

Interim Consolidated Financial Statements  
(Expressed in U.S. dollars)

**WORKBRAIN CORPORATION**

Three and nine months ended September 30, 2004  
(Unaudited)

**NOTICE TO READER**

Management has compiled the comparative unaudited interim financial information of Workbrain Corporation, consisting of the statements of operations and cash flows for the three months ended September 30, 2003. An accounting firm has not reviewed or audited the above-noted comparative financial information.

**CANADIAN GAAP**

**WORKBRAIN CORPORATION**

**INTERIM CONSOLIDATED BALANCE SHEETS**  
 (Amounts in U.S. Dollars, In Thousands, Except Share Data)  
 (Unaudited)

	<u>September 30,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
Assets:		
Current assets:		
Cash and cash equivalents .....	\$ 11,279	\$ 38,027
Short-term investments (note 2) .....	34,282	8,666
Accounts receivable, net of allowance for doubtful accounts of \$357 (December 31, 2003 - \$300) .....	11,103	6,929
Other .....	<u>3,599</u>	<u>2,632</u>
Total current assets .....	60,263	56,254
Property and equipment (note 3) .....	3,003	2,464
Intangibles (note 4) .....	310	602
Goodwill (note 4) .....	<u>2,545</u>	<u>2,545</u>
Total assets .....	<u>\$ 66,121</u>	<u>\$ 61,865</u>
Liabilities and shareholders' equity:		
Current liabilities:		
Accounts payable .....	\$ 1,621	\$ 1,504
Accrued payroll .....	2,965	2,460
Accrued liabilities .....	1,261	1,514
Deferred revenue .....	10,622	9,232
Current portion of capital lease obligation (note 5) .....	537	51
Current portion of leasehold inducements .....	<u>51</u>	<u>50</u>
Total current liabilities .....	<u>17,057</u>	<u>14,811</u>
Long-term liabilities:		
Capital lease obligation, net of current portion (note 5) .....	973	54
Leasehold inducements, net of current portion .....	<u>34</u>	<u>71</u>
Total long-term liabilities .....	<u>1,007</u>	<u>125</u>
Total liabilities .....	<u>18,064</u>	<u>14,936</u>
Shareholders' equity:		
Common shares (note 6):		
Authorized - unlimited		
Issued and outstanding - 16,972,003 (December 31, 2003 - 16,632,104) .....	62,103	60,905
Contributed surplus .....	5,876	2,058
Deferred stock-based compensation .....	(2,578)	(180)
Cumulative translation adjustment .....	(127)	(127)
Deficit .....	<u>(17,217)</u>	<u>(15,727)</u>
Total shareholders' equity .....	<u>48,057</u>	<u>46,929</u>
Total liabilities and shareholders' equity .....	<u>\$ 66,121</u>	<u>\$ 61,865</u>
Commitments (note 7)		
Guarantees (note 8)		
Contingencies (note 9)		

See accompanying Notes to Interim Consolidated Financial Statements

**CANADIAN GAAP**

**WORKBRAIN CORPORATION**

**INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS**

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

(Unaudited)

