.

*Net income (loss)* increased by \$4.3 million to net income of \$1.2 million in the year ended December 31, 2003 compared with a net loss of (\$3.1 million) in the year ended December 31, 2002. The increase was primarily related to a reduction in operating expenditures as a percentage of revenue in the year ended December 31, 2003 compared with the year ended December 31, 2002 and to the discontinuation of the zero-profit revenue recognition method. The increase was also related to the inclusion of a foreign exchange gain of \$2.0 million in the year ended December 31, 2003, compared with a foreign exchange loss of \$48,000 included in the year ended December 31, 2002.

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*Adjusted net loss*, as defined below, decreased by \$2.4 million to an adjusted net loss of (\$366,000) in the year ended December 31, 2003 compared with an adjusted net loss of (\$2.8 million) in the year ended December 31, 2002. The decrease in adjusted net loss was primarily due to operating efficiencies and the discontinuation of the zero-profit revenue recognition method described above.

Adjusted net loss is a non-GAAP measure related to net income (loss) and is defined as net income (loss) excluding foreign exchange gains or losses, stock-based compensation charges and amortization of acquisition related intangibles. We believe that this measure enhances an overall understanding of our operational results by revealing trends in our core operating margins, while removing the effects of short-term fluctuations in foreign exchange rates, changes in non-cash stock-based compensation expenses which relate primarily to a recent accounting pronouncement, and non-cash expenses relating to acquisitions. Adjusted net loss is a supplemental measure and should not be construed as an alternative to net income as defined under Canadian generally accepted accounting principles (Canadian GAAP) as a measure of profitability. Our method of measuring adjusted net loss is unlikely to be comparable to similar measures provided by other companies. A reconciliation of the Canadian GAAP information to the adjusted information is provided in the following table (tabular amounts in thousands of U.S. dollars):

|   | Years ended December 31, |                   |
|---|--------------------------|-------------------|
|   | <u>2003</u>              | <u>2002</u>       |
| Net income (loss)                               | \$ 1,240                 | \$ (3,082)        |
| Add back:                                       |                          |                   |
| Foreign exchange loss (gain)                    | (2,026)                  | 48                |
| Amortization of stock-based compensation        | 84                       | 268               |
| Amortization of acquisition-related intangibles | 336                      | -                 |
| Adjusted net loss                               | <u>\$ (366)</u>          | <u>\$ (2,766)</u> |

**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, 2004 we had cash and cash equivalents and short-term investments of \$51.1 million and working capital of \$45.9 million.

Cash provided by operating activities for the years ended December 31, 2004, 2003 and 2002 was \$1.0 million, \$1.2 million and \$2.9 million respectively. Cash provided by operations in the year ended December 31, 2004 was the result of our net loss of \$555,000 and non-cash charges for depreciation and amortization totaling \$3.8 million which was partially offset by a net increase in working capital requirements. 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 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.

Our investing activities consist of the purchase and maturity 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, 2004, 2003 and 2002, we purchased property and equipment, principally computers and related software for our growing employee base, of \$2.6 million, \$2.3 million and \$1.1 million 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, 2004, we purchased \$32.3 million in short-term investments and \$20.0 million of short-term investments matured. In the year ended December 31, 2003 we purchased \$8.6 million in short-term investments. In the year ended December 31, 2002 we purchased \$8.9 million in short-term investments, which matured in early 2003.

Our financing activities consist primarily of the issuance of share capital. In the year ended December 31, 2004, 2003 and 2002, \$4.6 million, \$32.9 million and \$7,000 of cash was provided by our financing activities, respectively. In 2004, we raised \$2.0 million and \$851,000 from stock option and warrant exercises during the year, respectively. In 2003, we raised \$32.4 million from the issuance of common shares in a public offering and \$520,000 from stock options exercised during the year.

