

WORKBRAIN CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF INTERIM FINANCIAL RESULTS
FOR THE THREE MONTHS ENDED MARCH 31, 2005 AND 2004

You should read the following management's discussion and analysis ("MD&A") in conjunction with our interim consolidated financial statements for the three month period ended March 31, 2005 and the notes thereto, and with our annual audited consolidated financial statements, including the notes thereto, and our annual MD&A for the year ended December 31, 2004. This MD&A is prepared as of May 1, 2005.

Forward-looking Statements

Certain statements included in this document constitute forward-looking statements, including those identified by the expressions *anticipate, believe, plan, estimate, expect, intend* and similar expressions to the extent they relate to us or our management. These forward looking statements are not facts, promises or guarantees; rather, they reflect our current expectations regarding future results or events. These forward-looking statements are subject to a number of known and unknown risks and uncertainties that could cause actual results, activities, performance or events to differ materially from current expectations. These risks include risks related to our revenue growth, operating results, industry, products, and litigation, as well as the matters discussed in our annual MD&A 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.

Comparison of Three Months Ended March 31, 2005 and 2004

Revenue:

Total revenue increased 103.2% to \$21.0 million in the three months ended March 31, 2005 from \$10.3 million in the three months ended March 31, 2004.

Licence revenue increased 24.1% to \$5.1 million in the three months ended March 31, 2005 compared with \$4.1 million in the three months ended March 31, 2004. The growth was substantially attributable to an increase in our cumulative number of new customers, which totaled 99 at March 31, 2005 compared with 67 at March 31, 2004. Growth was also a result of significant investments in sales infrastructure, primarily an increase in the number of direct sales personnel as well as a substantial expansion of marketing programs. We expect licence revenue to increase in dollar amounts as we expect to continue to add new customers and continue to invest in sales infrastructure in future periods.

Service, maintenance and other revenue increased 156.0% to \$15.9 million in the three months ended March 31, 2005 compared with \$6.2 million in the three months ended March 31, 2004. The increase was primarily attributable to additional product implementation projects related to new customers as well as a growing installed base, which provides recurring maintenance, hosting and other revenue.

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Cost of revenue:

Cost of licence revenue decreased 1.0% to \$95,000 in the three months ended March 31, 2005 compared with \$96,000 in the three months ended March 31, 2004, and represented 1.9% and 2.3% of licence revenue, respectively. The decrease in the dollar amount and as a percentage of licence revenue of the cost of licence revenue reflected marginally lower third-party software license costs in the three months ended March 31, 2005 compared with the same period of the prior year.

Cost of service, maintenance and other revenue increased 108.1% to \$11.3 million in the three months ended March 31, 2005 compared with \$5.4 million in the three months ended March 31, 2004, and represented 71.2% and 87.6% 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 to prepare for expected growth in our customer base. The average number of customer support, implementation and training personnel grew to 285 in the three months ended March 31, 2005 compared with 157 in the three months ended March 31, 2004. The cost of service, maintenance and other revenue included a foreign exchange gain of \$93,000 in the three months ended March 31, 2005 compared to a foreign exchange loss of \$(288,000) in the three months ended March 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 decrease as a percentage of revenue.

Cost of revenue accruals (recoveries), net was \$nil in the three months ended March 31, 2005 compared with \$(168,000) in the three months ended March 31, 2004. The decrease in dollar amount occurred because no contracts were accounted for under the zero-profit method during the three months ended March 31, 2005. We do not expect any future accrual or recovery of zero-profit provisions, since all projects where revenue was recognized using that method are now complete.