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
<b>Revenue:</b>				
Licence (note 10).....	\$ 4,140	\$ 2,555	\$ 11,972	\$ 7,840
Service, maintenance and other.....	11,867	6,400	27,237	16,481
Net revenue.....	<u>16,007</u>	<u>8,955</u>	<u>39,209</u>	<u>24,321</u>
<b>Cost of revenue:</b>				
Licence.....	7	19	199	279
Service, maintenance and other.....	7,752	4,503	19,523	12,148
Cost of revenue accruals (recoveries), net.....	-	(911)	(168)	(553)
Total cost of revenue.....	<u>7,759</u>	<u>3,611</u>	<u>19,554</u>	<u>11,874</u>
Gross profit.....	<u>8,248</u>	<u>5,344</u>	<u>19,655</u>	<u>12,447</u>
Gross margin.....	51.5%	59.7%	50.1%	51.2%
<b>Operating expenses:</b>				
Sales and marketing.....	3,229	2,088	9,669	6,216
Research and development (note 11).....	2,262	1,369	6,981	3,442
General and administrative.....	1,275	319	3,477	1,321
Amortization of acquisition-related intangibles.....	75	127	292	211
Amortization of stock-based compensation*.....	368	-	917	3
Total operating expenses.....	<u>7,209</u>	<u>3,903</u>	<u>21,336</u>	<u>11,193</u>
Income (loss) from operations.....	1,039	1,441	(1,681)	1,254
Interest income, net.....	204	50	689	170
Net income (loss).....	<u>\$ 1,243</u>	<u>\$ 1,491</u>	<u>\$ (992)</u>	<u>\$ 1,424</u>
<b>Income (loss) per share (note 12):</b>				
Basic.....	<u>\$ 0.07</u>	<u>\$ 0.11</u>	<u>\$ (0.06)</u>	<u>\$ 0.11</u>
Basic weighted average number of common shares outstanding.....	<u>16,899</u>	<u>13,299</u>	<u>16,765</u>	<u>12,983</u>
Diluted.....	<u>\$ 0.07</u>	<u>\$ 0.11</u>	<u>\$ (0.06)</u>	<u>\$ 0.11</u>
Diluted weighted average number of common shares outstanding.....	<u>17,419</u>	<u>13,868</u>	<u>16,765</u>	<u>13,400</u>

\*Note:

The amortization of stock-based compensation relates to cost of revenue and operating expenses as follows:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
<b>Amortization of stock-based compensation:</b>				
Cost of revenue - service, maintenance and other.....	\$ 149	\$ -	\$ 351	\$ -
Sales and marketing.....	124	-	300	2
Research and development.....	23	-	68	-
General and administrative.....	72	-	198	1
	<u>\$ 368</u>	<u>\$ -</u>	<u>\$ 917</u>	<u>\$ 3</u>

See accompanying Notes to Interim Consolidated Financial Statements

## WORKBRAIN CORPORATION

**INTERIM CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(Amounts in U.S. Dollars, In Thousands, Except Share Data)  
(Unaudited)

	Common Shares		Class A Preferred Shares		Class B Preferred Shares		Contributed Surplus	Deferred Stock-based Compensation	Cumulative Translation Adjustment	Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount					
Balances at December 31, 2002.....	6,362,845	\$ 1,007	1,297,686	\$ 4,680	4,932,009	\$ 19,963	\$ 1,756	\$ (128)	\$ (127)	\$ (16,967)	\$ 10,184
Issuance of common shares for services rendered.....	5,517	-	-	-	-	-	40	(40)	-	-	-
Issuance of common shares on stock options exercised.....	288,864	520	-	-	-	-	-	-	-	-	520
Issuance of common shares and warrants on the acquisition of the net operating assets of Workforce Logistics Inc. ....	446,183	2,309	-	-	-	-	47	-	-	-	2,356
Conversion of Class A and Class B preferred shares into common shares.....	6,229,695	24,643	(1,297,686)	(4,680)	(4,932,009)	(19,963)	-	-	-	-	-
Issuance of common shares on public offering.....	3,299,000	32,426	-	-	-	-	-	-	-	-	32,426
Deferred stock-based compensation.....	-	-	-	-	-	-	215	(215)	-	-	-
Amortization of stock-based compensation.....	-	-	-	-	-	-	-	203	-	-	203
Net income.....	=	=	=	=	=	=	=	=	=	1,240	1,240
Balances at December 31, 2003.....	16,632,104	60,905	-	-	-	-	2,058	(180)	(127)	(15,727)	46,929
Issuance of common shares on stock options exercised.....	339,899	1,198	-	-	-	-	-	-	-	-	1,198
Deferred stock-based compensation.....	-	-	-	-	-	-	3,818	(3,818)	-	-	-
Cumulative impact of change in accounting policy (note 1(b)).....	-	-	-	-	-	-	-	498	-	(498)	-
Amortization of stock-based compensation.....	-	-	-	-	-	-	-	922	-	-	922
Net loss.....	=	=	=	=	=	=	=	=	=	(992)	(992)
Balances at September 30, 2004.....	<u>16,972,003</u>	<u>\$ 62,103</u>	<u>=</u>	<u>\$ =</u>	<u>=</u>	<u>\$ =</u>	<u>\$ 5,876</u>	<u>\$ (2,578)</u>	<u>\$ (127)</u>	<u>\$ (17,217)</u>	<u>\$ 48,057</u>

