

**WORKBRAIN CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003**

The following table sets out selected consolidated financial information for the years ended December 31, 2005, 2004 and 2003 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,		
	2005	2004	2003
<i>(Amounts In U.S. Dollars, In Thousands, Except Per Share Data)</i>			
<b>Consolidated Statements of Operations Data:</b>			
Revenue:			
Licence .....	\$ 23,063	\$ 16,340	\$ 10,361
Service, maintenance and other .....	65,679	40,663	23,456
Net revenue .....	88,742	57,003	33,817
Cost of revenue:			
Licence .....	683	294	318
Service, maintenance and other .....	47,648	28,202	17,061
Cost of revenue accruals (recoveries), net .....	—	(168)	(561)
Total cost of revenue .....	48,331	28,328	16,818
Gross profit .....	40,411	28,675	16,999
Gross margin (%) .....	45.5%	50.3%	50.3%
Operating expenses:			
Sales and marketing .....	17,033	13,847	8,804
Research and development .....	13,254	9,650	5,153
General and administrative .....	7,076	5,039	1,614
Amortization of acquisition-related intangibles .....	190	367	336
Amortization of stock-based compensation .....	1,007	1,237	84
Total operating expenses .....	38,560	30,140	15,991
Income (loss) from operations .....	1,851	(1,465)	1,008
Interest income, net .....	1,260	910	232
Income (loss) before provision for income taxes .....	3,111	(555)	1,240
Provision for income taxes .....	75	—	—
Net income (loss) .....	\$ 3,036	\$ (555)	\$ 1,240
<i>Net income (loss) per share:</i>			
Basic .....	\$ 0.17	\$ (0.03)	\$ 0.09
Basic weighted average number of common shares outstanding .....	17,619	16,871	13,249
Diluted .....	\$ 0.17	\$ (0.03)	\$ 0.09
Diluted weighted average number of common shares outstanding .....	17,945	16,871	13,949
December 31,			
	2005	2004	2003
<i>(Amounts In U.S. Dollars, In Thousands)</i>			
<b>Consolidated Balance Sheet Data:</b>			
Cash and cash equivalents and short-term investments .....	\$ 49,063	\$ 51,077	\$ 46,693
Working capital .....	50,864	45,943	41,443
Total assets .....	83,127	72,926	61,865
Deferred revenue .....	12,166	12,852	9,232
Long-term liabilities .....	3,333	1,088	125
Total shareholders' equity .....	55,612	50,514	46,929

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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 15, 2006.*

### **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 in our annual MD&A and Annual Information Form 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 leading systems integrators and business process outsourcers.

### **Significant Accounting Policies**

#### **Revenue Recognition**

The Company's revenue is derived primarily from licence fees and service fees. The Company licenses software under non-cancellable licence agreements and provides services, including implementation, consulting, training, hosting and post-contract customer support (PCS) to its customers. In certain cases, the Company also provides customers with hardware related to its software offerings. The Company recognizes revenue in accordance with Canadian GAAP, which, in the Company's 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).

Following the requirements of SOP 97-2, the Company recognizes licence revenue when all of the following have occurred:

- persuasive evidence of an arrangement exists;
- delivery of the software product to the customer has occurred;
- the amount of the fees to be paid by the customer is fixed or determinable; and
- collection of these fees is probable.

*Persuasive evidence of an arrangement:* The Company requires a written contract signed by both the customer and the Company or a purchase order from those customers who have previously negotiated a standard licence arrangement with the Company.

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*Delivery has occurred:* Typically, the Company delivers its software electronically. If undelivered products or services exist in an arrangement that is essential to the functionality of a delivered product, delivery is not considered to have occurred until these products or services are delivered. In instances where delivery is electronic and all other criteria for revenue recognition have been achieved, the product is considered delivered when the software is sent to the customer electronically or the access code to download the software from the internet has been provided to the customer.

*Fee is fixed and determinable:* Customers generally pay in the following manner: for perpetual licences, customers pay according to terms consistent with standard business practice, for maintenance and support, customers pay annually at the beginning of the maintenance year, and for professional services, customers pay based on milestone achievements.

*Collectibility is probable:* The Company assesses collectibility on a customer-by-customer basis. The Company performs a credit review on certain new customers, based on established criteria, which evaluates the customer's financial position and ability to pay. If it is determined from the outset of an arrangement that collectibility is not probable based upon the credit review process, revenue is recognized on a cash-collected basis.

