

**WORKBRAIN CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**OF INTERIM FINANCIAL RESULTS**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2004 AND 2003**

*You should read the following management's discussion and analysis ("MD&A") in conjunction with our interim consolidated financial statements for the three and six month periods ended June 30, 2004 and the notes thereto, and with our annual audited consolidated financial statements, including the notes thereto, and our annual MD&A for the year ended December 31, 2003.*

**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 in our annual MD&A 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, Europe and Australia. Our sales channels are supported through marketing and implementation relationships with leading systems integrators and Business Process Outsourcers (BPOs).

**Comparison of Three Months Ended June 30, 2004 and 2003**

**Revenue:**

*Total revenue* increased 55.5% to \$12.9 million in the three months ended June 30, 2004 from \$8.3 million in the three months ended June 30, 2003.

*Licence revenue* increased 28.4% to \$3.7 million in the three months ended June 30, 2004 compared with \$2.9 million in the three months ended June 30, 2003. The growth was substantially attributable to an increase in the number of customers to 77 at June 30, 2004 compared with 46 at June 30, 2003. 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 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 69.9% to \$9.2 million in the three months ended June 30, 2004 compared with \$5.4 million in the three months ended June 30, 2003. The increase was primarily attributable to additional product implementation projects related to new customers as well as a growing installed base, which provides recurring maintenance and hosting revenue.

**Cost of revenue:**

*Cost of licence revenue* decreased 14.3% to \$96,000 in the three months ended June 30, 2004 compared with \$112,000 in the three months ended June 30, 2003, and represented 2.6% and 3.9% of licence revenue, respectively. The decrease in the dollar amount and as a percentage of licence revenue of the cost of licence revenue reflected the sale of fewer third-party software licenses in the three months ended June 30, 2004 compared with the same period of the prior year.

*Cost of service, maintenance and other revenue* increased 44.4% to \$6.3 million in the three months ended June 30, 2004 compared with \$4.4 million in the three months ended June 30, 2003, and represented 69.2% and 81.4% of service, maintenance and other revenue, respectively. These increases related primarily to the increase in the number of implementation, customer support, training and hosting personnel and related costs necessary to support our larger customer base and new and pending product implementations. The average number of customer support, implementation and training personnel grew to 187 in the three months ended June 30, 2004 compared with 120 at June 30, 2003. The cost of service, maintenance and other revenue also increased as a result of the inclusion of a foreign exchange loss of \$(287,000) in the three months ended June 30, 2004 compared to a foreign exchange gain of \$189,000 in the three months ended June 30, 2003. In future periods, we expect the cost of service, maintenance and other revenue to increase in absolute terms as we service our growing customer base, but to decrease as a percentage of revenue.

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*Cost of revenue accruals (recoveries), net* was \$nil in the three months ended June 30, 2004 compared with \$112,000 in the three months ended June 30, 2003. The decrease in dollar amount was due to no contracts being accounted for under the zero-profit method during Q2-2004. We expect the amounts of any future accrual or recovery of zero-profit provisions to be negligible, since all projects where revenue was recognized using the zero-profit method are now substantially complete.

**Operating expenses:**

*Sales and marketing expenses* increased 53.8% to \$3.6 million in the three months ended June 30, 2004 compared with \$2.3 million in the three months ended June 30, 2003, and represented 27.7% and 28.0% of net revenue, respectively. The increase in dollar amount was primarily attributable to the expansion of our sales and marketing workforce, which grew to an average of 63 personnel in the three months ended June 30, 2004 compared with an average of 51 in the three months ended June 30, 2003, increases in their related travel expenses in both North America and abroad, and increased marketing activities, trade shows and promotional expenses. Included in marketing activities for Q2-2004 and Q2-2003 was a seasonal charge associated with our annual Velocity conference for customers, partners and prospects. The decrease as a percentage of net revenue is due to increased productivity of our existing sales and marketing personnel offsetting rapid expansion of our sales and marketing staff. 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 in North America and abroad.

*Research and development expenses* increased 85.3% to \$2.5 million in the three months ended June 30, 2004 compared with \$1.3 million in the three months ended June 30, 2003, and represented 19.0% and 16.0% of net revenue, respectively. The increase in dollar amount in the three months ended June 30, 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 92 in the three months ended June 30, 2004 compared with 53 in the three months ended June 30, 2003. Research and development expenses also increased as a result of the inclusion of a foreign exchange loss of \$(152,000) in the three months ended June 30, 2004 compared to a foreign exchange gain of \$86,000 in the three months ended June 30, 2003. 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.