See accompanying Notes to Interim Consolidated Financial Statements

## WORKBRAIN CORPORATION

## INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in U.S. Dollars, In Thousands)

(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2004	2003	2004	2003
Cash flows from operating activities:				
Net income (loss).....	\$ 1,243	\$ 1,491	\$ (992)	\$ 1,424
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:				
Depreciation .....	546	410	1,585	1,153
Amortization of acquisition-related intangibles.....	75	127	292	211
Amortization of stock-based compensation.....	369	1	922	59
Amortization of leasehold inducements.....	(7)	(19)	(36)	(12)
Unrealized foreign exchange loss (gain).....	(1,032)	(38)	38	(101)
Change in operating assets and liabilities:				
Accounts receivable.....	(1,548)	(890)	(4,174)	(1,517)
Other assets .....	(466)	114	(967)	(202)
Accounts payable.....	(193)	(706)	117	(41)
Accrued payroll .....	198	88	505	628
Accrued liabilities.....	315	217	(253)	(211)
Deferred revenue .....	(317)	(111)	1,390	(554)
Net cash provided by (used for) operating activities .....	(817)	684	(1,573)	837
Cash flows from investing activities:				
Payments made on the acquisition of the net operating assets of Workforce Logistics Inc., net of cash acquired .....	-	(342)	-	(1,390)
Sale (purchase) of short-term investments.....	(32,282)	(8,427)	(25,616)	504
Purchase of property and equipment .....	(702)	(443)	(2,124)	(1,602)
Net cash used for investing activities .....	(32,984)	(9,212)	(27,740)	(2,488)
Cash flows from financing activities:				
Proceeds on issuance of common shares upon exercise of stock options .....	436	2	1,198	413
Proceeds on sale and leaseback of property and equipment.....	802	-	1,483	-
Repayment of obligations under capital lease.....	(51)	(12)	(78)	(47)
Net cash provided by (used for) financing activities .....	1,187	(10)	2,603	366
Foreign exchange gain (loss) on cash held in foreign currency.....	1,032	38	(38)	101
Change in cash and cash equivalents .....	(31,582)	(8,500)	(26,748)	(1,184)
Cash and cash equivalents, beginning of period.....	42,861	13,686	38,027	6,370
Cash and cash equivalents, end of period.....	\$ 11,279	\$ 5,186	\$ 11,279	\$ 5,186
Supplemental cash flow information:				
Cash paid for:				
Interest.....	\$ 6	\$ 2	\$ 10	\$ 6
Income taxes .....	\$ -	\$ -	\$ -	\$ -
Non-cash investing and financing activities:				
Deferred stock-based compensation .....	\$ 499	\$ -	\$ 3,818	\$ 3
Acquisition of Workforce Logistics Inc. partially financed by common shares .....	\$ -	\$ -	\$ -	\$ 2,309
Acquisition of Workforce Logistics Inc. partially financed by warrants .....	\$ -	\$ -	\$ -	\$ 47

See accompanying Notes to Interim Consolidated Financial Statements

## WORKBRAIN CORPORATION

## Notes to Interim Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Three and nine months ended September 30, 2004

(Unaudited)

Workbrain Corporation (the "Company") develops, markets, implements, and supports software that helps large organizations optimally deploy and manage their workforces. The Company's solutions automate workforce management processes, such as labour forecasting, employee schedule optimization, time and attendance, workforce analytics and employee self-service. The Company markets and sells its products through both direct and indirect channels, primarily in North America and Europe.

**1. Significant accounting policies:**

**a) Basis of presentation:**

These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and are presented in U.S. dollars. The notes presented in these interim consolidated financial statements include only significant changes and transactions occurring since the Company's last year end, and are not fully inclusive of all matters disclosed in the Company's annual audited consolidated financial statements. They should be read in conjunction with the audited consolidated financial statements, including the notes thereto, for the year ended December 31, 2003.

These interim consolidated financial statements follow the same accounting policies and methods of application as the most recent annual financial statements, with the exception of the change in accounting policy set out below.