SOP 97-2, as modified, generally requires revenue earned on software arrangements involving multiple elements, such as software products, upgrades, enhancements, PCS, or installation and training to be allocated to each element based on the relative fair values of the elements. The fair value of an element must be based on evidence that is specific to the vendor. The Company limits its assessment of vendor-specific objective evidence of fair value ("VSOE") for each element to the price charged when the same element is sold separately. If VSOE of all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred, and the remaining portion of the arrangement fee is recognized as revenue related to the delivered elements.

The Company analyzes all of the elements included in its multiple-element arrangements to determine whether there is sufficient VSOE to allocate revenue to the PCS component. The Company establishes VSOE for PCS based on a contract-specified renewal price provided to the customer where the rate is substantive. Accordingly, if all other revenue recognition criteria are met, revenue from licences is recognized upon delivery using the residual method in accordance with Statement of Position 98-9 *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*, and PCS revenue is recognized ratably over the PCS term.

When perpetual licences and professional services are elements of the same arrangement, the Company determines if there is sufficient VSOE to allocate revenue to the professional services and training components. Accordingly, if all other revenue recognition criteria are met and the professional services are not essential to the functionality of the software, revenue from perpetual licences is recognized upon delivery using the residual method and professional services and training revenue are recognized as the services are provided.

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

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

In accordance with the SOP 97-2, when the Company is unable to establish fair value for an undelivered element, and the only undelivered element is PCS, the entire arrangement fee is deferred and recognized ratably over the PCS period. If revenue from an arrangement is deferred due to the inability to establish fair value, the Company defers the direct and incremental costs associated with the arrangement. As such, the Company defers the commissions paid on contracts that are deferred to match those costs ratably against the revenue.

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To date, many of the Company's 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 toward completion. The Company uses either the completion of contractual milestones or the ratio of incurred costs to estimated total costs, as appropriate, as the measure of its progress on each contract. If a loss on a contract is considered probable, all of that loss will be recognized at the date the loss is determinable.

Under certain of the Company's 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, the Company 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 toward completion. The Company then recorded an equal amount of costs against the revenue. Cost of revenue was adjusted to recognize the profit element from the arrangement once the Company was able to estimate total revenue and total costs, which, in the Company's circumstances, was at the time of substantial contract completion.

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

**Comparison of Years Ended December 31, 2005 and 2004**

**Revenue:**

**Total revenue** increased 55.7% to \$88.7 million in the year ended December 31, 2005 from \$57.0 million in the year ended December 31, 2004.

**Licence revenue** increased 41.1% to \$23.1 million in the year ended December 31, 2005 compared with \$16.3 million in the year ended December 31, 2004. The increase in licence revenue was primarily attributable to the addition of 35 new customers in the year ended December 31, 2005 compared with 33 in the year ended December 31, 2004, to the recognition of committed licence backlog from prior years during the year ended December 31, 2005, as well as to the recognition of licence revenue in certain new customer arrangements where services were not essential to the functionality of the software and where the criteria for revenue recognition had been met. This licence revenue growth is an indirect result of significant investments we have made in sales and marketing personnel, infrastructure and 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 and marketing capabilities in future periods.

**Service, maintenance and other revenue** increased 61.5% to \$65.7 million in the year ended December 31, 2005 compared with \$40.7 million in the year ended December 31, 2004. The increase was primarily attributable to additional product implementation projects related to new customers as well as to a growing installed base, which provides recurring service, maintenance and other revenue.

**Cost of revenue:**

**Cost of licence revenue** increased 132.3% to \$683,000 in the year ended December 31, 2005 compared with \$294,000 in the year ended December 31, 2004, and represented 3.0% and 1.8% of licence revenue, respectively. The increase in the dollar amount and as a percentage of licence revenue of the cost of licence revenue reflected the inclusion of more third-party software licence costs associated with licence revenue in the year ended December 31, 2005 compared with the same period of the prior year.

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*Cost of service, maintenance and other revenue* increased 69.0% to \$47.6 million in the year ended December 31, 2005 compared with \$28.2 million in the year ended December 31, 2004, and represented 72.5% and 69.4% 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 anticipated product implementations. The average number of customer support, implementation and training personnel grew to 321 in the year ended December 31, 2005 compared with 214 in the year ended December 31, 2004. The increases were also attributable to a net foreign exchange loss of \$440,000 allocated to the cost of service, maintenance and other revenue in the year ended December 31, 2005 compared with a net foreign exchange loss of \$53,000 allocated to the cost of service, maintenance and other revenue in the year ended December 31, 2004. 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 gradually decrease as a percentage of revenue, as we improve operating efficiency.

