

10145 Pacific Heights Blvd.  
9th Floor  
San Diego, CA 92121  
**P (858) 450 9009**  
F (858) 450 9929  
**www.bakbone.com**



September, 2000

Dear BakBone Shareholder:

This letter is meant to serve as an introduction to our first annual report. In one sense, the term “annual report” is a misnomer: the financial results you’ll see reported here only cover one and a half months as a publicly-traded company, to the end of our old fiscal year on April 30<sup>th</sup>, 2000. In another sense, however, this letter and this report will give you a clear indication of the years of work that have gone into getting BakBone to this point, and the results we believe we’ll be able to report over the next year.

For example, as you’ll see in the table immediately following this letter, combined revenues from our NetVault and Tracer divisions for the period ending March 31<sup>st</sup>, 2000 add up to almost CDN\$10 million on a pro forma basis. We would remind you that these numbers are unaudited. They do, however, serve as an indicator of the financial performance of the companies which were acquired, and which make up today’s BakBone Software.

Our most important achievement has been the North American launch of NetVault, which took place at the end of July. It was warmly received, and garnered favorable notice from both industry analysts and reporters. For instance, David Hill of the Aberdeen Group said, “NetVault simplifies implementation, reconfiguration and troubleshooting and therefore can become one of the IS administrator’s best friends.” Federal Computer Week called NetVault “one of the top choices to safeguard (corporate) information.” And Dow Jones News Service ran a story about us, headlined, “BakBone A ‘Real Player’ In Data Storage.” We have implemented an aggressive public relations program that we believe will achieve more articles of this sort. It’s the kind of recognition that directly leads to increased sales.

In addition, we are also completing the global integration of BakBone facilities located in the United States, the United Kingdom and Japan. Each facility plays a crucial role in our company. The United Kingdom, for example, is home to our European research and development team. They are the men and women who, three years ago, foresaw the changing data storage needs of companies in the e-business environment, and who made the crucial decision to re-architect NetVault<sup>TM</sup> storage management software, which they had been regularly upgrading since its initial development at the Bell Laboratories.

That re-architecture took three years to complete, and has been highly successful. Today’s NetVault is modular in design, and features unparalleled ease of use throughout the entire product life cycle, from installation and operation, through scalability and support. And it clearly places NetVault at the forefront of products in the storage management software market. Today, our global team is continuing its work to make a great product even greater. We expect to report several significant product improvements over the next year, which will further heighten NetVault’s technical advantage over our competition.

The demand for NetVault, and products like it, continues to skyrocket. Industry analyst Dataquest reports that the market for backup/restore software is expected to grow from US\$1.4 billion in 1999 to US\$5.7 billion by 2004.

Our Japanese office has recently moved into larger facilities, designed to support its growing importance to the company. Japan is where the re-architected NetVault was first introduced to the reseller market. Our resellers were very impressed with what they saw, and we incorporated their suggestions to further improve the software and its level of quality and scalability. Today, NetVault is the backup solution of choice among more than half of Japan's largest storage resellers and systems integrators.

Our decision to adopt a channel-centric strategy, in Japan and now in North America, is a crucial factor in our anticipated growth. Storage resellers already have existing relationships with their customers, and understand their current and anticipated needs. Industry analyst IDC projects that much of the growth in the market for storage area networks (SANs), where NetVault excels, will be driven by resellers over the next three to five years. We intend to partner with key resellers worldwide, and leverage their relationships in a mutually beneficial manner. To date, we have obtained commitments from more than two dozen top resellers in North America; and we forecast more will follow.

In June 2000, BakBone completed its acquisition of Tracer Technologies, based in Lanham, Maryland. We regard Tracer as a key asset in BakBone's future; its MagnaVault™ is a market leader in file systems and device drivers for optical storage systems, with customers ranging from global financial institutions to major agencies of the United States Government. We expect to integrate much of Tracer's technological advantage into our other products over the coming year. (Please note that the audited numbers in this report do not include Tracer's results of operations, as the company was acquired subsequent to BakBone's fiscal year end.)

Finally, we opened our corporate headquarters in San Diego in May of this year. It features our world-class SAN Interoperability Lab, where we can test the abilities of a wide range of hardware products to work together. One of the biggest questions regarding the widespread adoption of SANs has been interoperability; we intend to position ourselves as a leader in this area, as a way of further establishing BakBone's understanding of and leadership in the SAN marketplace.

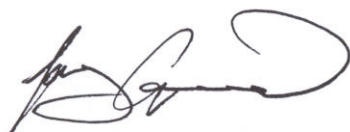
Taken together, all four offices (UK, Japan, Lanham, San Diego) provide the basis for our "follow-the-sun" commitment to our customers; we have installed a globally-integrated customer care system that will enable customers to contact a BakBone technical expert, real-time, regardless of where they are, regardless of when they call. We have committed to building a world-class organization, and world-class support is an essential part of that equation.