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In the year ended December 31, 2004, \$1.9 million of cash was provided by the sale and leaseback of property and equipment. During the second quarter of 2004, we negotiated a non-committed lease line of credit for up to \$2.5 million (Cdn\$3.0 million) with the equipment finance arm of a Canadian chartered bank to finance selected property and equipment purchases. At December 31, 2004, a total of \$1.8 million had been advanced to us in three transactions under the line at a fixed interest rate of approximately 6% for terms ranging from 24 to 36 months. Under the agreement, advances bear interest at fixed or floating benchmark rates plus 2%. Capital lease obligations are secured by the equipment that has been financed. Our other material contractual obligations include the future minimum lease payments relating to our premises, which total \$4.1 million.

**Contractual Obligations.** Payments due by Period (tabular amounts in thousands of U.S. dollars):

|                                     | Total           | Less Than<br>One Year | Two to Three<br>Years | Four to Five<br>Years | More Than<br>Five Years |
|-------------------------------------|-----------------|-----------------------|-----------------------|-----------------------|-------------------------|
| Capital lease obligations .....     | \$ 1,986        | \$ 862                | \$ 1,124              | \$ –                  | \$ –                    |
| Leasehold inducements .....         | 78              | 54                    | 24                    | –                     | –                       |
| Operating lease obligations .....   | <u>4,123</u>    | <u>1,029</u>          | <u>1,261</u>          | <u>1,169</u>          | <u>664</u>              |
| Total contractual obligations ..... | <u>\$ 6,187</u> | <u>\$ 1,945</u>       | <u>\$ 2,409</u>       | <u>\$ 1,169</u>       | <u>\$ 664</u>           |

We had cash, cash equivalents and short-term investments totaling \$51.1 million, \$46.7 million and \$15.3 million at December 31, 2004, 2003 and 2002, respectively. Total cash flow and cash provided by operations fluctuate quarterly as a result of changes in the timing of payments received and made by us, especially collections from customers and payment of compensation-related expenses; however, for each of the years ended December 31, 2004, 2003 and 2002, cash provided by operations and total cash flow were positive. We believe that our current cash, cash equivalents and short-term investments together with anticipated cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for the foreseeable future.

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 opportunities and/or broaden our customer base. We have no present agreements or commitments with respect to any prospective acquisition or investment. However, our total cash position could be significantly reduced if we choose to fund a significant acquisition partly or wholly with cash.

**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.

The proceeds we raised from our public offering in December 2003 were denominated in Canadian dollars, and we have since maintained a Canadian dollar treasury in addition to our U.S. treasury. During 2004, we used this Canadian dollar treasury as an alternative method of managing our Canadian and U.S. dollar denominated cash flows, instead of the foreign exchange forward contracts that we used during 2003, which are discussed above. We regularly sell U.S. dollars in order to maintain our Canadian dollar treasury and to fund our Canadian dollar denominated operating expenses. 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.

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**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, 2004. 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.

| Quarters Ended  |                 |                 |                 |                 |                 |                 |                 |
|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| 2004            |                 |                 |                 | 2003            |                 |                 |                 |
| Dec 31,<br>2004 | Sep 30,<br>2004 | Jun 30,<br>2004 | Mar 31,<br>2004 | Dec 31,<br>2003 | Sep 30,<br>2003 | Jun 30,<br>2003 | Mar 31,<br>2003 |