*General and administrative expenses* increased 138.7% to \$1.1 million in the three months ended June 30, 2004 compared with \$445,000 in the three months ended June 30, 2003, and represented 8.2% and 5.4% of net revenue, respectively. We increased the number of administrative and financial personnel, and there were 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 40 in the three months ended June 30, 2004 compared with 23 in the three months ended June 30, 2003. The increase in general and administrative costs as a percent of revenue was also the result of the inclusion of a foreign exchange gain of \$102,000 in general and administrative expenses in the three months ended June 30, 2004 compared with a foreign exchange gain of \$404,000 included in general and administrative expenses in the three months ended June 30, 2003. We anticipate that general and administrative expenses will increase in dollar amount in future periods in order to support the continuing growth we expect in our customer base.

*Amortization of acquisition-related intangibles* was \$91,000 in the three months ended June 30, 2004, compared with \$84,000 for the same period of the prior year. This expense relates to our acquisition of the net operating assets of Workforce Logistics Inc. in April 2003, which enhanced our existing workforce management solution with additional schedule optimization functionality. 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/or broaden our customer base. We have no present agreements or commitments with respect to any prospective acquisition or investment.

*Amortization of stock-based compensation* increased to \$320,000 for the three months ended June 30, 2004 compared with \$2,000 in the three months ended June 30, 2003 and represented 2.5% and 0.0% 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 requires that, beginning on January 1, 2004, we 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 \$212,000 in the three months ended June 30, 2004 compared with \$56,000 in the three months ended June 30, 2003. The increase in interest income was primarily due to an increase in cash balances in the three months ended June 30, 2004 compared with the three months ended June 30, 2003. We will continue to invest in accordance with our investment policy, which emphasizes liquidity and the minimization of risk.

*Foreign exchange.* Since the completion of our initial public offering in December 2003, we have maintained a Canadian dollar-denominated treasury in addition to our U.S. dollar-denominated treasury. We use those Canadian dollars to fund our Canadian denominated operating expenses. We are subject to gains and losses due to fluctuations between the U.S. and Canadian dollars. We recorded a net foreign exchange loss of approximately \$(386,000) for the three months ended June 30, 2004. This loss was primarily related to a decline in the value of the Canadian dollar against the U.S. dollar over the period. 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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**Net loss.** Net loss increased by \$394,000 to \$849,000 in the three months ended June 30, 2004 compared with \$455,000 in the three months ended June 30, 2003. The increase was primarily due to two items: a foreign exchange loss of \$386,000 included in Q2-2004, compared to a foreign exchange gain of \$727,000 included in Q2-2003; and the inclusion of a stock-based compensation expense of \$320,000 in Q2-2004 due to the adoption of the new accounting standard described above.

**Pro-forma net loss.** Pro-forma net loss decreased by \$1.0 million to \$52,000 in the three months ended June 30, 2004 compared with \$1.1 million in the three months ended June 30, 2003. The decrease was primarily due to two items: an improvement in our gross margin to 50.0% in Q2-2004 from 44.2% in Q2-2003; and the decrease, after the exclusion of the impact of foreign exchange, as a percentage of revenues, of our operating expenses in Q2-2004 compared with Q2-2003.

Pro-forma net loss is a non-GAAP measure related to net loss and is defined as net loss excluding foreign exchange charges, stock-based compensation charges and amortization of acquisition related intangibles. We believe that this measure enhances an overall understanding of our operational results and trends. Pro-forma 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 pro-forma net loss is unlikely to be comparable to similar measures provided by other companies. A reconciliation of the Canadian GAAP information to the pro-forma information is provided in the following table (tabular amounts in thousands of U.S. dollars):

	Three months ended June 30,	
	2004	2003
Net loss .....	\$ (849)	\$ (455)
Add back:		
Foreign exchange (gain) or loss .....	386	(727)
Amortization of stock-based compensation .....	320	2
Amortization of acquisition-related intangibles .....	91	84
Pro-forma net loss .....	\$ (52)	\$ (1,096)

**Comparison of Six Months Ended June 30, 2004 and 2003**

**Revenue:**

**Total revenue** increased 51.0% to \$23.2 million in the six months ended June 30, 2004 from \$15.4 million in the six months ended June 30, 2003.

**Licence revenue** increased 48.2% to \$7.8 million in the six months ended June 30, 2004 from \$5.3 million in the six months ended June 30, 2003. The growth was substantially attributable to an increase in the number of customers to 77 at June 30, 2004 compared with 46 at June 30, 2003. 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 52.5% to \$15.4 million in the six months ended June 30, 2004 from \$10.1 million in the six months ended June 30, 2003. The increase was primarily attributable to additional product implementation projects related to new customers as well as a growing installed base, which provides recurring maintenance and hosting revenue.