We're already seeing our efforts pay off: many industry analysts who focus on storage have commented favorably on both BakBone and NetVault. Reporters for outlets such as Dow Jones News Service, Bloomberg, The Wall Street Transcript, InformationWeek, Federal Computer Week, Network World, Computer Technology Review and more have written about us.

We believe the results of our efforts will be a company that steadily grows in size, revenue, profitability and market share. We will continue to work to make BakBone the kind of company that delivers strategic long-term shareholder value.

Thank you for your support. We look forward to growing BakBone with you.

Sincerely,



Tony Cerquiera  
Chief Executive Officer

Archie Nesbitt  
Chairman

**Unaudited Pro Forma Selected Consolidated Financial Information  
For the Year Ended March 31, 2000  
(000s Canadian dollars)**

	BakBone Software Consolidated (a)	Tracer Technologies	Pro Forma Adjustments (b)	Pro Forma
Revenues	4,425	5,473	-	9,898
Gross margin	3,277	5,330	-	8,607
Operating expenses	3,894	5,073	-	8,967
Net earnings (loss)	(578)	169	(3,010)	(3,419)
Cash and cash equivalents	31,277	1,310	(3,265)	29,322
Total assets	37,438	2,365	5,766	45,569
Total liabilities	2,038	1,832	-	3,870
Shareholders' equity	35,400	534	5,766	41,700

(a) Includes the results of operations of the predecessor Net Resources Inc. and the businesses acquired in March 2000: NetVault Holdings Limited (UK) and NetVault Corporation K.K. (Japan)

(b) Adjustments reflect the goodwill and related amortization from the Tracer Technologies acquisition.

The financial information above was prepared in accordance with Canadian generally accepted accounting principles. For additional information please refer to the Unaudited Pro Forma Consolidated Financial Statements for the Year Ended March 31, 2000 included in the Company's Prospectus dated July 12, 2000.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes included in this Annual Report. All statements have been prepared in accordance with accounting principles generally accepted in Canada and are expressed in Canadian dollars unless otherwise indicated. The following information contains forward-looking statements involving uncertainty and risk, and all assumptions, anticipations, and expectations stated herein are forward-looking statements. The actual results of the Company may differ materially from any forward-looking statements made herein due to such risks and uncertainties. The Company undertakes no obligation to revise any forward-looking statements to reflect events or circumstances that may arise after the date of this report.

### **OVERVIEW**

BakBone Software Incorporated (“BakBone” or the “Company”) is an international storage management software solutions company with offices in the United States, United Kingdom, Japan, and Canada. The Company develops and globally distributes storage management software solutions to the open systems markets, providing data protection and management solutions scalable from office to enterprise that will grow with a company’s needs. BakBone’s NetVault™ software products are designed to provide a robust data protection and recovery solution to meet the challenges of today’s computing infrastructures. NetVault’s comprehensive but easy to use features include versatile modular design, SAN LAN free support and specialized on-line application backup. Customers include major server OEMs and storage-centric value added resellers and distributors worldwide.

The Company was originally incorporated under the Company Act (British Columbia) through the amalgamation of Canu Resources Ltd. and Ican Resources Ltd. and operated under the name Ican Minerals Ltd. In November 1992 the Company continued from the Province of British Columbia to the Province of Alberta and, effective December 1998, changed its name to Net Resources Incorporated (“Net Resources”). By Articles of Amendment filed on March 13, 2000, the Company changed its name to BakBone Software Incorporated.

In December of 1999, the Company entered into each of the NVS Holdings (“NVS”) Agreement, NetVault Holdings Limited (“NVHL”) Agreement and NetVault K.K. Agreement, collectively referred to as the “NetVault Acquisition”, pursuant to which it agreed to acquire, directly or indirectly, all of the business and assets of each of NVS and NetVault Holdings and an aggregate of 47% of the outstanding equity in NetVault K.K. The closing of the NetVault Acquisition occurred on March 16, 2000. The consideration paid in respect of the NetVault Acquisition consisted of US\$3.1 million and an aggregate of 13,900,000 common shares. In addition, the Company allocated a further aggregate of 2,100,000 common shares to an employee benefit trust established for the benefit of certain employees and principals involved in the acquired companies with a view to ensuring such individuals’ continued involvement with the operation and affairs of BakBone.

On June 9, 2000, the Company acquired all of the issued and outstanding common shares of Tracer Technologies, Inc. (“Tracer”) in exchange for cash of US\$2.2 million and 600,000 Common Shares. Tracer’s business is the development, manufacture and sale of jukebox storage system software for Unix and Linux operating systems. With high-performance storage management software for rewritable and write-once optical, CD-ROM/CD-R, DVD, and tape storage peripherals, Tracer’s software products have been installed at more than 15,000 customer sites in over 70 countries. The acquisition will be accounted for using the purchase method of accounting.