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

**Consolidated Statement of Operations Data:**

|  |                |                 |                  |                   |                  |                 |                  |                |
|--|----------------|-----------------|------------------|-------------------|------------------|-----------------|------------------|----------------|
| <b>Revenue:</b>  |                |                 |                  |                   |                  |                 |                  |                |
| Licence .....  | \$ 4,368       | \$ 4,140        | \$ 3,703         | \$ 4,129          | \$ 2,521         | \$ 2,555        | \$ 2,883         | \$ 2,402       |
| Service, maintenance and other .....                               | <u>13,426</u>  | <u>11,867</u>   | <u>9,177</u>     | <u>6,193</u>      | <u>6,975</u>     | <u>6,400</u>    | <u>5,402</u>     | <u>4,679</u>   |
| Net revenue .....  | <u>17,794</u>  | <u>16,007</u>   | <u>12,880</u>    | <u>10,322</u>     | <u>9,496</u>     | <u>8,955</u>    | <u>8,285</u>     | <u>7,081</u>   |
| <b>Cost of revenue:</b>  |                |                 |                  |                   |                  |                 |                  |                |
| Licence .....  | 95             | 7               | 96               | 96                | 39               | 19              | 112              | 148            |
| Service, maintenance and other .....                               | 8,679          | 7,752           | 6,349            | 5,422             | 4,913            | 4,503           | 4,396            | 3,249          |
| Cost of revenue accruals (recoveries), net .....                   | —              | —               | —                | (168)             | (8)              | (911)           | 112              | 246            |
| Total cost of revenue .....  | <u>8,774</u>   | <u>7,759</u>    | <u>6,445</u>     | <u>5,350</u>      | <u>4,944</u>     | <u>3,611</u>    | <u>4,620</u>     | <u>3,643</u>   |
| Gross profit .....   | <u>9,020</u>   | <u>8,248</u>    | <u>6,435</u>     | <u>4,972</u>      | <u>4,552</u>     | <u>5,344</u>    | <u>3,665</u>     | <u>3,438</u>   |
| Gross margin (%) .....   | 50.7%          | 51.5%           | 50.0%            | 48.2%             | 47.9%            | 59.7%           | 44.2%            | 48.6%          |
| <b>Operating expenses:</b>   |                |                 |                  |                   |                  |                 |                  |                |
| Sales and marketing .....  | 4,178          | 3,229           | 3,572            | 2,868             | 2,588            | 2,088           | 2,322            | 1,806          |
| Research and development .....                                     | 2,669          | 2,262           | 2,451            | 2,268             | 1,711            | 1,369           | 1,323            | 750            |
| General and administrative .....                                   | 1,562          | 1,275           | 1,062            | 1,140             | 293              | 319             | 445              | 557            |
| Amortization of acquisition-related intangibles .....              | 75             | 75              | 91               | 126               | 125              | 127             | 84               | —              |
| Amortization of stock-based compensation .....                     | <u>320</u>     | <u>368</u>      | <u>320</u>       | <u>229</u>        | <u>81</u>        | —               | <u>2</u>         | <u>1</u>       |
| Total operating expenses .....                                     | <u>8,804</u>   | <u>7,209</u>    | <u>7,496</u>     | <u>6,631</u>      | <u>4,798</u>     | <u>3,903</u>    | <u>4,176</u>     | <u>3,114</u>   |
| Income (loss) from operations .....                                | 216            | 1,039           | (1,061)          | (1,659)           | (246)            | 1,441           | (511)            | 324            |
| Interest income, net .....   | <u>221</u>     | <u>204</u>      | <u>212</u>       | <u>273</u>        | <u>62</u>        | <u>50</u>       | <u>56</u>        | <u>64</u>      |
| Net income (loss) .....  | <u>\$ 437</u>  | <u>\$ 1,243</u> | <u>\$ (849)</u>  | <u>\$ (1,386)</u> | <u>\$ (184)</u>  | <u>\$ 1,491</u> | <u>\$ (455)</u>  | <u>\$ 388</u>  |
| <b>Net income (loss) per share:</b>                                |                |                 |                  |                   |                  |                 |                  |                |
| Basic .....  | <u>\$ 0.03</u> | <u>\$ 0.07</u>  | <u>\$ (0.05)</u> | <u>\$ (0.08)</u>  | <u>\$ (0.01)</u> | <u>\$ 0.11</u>  | <u>\$ (0.04)</u> | <u>\$ 0.03</u> |
| Basic weighted average number of common shares outstanding .....   | <u>17,187</u>  | <u>16,899</u>   | <u>16,751</u>    | <u>16,645</u>     | <u>14,039</u>    | <u>13,299</u>   | <u>12,955</u>    | <u>12,687</u>  |
| Diluted .....  | <u>\$ 0.02</u> | <u>\$ 0.07</u>  | <u>\$ (0.05)</u> | <u>\$ (0.08)</u>  | <u>\$ (0.01)</u> | <u>\$ 0.11</u>  | <u>\$ (0.04)</u> | <u>\$ 0.03</u> |
| Diluted weighted average number of common shares outstanding ..... | <u>17,819</u>  | <u>17,419</u>   | <u>16,751</u>    | <u>16,645</u>     | <u>14,039</u>    | <u>13,864</u>   | <u>12,955</u>    | <u>13,122</u>  |