The information furnished reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the interim periods presented. The operating results for the three and nine months ended September 30, 2004 are not necessarily indicative of the results expected for any succeeding quarter or the entire fiscal year ending on December 31, 2004.

**b) Change in accounting policy:**

Effective January 1, 2004, Canadian GAAP requires the Company 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 the Company 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.

**c) Use of estimates:**

Management of the Company has 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 these interim consolidated financial statements. Actual results could differ from those estimates.

Significant estimates in these interim 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 its determination of the valuation of accounts receivable, including the allowance for doubtful accounts, management relies on current customer information and its planned course of action, as well as assumptions about future business and economic conditions. Management has estimated the useful lives of its intangibles based upon rapidly changing industry trends and changes in its customers' businesses. In its determination of the amount and timing of revenue to be recognized, management relies on assumptions supporting its revenue recognition policy. Estimates of the percentage of completion for customer projects are based upon current actual and forecasted information and contractual terms. Vendor-specific objective evidence ("VSOE") established by management on the Company's licence and service elements is based upon the prices charged when the Company sells specific elements to customers separately or contractually stated renewal prices. Changes in the Company's business practices or sales arrangements may impact its ability to establish VSOE on current or newly offered elements, thereby changing the amount and timing of revenue recognized.

## WORKBRAIN CORPORATION

## Notes to Interim Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Three and nine months ended September 30, 2004

(Unaudited)

**d) Foreign currency translation:**

The U.S. dollar is the Company's functional currency. Balances of the Company denominated in currencies other than the U.S. dollar have been translated into U.S. dollars. On the interim consolidated balance sheets, monetary items have been translated into U.S. dollars at exchange rates prevailing at the balance sheet dates and non-monetary items have been translated at historical exchange rates. Amounts included in the Company's interim consolidated statements of operations have been translated at the average exchange rates for the periods, except for depreciation and amortization, which have been translated at historical rates. Exchange gains and losses resulting from the translation of amounts into U.S. dollars are reflected in the interim consolidated statements of operations in the period in which they occurred.

Foreign exchange gains (losses) included in net income (loss) for the three and nine months ended September 30, 2004 and 2003 were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Cost of revenue - service, maintenance and other .....	\$ 382	\$ (179)	\$ (193)	\$ 386
Sales and marketing .....	71	(60)	(54)	106
Research and development .....	208	(73)	(97)	182
General and administrative.....	230	513	292	1,061
	<u>\$ 891</u>	<u>\$ 201</u>	<u>\$ (52)</u>	<u>\$ 1,735</u>

**e) Goodwill:**

The Company is required to evaluate goodwill annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment is tested at the reporting unit level by comparing the reporting unit's carrying value to its fair value. To the extent a reporting unit's carrying amount exceeds its fair value, an impairment of goodwill exists. Impairment is measured by comparing the fair value of goodwill to its carrying amount. During the first quarter of fiscal 2004, the Company performed its annual impairment test and determined that there was no goodwill impairment in the period.

**f) Income (loss) per share:**

Basic income (loss) per share has been computed by dividing net income (loss) by the weighted average number of common shares outstanding for the year. Diluted income (loss) per share includes the effect, if any, of securities with dilutive potential on the Company's common shares.

Potentially dilutive items to the Company's common shares include stock options and warrants issued by the Company. A reconciliation of the numerator and denominator used in the calculation of the Company's diluted income (loss) per share is disclosed in note 12.

**g) Stock-based compensation:**

The fair value of option grants prior to December 2, 2003 were estimated using the minimum value method with the following assumptions: risk-free interest rates ranging from 3% to 6%, dividend yield of 0% and expected lives of options of five years. Subsequent to December 2, 2003, the fair value of option grants was estimated using the Black-Scholes option pricing model, with the following assumptions: expected volatility ranging from 31% to 44%, risk-free interest rate of 3%, dividend yield of 0% and expected lives of options of four to five years.

## WORKBRAIN CORPORATION

## Notes to Interim Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Three and nine months ended September 30, 2004

(Unaudited)

The following table reports pro forma amounts for net income (loss) and basic and diluted income (loss) per share, including stock-based compensation expense, based on stock options issued subsequent to January 1, 2002 for the three and nine months ended September 30, 2003.

