

WORKBRAIN CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF INTERIM FINANCIAL RESULTS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2006, AND 2005

The following management's discussion and analysis ("MD&A") should be read in conjunction with Workbrain's interim consolidated financial statements for the three and six month periods ended June 30, 2006, and the notes thereto, and with Workbrain's annual audited consolidated financial statements, including the notes thereto, and annual MD&A for the year ended December 31, 2005. This MD&A is prepared as of August 2, 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 Workbrain or its management. These forward-looking statements are not facts, promises or guarantees; rather, they reflect 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 revenue growth, operating results, industry, products, and litigation, as well as the matters discussed in Workbrain's 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. Workbrain disclaims any obligation to publicly update or to revise any such statements to reflect any change in the Company's 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, hosts, and supports software that helps large organizations to optimally deploy and to manage their workforces. Workbrain solutions automate workforce management processes, such as labour forecasting, employee schedule optimization, time and attendance, workforce analytics, and employee self-service. Workbrain markets and sells its products through both direct and indirect channels to maximize market coverage in a cost-effective manner. Workbrain employs a direct sales force that sells Workbrain software and services in North America, Europe, and Australia. The Company's sales channels are supported through marketing and implementation relationships with leading systems integrators and business process outsourcers.

Comparison of Results for the Three Months ended June 30, 2006, and 2005

Revenue

Total revenue increased by \$0.4 million, or 1.6 percent, from \$22.1 million in the three months ended June 30, 2005, to \$22.4 million in the three months ended June 30, 2006. As noted on July 5, 2006, when preliminary revenue for the second quarter of 2006 was announced, two enterprise license sales that were expected to contribute approximately \$2.5 million in license revenue did not close in the second quarter. Subsequent to the end of the quarter, one of the two sales has closed, and the other is expected to close before the end of the year. Based on the current sales pipeline, Workbrain has reiterated its expectation of total revenue in the range of \$102 million to \$108 million for 2006.

License revenue declined by approximately \$1.7 million, from \$5.8 million in the second quarter of 2005 to \$4.1 million in the second quarter of 2006. As noted above, the decline in license revenue was primarily due to two enterprise license sales that were expected to close in the second quarter. New license sales in the second quarter of 2006 included three new clients in the retail sector and a global media and entertainment company.

Service, maintenance, and other revenue increased by \$2.0 million, or 12.4 percent, from \$16.3 million in the three months ended June 30, 2005, to \$18.3 million in the three months ended June 30, 2006. Professional services revenue increased by \$1.3 million, or 10.4 percent, from \$12.9 million in the second quarter of 2005 to \$14.2 million in the second quarter of 2006; and maintenance revenue increased by \$1.0 million, from \$2.2 million in the second quarter of 2005 to \$3.2 million in the second quarter of 2006. These increases were partially offset by a \$0.3 million decline in other revenue, primarily revenue from the sale of hardware, which is sold primarily as an additional offering to customers who seek a whole product solution from a single vendor. Professional services revenue per professional services employee increased 4.7 percent, from \$40,338 in the second quarter of 2005 to \$42,254 in the second quarter of 2006. As the number of customers deploying Workbrain solutions continues to grow, maintenance revenue is expected to continue to increase. Services revenue is expected to grow at a slower rate as the Company pursues more packaged implementation services and sales through third-party service providers.

Total Cost of Revenue

Cost of revenue increased by approximately \$1.0 million, or 8.5 percent, from \$12.2 million in the second quarter of 2005 to \$13.2 million in the second quarter of 2006. In the second quarter of 2006, management undertook a review of personnel resources in light of the projected demand for services and decided to eliminate 24 full-time positions, 17 of which were in services. This action focused on improving the cost-effectiveness of services by better matching personnel skills and future requirements. Of the total \$1.0 million increase, approximately \$0.4 million was attributable to severance charges for services employees terminated during the second quarter.

Cost of license revenue is composed primarily of royalties on sales of third party software products and totaled approximately \$0.3 million in the second quarter of 2006 and \$0.2 million in the second quarter of 2005.

Cost of service, maintenance, and other revenue increased approximately \$1.0 million, or 8.4 percent, from \$11.9 million in the second quarter of 2005 to \$12.9 million in the second quarter of 2006. Professional services costs increased \$1.0 million, or 9.5 percent. This increase was primarily due to increased personnel costs as a result of a 5.4 percent increase in the average number of professional services employees (from 318.7 to 336.0), increased variable compensation costs, and severance charges. Including \$0.4 million in severance charges, the total services, maintenance, and other revenues contribution margin was \$5.4 million, compared to \$4.4 million in the second quarter of 2005, and the margin percentage increased to 29.4 percent from 26.8 percent. The professional services contribution margin increased from \$2.3 million in the second quarter of 2005 to \$2.6 million in the second quarter of 2006; and the professional services margin percentage increased from 17.6 percent to 18.3 percent as a result of higher utilization. Maintenance costs increased from \$0.5 million to \$0.6 million, the maintenance contribution margin increased from \$1.7 million in the second quarter of 2005 to \$2.7 million in the second quarter of 2006, and the maintenance margin percentage increased from 78.2 percent in the second quarter of 2005 to 82.4 percent in the second quarter of 2006. Other costs, which were primarily composed of hardware costs, were \$0.9 million in both periods. The following table details the components of services, maintenance, and other revenues and costs for the six quarters ended June 30, 2006.

