

**WORKBRAIN CORPORATION**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**OF INTERIM FINANCIAL RESULTS**  
**FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005**

*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, 2006 and the notes thereto, and with our annual audited consolidated financial statements for the twelve months ended December 31, 2005, including the notes thereto, and our annual MD&A for the twelve months ended December 31, 2005. This MD&A is prepared as of May 9, 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.

**Comparison of the Three Months Ended March 31, 2006 and 2005**

**Revenue:**

**Total revenue** increased 18.9% to \$24.9 million in the three months ended March 31, 2006 from \$21.0 million in the three months ended March 31, 2005.

**Licence revenue** increased 38.1% to \$7.1 million in the three months ended March 31, 2006 compared with \$5.1 million in the three months ended March 31, 2005. The increase in licence revenue was attributable to the increased recognition of licence revenue from committed backlog during the three months ended March 31, 2006 compared with the three months ended March 31, 2005, as well as to an increase in the licence revenue recognized from new clients acquired during the three months ended March 31, 2006 compared with the three months ended March 31, 2005, which in turn was partly due to the increased recognition of licence revenue upon the completion of the criteria under SOP 97-2 for certain new client arrangements. 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 amount as we expect to continue to add new clients and continue to invest in sales and marketing capabilities in future periods.

**Service, maintenance and other revenue** increased 12.7% to \$17.9 million in the three months ended March 31, 2006 compared with \$15.9 million in the three months ended March 31, 2005. The increase was primarily attributable to additional product implementation projects related to new clients as well as to a growing installed base, which provides recurring service, maintenance and other revenue. We expect service, maintenance and other revenue to increase in dollar amount as we expect to provide services to our growing client base.

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**Cost of revenue:**

*Cost of license revenue* increased 318.9% to \$398,000 in the three months ended March 31, 2006 compared with \$95,000 in the three months ended March 31, 2005, and represented 5.6% and 1.9% 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 three months ended March 31, 2006 compared with the same period of the prior year.

*Cost of service, maintenance and other revenue* increased 13.5% to \$12.8 million in the three months ended March 31, 2006 compared with \$11.3 million in the three months ended March 31, 2005, and represented 71.7% and 71.2% of service, maintenance and other revenue, respectively. These increases related primarily to the increase in the number of implementation, support, training and hosting personnel and related costs necessary to support our larger client base and new and anticipated product implementations. The average number of support, implementation and training personnel grew to 345 in the three months ended March 31, 2006 compared with 285 in the three months ended March 31, 2005.

**Operating expenses:**

*Sales and marketing expenses* increased 31.7% to \$5.2 million in the three months ended March 31, 2006 compared with \$4.0 million in the three months ended March 31, 2005, and represented 21.0% and 19.0% of revenue, respectively. The increase was primarily attributable to the expansion of our sales and marketing workforce, which grew to an average of 87 personnel in the three months ended March 31, 2006 compared with an average of 70 in the three months ended March 31, 2005, and to increased marketing activities, trade shows and promotional expenses. 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 46.6% to \$4.3 million in the three months ended March 31, 2006 compared with \$3.0 million in the three months ended March 31, 2005, and represented 17.4% and 14.1% of revenue, respectively. The increases were 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 179 in the three months ended March 31, 2006 compared with 127 in the three months ended March 31, 2005. Up to March 31, 2006, 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 14.3% to \$2.0 million in the three months ended March 31, 2006 compared with \$1.8 million in the three months ended March 31, 2005, and represented 8.0% and 8.3% of revenue, respectively. The increase in dollar amount was due primarily to an increase in the average number of administrative and financial personnel, to 49 in the three months ended March 31, 2006 compared with 33 in the three months ended March 31, 2005, as well as to increases in professional fees and other general corporate expenses necessary to manage and support our growth, such as information technology expenses. 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 client base.

*Amortization of acquisition-related intangibles* was \$34,000 in the three months ended March 31, 2006, compared with \$74,000 for the three months ended March 31, 2005. 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 \$202,000 for the three months ended March 31, 2006 compared with \$280,000 in the three months ended March 31, 2005 and represented 0.8% and 1.3% of revenue, respectively. The decrease was the result of the discontinuation, during 2004, of our previous practice of granting stock options to every new employee.

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*Interest income, net* increased to \$384,000 in the three months ended March 31, 2006 compared with \$316,000 in the three months ended March 31, 2005. The increase in interest income was primarily due to increased yield due to higher interest rates in the three months ended March 31, 2006 compared with the three months ended March 31, 2005. We will continue to invest in accordance with our investment policy, which emphasizes liquidity and the minimization of risk.

*Net income* decreased by \$488,000 to \$307,000 in the three months ended March 31, 2006 compared with net income of \$795,000 in the three months ended March 31, 2005. The decrease was primarily attributable to an increase in operating expenses, from 43.1% of revenue in the three months ended March 31, 2005, to 47.4% of revenue in the three months ended March 31, 2006, which more than offset an increase in gross margin from 45.8% of revenue in the three months ended March 31, 2005, to 47.1% of revenue in the three months ended March 31, 2006.

*Adjusted net income* decreased by \$491,000, to adjusted net income of \$494,000 in the three months ended March 31, 2006 compared with adjusted net income of \$985,000 in the three months ended March 31, 2005. The decrease was due to the decrease in net income described above (after adjusting for the effect of foreign exchange, stock-based compensation charges, and the amortization of acquisition-related intangibles).