## RESULTS OF OPERATIONS

The acquisition of NVS by the Company resulted in a reverse takeover for accounting purposes and the historical financial statements are considered to be the continuation of the legal subsidiary, NVS. NVS was formed as a special purpose vehicle to effect the NetVault Acquisition and essentially had no results of operations since its inception in December 1998. As such, the Company effectively commenced operations in March 2000 after the close of the NetVault Acquisition. The previous operating loss and accumulated deficit of the Company up to the NetVault Acquisition date were eliminated upon application of reverse takeover accounting. The financial statements included in the Annual Report are the consolidated balance sheet as of April 30, 2000 and the consolidated statements of operations and cash flows for the year ended April 30, 2000. Due to the nature of the reverse acquisition with NVS as previously described, there were effectively no comparative prior year operating results to be discussed in relation to the financial statements herein. Due to the Company's limited operating history the results of operations should not be relied upon as an indication of future performance.

The acquisition of NVHL, which closed on March 16, 2000, was accounted for using the purchase method of accounting. Accordingly, the operating results of NVHL have been included in the consolidated financial statements of the Company from the date of acquisition. The operating results of NetVault K.K. are included in the consolidated financial statements as both the Company and NetVault K.K. were under common control from the date of acquisition.

The Company's revenues consist of software licensing and maintenance revenues. Licensing revenues are recognized provided that a non-cancelable license agreement has been signed, the software and related documentation have been shipped, there are no material uncertainties regarding customer acceptance, collection of the resulting receivable is deemed probable, and no other significant vendor obligations exist. Maintenance revenues are deferred and recognized over the related contract period. Revenues for the year ended April 30, 2000 were \$483,000, the majority of which related to licensing sales to the Japanese and European markets of \$347,000 and \$136,000, respectively. Costs of revenues for the period were \$51,000, which consisted of packaging and shipping costs for software sales and costs associated with technical support in Japan and Europe.

Operating expenses have increased significantly since the NetVault Acquisition, and the rate of this increase has accelerated with the expansion of the North American operations. These increases are primarily due to additions to staffing as the Company has expanded all aspects of the operations. Operating expenses for the year ended April 30, 2000 totaled \$1.8 million consisting of sales and marketing, product development, and administration costs. Such costs were primarily for general and administrative expenses consisting of personnel and other costs of finance, human resources, facilities and information systems incurred in the North American operations in the amount of \$1.3 million for the period. In the future, operating expenses are expected to increase primarily as a result of planned increased revenues and the continued expansion of operations, infrastructure, and personnel worldwide. The net loss for the period was \$1.3 million.

## **LIQUIDITY AND CAPITAL RESOURCES**

Since inception, the Company has financed its operations primarily through private placements of warrants and common stock. On March 16, 2000, the Company raised gross proceeds of \$38,700,000 through the private placement of 6,000,000 Series A Special Warrants and 3,000,000 Series B Special Warrants at prices of \$1.50 and \$9.90, respectively, for net proceeds of \$35,630,000. Each Special A Warrant is exercisable, without additional payment, into one common share and one-half of one Series A Warrant. Each Special B Warrant is exercisable, without additional payment, into 1.1 common shares and 0.55 Series B Warrants. Each full Series A Warrant and Series B Warrant entitles the holder to purchase one common share of the Company at a price of \$1.80 and \$15.00, respectively, per common share from the closing of the private placement until the one-year expiry date.

Net cash used in operating activities for the year ended April 30, 2000 was \$881,000 which was primarily attributable to a net loss of \$1.3 million and a decrease in accounts payable of \$287,000, offset by an increase in accrued liabilities of \$596,000. Cash used in investing activities of \$4.6 million consisted of \$4.3 million for the NetVault Acquisition (net of cash acquired), which closed on March 16, 2000, and capital expenditures of \$318,000. Cash flows from financing activities of \$36.1 million, net of financing costs, resulted from the Series A and Series B Special Warrants financing previously described, in addition to proceeds from warrants and stock options exercised of \$495,000.

As of April 30, 2000, the Company had \$30.7 million in cash and cash equivalents. The Company expects that it will increase its capital expenditures consistent with planned growth in operations and infrastructure. It is expected that revenues from the expansion of the North American operations will commence in 2000. The Company believes that its current cash and cash equivalents will be sufficient to meet its anticipated cash requirements for at least twelve months, although the Company may seek to raise additional cash during that time period. The sale of additional equity securities could result in additional dilution to the Company's stockholders.

## **RISKS AND UNCERTAINTIES**

The Company faces a number of risks and uncertainties, in addition to normal business and operating risks. The principal risks and uncertainties facing the business include: the demand for the Company's software products may prove less than anticipated; the markets in which the Company competes are intensely competitive and rapidly changing; the costs of integrating recent acquisitions may be significant to the operating results going forward; the dependency of its ability to attract and retain highly skilled personnel; the formation of strategic alliances with third party suppliers, distributors, OEM's and other businesses integral to the Company's future success; the ability to maintain the proprietary nature of its internal operations, software and related documentation and to successfully defend against infringement by others.