Components of Services, Maintenance, and Other Revenues and Costs

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

| | Quarters Ended | | | | | |
|--------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| | 2006 | | 2005 | | | |
| | Jun 30, 2006 | Mar 31, 2006 | Dec 31, 2005 | Sep 30, 2005 | Jun 30, 2005 | Mar 31, 2005 |
| Revenue: | | | | | | |
| Maintenance | \$ 3,223 | \$ 2,822 | \$ 2,426 | \$ 2,233 | \$ 2,200 | \$ 2,010 |
| Professional Services | 14,197 | 14,191 | 14,260 | 13,462 | 12,856 | 12,346 |
| Other | 903 | 855 | 428 | 716 | 1,246 | 1,496 |
| Total | \$ 18,323 | \$ 17,868 | \$ 17,114 | \$ 16,411 | \$ 16,302 | \$ 15,852 |
| Costs of revenue: | | | | | | |
| Maintenance | \$ 568 | \$ 519 | \$ 466 | \$ 424 | \$ 480 | \$ 388 |
| Professional Services | 11,518 | 11,636 | 11,867 | 10,585 | 10,590 | 9,827 |
| Other | 851 | 648 | 538 | 547 | 869 | 1,067 |
| Total | \$ 12,937 | \$ 12,803 | \$ 12,871 | \$ 11,556 | \$ 11,939 | \$ 11,282 |

Gross profit declined by \$0.7 million, to \$9.2 million, as compared to \$9.9 million in the corresponding period last year; and the gross margin percentage declined from 44.9 percent to 41.2 percent. The decline in gross profit and gross margin percentage was primarily due to the decline in license revenue.

Operating Expenses

Operating expenses increased by \$1.9 million, or 19.3 percent, from \$10.1 million in the second quarter of 2005 to \$12.0 million in the second quarter of 2006. Of the total \$1.9 million increase in operating expenses, \$0.9 million was attributable to an increase in the allowance for doubtful accounts, based on a review of accounts receivable at June 30, 2006, which was reflected in general and administrative expenses, and \$0.6 million was due to an increase in research and development expenses.

Sales and marketing expenses increased \$0.1 million, or 1.4 percent, from \$4.5 million in the second quarter of 2005 to \$4.6 million in the second quarter of 2006. This increase was primarily attributable to increased personnel expenses as a result of a 13.5 percent increase in the average number of sales and marketing employees (from 77.3 to 87.7), which were partially offset by a reduction in marketing expenses associated with Workbrain's annual user conference. In 2005 the annual user conference was held in the second quarter and in 2006 it will be held in the fourth quarter. Sales and marketing expenses are expected to continue to grow as sales and marketing activities are increased in North America and abroad.

Research and development expenses increased by approximately \$0.6 million, or 19.5 percent, from \$3.3 million in the second quarter of 2005 to \$4.0 million in the second quarter of 2006. The increase in research and development expenses was primarily attributable to a 19.6 percent increase in the average number of research and development employees and associated non-personnel costs. The average number of research and development employees grew to 187.0 in the second quarter of 2006, compared to 156.3 in the second quarter of 2005. This increase reflected investments in product enhancements and additional functionality. Research and development expenses are expected to grow at a slower rate through the second half of 2006. All research and development expenses through the second quarter of 2006 have been expensed as incurred.

General and administrative expenses increased by approximately \$1.3 million, from \$1.8 million in the second quarter of 2005 to \$3.2 million in the second quarter of 2006. The increase in general and administrative expenses was primarily attributable to a \$0.9 million charge to increase the Company's provision for doubtful accounts based on a review of accounts receivable at June 30, 2006, and to an increase in the average number of general and administrative positions (from 39.7 to 50.0).

Amortization of acquisition-related intangibles was \$11 thousand in the second quarter of 2006, compared to \$48 thousand in the second quarter of 2005. This expense related to Workbrain's acquisition of the net operating assets of Workforce Logistics Inc. in April 2003, which enhanced Workbrain's existing workforce management solution with additional schedule optimization functionality. As of June 30, 2006, these intangible assets have been fully amortized.