**Operating expenses:**

*Sales and marketing expenses* increased 23.0% to \$17.0 million in the year ended December 31, 2005 compared with \$13.8 million in the year ended December 31, 2004, and represented 19.2% and 24.3% of 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 77 personnel in the year ended December 31, 2005 compared with an average of 65 in the year ended December 31, 2004, and to increased marketing activities, trade shows and promotional expenses. The decrease in sales and marketing expenses as a percentage of revenue was due to the increased productivity of our sales and marketing personnel. 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 37.3% to \$13.3 million in the year ended December 31, 2005 compared with \$9.7 million in the year ended December 31, 2004, and represented 14.9% and 16.9% of revenue, respectively. The increase in the year ended December 31, 2005 over the prior year was primarily attributable to increased staffing and associated support in order to expand and enhance our product offering. The average number of research and development personnel grew to 151 in the year ended December 31, 2005 compared with 97 in the year ended December 31, 2004. The increase in research and development expenses was offset by investment tax credits of \$455,000 earned in the year ended December 31, 2005 compared with \$149,000 earned in the year ended December 31, 2004. Up to December 31, 2005, 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 continue to enhance our products and introduce new functionality.

*General and administrative expenses* increased 40.4% to \$7.1 million in the year ended December 31, 2005 compared with \$5.0 million in the year ended December 31, 2004, and represented 8.0% and 8.8% of revenue, respectively. The increase in dollar amount was due primarily to increases in professional fees and other general corporate expenses necessary to manage and support our growth, such as recruiting and information technology expenses. The average number of administrative and financial personnel grew to 43 in the year ended December 31, 2005 compared with 41 in the year ended December 31, 2004. 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 \$190,000 in the year ended December 31, 2005, compared with \$367,000 for the year ended December 31, 2004. 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* was \$1.0 million for the year ended December 31, 2005 compared with \$1.2 million in the year ended December 31, 2004 and represented 1.1% and 2.2% of revenue, respectively. The decrease was attributable to: (i) the forfeiture of unvested options by employees

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whose employment terminated, including an executive who departed during the three months ended December 31, 2005; (ii) the discontinuation, during 2004, of our previous practice of granting stock options to every new employee and the continuing amortization of deferred stock-based compensation amounts which resulted from such grants; and (iii) the reduced average fair value of ongoing stock option grants.

*Interest income, net* increased to \$1.3 million in the year ended December 31, 2005 compared with \$910,000 in the year ended December 31, 2004. The increase in interest income was primarily due to increased yield due to higher interest rates in the year ended December 31, 2005 compared with the year ended December 31, 2004. We will continue to invest in accordance with our investment policy, which emphasizes liquidity and the minimization of risk.

*Income taxes.* The differences between the effective tax rates and the statutory combined Canadian federal and provincial tax rates are explained in Note 12 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 \$1.0 million for the year ended December 31, 2005 which was primarily as a result of the appreciation in the value of the Canadian dollar over the period (from 0.831 U.S. dollars at December 31, 2004 to 0.857 U.S. dollars at December 31, 2005). 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. Gains and losses resulting from the revaluation of certain assets and liabilities, primarily our Canadian dollar treasury, are allocated to the cost of services, maintenance and other revenue and to operating expenses.

*Net income (loss).* Net income increased by \$3.6 million to \$3.0 million in the year ended December 31, 2005 compared with net loss of \$555,000 in the year ended December 31, 2004. The increase was due primarily to an increase in revenue, to \$88.7 million in the year ended December 31, 2005 from \$57.0 million in the year ended December 31, 2004, coupled with a decrease in operating expenses as a percent of revenue, to 43.5% in the year ended December 31, 2005 from 52.9% in the year ended December 31, 2004, which was partly offset by a decrease in gross margin as a percent of revenue, to 45.5% in the year ended December 31, 2005 from 50.3% in the year ended December 31, 2004. The increase in net income was also partly attributable to a net foreign exchange gain of \$1.0 million in the year ended December 31, 2005 compared with a net gain of \$400,000 in the year ended December 31, 2004.

*Adjusted net income.* Adjusted net income increased by \$2.5 million to adjusted net income of \$3.2 million in the year ended December 31, 2005 compared with adjusted net income of \$649,000 in the year ended December 31, 2004. The increase was due primarily to the increase in revenue described above and to the decrease in operating expenses as a percentage of revenue (after adjusting for the effect of foreign exchange), which was partly offset by a decrease in gross margin as a percent of revenue (after adjusting for the effect of foreign exchange).