Adjusted net income is a non-GAAP measure related to net income and is defined as net income excluding foreign exchange gains, stock-based compensation charges, and the 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 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):

	<u>Three months ended March 31,</u>	
	<u>2006</u>	<u>2005</u>
Net income	\$ 307	\$ 795
Add back:		
Foreign exchange gain	(49)	(164)
Amortization of stock-based compensation	202	280
Amortization of acquisition-related intangibles	34	74
Adjusted net income	<u>\$ 494</u>	<u>\$ 985</u>

**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 \$49,000 for the three months ended March 31, 2006, despite a slight reduction in the value of the Canadian dollar, from 0.857 U.S. dollars at December 31st 2005 to 0.856 at March 31st 2006. 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.

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**Liquidity and Capital Resources**

At March 31, 2006 we had cash and cash equivalents and short-term investments of \$46.7 million and working capital of \$51.6 million.

Cash provided by (used for) operating activities for the three months ended March 31, 2006, and 2005 was \$(1.8 million), and \$350,000 respectively. Cash used for operations in the three months ended March 31, 2006 was primarily the result of an increase in working capital requirements, including an increase in accounts receivable of \$523,000, an increase in other assets of \$458,000, an increase in accrued revenue of \$1.9 million, a decrease in accrued payroll of \$1.3 million, and a decrease in deferred revenue of \$1.1 million. These were partially offset by an increase in accounts payable of \$2.2 million and by non-cash charges for depreciation and amortization of \$1.1 million. 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.

Our investing activities consist of the purchase and maturity of short-term investments, and the purchase of property and equipment. In the three months ended March 31, 2006, and 2005, we purchased property and equipment, principally computers and related software for our growing employee base, of \$541,000, and \$795,000 respectively. We expect that our investment in property and equipment will continue to increase as our employee base continues to grow. Cash provided by the proceeds on maturity of short-term investments (net of additional purchases of short-term investments) during the three months ended March 31, 2006 and 2005 was \$25.1 million and \$5.9 million, respectively.

Our financing activities consist primarily of the issuance of share capital and to the sale and leaseback of property and equipment. In the three months ended March 31, 2006, \$34,000 of cash was used for financing activities, compared with \$543,000 of cash provided by our financing activities in the three months ended March 31, 2005. In the three months ended March 31, 2006, \$357,000 of cash was provided by the sale and leaseback of property and equipment, compared with \$292,000 of cash provided by the sale and leaseback of property and equipment in the three months ended March 31, 2005. 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 \$7.1 million (Cdn\$8.3 million). At March 31, 2006, a total of \$4.0 million had been advanced to the Company through transactions under the line of credit at fixed rates of interest between 6% and 7% for terms ranging from 24 to 36 months. Under the agreement, advances bear interest at fixed or floating benchmark rates between 2% and 2.5%. 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 other assets.

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 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 client 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**

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 \$4.8 million as at March 31, 2006.

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**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.

**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, 2006, the total expense incurred by us from such law firm for legal and other services aggregated \$50,000, compared with \$40,000 during the three months ended March 31, 2005.

**Outstanding Share Data**

As at March 31, 2006, there were 17,757,493 common shares issued and outstanding. In addition, a total of 1,221,510 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, 2006. 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							
	2006		2005				2004	
	Mar 31, 2006	Dec 31, 2005	Sep 30, 2005	Jun 30, 2005	Mar 31, 2005	Dec 31, 2004	Sep 30, 2004	Jun 30, 2004
(Amounts In U.S. Dollars, In Thousands, Except Per Share Data, Unaudited)								
<b>Consolidated Statement of Operations Data:</b>								
Revenue:								
Licence	\$ 7,073	\$ 6,735	\$ 5,443	\$ 5,762	\$ 5,123	\$ 4,368	\$ 4,140	\$ 3,703
Service, maintenance and other	17,868	17,114	16,411	16,302	15,852	13,426	11,867	9,177
Total revenue	<u>24,941</u>	<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>
Cost of revenue:								
Licence	398	257	115	216	95	95	7	96
Service, maintenance and other	12,803	12,871	11,556	11,939	11,282	8,679	7,752	6,349
Total cost of revenue	<u>13,201</u>	<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>
Gross profit	<u>11,740</u>	<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>
Gross margin (%)	47.1%	45.0%	46.6%	44.9%	45.8%	50.7%	51.5%	50.0%
Operating expenses:								
Sales and marketing	5,248	4,642	3,852	4,555	3,984	4,178	3,229	3,572
Research and development	4,333	3,630	3,352	3,316	2,956	2,669	2,262	2,451
General and administrative	2,000	2,160	1,348	1,818	1,750	1,562	1,275	1,062
Amortization of intangibles	34	34	34	48	74	75	75	91
Amortization of stock-based comp	202	97	310	320	280	320	368	320
Total operating expenses	<u>11,817</u>	<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>
Income (loss) from operations	(77)	158	1,287	(148)	554	216	1,039	(1,061)
Interest income, net	384	329	305	310	316	221	204	212
Income (loss) before provision for income taxes	307	487	1,592	162	870	437	1,243	(849)
Provision for income taxes	-	-	-	-	75	-	-	-
Net income (loss)	<u>\$ 307</u>	<u>\$ 487</u>	<u>\$ 1,592</u>	<u>\$ 162</u>	<u>\$ 795</u>	<u>\$ 437</u>	<u>\$ 1,243</u>	<u>\$ (849)</u>
Net income (loss) per share:								
Basic	<u>\$ 0.02</u>	<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>
Basic weighted average number of common shares outstanding	<u>17,738</u>	<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>
Diluted	<u>\$ 0.02</u>	<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>\$ (0.08)</u>
Diluted weighted average number of common shares outstanding	<u>18,011</u>	<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>

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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 client 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.

**Additional Information**

Additional information relating to us, including our most recently filed Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).