Amortization of stock-based compensation was \$253 thousand in the second quarter of 2006, compared to \$320 thousand in the second quarter of 2005. The reduction in stock-based compensation expense was due to the discontinuation, during 2004, of the Company's previous practice of granting stock options to every new employee.

Interest income was \$442 thousand in the second quarter of 2006, compared to \$310 thousand in the second quarter of 2005. The increase in interest income was attributable primarily to higher interest rates prevailing in the second quarter of 2006 compared with the second quarter of 2005.

Net income (loss). Workbrain incurred a net loss of \$(2.3) million, or a loss of \$(0.13) per share, in the second quarter of 2006, compared to net income of \$0.2 million, or \$0.01 per share, in the second quarter of 2005. The net loss in the second quarter of 2006 was primarily attributable to two enterprise license sales that were expected to contribute approximately \$2.5 million in license revenue, which did not close in the second quarter. In addition, costs and operating expenses were adversely affected by a charge of \$0.9 million to increase the allowance for doubtful accounts and employee severance charges of \$0.5 million.

Comparison of Results for the Six Months ended June 30, 2006, and 2005

Revenue

Total revenue increased by \$4.3 million, or 10.1 percent, from \$43.0 million in the six months ended June 30, 2005, to \$47.4 million in the six months ended June 30, 2006. Revenue per employee declined by 7.6 percent, from \$77,617 in the first half of 2005 to \$71,746 in the first half of 2006. The decline in revenue per employee was primarily due to a 19.1 percent increase in the average number of employees, from 554.5 in the first six months of 2005 to 660.2 in the first six months of 2006, and to two enterprise license sales that were expected to contribute \$2.5 million in license revenue that did not close in the second quarter of 2006. Of the total \$47.4 million in revenue in the first six months of 2006, \$24.9 million was recognized in the first quarter, and \$22.4 million in the second quarter, with the decline in sequential revenue primarily attributable to a \$3.0 million decline in license revenue.

License revenue increased by \$0.3 million, or 2.7 percent, from \$10.9 million in the first half of 2005 to \$11.2 million in the first half of 2006. New clients in the first half of 2006 included five large retailers, a financial services firm, a municipal government, a global staffing organization, and a global media and entertainment company.

Service, maintenance, and other revenue increased by \$4.0 million, or 12.6 percent, from \$32.2 million in the six months ended June 30, 2005, to \$36.2 million in the six months ended June 30, 2006. Professional services revenue increased by \$3.2 million, or 12.6 percent, from \$25.2 million in the first half of 2005 to \$28.4 million in the first half of 2006; and maintenance revenue increased by \$1.8 million, from \$4.2 million in the first half of 2005 to \$6.0 million in the first half of 2006. These increases were partially offset by a \$1.0 million decline in other revenue, primarily revenue from the sale of hardware. Professional services revenue per professional services employee declined by 0.1 percent, from \$83,536 in the first half of 2005 to \$83,411 in the first half of 2006.

Total Cost of Revenue

Cost of revenue increased by \$2.9 million, or 12.2 percent, from \$23.5 million in the first half of 2005 to \$26.4 million in the first half of 2006. This increase was primarily attributable to increased professional services costs, including \$0.4 million in employee severance charges incurred in the second quarter of 2006. Of the total \$26.4 million in costs in the first six months of 2006, \$13.2 million was incurred in each quarter

Cost of license revenue increased from \$0.3 million in the first half of 2005 to \$0.7 million in the first half of 2006. This increase was attributable to increased royalties resulting from increased sales of third party software products, primarily in the first quarter of 2006.

Cost of service, maintenance, and other revenue increased \$2.5 million, or 10.9 percent, from \$23.2 million in the first half of 2005 to \$25.7 million in the first half of 2006. For the first six months, the total services, maintenance and other revenues contribution margin was \$10.5 million, up from \$8.9 million in the first half of 2005; and the margin percentage increased to 28.9 percent from 27.8 percent. Professional services costs increased \$2.8 million, or 13.9 percent, from \$20.4 million in the first half of 2005 to \$23.3 million. This increase was primarily due to a 12.8 percent increase in the average number of professional services employees (from 301.7 to 340.4), increased variable compensation expense, and employee severance charges incurred in the second quarter of 2006. The professional services contribution margin increased from \$4.8 million in the first half of 2005 to \$5.1 million in the first half of 2006; however, the professional services margin percentage declined from 19.0 percent to 18.1 percent as increased revenues were offset by increased costs. Maintenance costs increased from \$0.9 million to \$1.1 million, and the maintenance contribution margin increased from \$3.3 million in the first half of 2005 to \$5.0 million in the first half of 2006. The maintenance margin percentage increased from 79.4 percent in the first half of 2005 to 82.0 percent in the first half of 2006. Other costs, primarily composed of hardware costs, declined from \$1.9 million in the first half of 2005 to \$1.5 million in the first half of 2006, primarily as a result of the decline in hardware sales.