The viability and success of the business is dependent on the Company's ability to manage or mitigate such risks. For further details regarding the risks and uncertainties facing the business refer to the section entitled "Business Risks" in the Company's Annual Information Form, which section is incorporated herein by reference.

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## **INDEPENDENT AUDITORS' REPORT**

To the Board of Directors and Shareholders of  
BakBone Software Incorporated:

We have audited the consolidated balance sheet of BakBone Software Incorporated (the "Company") as of April 30, 2000 and the related consolidated statements of loss and deficit and of cash flows for the year then ended (all expressed in Canadian dollars). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in Canada and the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company as of April 30, 2000 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in Canada.

*Deloitte & Touche LLP*

San Diego, California  
August 18, 2000

# BAKBONE SOFTWARE INCORPORATED

## CONSOLIDATED BALANCE SHEET AS OF APRIL 30, 2000

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### ASSETS

#### CURRENT ASSETS:

Cash and cash equivalents	\$ 30,687,388
Accounts receivable	1,088,286
Other current assets	<u>468,811</u>

Total current assets 32,244,485

Capital assets, net (Note 3)	801,677
Goodwill, net	4,129,020
Other non-current assets	<u>141,244</u>

TOTAL \$ 37,316,426

### LIABILITIES AND SHAREHOLDERS' EQUITY

#### CURRENT LIABILITIES:

Accounts payable	\$ 1,145,144
Deferred revenue	420,557
Accrued liabilities	<u>1,322,006</u>

Total current liabilities 2,887,707

#### COMMITMENTS (Note 9)

#### SHAREHOLDERS' EQUITY:

Share capital (Note 5)	87,243
Special warrants (Note 4)	35,630,000
Accumulated deficit	(1,314,160)
Cumulative exchange adjustment	<u>25,636</u>

Total shareholders' equity 34,428,719

TOTAL \$ 37,316,426

#### APPROVED BY THE BOARD

ARCHIE NESBITT  
Director

J.G. (JEFF) LAWSON  
Director

*See notes to consolidated financial statements.*

## BAKBONE SOFTWARE INCORPORATED

### CONSOLIDATED STATEMENT OF LOSS AND DEFICIT FOR THE YEAR ENDED APRIL 30, 2000

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REVENUES	\$ 483,299
COST OF REVENUES	<u>51,225</u>
GROSS MARGIN	432,074
OPERATING EXPENSES	<u>1,823,105</u>
OPERATING LOSS BEFORE UNDERNOTED	(1,391,031)
Interest income, net	227,745
Amortization of goodwill	(241,342)
Other income, net	<u>90,468</u>
NET LOSS	(1,314,160)
DEFICIT, BEGINNING OF YEAR	<u>-</u>
DEFICIT, END OF YEAR	<u>\$ (1,314,160)</u>
LOSS PER SHARE	\$ (0.14)
WEIGHTED AVERAGE COMMON SHARES	9,525,057

*See notes to consolidated financial statements.*

# BAKBONE SOFTWARE INCORPORATED

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED APRIL 30, 2000

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CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss	\$ (1,314,160)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	286,994
Changes in assets and liabilities, net of effects of acquisitions:	
Decrease in accounts receivable	66,847
Increase in other assets	(244,756)
Decrease in accounts payable	(286,585)
Increase in deferred revenue	14,022
Increase in accrued liabilities	<u>596,367</u>
Net cash used in operating activities	<u>(881,271)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Capital expenditures	(317,653)
Acquisitions of businesses, net of cash acquired	<u>(4,264,731)</u>
Net cash used in investing activities	<u>(4,582,384)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from issuance of special warrants, net	35,630,000
Proceeds from issuance of share capital	<u>495,407</u>
Net cash provided by financing activities	<u>36,125,407</u>
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	<u>25,636</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	30,687,388
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>-</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 30,687,388</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:	
Businesses acquired:	
Fair value of assets acquired, net of cash	\$ 6,828,634
Liabilities assumed	2,563,903

*See notes to consolidated financial statements.*

# BAKBONE SOFTWARE INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED APRIL 30, 2000

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### 1. THE COMPANY AND BUSINESS COMBINATIONS

BakBone Software Incorporated (“BakBone” or the “Company”) is an international storage management software company that develops and globally distributes industry-leading storage management solutions to the open systems markets, providing data protection and management solutions scalable from workgroup to enterprise that will grow with a company's needs. BakBone's corporate headquarters are located in San Diego, California.

The Company, formerly Net Resources Incorporated (“Net Resources”), was originally incorporated under the Company Act (British Columbia) through the amalgamation of Canu Resources Ltd. and Ican Resources Ltd. In November 1992 the Company continued from the Province of British Columbia to the Province of Alberta. By Articles of Amendment filed on March 13, 2000, the Company changed its name to BakBone Software Incorporated.