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**Variation in Operating Results**

Our quarterly operating results have fluctuated in the past, and may fluctuate significantly in the future, depending on factors such as the demand for our products, the size and timing of customer 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, foreign exchange rates, 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.

**Results for the Three Months Ending December 31, 2004**

**Revenue.** Net revenue increased 87.4% to \$17.8 million for the three months ending December 31, 2004, compared with \$9.5 million for the three months ending December 31, 2003. The three months ending December 31, 2004 mark our 14th consecutive quarter of revenue growth. The increase in revenue was primarily attributable to additional product implementation projects related to recent customers as well as to our growing installed base, which has continued to purchase products and services.

**Operating expenses** increased 83.5% to \$8.8 million in the three months ending December 31, 2004, compared with \$4.8 million in the three months ending December 31, 2003, however, operating expenses decreased to 49.5% as a percentage of net revenue in the three months ending December 31, 2004, compared with 50.5 % of net revenue in the three months ending December 31, 2003. The increase in dollar amount was primarily related to the growth in our employee base, whereas the decrease in percentage terms was primarily related to increases in operating efficiencies, partly offset by increases in stock-based compensation expenses and lower foreign exchange gains.

**Net income (loss)** increased to net income of \$437,000 for the three months ending December 31, 2004, compared with a net loss of (\$184,000) for the three months ending December 31, 2003, primarily as a result of this decrease in total operating expenses as a percentage of net revenue.

**Liquidity and capital resources.** Cash, cash equivalents and short-term investments increased by \$5.5 million in the three months ending December 31, 2004, from \$45.6 million at September 30, 2004, to \$51.1 million at December 31, 2004. The increase in cash, cash equivalents and short-term investments was related primarily to cash provided by operations of \$2.6 million for the three months ending December 31, 2004. The increase in cash provided by operations was related primarily to increases in deferred revenue and accrued payroll.

**Related Party Transactions**

We have entered into certain transactions in the normal course of business with a law firm, a partner of which is a director of Workbrain and the brother of our Chief Executive Officer. Fees charged by that law firm were based on the same hourly rates charged by the applicable professionals to unrelated parties. During the year ended December 31, 2004, total amounts paid by us to such law firm for legal services and other services aggregated \$377,000 (2003 - \$282,000).

**Outstanding Share Data**

As at January 31, 2005, there were 17,437,090 common shares outstanding. In addition, a total of 1,273,603 stock options and 37,596 warrants were outstanding, which are exercisable for an equal number of common shares.

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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 (such as our most recent annual information form), 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. We believe that our ability to manage future growth will depend in large part upon a number of factors, including our ability to:

- 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 and deliver reliable and scalable products and services that respond to evolving customer and industry requirements;
- develop customer support capacity as our installed customer base increases; 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 increase.

**We may not be able to hire or retain key personnel essential to our business.**

We believe that our success depends on key employees, including senior management and key technical resources, to develop, market, and support our products and to manage our business. The loss of one or more of these key employees could have a material adverse effect on our business. The success of our business is also highly dependent on our continuing ability to attract and retain additional, highly-qualified personnel. The failure to attract and retain key personnel could adversely affect our future growth and profitability.