	<b>Three months ended September 30, 2003</b>	<b>Nine months ended September 30, 2003</b>
Net income (loss):		
As reported.....	\$ 1,491	\$ 1,424
Pro forma .....	\$ 250	\$ (417)
Basic income (loss) per share:		
As reported.....	\$ 0.11	\$ 0.11
Pro forma .....	\$ 0.02	\$ (0.03)
Diluted income (loss) per share:		
As reported.....	\$ 0.11	\$ 0.11
Pro forma .....	\$ 0.02	\$ (0.03)

**2. Short-term investments:**

At September 30, 2004, the Company had no restricted short-term investments related to security posted against foreign exchange forward contracts (December 31, 2003 - \$800,000).

**3. Property and equipment:**

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
Computer equipment.....	\$ 2,719	\$ 2,399
Office furniture and equipment .....	1,692	1,200
Computer software.....	794	1,127
Leasehold improvements.....	239	231
	5,444	4,957
Less: Accumulated depreciation.....	(2,441)	(2,493)
Total property and equipment .....	\$ 3,003	\$ 2,464

At September 30, 2004, the cost and accumulated depreciation of assets under capital lease included above were \$1,530,000 and \$319,000 respectively (December 31, 2003 - \$160,000 and \$57,000).

## WORKBRAIN CORPORATION

## Notes to Interim Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Three and nine months ended September 30, 2004

(Unaudited)

## 4. Intangibles and goodwill:

	<u>September 30,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
Customer relationships.....	\$ 325	\$ 325
Developed technology .....	408	408
Purchased in-process research and development.....	<u>205</u>	<u>205</u>
	938	938
Less: Accumulated amortization .....	<u>(628)</u>	<u>(336)</u>
Total intangibles.....	310	602
Goodwill .....	<u>2,545</u>	<u>2,545</u>
Total intangibles and goodwill.....	<u>\$ 2,855</u>	<u>\$ 3,147</u>

## 5. Capital lease obligation:

The following are the Company's minimum lease payments under non-cancelable capital leases:

	<u>September 30,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
2004 .....	\$ 184	\$ 56
2005 .....	577	56
2006 .....	551	-
2007 .....	324	-
Thereafter.....	<u>-</u>	<u>-</u>
	1,636	112
Less: Amounts representing interest (at an effective rate of approximately 6%) .....	<u>(126)</u>	<u>(7)</u>
Balance of capital lease obligation.....	1,510	105
Less: Current portion .....	<u>(537)</u>	<u>(51)</u>
Capital lease obligation, net of current portion .....	<u>\$ 973</u>	<u>\$ 54</u>

The Company has an agreement in place for a non-committed lease line of credit for up to \$2,374,000 (Cdn. \$3,000,000) with the equipment finance arm of a Canadian chartered bank to finance selected property and equipment purchases. At September 30, 2004, a total of \$1,441,000 (Cdn. \$1,821,000) 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.

## WORKBRAIN CORPORATION

## Notes to Interim Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Three and nine months ended September 30, 2004

(Unaudited)

**6. Common shares:**

**a) Authorized:**

Unlimited number of common shares without par value.

**b) Transactions:**

September 30, 2004:

The Company issued 339,899 common shares to stock option holders for total consideration of \$1,198,000 under stock option exercises.

December 31, 2003:

The Company issued 3,299,000 common shares for cash consideration of \$32,426,000 (net of offering costs of \$3,311,000) in a public offering on December 11, 2003.

The Company issued 446,183 common shares valued at \$2,309,000 in partial consideration for the acquisition of Workforce Logistics Inc. ("Workforce"). The Company issued 5,517 common shares to directors for no cash consideration as a portion of fees for directorship services rendered. In addition, the Company issued 288,864 common shares to a director and employees for total consideration of \$520,000 under stock option exercises.

**c) Stock option plan:**

The Company's stock option plan (the "Plan") was implemented to encourage ownership of the Company by directors, officers, employees and consultants of the Company and its subsidiaries. The maximum number of common shares which may be set aside for issuance under the Plan is 2,740,000 shares, provided that the Board of Directors of the Company has the right, from time to time, to increase such number subject to the approval of the shareholders of the Company when required by law or regulatory authority. Generally, options issued under the Plan vest over a three to five-year period. Any option granted which, for any reason, is canceled or terminated prior to its exercise, will become available for grant under the Plan. In accordance with the Plan, the exercise price of options is based on the quoted market price of the Company's common shares on the date of grant.