Gross profit increased by \$1.5 million, to \$21.0 million, compared to \$19.5 million in the corresponding period last year; however, the gross margin percentage declined from 45.3 percent to 44.3 percent as increased revenues were offset by increased costs, including employee severance charges of \$0.4 million in the second quarter of 2006.

Operating Expenses

Operating expenses increased by \$4.7 million, or 24.7 percent, from \$19.1 million in the first half of 2005 to \$23.8 million in the first half of 2006. Of the total increase in operating expenses, \$2.0 million was attributable to increased research and development expenses, \$1.3 million was due to increased sales and marketing expenses, and \$0.9 million was attributable to an increase in the allowance for doubtful accounts based on a review of accounts receivable at June 30, 2006. Of the total \$23.8 million in operating expenses in the first six months of 2006, \$11.8 million was incurred in the first quarter, and \$12.0 million was incurred in the second quarter. The \$0.2 million sequential increase in operating expenses was primarily attributable to a \$0.9 million charge to increase the provision for doubtful accounts in the second quarter, and a \$0.3 million increase in other general and administrative expenses, which were offset by a sequential \$0.6 million reduction in sales and marketing expenses and a \$0.4 million reduction in research and development expenses.

Sales and marketing expenses increased \$1.3 million, or 15.6 percent, from \$8.5 million in the first half of 2005 to \$9.9 million in the first half of 2006. This increase was primarily attributable to increased personnel expenses as a result of an 18.6 percent increase in the average number of sales and marketing employees (from 73.7 to 87.4) and to increased sales commissions associated with increased revenue. These increases were partially offset by a reduction in marketing expenses associated with Workbrain's annual user conference, which in 2006 is scheduled for the fourth quarter but in 2005 was held in the

second quarter. Sales and marketing expenses are expected to continue to grow, in line with revenue growth, through the second half of 2006.

Research and development expenses increased by \$2.0 million, or 32.2 percent, from \$6.3 million in the first half of 2005 to \$8.3 million in the first half of 2006. The increase in research and development expenses is primarily attributable to a 29.2 percent increase in the average number of research and development employees and associated non-personnel costs. The average number of research and development employees grew to 183.0 in the first half of 2006, compared to 141.7 in the first half of 2005. This increase reflects investments in product enhancements and additional functionality. Research and development expenses are expected to grow at a slower rate through the second half of 2006. All research and development expenses through the first half of 2006 have been expensed as incurred.

General and administrative expenses increased by \$1.6 million, from \$3.6 million in the first half of 2005 to \$5.2 million in the first half of 2006. The increase in general and administrative expenses was primarily due to an increase in the average number of administrative and financial employees, from 37.5 in the first half of 2005 to 49.5 in the first half of 2006, and a \$0.9 million charge in the second quarter of 2006 to increase the Company's allowance for doubtful accounts.

Amortization of acquisition-related intangibles was \$45 thousand in the first half of 2006, compared to \$122 thousand in the first half of 2005. This expense related to Workbrain's acquisition of the net operating assets of Workforce Logistics Inc. in April 2003, which enhanced Workbrain's existing workforce management solution with additional schedule optimization functionality. As of June 30, 2006, these acquisition-related intangibles have been fully amortized.

Amortization of stock-based compensation was \$455 thousand in the first half of 2006, compared to \$600 thousand in the first half of 2005. The reduction in stock-based compensation expense was due to the discontinuation, during 2004, of the Company's previous practice of granting stock options to every new employee.

Interest income was \$826 thousand in the first half of 2006, compared to \$626 thousand in the first half of 2005. The increase in interest income was attributable to higher interest rates and interest-earning cash balances.

Net income (loss). Workbrain incurred a net loss of \$(2.0) million, or a loss of \$(0.11) per share, in the first half of 2006, compared to net income of \$1.0 million, or \$0.05 per share, in the first half of 2005. The net loss in the first half of 2006 was primarily attributable to two enterprise license sales that were expected to contribute approximately \$2.5 million in license revenue, which did not close in the first half. In addition, costs and operating expenses were adversely affected by a charge of \$0.9 million to increase the allowance for doubtful accounts and severance charges of \$0.5 million.