**Cost of revenue:**

**Cost of licence revenue** decreased 26.2% to \$192,000 in the six months ended June 30, 2004 compared with \$260,000 in the six months ended June 30, 2003, and represented 2.5% and 4.9% of licence revenue, respectively. The decrease in the dollar amount and as a percentage of licence revenue of the cost of licence revenue reflected the sale of fewer third-party software licenses in the six months ended June 30, 2004 compared with the same period of the prior year.

**Cost of service, maintenance and other revenue** increased 54.0% to \$11.8 million in the six months ended June 30, 2004 compared with \$7.6 million in the six months ended June 30, 2003, and represented 76.6% and 75.8% of service, maintenance and other revenue, 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 six months ended June 30, 2004 related primarily to the increase in the number of implementation, customer support, training and hosting personnel and related costs necessary to support our larger customer base and new and pending product implementations. The average number of customer support, implementation and training personnel grew to 174 in the six months ended June 30, 2004 compared with 116 at June 30, 2003. The cost of service, maintenance and other revenue also increased as a result of the inclusion of a foreign exchange loss of \$(575,000) in the six months ended June 30, 2004 compared to a foreign exchange gain of \$565,000 in the six months ended June 30, 2003.

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*Cost of revenue accruals (recoveries), net* was (\$168,000) in the six months ended June 30, 2004 compared with \$358,000 in the six months ended June 30, 2003. The cost of revenue accruals (recoveries), net, in the six months ended June 30, 2004 results from the reversal, during 2004, of zero-profit provisions made in prior years related to a project substantially completed during 2004. The cost of revenue accruals (recoveries), net, in the six months ended June 30, 2003 results from the accrual of zero-profit provisions related to progress, during 2003, on an on-going project where the zero-profit method was applied.

**Operating expenses:**

*Sales and marketing expenses* increased 56.0% to \$6.4 million in the six months ended June 30, 2004 compared with \$4.1 million in the six months ended June 30, 2003, and represented 27.8% and 26.9% of net revenue, respectively. The increase in dollar amount was primarily attributable to the expansion of our sales and marketing workforce, which grew to an average of 60 personnel in the six months ended June 30, 2004 compared with an average of 49 in the six months ended June 30, 2003, increases in their related travel expenses in both North America and abroad, and increased marketing activities, trade shows and promotional expenses. Included in marketing activities for Q2-2004 and Q2-2003 was a seasonal charge associated with our annual Velocity conference for customers, partners and prospects. The increase as a percentage of net revenue is due to a more rapid expansion of our sales and marketing staff, which was partly offset by increased productivity of our existing sales and marketing personnel.

*Research and development expenses* increased 127.6% to \$4.7 million in the six months ended June 30, 2004 compared with \$2.1 million in the six months ended June 30, 2003, and represented 20.3% and 13.5% of net revenue, respectively. The increase in dollar amount in the six months ended June 30, 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 89 in the six months ended June 30, 2004 compared with 49 in the six months ended June 30, 2003. Research and development expenses also increased as a result of the inclusion of a foreign exchange loss of \$(305,000) in the six months ended June 30, 2004 compared to a foreign exchange gain of \$255,000 in the six months ended June 30, 2003.

*General and administrative expenses* increased 119.8% to \$2.2 million in the six months ended June 30, 2004 compared with \$1.0 million in the six months ended June 30, 2003, and represented 9.5% and 6.5% of net revenue, respectively. We increased the number of administrative and financial personnel, and there were 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 37 in the six months ended June 30, 2004 compared with 23 in the six months ended June 30, 2003. The increase in general and administrative costs as a percent of revenue was primarily the result of the inclusion of a foreign exchange gain of \$62,000 included in general and administrative expenses in the six months ended June 30, 2004 compared with a foreign exchange gain of \$548,000 included in general and administrative expenses in the six months ended June 30, 2003.

*Amortization of acquisition-related intangibles* was \$217,000 in the six months ended June 30, 2004, compared with \$84,000 for the same period of the prior year. This expense relates to our acquisition of the net operating assets of Workforce Logistics Inc. in April 2003, which enhanced our existing workforce management solution with additional schedule optimization functionality.

*Amortization of stock-based compensation* increased to \$549,000 for the six months ended June 30, 2004 compared with \$3,000 in the six months ended June 30, 2003 and represented 2.4% and 0.0% 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 requires that, beginning on January 1, 2004, we 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* increased to \$485,000 in the six months ended June 30, 2004 compared with \$120,000 in the six months ended June 30, 2003. The increase in interest income was primarily due to an increase in cash balances in the six months ended June 30, 2004 compared with the six months ended June 30, 2003.