Options may be granted under the Plan to be exercised during a period of up to 10 years from the date of grant, subject to earlier termination upon the optionee ceasing to be a director, officer, employee or consultant of the Company or one of its subsidiaries, as applicable. Options issued under the Plan are non-transferable. During 2003, the Company extended the term of all then outstanding stock options granted to employees from four years to seven years.

## WORKBRAIN CORPORATION

## Notes to Interim Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Three and nine months ended September 30, 2004

(Unaudited)

## d) Continuity of options issued under the Plan:

A summary of the status of the Plan as of September 30, 2004 and December 31, 2003, and the changes during the periods then ended is presented below:

	September 30, 2004		December 31, 2003	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period .....	1,641,402	\$ 4.74	1,492,340	\$ 3.05
Granted .....	363,583	11.14	611,704	7.35
Exercised .....	(339,899)	3.53	(288,864)	1.80
Forfeited .....	(90,524)	6.76	(173,778)	4.34
Outstanding, end of period .....	<u>1,574,562</u>	\$ 6.56	<u>1,641,402</u>	\$ 4.74
Options exercisable, end of period .....	<u>710,325</u>	\$ 3.64	<u>826,210</u>	\$ 3.08
Weighted average per share fair value of options granted during the period .....		\$ 4.84		\$ 3.09

All options granted during the year ended December 31, 2003 and during the nine months ended September 30, 2004 were granted with exercise prices equal to the fair value of the common shares at the grant date.

## e) Summary of the balances of options issued under the Plan:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Number Outstanding at September 30, 2004	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable at September 30, 2004	Weighted Average Exercise Price
\$ 0.63 to 0.94	149,871	2.39	\$ 0.87	149,871	\$ 0.87
3.13 to 3.60	239,891	2.74	3.26	236,141	3.26
4.03 to 4.38	320,588	4.31	4.03	189,302	4.04
5.18 to 7.25	363,953	5.63	6.33	118,257	6.14
9.31 to 13.84	<u>500,259</u>	5.89	11.62	<u>16,754</u>	11.65
\$ 0.63 to 13.84	<u>1,574,562</u>	4.69	\$ 6.56	<u>710,325</u>	\$ 3.64

## f) Warrants issued:

As part of the acquisition of the net operating assets of Workforce, effective April 1, 2003, the Company issued warrants that are exercisable into 94,612 common shares upon the payment of \$5.18 per share by the holder of the warrants, which expire in June 2006.

As at September 30, 2004, there are warrants outstanding exercisable into 247,263 common shares (December 31, 2003 - 247,263) upon the payment of \$4.03 per share by the holder of the warrants. The warrants have expiry dates ranging from April 20, 2006 to December 31, 2008. The Company may be required to issue additional warrants that are exercisable for up to 21,226 common shares.

All of these warrants were unexercised at September 30, 2004.

## WORKBRAIN CORPORATION

## Notes to Interim Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Three and nine months ended September 30, 2004

(Unaudited)

**7. Commitments:**

Future minimum lease payments under non-cancelable operating leases, as of September 30, 2004, are as follows:

2004 .....	\$	474
2005 .....		934
2006 .....		501
2007 .....		458
Thereafter .....		<u>1,394</u>
Total minimum lease payments .....	<u>\$</u>	<u>3,761</u>

Rent expense for the three and nine months ended September 30, 2004 was \$386,000 and \$1,114,000, respectively (September 30, 2003 - \$284,000 and \$936,000). The Company is also responsible for certain common area costs at its various leased premises.

**8. Guarantees:**

The Company has provided routine indemnifications to its customers against liability if the Company's products infringe on a third party's intellectual property rights. The maximum exposure from these indemnifications cannot be reasonably estimated. In some cases, the Company has recourse against other parties to mitigate its risk of loss from these guarantees. Historically, the Company has made no payments relating to these indemnifications, and the Company is not subject to any pending litigation on this matter.