Adjusted net income (loss) is a non-GAAP measure related to net income and has been defined as net income excluding foreign exchange gains and losses, stock-based compensation charges, and the amortization of acquisition-related intangibles. The Company has historically reported this measure to enhance an overall understanding of 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. Moreover, Workbrain's 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. Workbrain incurred an adjusted net loss of \$(3.3) million in the second quarter of 2006, compared to adjusted net income of \$0.8 million in the second quarter of 2005. For the first half of 2006, Workbrain incurred an adjusted net loss of \$(2.8) million, compared to adjusted net income of \$1.8 million in the first half of 2005.

| | 3 months ending | | 6 months ending | |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
| | Jun 30, 2006 | Jun 30, 2005 | Jun 30, 2006 | Jun 30, 2005 |
| Net Income (loss) | \$ (2,327) | \$ 162 | \$ (2,020) | \$ 957 |
| Add back: | | | 0 | |
| Foreign exchange (gain)/loss | (1,243) | 297 | (1,293) | 132 |
| Amortization of Stock-based compensation | 253 | 320 | 455 | 600 |
| Amortization of acquisition - related intangibles | 11 | 48 | 45 | 122 |
| Adjusted Net Income | <u>\$ (3,306)</u> | <u>\$ 827</u> | <u>\$ (2,813)</u> | <u>\$ 1,811</u> |

Foreign exchange. In addition to a U.S. dollar denominated treasury, the Company maintains a Canadian dollar denominated treasury to fund research and development and other Canadian dollar denominated expenditures. As a result, the Company is subject to gains and losses due to fluctuations in exchange rates, primarily between the U.S. and Canadian dollars. Workbrain recorded net foreign exchange gains of approximately \$1.2 million for the second quarter of 2006 and \$1.3 million for the first half of 2006, which were primarily a result of the appreciation in the value of the Canadian dollar relative to the U.S. dollar during these periods. Last year Workbrain recorded a net foreign exchange loss of \$(0.3) million for the second quarter and a loss \$(0.1) million for the first half of 2005.

Liquidity and Capital Resources

At the end of the second quarter of 2006, cash and cash equivalents totaled \$38.5 million, compared to \$39.3 million at the end of the first quarter of 2006, \$16.6 million at the end of 2005, and \$41.2 million at the end of the second quarter of 2005. Including short-term investments, cash, cash equivalents and short-term investments totaled \$47.7 million at the end of the second quarter, compared to \$46.7 million at the end of the first quarter of 2006, \$49.1 million at the end of 2005, and \$49.2 million at the end of the second quarter of 2005.

Cash provided by operating activities, including the effect of changes in non-cash working capital, was \$1.0 million in the second quarter of 2006, compared to cash used for operating activities of \$1.4 million in the second quarter of 2005. For the first half of 2006 cash used for operating activities was \$0.8 million, compared to cash used for operating activities of \$1.0 million in the first half of 2005. Excluding changes in non-cash working capital, cash used for operating activities was \$2.4 million in the second quarter of 2006, compared to cash provided by operating activities of \$1.6 million in the corresponding period last year. This \$4.0 million decline was primarily due to the decline in operating results, from net income of \$0.2 million in the second quarter of 2005 to a net loss of \$(2.3) million in the second quarter of 2006. For the first half of 2006, cash used for operating activities, excluding changes in non-cash working capital, was \$1.0 million, compared to cash provided by operating activities of \$3.4 million in the first half of 2005. This \$4.4 million decline was primarily due to the decline in operating results, from net income of \$1.0 million in the first half of 2005 to a net loss of \$(2.0) million in the first half of 2006. Cash flow from operating activities, due to changes in non-cash working capital increased by \$3.4 million in the second quarter of 2006, primarily as a result of a \$2.4 million increase in accrued payroll expenses, a \$1.0 million reduction in accrued revenue, a \$0.7 million increase in deferred revenue and a \$0.4 million reduction in accounts receivable, which were partially offset by a \$1.1 million reduction in accounts payable. In the corresponding period last year, cash flow from operating activities due to changes in non-cash working capital declined by \$3.0 million, primarily as a result of a \$4.5 million increase in accounts receivable and a \$1.4 million increase in accrued revenue, which were partially offset by a \$1.8 million increase in accrued payroll and a \$1.2 million increase in deferred revenue. For the first half of 2006, cash flow from operating activities due to changes in non-cash working capital increased by \$0.2 million, primarily as a result of a \$1.1 million increase in accrued payroll and a \$1.1 million increase in accounts payable, which were partially offset by a \$0.4 million decline in deferred revenue, a \$0.9 million increase in accrued revenue, a \$0.6 million reduction in accrued liabilities, and a \$0.1 million combined increase in accounts receivable

and other assets. For the first half of 2005, cash flow from operating activities due to changes in non-cash working capital declined by \$4.4 million, primarily as a result of a \$5.7 million increase in accounts receivable, a \$1.5 million increase in accrued revenue and a \$0.7 million increase in other assets, which were partially offset by a \$1.5 million increase in accounts payable, a \$1.3 million increase in deferred revenue, and a \$0.8 million increase in other accrued liabilities.