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

Our revenue is difficult to forecast and is likely to fluctuate significantly from quarter to quarter. We rely on revenue related to a single line of software products. Although we have experienced revenue growth from these products in past periods, there is a risk that revenue from these products will not continue to grow, or will not grow at rates projected by management, or will not follow any past trends. Our anticipated revenue may be reduced by any one, or a combination of, unforeseen market, economic, competitive, or organizational factors, many of which are outside of our control, including:

- 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 services personnel;
- our ability to complete service obligations related to the implementation of our licenced product in a timely manner;
- the 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 length and variability of the sales cycles for our products;
- changes in our pricing policies and the pricing policies of our competitors;
- the timing of product developments and new product initiatives;
- changes in the mix of revenue attributable to substantially lower-margin service revenue as opposed to higher-margin product licence revenue;
- 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;
- strategic decisions by us or our competitors, such as acquisitions, divestitures, spin-offs, joint ventures, strategic investments or changes in business strategy; and
- a general weakening of the economy, or a weakening of the economic conditions in the particular industries and geographical regions in which we provide solutions, or any political or economic crises, natural disasters, terrorist acts, or other hostilities, which result in a decrease in the overall demand for computer software and services or otherwise affect our customers' investment in workforce management software.

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Our quarterly revenue depends largely on the progress we make on existing customer contracts during the quarter, as well as on sales to new and existing customers. Delays, reductions in the amount or cancellations of customers' purchases would adversely affect our revenue. We often complete a large percentage of sales transactions near the end of a quarter. In addition, our quarterly revenue is dependent upon a relatively small number of customers, and the absence of one or more anticipated large transactions in a particular period may have a material effect on revenue in that period. Even minor variations in the rate and timing of sales or our progress on customer contracts could materially impact revenue, which in turn could adversely affect our business and our financial results. If we experience a shortfall in revenue or otherwise fail to meet public market expectations, there could be a material, adverse impact on our business, our financial condition, the results of our operations, and on the market price of our common shares

**Our quarterly and annual operating results may vary significantly between periods, and our expenses may not match anticipated revenues.**

Historically, our operating results have varied from quarter to quarter, and we expect this variation to continue. We plan and manage our operating expenses based on anticipated revenue. Since a significant percentage of our expenses are relatively fixed, and because it is difficult to anticipate the revenue that we will realize in any particular quarter until near the end of that quarter, any delay or reduction in revenue could cause significant variations in operating results from quarter to quarter, including potential net losses and negative cash flow. Therefore, the potential causes of reductions or delays in revenue recognition (set out above under the heading 'Our revenue can be difficult to predict and can fluctuate substantially, which may harm the results of our operations') also apply to our ability to predict and manage quarterly earnings. As a result, such delays or reductions in revenue could materially and adversely affect our business, our financial condition and the results of our operations.

**We face substantial competition and we may not compete successfully, which could adversely affect our operating results.**

We face significant competition and we expect our competitors to continue to improve the performance of their current products and to introduce new products and new technologies. Many of our competitors have substantially greater financial and other resources with which to pursue research and development, marketing, and distribution of their products. New product announcements or introductions by our competitors could impact our ability to compete effectively. The intensely competitive market in which we conduct our business also could 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 quantity of sales or through lower spending, the reduced revenue resulting from lower prices would adversely affect our margins and operating results. In addition, if one or more of our competitors merges, acquires or partners with another of our competitors, the resulting change in the competitive environment could adversely affect our ability to compete. Competition also may increase if new vendors enter the market. Any reduction in our ability to compete effectively against our current and future competitors could have a material adverse effect on our business, results of operations, and financial condition.

**Our industry is subject to rapid technological change and our products may become obsolete.**

The market for workforce management solutions is characterized by rapid technological change, including new product introductions by our competitors and new entrants to the market; changes in the industry standard components with which our software inter-operates (such as operating systems, databases and application server technologies); and concomitant changes in customers' technological standards and requirements. We cannot provide assurance that our products will remain highly competitive regardless of such future technological changes. If we fail to anticipate or respond quickly to such changes by bringing new developments to market in a timely and cost-effective manner, our products may become obsolete, which could affect our competitiveness and could have a material adverse effect on our business, results of operations, and financial condition.