Operating expenses:

Sales and marketing expenses increased 38.9% to \$4.0 million in the three months ended March 31, 2005 compared with \$2.9 million in the three months ended March 31, 2004, and represented 19.0% and 27.8% 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 70 personnel in the three months ended March 31, 2005 compared with an average of 58 in the three months ended March 31, 2004, increases in their related travel expenses in both North America and abroad, and increased marketing activities, trade shows and promotional expenses. The decrease as a percentage of revenue is due to increased productivity of our existing sales and marketing personnel. Sales and marketing expenses included a foreign exchange loss of \$(19,000) in the three months ended March 31, 2005 compared to a foreign exchange loss of \$(75,000) in the three months ended March 31, 2004. 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 30.3% to \$3.0 million in the three months ended March 31, 2005 compared with \$2.3 million in the three months ended March 31, 2004, and represented 14.1% and 22.0% of revenue, respectively. The increase in dollar amount in the three months ended March 31, 2005 over the prior year was primarily attributable to increased staffing and associated support. The average number of research and development personnel grew to 127 in the three months ended March 31, 2005 compared with 85 in the three months ended March 31, 2004. Research and development expenses included a foreign exchange gain of \$49,000 in the three months ended March 31, 2005 compared to a foreign exchange loss of \$(153,000) in the three months ended March 31, 2004. 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.

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General and administrative expenses increased 53.5% to \$1.8 million in the three months ended March 31, 2005 compared with \$1.1 million in the three months ended March 31, 2004, and represented 8.3% and 11.0% of revenue, respectively. These increases were attributable to increases in professional fees and other general corporate expenses necessary to manage and support our growth. General and administrative costs included a foreign exchange gain of \$41,000 in the three months ended March 31, 2005 compared with a foreign exchange loss of \$(41,000) in the three months ended March 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 \$74,000 in the three months ended March 31, 2005, compared with \$126,000 for the same period of the prior year. This expense relates to our acquisition of the net operating assets of Workforce Logistics Inc. in April 2003, which enhanced our existing workforce management solution with additional schedule optimization functionality.

Amortization of stock-based compensation increased to \$280,000 for the three months ended March 31, 2005 compared with \$229,000 in the three months ended March 31, 2004 and represented 1.3% and 2.2% of revenue, respectively. The increase in dollar amount was the result of options granted to certain new and existing employees, whereas the decrease in percentage terms was the result of the discontinuation, during 2004, of our previous practice of granting stock options to all new employees.

Interest income, net increased to \$316,000 in the three months ended March 31, 2005 compared with \$273,000 in the three months ended March 31, 2004. The increase in interest income was primarily due to an increase in cash balances in the three months ended March 31, 2005 compared with the three months ended March 31, 2004. We will continue to invest in accordance with our investment policy, which emphasizes liquidity and the minimization of risk.

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 \$164,000 for the three months ended March 31, 2005 which was due primarily to the favorable timing of certain foreign exchange transactions, which more than offset the slight depreciation in the value of the Canadian dollar over the period (from 0.831 U.S. dollars at December 31, 2004 to 0.827 U.S. dollars at March 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.

Net income (loss). Net income (loss) increased by \$2.2 million, to net income of \$795,000 in the three months ended March 31, 2005 compared with net loss of \$(1.4 million) in the three months ended March 31, 2004. The increase was primarily due to revenue growth combined with a decrease in operating expenditures as a percentage of revenue, to 43.1% in the three months ended March 31, 2005, compared to 64.2% in the three months ended March 31, 2004. The increase was also due to the inclusion of a foreign exchange gain of \$164,000 in the three months ended March 31, 2005, compared to a foreign exchange loss of \$(557,000) in the three months ended March 31, 2004.

Adjusted net income (loss). Adjusted net income (loss) increased by \$1.5 million to adjusted net income of \$985,000 in the three months ended March 31, 2005 compared with adjusted net loss of \$(474,000) in the three months ended March 31, 2004. The increase was primarily due to the revenue growth and decrease in operating expenditures as a percentage of revenue, as noted above.