Effective December 22, 1999, the Company, then known as Net Resources, entered into agreements to acquire, directly or indirectly, all of the business and assets of NVS Holdings Inc. (“NVS”) and NetVault Holdings Limited (“NVHL”) and an aggregate 47% ownership of the outstanding common shares of NetVault Corporation (“NVKK”). The transactions related to these acquisitions are detailed below.

- a) On March 16, 2000, NVS acquired all outstanding common shares of NetVault Holdings Limited, which included its wholly owned subsidiary, NetVault Limited, and 25% of the outstanding common shares of NVKK, in exchange for a cash payment of US\$3,070,000 (CDN\$ 4,507,798). The acquisition of NVHL was accounted for by the purchase method of accounting. Accordingly, the operating results of NVHL have been included in the accompanying consolidated financial statements of the Company from the date of acquisition. The fair value of the assets and liabilities acquired were as follows:

Net working capital deficiency	\$ (81,220)
Capital assets	369,185
Goodwill	<u>4,317,967</u>
Purchase price (\$4,507,798 of a cash payment plus \$98,134 of transaction costs)	<u>\$ 4,605,932</u>

- b) On March 16, 2000, the Company (previously known as Net Resources) issued 15,625,000 common shares in exchange for all issued and outstanding shares of NVS. NVS was formed as a special purpose entity solely to effect the NVHL acquisition and was incorporated under the laws of the Province of Alberta on December 17, 1998. The transaction resulted in a reverse takeover of the Company by NVS as the shareholders of NVS owned a majority of the combined company as of the acquisition date.

Under the principles of reverse takeover accounting, NVS was deemed to be the acquirer of the Company and the consolidated financial statements of the Company, the legal parent, are presented as a continuation of the financial position and results from operations of NVS, the legal subsidiary.

The application of reverse takeover accounting results in the following:

- i) The consolidated financial statements of the combined entity are issued under the name of the legal parent but are considered a continuation of the financial statements of the legal subsidiary, NVS;
- ii) NVS is deemed to be the acquirer for accounting purposes and its assets and liabilities are included in the consolidated financial statements at their historical carrying values;
- ii) Control of the net assets and operations of the Company are deemed to have been acquired by NVS effective March 16, 2000. For the purposes of this transaction, the deemed consideration is \$(302,610) representing the ascribed value of the common shares of Net Resources immediately prior to the business combination. The operating results of Net Resources are included in the consolidated financial statements from the date of acquisition;
- iii) The accumulated deficit of the Company at March 16, 2000 was eliminated upon acquisition. In accordance with reverse takeover accounting, the amount allocated to share capital represents the net book value of NVS of \$13,000 plus the amount of net equity of the Company. The number of shares subsequent to the reverse takeover include those of the Company outstanding at March 16, 2000 plus the shares issued to effect the reverse takeover.

With respect to the 15,625,000 shares issued by the Company, NVS had the ability to allocate the shares to other parties or companies as part of the closing of the transaction. As a result, 2.1 million shares were issued to an employee benefit trust established for the benefit of certain employees and principals involved in the acquired companies to ensure their continued involvement in the operations of the Company.

- c) On March 16, 2000, the Company issued 375,000 shares in exchange for 22% of the outstanding common shares of NVKK. Given that the Company already had a 25% equity interest through the acquisition of NVS and NVHL described above, the aggregate interest increased to 47%.

This transaction was recorded at its carrying value of \$(45,494). The carrying value basis of valuation was used as this transaction represented a non-monetary related party transaction. Of the 53% of NVKK ownership not held by the Company, 46% is owned by two directors and officers of the Company. These individuals represent two-thirds of the total board of directors of NVKK. Accordingly, the operating results of NVKK have been included in the accompanying consolidated financial statements of the Company from the date of acquisition.

## 2. SIGNIFICANT ACCOUNTING POLICIES

**Principles of Consolidation** – The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, BakBone Software, Inc., NVS and BakBone Software Ltd. (formerly NetVault Holdings Ltd.). In addition, the consolidation includes the accounts of BakBone Software K.K. (formerly NetVault Corporation) as the Company and BakBone Software K.K. were under common control from the date of acquisition. All material intercompany transactions and accounts have been eliminated on consolidation.

**Foreign Currency Translation** – The accounts of the Company's self-sustaining operations in foreign subsidiaries are translated into Canadian dollars using the current rate method whereby monetary items are translated at the rate of exchange in effect at the balance sheet date. Revenue and expense items are translated at the average exchange rate in effect for the reporting period. Foreign exchange gains and losses are included as a separate component of equity.

**Use of Estimates** – The amounts recorded for allowance for doubtful accounts, amortization period of goodwill, estimated useful life of capital assets, and provisions for contingent liabilities are based on management’s best estimates. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in estimates in future periods could be significant.

**Cash and Cash Equivalents** – Cash and cash equivalents consist of money market instruments, commercial paper and other highly liquid investments purchased with original maturities of three months or less.