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Adjusted net income is a non-GAAP measure related to net income (loss) and is defined as net income excluding foreign exchange gains or losses, stock-based compensation and amortization of acquisition-related intangibles. We believe that this measure enhances an overall understanding of our operational results and trends. Adjusted net income is a supplemental measure and should not be construed as an alternative to net income (loss) as defined under Canadian generally accepted accounting principles (Canadian GAAP) as a measure of profitability. Our method of measuring adjusted net income 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>2005</u>	<u>2004</u>
Net income (loss)	\$ 3,036	\$ (555)
Add back:		
Foreign exchange loss (gain)	(1,047)	(400)
Amortization of stock-based compensation	1,007	1,237
Amortization of acquisition-related intangibles	190	367
Adjusted net income	<u>\$ 3,186</u>	<u>\$ 649</u>

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

**Revenue:**

**Total revenue** increased 68.6% to \$57.0 million in the year ended December 31, 2004 from \$33.8 million in the year ended December 31, 2003.

**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

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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.

*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 earned in the year ended December 31, 2004 compared with \$540,000 earned 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

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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 12 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 0.774 U.S. dollars at December 31, 2003 to 0.831 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).* 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.

*Adjusted net income (loss).* 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

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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,	
	<u>2004</u>	<u>2003</u>
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)	<u>\$ 649</u>	<u>\$ (366)</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. At December 31, 2005 we had cash and cash equivalents and short-term investments of \$49.1 million and working capital of \$50.9 million.

Cash provided by (used for) operating activities for the years ended December 31, 2005, 2004, and 2003 was (\$1.6 million), \$1.0 million, and \$1.2 million respectively. Cash used for operations in the year ended December 31, 2005 was primarily the result of increases in accounts receivable and accrued revenue totaling \$10.0 million, which were partially offset by our net income of \$3.0 million and by non-cash charges for depreciation and amortization totaling \$4.3 million. 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, 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 were partially offset by a net increase in working capital requirements.

Our investing activities consist of the purchase and maturity of short-term investments and the purchase of property and equipment. In addition, 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, 2005, 2004, and 2003, we purchased property and equipment, principally computers and related software for our growing employee base, of \$4.3 million, \$2.6 million, and \$2.3 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, 2005 we purchased \$32.5 million in short-term investments and \$20.9 million of short-term investments matured. 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 \$8.7 million in short-term investments and \$8.9 million of short-term investments matured.

Our financing activities consist primarily of the issuance of share capital. In the years ended December 31, 2005, 2004, and 2003, \$3.3 million, \$4.6 million, and \$32.9 million of cash was provided by our financing activities, respectively. In 2005, we raised \$1.0 million from stock option exercises and \$12,000 from warrant exercises. In 2004, we raised \$2.0 million from stock option exercises and \$851,000 from warrant

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exercises. 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.

In the year ended December 31, 2005, \$3.2 million of cash was provided by the sale and leaseback of property and equipment. During 2004, we negotiated a non-committed lease line of credit with an equipment finance lender to finance selected property and equipment purchases. This line of credit was subsequently expanded to a total limit of \$4.3 million (Cdn\$5.1 million). At December 31, 2005, an accumulation of \$4.1 million had been advanced to the Company through transactions under the line of credit at fixed rates of interest approximating 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. In addition to our lease line, we have also entered into other lending agreements to finance our acquisition of assets.

We had cash, cash equivalents and short-term investments totaling \$49.1 million, \$51.1 million, and \$46.7 million at December 31, 2005, 2004, and 2003 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. 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.

**Contractual Obligations**

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

	Total	Less Than One Year	Two to Three Years	Four to Five Years	More Than Five Years
Capital lease obligations .....	\$ 6,128	\$ 2,637	\$ 3,189	\$ 302	\$ -
Leasehold inducements .....	112	56	56	-	-
Operating lease obligations .....	<u>4,294</u>	<u>1,195</u>	<u>1,729</u>	<u>1,370</u>	<u>-</u>
Total contractual obligations .....	<u>\$ 10,534</u>	<u>\$ 3,888</u>	<u>\$ 4,974</u>	<u>\$ 1,672</u>	<u>\$ -</u>

**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, whereas the majority of our operating cash outflows have been denominated in Canadian dollars. To assist us in managing our U.S. and Canadian dollar denominated cash flows, we maintain both Canadian and U.S. dollar treasuries. We regularly sell U.S. dollars in order to maintain our Canadian dollar treasury and fund our Canadian dollar denominated operating expenses. We are subject to gains and losses due to fluctuations between the U.S. and Canadian dollars. As we continue to expand our

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operations internationally, we will be subjected to additional potential gains and losses against currencies in addition to our exposure to the Canadian dollar.