**9. Contingencies:**

The Company is subject to legal proceedings and claims that arise in the ordinary course of its business. While management currently believes the amount of ultimate liability, if any, with respect to these actions will not materially affect the financial position, results of operations, or liquidity of the Company, the ultimate outcome of any litigation is uncertain. Were an unfavourable outcome to occur, the impact could be material to the Company.

The Company does not believe that it is probable that a liability has been incurred nor does it believe that the amount of any loss can be reasonably estimated. Accordingly, no liability has been accrued for these matters.

**10. Stock-based compensation related to licence revenue:**

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Gross licence revenue.....	\$ 4,141	\$ 2,556	\$ 11,977	\$ 7,896
Less: Stock-based compensation related to licence revenue .....	<u>(1)</u>	<u>(1)</u>	<u>(5)</u>	<u>(56)</u>
Net licence revenue .....	<u>\$ 4,140</u>	<u>\$ 2,555</u>	<u>\$ 11,972</u>	<u>\$ 7,840</u>

The stock-based compensation related to licence revenue results from warrants that have been issued to a reseller of the Company's software based on customer referrals from that reseller.

## WORKBRAIN CORPORATION

## Notes to Interim Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Three and nine months ended September 30, 2004

(Unaudited)

## 11. Research and development expenses:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Gross research and development expenses .....	\$ 2,333	\$ 1,528	\$ 7,127	\$ 3,677
Less: Investment tax credits realized .....	(71)	(159)	(146)	(235)
Net research and development expenses .....	<u>\$ 2,262</u>	<u>\$ 1,369</u>	<u>\$ 6,981</u>	<u>\$ 3,442</u>

## 12. Income (loss) per share:

The following table presents a reconciliation of the numerators and denominators used in the calculations of the basic and diluted income (loss) per share.

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net income (loss):				
Basic and diluted net income (loss) .....	<u>\$ 1,243</u>	<u>\$ 1,491</u>	<u>\$ (992)</u>	<u>\$ 1,424</u>
Weighted average number of common shares outstanding (in thousands of shares):				
Common shares .....	16,899	13,299	16,765	12,983
Effect of stock options issued .....	314	482	–	359
Effect of warrants outstanding .....	206	87	–	58
Diluted .....	<u>17,419</u>	<u>13,868</u>	<u>16,765</u>	<u>13,400</u>
Net income (loss) per share:				
Basic .....	<u>\$ 0.07</u>	<u>\$ 0.11</u>	<u>\$ (0.06)</u>	<u>\$ 0.11</u>
Diluted .....	<u>\$ 0.07</u>	<u>\$ 0.11</u>	<u>\$ (0.06)</u>	<u>\$ 0.11</u>

For the nine months ended September 30, 2004, stock options and warrants outstanding were not included in the calculation of diluted loss per share because the Company had a loss for that period and to do so would have been anti-dilutive.

## WORKBRAIN CORPORATION

## Notes to Interim Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Three and nine months ended September 30, 2004

(Unaudited)

**13. Segmented information:**

The Company operates in a single reportable operating segment, the workforce management software market. The single reportable operating segment derives its revenue from the sale of software solutions, including related services, training and hardware. The following information provides the required enterprise-wide disclosures:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Revenue by geographic location:				
United States .....	\$ 13,453	\$ 8,015	\$ 34,145	\$ 21,037
United Kingdom.....	1,448	400	2,869	1,867
Canada .....	499	540	1,588	1,417
Pacific Rim .....	607	—	607	—
	<u>\$ 16,007</u>	<u>\$ 8,955</u>	<u>\$ 39,209</u>	<u>\$ 24,321</u>

Revenue is attributed to geographic locations based on the location of the external customer.

	September 30, 2004	December 31, 2003
Property and equipment by geographic location:		
Canada .....	\$ 2,836	\$ 2,299
United States .....	167	165
	<u>\$ 3,003</u>	<u>\$ 2,464</u>

Substantially all intangibles and goodwill recognized in the interim consolidated financial statements are held by one of the Company's Canadian subsidiaries.

During the nine months ended September 30, 2004 and 2003, no customers of the Company accounted for 10% or greater of net revenue.