**Capital Assets** – Capital assets are recorded at cost and depreciation and amortization are provided for using the straight-line basis over the assets’ useful lives as follows:

Computer equipment and software	3-5 years
Furniture and fixtures	5-7 years
Leasehold improvements	Life of lease

**Goodwill** – Goodwill was generated from the acquisition of NVHL as described in Note 1. These assets have been recorded at cost, and are amortized on a straight line basis over 3 years.

**Impairment** – The Company reviews the carrying value of its long-lived assets and goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. To the extent the estimated future cash inflows from such assets less estimated future cash outflows is less than the carrying amount, an impairment loss is recognized. At April 30, 2000, no such losses have been recognized.

**Revenue Recognition** – The Company recognizes revenues from licenses of its software provided that a non-cancelable license agreement has been signed, the software and related documentation have been shipped, there are no material uncertainties regarding customer acceptance, collection of the resulting receivable is deemed probable, and no other significant vendor obligations exist. Maintenance revenues are deferred and recognized over the related contract period.

**Research and Development Costs** – Research costs are expensed as incurred. Development costs incurred prior to the establishment of technological and financial feasibility of a project are expensed as incurred. Software development costs are capitalized when the technological and financial feasibility of a project is established. These costs are subsequently amortized using the straight-line method over the related product’s estimated useful life.

**Loss Per Share** – Loss per share is calculated using the weighted average number of common shares outstanding. Fully diluted loss per share is not presented because the effect of exercising common stock equivalents is anti-dilutive.

**Stock-Based Compensation Plan** – The Company has a stock-based compensation plan, which is described in Note 6. No compensation expense is recognized for this plan when stock or stock options are issued to employees. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to share capital. If stock or stock options are repurchased from employees, the excess of the consideration paid over the carrying amount of the stock or stock option cancelled is charged to accumulated deficit.

**Statement of Cash Flows** – Section 1540 of the Canadian Institute of Chartered Accountants Handbook has been adopted for the year ended April 30, 2000. This section requires that transactions that do not require the use of cash or cash equivalents be excluded from the cash flow statement.

For purposes of the consolidated statement of cash flows, the Company considers all money market instruments, commercial paper and other highly liquid investments with original maturities of three months or less to be cash and cash equivalents.

**Financial Instruments** – The Company is exposed to the risk that arises from fluctuations in foreign exchange rates, and the volatility of those rates. The Company does not use derivative instruments to reduce its exposure to foreign currency exchange risk.

Accounts receivable and accounts payable constitute financial instruments. The carrying value of these financial instruments approximates their fair value given the relatively short periods to maturity.

### 3. CAPITAL ASSETS

Capital assets consist of the following:

	Cost	Accumulated Depreciation	Net Book Value
Computer equipment and software	\$ 447,820	\$ 24,315	\$ 423,505
Furniture and fixtures	65,765	2,656	63,109
Leasehold improvements	169,203	2,306	166,897
Construction work-in-process	148,166	-	148,166
	<u>\$ 830,954</u>	<u>\$ 29,277</u>	<u>\$ 801,677</u>

### 4. SPECIAL WARRANTS

Proceeds from issuance of Series A Special Warrants	\$ 9,000,000
Proceeds from issuance of Series B Special Warrants	29,700,000
Special Warrants issue costs	<u>(3,070,000)</u>
Net Proceeds from Special Warrants	<u>\$ 35,630,000</u>

On March 16, 2000, the Company raised gross proceeds of \$38,700,000 through the private placement of 6,000,000 Series A Special Warrants and 3,000,000 Series B Special Warrants at a price of \$1.50 and \$9.90, respectively, for net proceeds of \$35,630,000. Each Special Warrant is exercisable, without additional payment, into one common share and one-half warrant. Each full Series A Warrant and Series B Warrant entitles the holder to purchase one common share of the Company at a price of \$1.80 and \$15.00, respectively, per common share from the closing of the private placement until the one year expiry date. If a receipt for the Prospectus to qualify the Series B Special Warrants is not issued on or before July 14, 2000, holders of the Series B Special Warrants are entitled to receive 1.1 common shares and 0.55 Series B Warrants (in lieu of one common share and one-half of one Series B Special Warrant otherwise receivable) at no additional cost. See additional information at Note 11.

The Series C Special Warrants were issued pursuant to an agreement, which terms include payment by the Company to a third party consultant of an aggregate of 426,000 Series C Special Warrants. Of the total Series C Special Warrants, 300,000 were issued to the consultant with the balance issued to two directors of the Company in repayment of an aggregate of 126,000 common shares owed by the consultant to those individuals. The Company did not receive any proceeds from the issuance of the Series C Special Warrants. Each Series C Special Warrant is exercisable, without

additional payment, into one common share, subject to customary anti-dilution provisions, during the period commencing on March 16, 2000 and ending at the earlier of: (i) the date which is five business days following the day upon which a receipt of the prospectus has been obtained from each of the securities commissions and (ii) March 16, 2001.