**Litigation**

We are subject to legal proceedings and claims that arise in the ordinary course of our business. While management currently believes the amount of ultimate liability, if any, with respect to these actions will not materially affect our financial position, results of operations, or liquidity, the ultimate outcome of any litigation is uncertain. Were an unfavourable outcome to occur, the impact could be material. We do not believe that it is probable that a liability has been incurred, nor do we believe that the amount of any loss can be reasonably estimated. Accordingly, no liability has been accrued for these matters.

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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, 2005. In the opinion of management, this information has been presented on the same basis as our interim consolidated financial statements and the audited annual consolidated financial statements appearing in our annual report, and include all necessary adjustments, consisting only of normal recurring adjustments, to present fairly the unaudited quarterly results when read in conjunction with our interim consolidated financial statements and the notes thereto and our 2005 annual 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							
	2005				2004			
	Dec 31, 2005	Sep 30, 2005	Jun 30, 2005	Mar 31, 2005	Dec 31, 2004	Sep 30, 2004	Jun 30, 2004	Mar 31, 2004
(Amounts In U.S. Dollars, In Thousands, Except Per Share Data, Unaudited)								
<b>Consolidated Statement of Operations Data:</b>								
<b>Revenue:</b>								
Licence .....	\$ 6,735	\$ 5,443	\$ 5,762	\$ 5,123	\$ 4,368	\$ 4,140	\$ 3,703	\$ 4,129
Service, maintenance and other .....	<u>17,114</u>	<u>16,411</u>	<u>16,302</u>	<u>15,852</u>	<u>13,426</u>	<u>11,867</u>	<u>9,177</u>	<u>6,193</u>
Total revenue .....	<u>23,849</u>	<u>21,854</u>	<u>22,064</u>	<u>20,975</u>	<u>17,794</u>	<u>16,007</u>	<u>12,880</u>	<u>10,322</u>
<b>Cost of revenue:</b>								
Licence .....	257	115	216	95	95	7	96	96
Service, maintenance and other .....	12,871	11,556	11,939	11,282	8,679	7,752	6,349	5,422
Cost of revenue accruals (recoveries), net .....	—	—	—	—	—	—	—	(168)
Total cost of revenue .....	<u>13,128</u>	<u>11,671</u>	<u>12,155</u>	<u>11,377</u>	<u>8,774</u>	<u>7,759</u>	<u>6,445</u>	<u>5,350</u>
Gross profit .....	<u>10,721</u>	<u>10,183</u>	<u>9,909</u>	<u>9,598</u>	<u>9,020</u>	<u>8,248</u>	<u>6,435</u>	<u>4,972</u>
Gross margin (%) .....	45.0%	46.6%	44.9%	45.8%	50.7%	51.5%	50.0%	48.2%
<b>Operating expenses:</b>								
Sales and marketing .....	4,642	3,852	4,555	3,984	4,178	3,229	3,572	2,868
Research and development .....	3,630	3,352	3,316	2,956	2,669	2,262	2,451	2,268
General and administrative .....	2,160	1,348	1,818	1,750	1,562	1,275	1,062	1,140
Amortization of acquisition-related intangibles .....	34	34	48	74	75	75	91	126
Amortization of stock-based compensation .....	<u>97</u>	<u>310</u>	<u>320</u>	<u>280</u>	<u>320</u>	<u>368</u>	<u>320</u>	<u>229</u>
Total operating expenses .....	<u>10,563</u>	<u>8,896</u>	<u>10,057</u>	<u>9,044</u>	<u>8,804</u>	<u>7,209</u>	<u>7,496</u>	<u>6,631</u>
Income (loss) from operations .....	158	1,287	(148)	554	216	1,039	(1,061)	(1,659)
Interest income, net .....	<u>329</u>	<u>305</u>	<u>310</u>	<u>316</u>	<u>221</u>	<u>204</u>	<u>212</u>	<u>273</u>
Income (loss) before provision for income taxes .....	487	1,592	162	870	437	1,243	(849)	(1,386)
Provision for income taxes .....	—	—	—	75	—	—	—	—
Net income (loss) .....	<u>\$ 487</u>	<u>\$ 1,592</u>	<u>\$ 162</u>	<u>\$ 795</u>	<u>\$ 437</u>	<u>\$ 1,243</u>	<u>\$ (849)</u>	<u>\$ (1,386)</u>
<b>Net income (loss) per share:</b>								
Basic .....	<u>\$ 0.03</u>	<u>\$ 0.09</u>	<u>\$ 0.01</u>	<u>\$ 0.05</u>	<u>\$ 0.03</u>	<u>\$ 0.07</u>	<u>\$ (0.05)</u>	<u>\$ (0.08)</u>
Basic weighted average number of common shares outstanding .....	<u>17,711</u>	<u>17,657</u>	<u>17,622</u>	<u>17,487</u>	<u>17,187</u>	<u>16,899</u>	<u>16,751</u>	<u>16,645</u>
Diluted .....	<u>\$ 0.03</u>	<u>\$ 0.09</u>	<u>\$ 0.01</u>	<u>\$ 0.04</u>	<u>\$ 0.02</u>	<u>\$ 0.07</u>	<u>\$ (0.05)</u>	<u>\$ (0.08)</u>
Diluted weighted average number of common shares outstanding .....	<u>17,997</u>	<u>18,020</u>	<u>18,042</u>	<u>17,951</u>	<u>17,819</u>	<u>17,419</u>	<u>16,751</u>	<u>16,645</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 market demand for our products and services, 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, seasonal events such as our annual conference, 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 is 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 and quarters, there can be no assurance that in the future we will sustain such revenue growth or be profitable on an annual and on a quarterly basis.