**We operate internationally, and we face currency fluctuation risks and other risks relating to international operations.**

We enter into transactions in multiple currencies and we are subject to gains and losses due to fluctuations between those currencies. The majority of our revenue is denominated in U.S. dollars whereas the majority of our operating expenses are denominated in Canadian dollars. We also generate revenue and incur expenditures in currencies other than the U.S. and Canadian dollars. In addition, we maintain a Canadian dollar denominated treasury to fund our Canadian denominated operating expenses, in addition to our U.S. dollar-denominated treasury. Therefore, fluctuations in the exchange rate between the U.S. dollar and other currencies, especially the Canadian dollar, may have a material adverse effect on our business, financial condition, and operating results. We intend to continue to expand our operations internationally, so we may be subject to additional gains and losses against additional currencies. Please see our discussion regarding the impact of foreign exchange and the management of foreign currency risk in the section of this document entitled 'Foreign Exchange Management'.

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In addition, we generate a material amount of revenue through our overseas operations, and we intend to continue to expand these international operations. These foreign operations face risks arising from local political, legal and economic factors such as varying regulatory requirements, compliance with international and local trade, labour and other laws, and differences in intellectual property protections in certain jurisdictions. We may also face difficulties in managing these international operations, collecting receivables in a timely fashion, and repatriating earnings. These factors could materially impact our international operations and adversely affect the results of our operations as a whole.

**Making and integrating acquisitions could impair our operating results.**

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 opportunities and/or broaden our customer base. We have no present agreements or commitments with respect to any prospective acquisition or investment. However, if we do make acquisitions, these will involve a number of risks, including: potential reduction in management's attention to our current operations and the potential disruption of these operations; potential difficulties in integrating and retaining all or part of the acquired business and its key personnel; and the potential assumption of disclosed and undisclosed liabilities. Acquisitions may also reduce our cash position and dilute our earnings across a larger shareholder base. Furthermore, we may incorrectly assess the value of an acquisition target or fail to accurately estimate the amount, extent and timing of the costs and benefits associated with an acquisition. These acquisition-related risks could materially and adversely affect our business, our financial condition and the results of our operations.

**We may have exposure to greater-than-anticipated tax liabilities.**

We are subject to taxes related to our income and to other taxes in the jurisdictions in which we operate. Our tax structure is subject to review by various taxation authorities. The determination of provisions for income taxes and the estimation of tax assets and liabilities require significant judgment. Although we believe our current estimates are reasonable, the taxes we may ultimately owe may differ from the amounts we record in our financial statements which could materially affect our financial results.

**Our intellectual property rights may be infringed or we may have to defend ourselves against other parties' intellectual property infringement claims.**

We rely on various intellectual property protections, including contractual provisions, patents, copyright, trademark, and legislation governing trade secrets, to protect our intellectual property rights. Despite these measures, third parties may misappropriate our intellectual property, which could result in lost revenue opportunities and impair our ability to compete. Alternatively, we could be subject to claims by third parties that our products or services infringe their intellectual property rights. In either case, we would incur expenditures and may be subject to costly litigation that would divert the attention of our management away from our ongoing business. Third party claims also could result in damages or other costs (for example, to develop similar non-infringing intellectual property or licence the intellectual property at issue) which could materially disrupt our business, and could adversely affect our financial condition and the results of our operations.

**We could face liability claims if our products or services fail to perform as intended.**

We are subject to legal proceedings and claims that may arise in the conduct of our business, including product and service warranty claims, which could be substantial. Software products and related services are complex and may contain errors or defects, particularly when configured to meet specific customer requirements. We believe that our current procedures provide a reasonable degree of quality control and the ability to respond to defects and errors found in our products and services. We also seek to limit our liability contractually in accordance with prevailing industry practice. Nevertheless, defects and errors in our products could inhibit or prevent successful customer deployment of our products and cause us to lose customers or require us to pay penalties or damages. A successful product liability claim against us could materially disrupt our business and could adversely affect our financial condition and the results of our operations.