Adjusted net income (loss) is a non-GAAP measure related to net income (loss) and is defined as net income (loss) excluding foreign exchange charges, stock-based compensation charges and amortization of acquisition-related intangibles. We believe that this measure enhances an overall understanding of our operational results and trends. Adjusted net income (loss) is a supplemental measure and should not be construed as an alternative to net income (loss) as defined under Canadian generally accepted accounting

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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):

| | Three months ended March 31, | |
|---|------------------------------|-----------------|
| | <u>2005</u> | <u>2004</u> |
| Net income (loss) | \$ 795 | \$ (1,386) |
| Add back: | | |
| Foreign exchange loss (gain) | (164) | 557 |
| Amortization of stock-based compensation | 280 | 229 |
| Amortization of acquisition-related intangibles | 74 | 126 |
| Adjusted net income (loss) | <u>\$ 985</u> | <u>\$ (474)</u> |

Liquidity and Capital Resources

At March 31, 2005 we had cash and cash equivalents and short-term investments of \$51.2 million and working capital of \$47.4 million, compared with cash and cash equivalents and short-term investments of \$51.1 million and working capital of \$45.9 million at December 31, 2004.

Cash provided by (used in) operating activities for the three months ended March 31, 2005 and 2004 was \$350,000, and \$(2.2 million) respectively. Cash provided by operations in the three months ended March 31, 2005 was primarily the result of our net income of \$795,000 which was partially offset by increases in working capital requirements, primarily an increase in accounts receivable and a decrease in accrued payroll. Cash used in operations in the three months ended March 31, 2004 was primarily the result of our net loss of \$1.4 million, and a net increase in working capital requirements, which related primarily to an increase in accounts receivable and other short-term assets and to a decrease in accounts payable and accrued payroll.

Investment activities during the three months ended March 31, 2005 and 2004 included cash used for the purchase of property and equipment totaling \$795,000, and \$789,000, respectively. We expect that our investment in property and equipment will continue to increase as our employee base and customer base continue to grow. Cash provided by (used for) the net maturity (purchase) of short-term investments during the three months ended March 31, 2005 and 2004 were \$5.9 million and \$(9.1) million, respectively.

Financing activities during the three months ended March 31, 2005 and 2004 consisted primarily of the issuance of share capital pursuant to stock option exercises which totaled \$431,000 and \$115,000, respectively. The Company has an agreement in place for a non-committed lease line of credit for up to \$2.5 million (Cdn\$3.0 million) with the equipment finance arm of a Canadian chartered bank to finance selected property and equipment purchases. At March 31, 2005, a total of \$1.9 million (Cdn\$2.3 million) had been advanced to the Company under the line at a fixed interest rate of approximately 6% for initial 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.

We believe that our current cash and short-term investments and anticipated cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for the foreseeable future.

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

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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

Our material contractual obligations include the capital equipment lease obligations noted above, as well as future minimum lease payments under non-cancelable operating leases relating to our premises, which total \$4.5 million as at March 31, 2005.

Litigation

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 unfavorable 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.

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 three months ended March 31, 2005, the total expense incurred by us from such law firm for legal and other services aggregated \$40,000 (March 31, 2004 - \$49,000).

Outstanding Share Data

As at May 1, 2005, there were 17,621,033 common shares issued and outstanding. In addition, a total of 1,106,465 stock options and 37,596 warrants were outstanding, which are exercisable for an equal number of common shares.

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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 March 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 2004 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 | | | | 2003 | | |
| | Mar 31, 2005 | Dec 31, 2004 | Sep 30, 2004 | Jun 30, 2004 | Mar 31, 2004 | Dec 31, 2003 | Sep 30, 2003 | Jun 30, 2003 |

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

Consolidated Statement of Operations Data:

| | | | | | | | | |
|--|----------------|----------------|-----------------|------------------|-------------------|------------------|-----------------|------------------|
| Revenue: | | | | | | | | |
| Licence | \$ 5,123 | \$ 4,368 | \$ 4,140 | \$ 3,703 | \$ 4,129 | \$ 2,521 | \$ 2,555 | \$ 2,883 |
| Service, maintenance and other | <u>15,852</u> | <u>13,426</u> | <u>11,867</u> | <u>9,177</u> | <u>6,193</u> | <u>6,975</u> | <u>6,400</u> | <u>5,402</u> |
| Total revenue | <u>20,975</u> | <u>17,794</u> | <u>16,007</u> | <u>12,880</u> | <u>10,322</u> | <u>9,496</u> | <u>8,955</u> | <u>8,285</u> |
| Cost of revenue: | | | | | | | | |
| Licence | 95 | 95 | 7 | 96 | 96 | 39 | 19 | 112 |
| Service, maintenance and other | 11,282 | 8,679 | 7,752 | 6,349 | 5,422 | 4,913 | 4,503 | 4,396 |
| Cost of revenue accruals (recoveries), net | — | — | — | — | (168) | (8) | (911) | 112 |
| Total cost of revenue | <u>11,377</u> | <u>8,774</u> | <u>7,759</u> | <u>6,445</u> | <u>5,350</u> | <u>4,944</u> | <u>3,611</u> | <u>4,620</u> |
| Gross profit | <u>9,598</u> | <u>9,020</u> | <u>8,248</u> | <u>6,435</u> | <u>4,972</u> | <u>4,552</u> | <u>5,344</u> | <u>3,665</u> |
| Gross margin (%) | 45.8% | 50.7% | 51.5% | 50.0% | 48.2% | 47.9% | 59.7% | 44.2% |
| Operating expenses: | | | | | | | | |
| Sales and marketing | 3,984 | 4,178 | 3,229 | 3,572 | 2,868 | 2,588 | 2,088 | 2,322 |
| Research and development | 2,956 | 2,669 | 2,262 | 2,451 | 2,268 | 1,711 | 1,369 | 1,323 |
| General and administrative | 1,750 | 1,562 | 1,275 | 1,062 | 1,140 | 293 | 319 | 445 |
| Amortization of acquisition-related intangibles | 74 | 75 | 75 | 91 | 126 | 125 | 127 | 84 |
| Amortization of stock-based compensation | <u>280</u> | <u>320</u> | <u>368</u> | <u>320</u> | <u>229</u> | <u>81</u> | <u>—</u> | <u>2</u> |
| Total operating expenses | <u>9,044</u> | <u>8,804</u> | <u>7,209</u> | <u>7,496</u> | <u>6,631</u> | <u>4,798</u> | <u>3,903</u> | <u>4,176</u> |
| Income (loss) from operations | 554 | 216 | 1,039 | (1,061) | (1,659) | (246) | 1,441 | (511) |
| Interest income, net | <u>316</u> | <u>221</u> | <u>204</u> | <u>212</u> | <u>273</u> | <u>62</u> | <u>50</u> | <u>56</u> |
| Income (loss) before provision for income taxes | 870 | 437 | 1,243 | (849) | (1,386) | (184) | 1,491 | (455) |
| Provision for income taxes | <u>75</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| Net income (loss) | <u>\$ 795</u> | <u>\$ 437</u> | <u>\$ 1,243</u> | <u>\$ (849)</u> | <u>\$ (1,386)</u> | <u>\$ (184)</u> | <u>\$ 1,491</u> | <u>\$ (455)</u> |
| Net income (loss) per share: | | | | | | | | |
| Basic | <u>\$ 0.05</u> | <u>\$ 0.03</u> | <u>\$ 0.07</u> | <u>\$ (0.05)</u> | <u>\$ (0.08)</u> | <u>\$ (0.01)</u> | <u>\$ 0.11</u> | <u>\$ (0.04)</u> |
| Basic weighted average number of common shares outstanding | <u>17,487</u> | <u>17,187</u> | <u>16,899</u> | <u>16,751</u> | <u>16,645</u> | <u>14,039</u> | <u>13,299</u> | <u>12,955</u> |
| Diluted | <u>\$ 0.04</u> | <u>\$ 0.02</u> | <u>\$ 0.07</u> | <u>\$ (0.05)</u> | <u>\$ (0.08)</u> | <u>\$ (0.01)</u> | <u>\$ 0.11</u> | <u>\$ (0.04)</u> |
| Diluted weighted average number of common shares outstanding | <u>17,951</u> | <u>17,819</u> | <u>17,419</u> | <u>16,751</u> | <u>16,645</u> | <u>14,039</u> | <u>13,864</u> | <u>12,955</u> |

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Variation in Operating Results

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

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

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