Cash flows from investing activities were attributable to short-term investments and expenditures for property and equipment. Net cash used for investing activities totaled \$2.7 million in the second quarter of 2006, as the balance in short-term investments increased by \$1.9 million and investment in expenditures for property and equipment was \$0.8 million. In the comparable period last year, net cash inflows from investing activities totaled \$6.3 million and were attributable to \$7.0 million in net proceeds from the maturity of short-term investments, which were partially offset by \$0.7 million in property and equipment expenditures. For the first half of 2006, net cash provided by investing activities totaled \$21.9 million as \$23.2 million in net proceeds from the maturity of short-term investments were partially offset by \$1.3 million in property and equipment expenditures. In the first half of 2005, net cash provided by investing activities totaled \$11.4 million and were attributable to \$12.9 million in net proceeds from short-term investments, which were partially offset by \$1.5 million in property and equipment expenditures. Workbrain's investment in property and equipment is expected to continue to increase as the employee base continues to grow.

Net cash used by financing activities was \$0.6 million in the second quarter of 2006, which was due to \$0.7 million in repayment of capital lease obligations, partially offset by \$0.1 million in proceeds from the issuance of common shares on exercise of stock options. In the comparable period last year, net cash provided by financing activities was \$0.5 million, which reflects \$0.3 million in proceeds from the issuance of common shares on exercise of stock options and \$0.2 million in net proceeds from the sale and leaseback of property and equipment. In the first half of 2006, net cash used in financing activities was \$0.6 million, which was due to \$0.8 million in net lease repayments, partially offset by \$0.2 million in proceeds from the issuance of common shares on exercise of stock options. In the first half of 2005, net cash provided by financing activities was \$1.1 million and was primarily due to \$0.7 million in proceeds from the issuance of common shares on exercise of stock options and \$0.4 million in net proceeds from the sale and leaseback of property and equipment. During 2004, the Company 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 (CA\$8.3 million). At June 30, 2006, a total of \$3.7 million had been advanced to the Company through transactions under the line of credit at fixed rates of interest between 6 percent and 7 percent for terms ranging from 24 to 36 months. Capital lease obligations have been secured by the equipment that has been financed. In addition to this lease line of credit, the Company has also entered into other lending agreements to finance the acquisition of other assets. In the second quarter of 2006, the practice of selling and leasing back new property and equipment has been discontinued.

Workbrain's management believes that current cash and short-term investments and anticipated cash flow from operations will be sufficient to meet the Company's working capital and capital expenditure requirements for the foreseeable future. There are no present agreements or commitments with respect to any prospective acquisition or investment; however, the Company continually reviews opportunities to make strategic acquisitions to add functionality to its product offerings, to increase its distribution channels, to expand its market opportunities, and to broaden its client base. The Company's cash position could be significantly reduced if a significant acquisition were funded partly or wholly with cash.

Accounts receivable, net of an allowance for doubtful accounts, at the end of the second quarter of 2006 totaled \$19.2 million, compared to \$19.7 million at the end of the first quarter of 2006 and \$19.1 million at the end of 2005. Expressed in terms of "days sales outstanding" (DSO), based on revenue for the preceding 12 months, the accounts receivable balance at the end of the second quarter of 2006 was equivalent to 75 days of sales, compared to 77 days at the end of the first quarter and 79 days at the end of 2005. Based on a review of accounts as of June 30, 2006, the allowance for doubtful accounts was increased from \$0.5 million at December 31, 2005, to \$1.4 million.

Accrued revenue is composed of fees that have been recognized as revenue but have not yet been billed. At the end of the second quarter of 2006, accrued revenue totaled \$4.1 million, as compared to \$5.2 million at the end of the first quarter and \$3.2 million at the end of 2005.

Other current assets, composed primarily of deposits and prepaid items, totaled \$3.8 million at June 30, 2006, compared to \$4.1 million at March 31, 2006, and \$3.6 million at December 31, 2005. Compared to the balance at the end of the first quarter of 2006, the \$0.3 million decline in other assets was primarily attributable to a decline in prepaid commissions. Compared to the balance at the end of 2005, the \$0.2 million increase in other current assets was primarily due to the net effect of a \$0.7 million increase in deposits and prepaid items, which was partially offset by a \$0.3 million decline in taxes recoverable and a \$0.3 million decline in accrued interest.