In addition, the Company issued 200,000 Series A Broker Warrants and 260,995 Series B Broker Warrants. Each Series A Broker Warrant is exercisable, at no additional cost, into one Series A Broker Option entitling the holder thereof to purchase, subject to adjustment, one common share and one-half of one Series A Warrant at a price of \$1.60 per Series A Broker Option exercisable at any time on or prior to March 16, 2001. Each Series B Broker Warrant is exercisable, at no additional cost, into a Series B Broker Option entitling the holder thereof to purchase, subject to adjustment, one common share and one-half of one Series B Warrant at a price of \$9.90 per Series B Broker Option exercisable at any time on or prior to March 16, 2001.

## 5. SHARE CAPITAL

### Authorized

An unlimited number of common shares.

### Issued – common shares

	Net Resources		NVS	
	Number of Shares	Amount	Number of Shares	Amount
<b>Balance, May 1, 1999</b>	5,662,348	\$ 25,329,622	13,000,000	\$ 13,000
Issued for cash in private placements	2,860,000	720,200	-	-
Issued for cash on exercise of stock options	550,600	230,880	-	-
Issued for cash on exercise of warrants	2,350,001	291,825	-	-
Issued to acquire Net Resources (Note 1)	15,625,000	(302,610)	-	-
Issued to acquire NVKK (Note 1)	375,000	(45,494)	-	-
Cancellation of NVS shares and Net Resources share capital (Note 1)	-	(26,150,180)	(13,000,000)	-
Continuation of NVS share capital (Note 1)	-	13,000	-	(13,000)
	<u>27,422,949</u>	<u>87,243</u>	<u>-</u>	<u>-</u>
<b>Special Warrants</b>				
Proceeds from issuance of special warrants (Note 4)		38,700,000	-	-
Special warrants issue costs (Note 4)	-	(3,070,000)	-	-
	<u>-</u>	<u>35,630,000</u>	<u>-</u>	<u>-</u>
<b>Balance, April 30, 2000</b>	<u>27,422,949</u>	<u>\$ 35,717,243</u>	<u>-</u>	<u>\$ -</u>

During the year ended April 30, 2000, the Company issued, by way of private placement, a total of 2,860,000 common shares for cash consideration of \$720,200.

During the year ended April 30, 2000, the Company issued, by way of exercise of stock options at exercise prices ranging from \$0.14 to \$14.20, a total of 550,600 common shares for cash consideration of \$230,880.

During the year ended, the Company issued warrants at exercise prices ranging from \$0.12 to \$0.18 per warrant, which expire on October 14, 2000 if not converted. Warrants were converted into 2,350,001 common shares during the year ended April 30, 2000 for cash consideration of \$291,825. In addition, 322,500 share purchase warrants at an exercise price of \$0.75 per warrant which expire on October 14, 2000 are outstanding as of April 30, 2000.

***Escrowed Shares***

In connection with the NVS acquisition, 10,425,000 common shares have been deposited in escrow. The escrowed shares shall be released as to one-third on each of September 16, 2000, March 16, 2001, and September 16, 2001. See additional information at Note 11.

**6. STOCK-BASED COMPENSATION PLAN**

The Company has a stock option plan (the “Plan”) pursuant to which the board of directors (the “Board”) of the company may grant non-transferable stock options to purchase shares of the Company’s common stock to directors, officers, employees and consultants. Currently 3,340,304 shares have been reserved for issuance under this plan. The maximum number of common shares which may be reserved for issuance to any one person under the Plan is 5% of the common shares outstanding at the time of grant (calculated on a non-diluted basis). Options granted under the Plan are exercisable at the closing price per share on the last trading date preceding the date of grant and an option’s maximum term is 10 years.

A summary of the status of the Company’s stock option plan as of April 30, 2000, and changes during the year, is as follows:

	<u>Number of Shares</u>	<u>Weighted-Average Exercise Price</u>
Outstanding at May 1, 1999	490,667	\$0.35
Granted	3,660,500	\$13.10
Exercised	(550,600)	\$0.42
Cancelled	<u>(71,667)</u>	\$1.53
Outstanding at April 30, 2000	<u>3,528,900</u>	\$13.54

The following table summarizes information about the stock options outstanding at April 30, 2000:

<u>Exercise Prices</u>	<u>Number Outstanding</u>	<u>Average Remaining Contractual Life (Years)</u>	<u>Weighted Average Exercise Price</u>
\$0.95	387,000	2.5	\$0.95
\$1.20	119,400	2.2	\$1.20
\$6.00	497,000	4.6	\$6.00
\$13.75	150,000	1.7	\$13.75
\$14.20	549,000	2.7	\$14.20
\$18.85	<u>1,826,500</u>	9.8	\$18.85
	<u>3,528,900</u>		\$13.54

On May 11, 2000 the Company filed an application with the Toronto Stock Exchange to reprice 1,686,500 of the \$18.85 employee options from \$18.85 to \$12.35.