**Results for the Three Months Ending December 31, 2005**

**Revenue.** Net revenue increased 34.0% to \$23.8 million for the three months ending December 31, 2005, compared with \$17.8 million for the three months ending December 31, 2004. The increase in revenue was primarily attributable to the addition of 11 new customers in the three months ended December 31, 2005 compared with 5 new customers in the three months ended December 31, 2004, to the recognition of licence revenue in certain new customer arrangements where services were not essential to the functionality of the software and where the criteria for revenue recognition had been met during the three months ended December 31, 2005, and to the recognition of revenue from a larger committed backlog during the three months ended December 31, 2005 compared with the three months ended December 31, 2004.

**Operating expenses** increased 20.0% to \$10.6 million in three months ending December 31, 2005, compared with \$8.8 million in the three months ending December 31, 2004, but decreased as a percentage of revenue, to 44.3% of net revenue in three months ending December 31, 2005, compared with 49.5% of net revenue in the three months ending December 31, 2004. 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 in our sales & marketing organization as well as to a decrease in stock based compensation expenses. Seasonal factors affecting fourth quarter operating expenses included an increase in sales compensation expense relating to bonuses based on the achievement of annual sales targets.

**Net income** increased to \$487,000 for the three months ending December 31, 2005, compared with net income of \$437,000 for the three months ending December 31, 2004, primarily as a result of the decrease in total operating expenses as a percentage of revenue noted above and to higher interest income, which were partially offset by the lower gross margin in three months ending December 31, 2005 compared with the three months ending December 31, 2004.

**Liquidity and capital resources.** Cash, cash equivalents and short-term investments increased by \$1.2 million in the three months ending December 31, 2005, from \$47.8 million at September 30, 2005, to \$49.1 million at December 31, 2005. The increase in cash, cash equivalents and short-term investments was related primarily to cash provided by operations of \$2.2 million for the three months ending December 31,

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2005. Cash provided by operations in the three months ended December 31, 2005 was related primarily to our net income and non-cash charges as well as the seasonal effect of accrued payroll liabilities relating to employee bonuses.

**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, 2005, the total expense incurred by us from such law firm for legal and other services aggregated \$124,000, compared with \$177,000 during the year ended December 31, 2004.

**Outstanding Share Data**

As at December 31, 2005, there were 17,730,825 common shares issued and outstanding. In addition, a total of 1,147,528 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.

**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, we cannot provide assurance that revenue from these products will continue to grow, or will grow at rates projected by management, or will 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 licensed 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

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- 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.

Our quarterly revenue depends both on the progress we make on existing customer projects 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 significant 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 new sales or our progress on existing customer projects 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.

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**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.

**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 on regarding the impact of foreign exchange and the management of foreign currency risk in the section of this document entitled 'Foreign Exchange Management'.

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.

**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.

**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

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example, to develop similar non-infringing intellectual property or license the intellectual property at issue) which could materially disrupt our business, and could adversely affect our financial condition and the results of our operations.

**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 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.