Deferred revenue is composed of deferred maintenance and support revenues, which are recognized ratably over the term of the related maintenance agreement, which is normally one year; deferred professional services revenue, which is recognized as such services are performed; and deferred license revenue, which is recognized on a contract-accounting basis as related services are performed. Deferred license revenue arises because many of the Company's arrangements with customers have involved services that have been determined to be essential to the functionality of the software, and revenue from such arrangements has been recognized under contract accounting using the percentage of completion method to measure progress toward completion. Total deferred revenue was \$11.8 million at the end of the second quarter of 2006, compared to \$11.1 million at the end of the first quarter and \$12.2 million at the end of 2005. Compared to the balance at the end of the first quarter, the \$0.7 million increase in total deferred revenue was due to the net effect of a \$0.9 million increase in deferred maintenance revenue and a \$0.4 million increase in deferred professional services revenue, primarily attributable to deferred implementation revenue, which were partially offset by a \$0.6 million decline in deferred license revenue. Compared to the balance at the end of 2005, the \$0.4 million decline in total deferred revenue was due to the net effect of a \$1.6 million decline in deferred license revenue, which was partially offset by a \$0.9 million increase in deferred maintenance revenue and a \$0.3 million increase in deferred professional services revenue. License revenue in general, and the proportion of license revenue recognized that is deferred and recognized on a contract accounting basis in particular, can fluctuate substantially from quarter to quarter. However, as additional functionality has been incorporated into Workbrain's core software products and as the Company has successfully pursued more packaged implementation services and sales through third-party service providers, the proportion of license revenue deferred and recognized on a contract accounting basis has declined. As shown in the table below, which details the components of deferred revenue at the end of each of the eight quarters ended June 30, 2006, deferred license revenue has declined by 57.0 percent, from \$8.7 million at the end of 2004 to \$3.7 million. During the same period, as the number of customers deploying Workbrain solutions has increased, deferred maintenance revenue has increased by 70.3 percent, or \$2.6 million from \$3.8 million at the end of 2004 to \$6.4 million at the end of the second quarter of 2006.

Components of Deferred Revenues at Quarter End

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

| | Quarters Ended | | | | | | | |
|--------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 2006 | | 2005 | | | | 2004 | |
| | Jun 30, 2006 | Mar 31, 2006 | Dec 31, 2005 | Sep 30, 2005 | Jun 30, 2005 | Mar 31, 2005 | Dec 31, 2004 | Sep 30, 2004 |
| Deferred revenue: | | | | | | | | |
| Licenses | \$ 3,725 | \$ 4,335 | \$ 5,296 | \$ 5,048 | \$ 7,802 | \$ 7,921 | \$ 8,671 | \$ 7,681 |
| Maintenance | 6,390 | 5,518 | 5,490 | 5,752 | 5,330 | 4,262 | 3,753 | 2,818 |
| Professional Services | 1,642 | 1,207 | 1,380 | 1,268 | 977 | 714 | 428 | 123 |
| Total deferred revenue | \$ 11,757 | \$ 11,060 | \$ 12,166 | \$ 12,068 | \$ 14,109 | \$ 12,897 | \$ 12,852 | \$ 10,622 |

Other current liabilities, in aggregate, were \$13.9 million at the end of the second quarter of 2006, compared to \$13.0 million at the end of the first quarter, and \$12.0 million at the end of 2005. Compared to the balance at the end of the first quarter of 2006, the \$0.9 million increase in other current liabilities was primarily due to the net effect of a \$2.4 million increase in accrued payroll expenses which was partially offset by a \$1.1 million reduction in accounts payable, and a net \$0.4 million reduction in other items. The increase in accrued payroll expenses relative to the end of the first quarter was due, in part, to accruals for variable compensation, which is paid semi-annually, and to the fact that the last day of the first quarter coincided with the end of a bi-weekly pay period, whereas the last day of the second quarter did not. Compared to the balance at the end of 2005, the \$1.9 million increase in other current liabilities was primarily due to the net effect of a \$1.1 million increase in accrued payroll expenses and a \$1.1 million increase in accounts payable, which were partially offset by a net \$0.3 million reduction in other items.

Commitments and Contingencies

The Company does not have derivative financial instruments or any equity interests in unconsolidated companies or any other business arrangements related to the foregoing that would have a material effect on the assets and liabilities of the Company at June 30, 2006.

As disclosed in note 6 to the 2006 interim financial statements and in accordance with Canadian GAAP, the Company has commitments that are not reflected in the balance sheet of the Company. These commitments, which are composed primarily of capital equipment lease obligations and future minimum lease payments under non-cancelable operating leases related to our premises, totaled \$4.7 million at June 30, 2006. The Company does not have any other business arrangements, derivative financial instruments, or any equity interests in unconsolidated companies that would have a material effect on the assets and liabilities of the Company at June 30, 2006.

The Company, in the normal course of business, is subject to legal proceedings being brought against it. While management currently believes that the amount of ultimate liability, if any, with respect to these proceedings will not materially affect the Company's financial position, results of operations, or liquidity, the ultimate outcome of any litigation is uncertain. Were an unfavorable outcome to occur, the impact could be material. Management does not believe that it is probable that a liability has been incurred, nor does management believe that the amount of any loss can be reasonably estimated. Accordingly, no liability has been accrued for these matters.