Included in the stock options outstanding are approximately 780,000 options granted to employees in excess of the available shares under the Plan. The increase in the number of shares reserved for these stock options pursuant to the Plan requires shareholder and Toronto Stock Exchange approval.

## 7. INCOME TAXES

The Company and its subsidiaries have incurred losses for both accounting and income tax purposes for which the potential tax benefits have not been recognized in the consolidated financial statements.

The Company has U.S. net operating loss carryforwards of approximately US \$671,923 at April 30, 2000 that are available as reductions to its U.S. taxable income in future years. These carryforwards will expire in the year 2020.

The Company has U.K. trade loss carryforwards of approximately UK £80,597 at April 30, 2000 that are available as reductions to its U.K. taxable income in future years. These carryforwards generally have an indefinite carryforward period.

The Company has Japan net operating loss carryforwards of approximately Y2,300,000 at April 30, 2000 that are available as reductions to its Japan taxable income in future years. These carryforwards will expire in the year 2003.

The Company has Canadian non-capital losses of \$77,101 at April 30, 2000 which may be available to apply against future Canadian taxable income. These losses expire in 2007.

## 8. RELATED PARTY TRANSACTIONS

A director of the Company is also a partner of a law firm which provides legal services to the Company.

## 9. COMMITMENTS

The Company rents premises and equipment under operating leases, which expire at various dates through April 30, 2005. Future annual rentals under these leases are as follows:

Year Ending April 30,

2001	\$ 738,943
2002	526,387
2003	485,587
2004	485,587
2005	<u>485,587</u>
	<u>\$2,722,091</u>

## 10. SEGMENTED INFORMATION

The Company has segmented its operations on the basis of the major regions in which it operates. Operating revenue is generated primarily from the licensing of software in all segments.

	Europe	Asia	North America	Total
Revenues	\$ 136,384	\$ 346,915	\$ -	\$ 483,299
Net (loss) income	\$ (312,897)	\$ 75,515	\$ (1,076,778)	\$ (1,314,160)
Total assets	\$ 5,651,941	\$ 830,136	\$ 30,834,349	\$ 37,316,426

## 11. SUBSEQUENT EVENTS

- a) Effective June 19, 2000, the Company acquired all of the issued and outstanding common shares of Tracer Technologies Inc. ("Tracer") pursuant to a transaction in which former shareholders of Tracer received an aggregate of US \$2,251,934 (CDN \$3,265,304) and 600,000 common shares of the Company pro rata to their proportionate shareholdings in Tracer. Of the 600,000 shares, a Family Trust (the trustees of which are relatives of a director of the Company) received 122,240 common shares of the Company. Certain principals of Tracer also received options (the "Options") to acquire 250,000 common shares of the Company, each exercisable at a price of \$6.00 per share. One of these individuals, a relative of a director of the Company, received options to acquire 62,500 common shares. The director also received (indirectly) 12,000 common shares of the Company through his ownership in Tracer Technologies Japan Corporation, one of the former shareholders of Tracer.
- b) The following share capital activities took place subsequent to April 30, 2000:
  - 1) 350,000 stock options, expiring in ten years, were issued; and
  - 2) 13,000 stock options were exercised for total consideration of \$62,850.
  - 3) 75,000 Series A Broker Options were exercised for total consideration of \$120,000.
- c) The Company filed a final prospectus on July 12, 2000 with the securities commissions in the Provinces of Alberta, British Columbia and Ontario, to qualify the distribution of 9,426,000 common shares of the Company, 3,000,000 Series A Warrants and 1,500,000 Series B Warrants issuable upon exercise of 6,000,000 Series A Special Warrants, 3,000,000 Series B Special Warrants and 426,000 Series C Special Warrants. In conjunction with receipt of the final prospectus from Alberta and British Columbia, 5,900,000 common shares of the Company were

issued upon the exercise of Series A Special Warrants and 3,056,353 common shares of the Company upon the exercise of Series B Special Warrants. Due to the pending notification of receipt from the Ontario Securities Commission as of the qualification date of July 14, 2000, each holder of Series B Special Warrants is entitled to receive 1.1 common shares and 0.55 Series B Warrants upon exercise as opposed to 1.0 common share and 0.50 Series B Warrants.

In connection with the final prospectus, the Company has agreed to enter into an additional agreement related to certain of the escrowed shares described in Note 5. 4,956,686 of the shares described in Note 5 will be redeposited in escrow. Also, an additional 329,000 common shares (or securities convertible into such shares) will be deposited in escrow and will be released as to one-third thereof on each of July 12, 2001, July 12, 2002, and July 12, 2003.

- d) In August 2000 the Board of Directors approved a change in the fiscal year end of the Company for financial reporting purposes from April 30 to March 31, effective with the fiscal year beginning May 1, 2000.