*Foreign exchange.* Since the completion of our initial public offering in December 2003, we have maintained a Canadian dollar-denominated treasury in addition to our U.S. dollar-denominated treasury. We use those Canadian dollars to fund our Canadian denominated operating expenses. We are subject to gains and losses due to fluctuations between the U.S. and Canadian dollars. We recorded a net foreign exchange loss of approximately \$(943,000) for the six months ended June 30, 2004. This loss was primarily related to a decline in the value of the Canadian dollar against the U.S. dollar over the period.

*Net loss.* Net loss increased by \$2.2 million to \$2.2 million in the six months ended June 30, 2004 compared with \$67,000 in the six months ended June 30, 2003. The increase was primarily due to two items: a foreign exchange loss of \$943,000 included in the six months ended June 30, 2004, compared to a foreign exchange gain of \$1.5 million included in the same period of the prior year; and the inclusion of a stock-based compensation expense of \$549,000 in the six months ended June 30, 2004 due to the adoption of the new accounting standard described above.

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**Pro-forma net loss.** Pro-forma net loss decreased by \$1.0 million to \$526,000 in the six months ended June 30, 2004 compared with \$1.5 million in the six months ended June 30, 2003. The decrease was primarily due to two items: an improvement in our gross margin to 49.2% in the six months ended June 30, 2004 from 46.2% in the same period of the prior year; and the decrease, after the exclusion of the impact of foreign exchange, as a percentage of revenues, of our operating expenses in the six months ended June 30, 2004 compared with the same period of the prior year.

Pro-forma net loss is a non-GAAP measure related to net loss and is defined as net loss excluding foreign exchange charges, stock-based compensation charges and amortization of acquisition related intangibles. We believe that this measure enhances an overall understanding of our operational results and trends. Pro-forma net loss is a supplemental measure and should not be construed as an alternative to net income as defined under Canadian GAAP as a measure of profitability. Our method of measuring pro-forma net loss is unlikely to be comparable to similar measures provided by other companies. A reconciliation of the Canadian GAAP information to the pro-forma information is provided in the following table (tabular amounts in thousands of U.S. dollars):

	<u>Six months ended June 30,</u>	
	<u>2004</u>	<u>2003</u>
Net loss .....	\$ (2,235)	\$ (67)
Add back:		
Foreign exchange (gain) or loss .....	943	(1,534)
Amortization of stock-based compensation .....	549	3
Amortization of acquisition-related intangibles .....	<u>217</u>	<u>84</u>
Pro-forma net loss .....	<u>\$ (526)</u>	<u>\$ (1,514)</u>

**Liquidity and Capital Resources**

At June 30, 2004 we had cash and cash equivalents and short-term investments of \$44.9 million and working capital of \$40.8 million.

**Cash provided by (used in) operating activities** for the three months ended June 30, 2004 and 2003 and the six months ended June 30, 2004 and 2003 was \$1.5 million, \$911,000, (\$756,000) and \$153,000, respectively. Cash provided by operations in the three months ended June 30, 2004 was primarily the result of an increase in deferred revenue. Cash provided by operations in the three months ended June 30, 2003 was primarily the result of an increase in accounts payable and accrued payroll. Cash used in operations in the six months ended June 30, 2004 was primarily the result of the net loss for the period, which was partially offset by non-cash depreciation and amortization charges. Cash provided by operations in the six months ended June 30, 2003 was primarily the result of the non-cash depreciation and amortization charges for the period, which were partially offset by increased working capital requirements.

**Investment activities** during the three months ended June 30, 2004 and 2003 and the six months ended June 30, 2004 and 2003 included cash used for the purchase of property and equipment totaling \$633,000, \$678,000, \$1.4 million and \$1.2 million, respectively, which was more than offset by cash provided by the sale of short-term investments totaling \$3.7 million, \$nil, \$6.7 million and \$8.9 million, respectively. We expect that our investment in property and equipment will continue to increase as our employee base and customer base continue to grow. In Q2-2003, \$1.0 million of cash was used to fund a portion of the purchase price of the acquisition of Workforce Logistics Inc.

**Financing activities** during the three months ended June 30, 2004 and 2003 and the six months ended June 30, 2004 and 2003 consisted primarily of the issuance of share capital pursuant to stock option exercises which totaled \$647,000, \$284,000, \$762,000 and \$411,000, respectively. In Q2-2004, \$681,000 of cash was provided by the sale and leaseback of property and equipment.

During Q2-2004, the Company negotiated a non-committed lease line of credit for up to \$2,238,000 with the equipment finance arm of a Canadian chartered bank to finance selected property and equipment purchases. At June 30, 2004, a total of \$681,000 had been drawn by the Company under the line at a fixed interest rate of approximately 6% for a term of 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.

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.

**Share capital** at June 30, 2004 consisted of 16,851,844 common shares issued and outstanding.