Related Party Transactions

Workbrain has in the normal course of business engaged the services of a law firm, a partner of which is a director of Workbrain and a relative of Workbrain's Chief Executive Officer. Fees charged by that law firm include a fixed monthly fee of \$10 thousand for the ongoing advice and legal services provided by such party and fees for the services of other lawyers at the law firm based on the same hourly rates charged to unrelated parties. During the six months ended June 30, 2006, the expenses incurred by Workbrain from such law firm for services totaled approximately \$69 thousand. In the corresponding period last year, these expenses totaled \$59 thousand.

Outstanding Share Data

As at June 30, 2006, there were 17,781,945 common shares issued and outstanding. In addition, a total of 1,238,770 stock options and 37,596 warrants were outstanding, which are exercisable for an equal number of common shares.

SELECTED CONSOLIDATED QUARTERLY FINANCIAL INFORMATION

The following table sets out unaudited selected consolidated financial information for each of the eight quarters ended June 30, 2006. In the opinion of management, this information has been presented on the same basis as Workbrain's interim consolidated financial statements and the audited annual consolidated financial statements appearing in Workbrain's annual report, and includes all necessary adjustments, consisting only of normal recurring adjustments, to present fairly the unaudited quarterly results when read in conjunction with Workbrain's interim consolidated financial statements and the notes thereto and Workbrain's 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 | |
| | Jun 30, 2006 | Mar 31, 2006 | Dec 31, 2005 | Sep 30, 2005 | Jun 30, 2005 | Mar 31, 2005 | Dec 31, 2004 | Sep 30, 2004 |
| (Amounts In U.S. Dollars, In Thousands, Except Per Share Data, Unaudited) | | | | | | | | |
| Consolidated Statement of Operations Data: | | | | | | | | |
| Revenue: | | | | | | | | |
| Licence | \$ 4,102 | \$ 7,073 | \$ 6,735 | \$ 5,443 | \$ 5,762 | \$ 5,123 | \$ 4,368 | \$ 4,140 |
| Service, maintenance and other | 18,323 | 17,868 | 17,114 | 16,411 | 16,302 | 15,852 | 13,426 | 11,867 |
| Total revenue | <u>22,425</u> | <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> |
| Cost of revenue: | | | | | | | | |
| Licence | 253 | 398 | 257 | 115 | 216 | 95 | 95 | 7 |
| Service, maintenance and other | 12,937 | 12,803 | 12,871 | 11,556 | 11,939 | 11,282 | 8,679 | 7,752 |
| Total cost of revenue | <u>13,190</u> | <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> |
| Gross profit | <u>9,235</u> | <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> |
| Gross margin (%) | 41.2% | 47.1% | 45.0% | 46.6% | 44.9% | 45.8% | 50.7% | 51.5% |
| Operating expenses: | | | | | | | | |
| Sales and marketing | 4,621 | 5,248 | 4,642 | 3,852 | 4,555 | 3,984 | 4,178 | 3,229 |
| Research and development | 3,961 | 4,333 | 3,630 | 3,352 | 3,316 | 2,956 | 2,669 | 2,262 |
| General and administrative | 3,158 | 2,000 | 2,160 | 1,348 | 1,818 | 1,750 | 1,562 | 1,275 |
| Amortization of acquisition-related intangibles | 11 | 34 | 34 | 34 | 48 | 74 | 75 | 75 |
| Amortization of stock-based compensation | 253 | 202 | 97 | 310 | 320 | 280 | 320 | 368 |
| Total operating expenses | <u>12,004</u> | <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> |
| Income (loss) from operations | <u>(2,769)</u> | <u>(77)</u> | <u>158</u> | <u>1,287</u> | <u>(148)</u> | <u>554</u> | <u>216</u> | <u>1,039</u> |
| Interest income, net | 442 | 384 | 329 | 305 | 310 | 316 | 221 | 204 |
| Income (loss) before provision for income taxes | <u>(2,327)</u> | <u>307</u> | <u>487</u> | <u>1,592</u> | <u>162</u> | <u>870</u> | <u>437</u> | <u>1,243</u> |
| Provision for income taxes | - | - | - | - | - | 75 | - | - |
| Net income (loss) | <u>\$ (2,327)</u> | <u>\$ 307</u> | <u>\$ 487</u> | <u>\$ 1,592</u> | <u>\$ 162</u> | <u>\$ 795</u> | <u>\$ 437</u> | <u>\$ 1,243</u> |
| Net income (loss) per share: | | | | | | | | |
| Basic | <u>\$ (0.13)</u> | <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> |
| Basic weighted average number of common shares outstanding | <u>17,764</u> | <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> |
| Diluted | | | | | | | | |
| Diluted | <u>\$ (0.13)</u> | <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> |
| Diluted weighted average number of common shares outstanding | <u>17,764</u> | <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> |