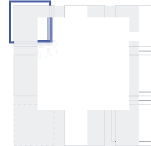
the BakBone of Data Protection

annual report

02

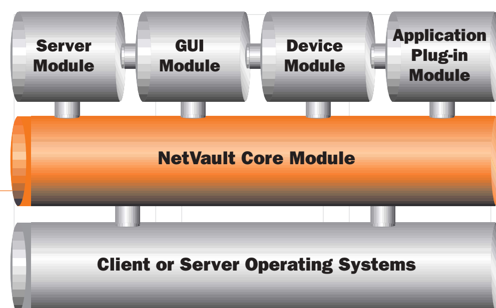
BakBone ('bak-bōn) *n* **1:** a main support or major sustaining factor <the *BakBone* of a business plan> **2:** strength of character; determination <displayed grit and *BakBone* in facing adversity in a tough economic climate> **3:** The storage industry's most well-conceived backup, restore and archival software <*BakBone* is data protection defined>



BakBone™ SOFTWARE

products

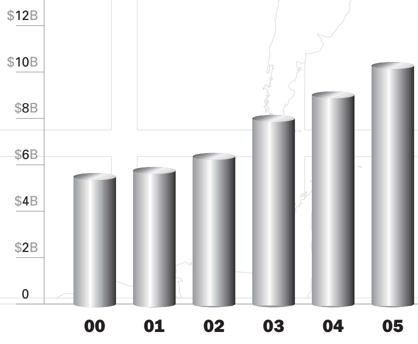
NetVault™ Software manages the backup, restore and disaster recovery functions for your enterprise, data center or workgroup. NetVault's setup and installation are the fastest and easiest in the industry, and it runs on all major platforms including Linux, Unix and Windows. Application Plugin Modules (APMs) provide Hot-Backup for all of today's most popular database applications. NetVault's modular architecture means that our APM's are capable of being delivered to our customers in a fraction of the time compared to our competition. Their adaptability and reduced time-to-market yield a competitive advantage for our channels and delighted customers.



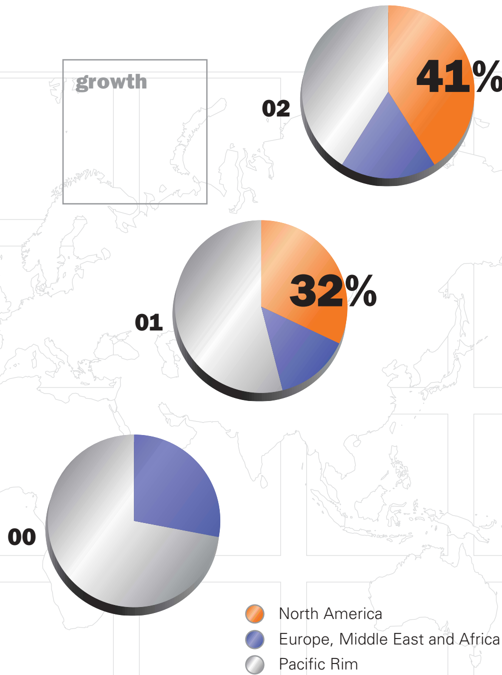
MagnaVault™
Industry leading software for Unix- and Linux-based optical storage management. MagnaVault rapidly archives and accesses documents and other images on optical disks, including CDs, DVDs, and magneto-optical media.

markets

The amount of electronic data being generated continues its unrelenting, exponential advance. Finding reliable and efficient methodologies to store, backup and retrieve mission-critical data has taken on unprecedented urgency. Network Attached Storage (NAS) and Storage Area Network (SAN) configurations have moved storage from the network server to outlying devices — increasing performance while freeing up network bandwidth. NAS and SAN environments continue to outpace legacy networks such as Direct Attached Storage (DAS). BakBone's technology and strategic alliances make it well-positioned to capitalize on the growth of NAS, SAN and other emerging networks. IDC projects the following market growth.

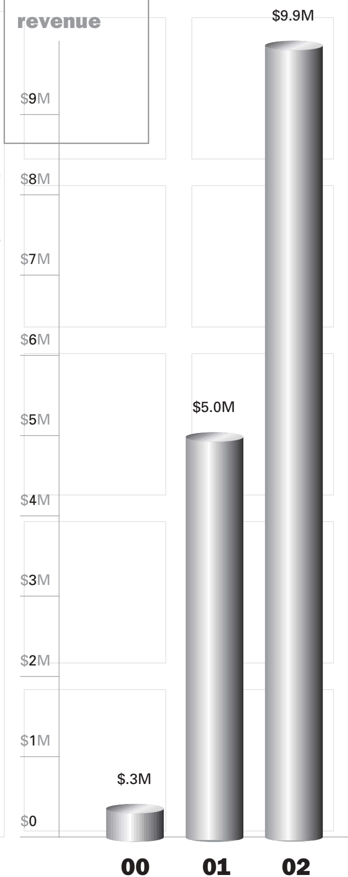


growth



North American Markets BakBone's launch into the North American Market is yielding impressive results. While revenues in all regions continue to increase, our North American share is growing the fastest.

revenue



BakBone Revenue Now more than ever, companies are grasping the importance of backing up their data. BakBone's three-year revenue chart reflects this priority shift.

Our business is backup and recovery. Our alliances and partnerships are with the top backup names in the industry. BakBone has long-standing relationships with storage leaders from the tape, optical and infrastructure sectors, including:

tape

HP

IBM

Overland Data

Quantum

Seagate

Sony

Spectra Logic

Storage Tek

optical

DISC

GRAU Data Storage

Hitachi

HP

JVC

Panasonic

Pioneer

Infrastructure

Brocade

Compaq

EMC

Intel

Network Appliance

NCR

Oracle

Sun Microsystems

BakBone is gaining traction. Winning Customers. Growing its market share. How? With the storage industry's best conceived and developed software. With teamwork that's focused on customers and their business needs. BakBone Software is winning accolades from everyone. Why? The industry's most comprehensive support – more platforms, operating systems, databases and applications than anyone else. Software that's easy to install and use, even in the most complex environments. Just listen to our customers…

what our customers say...

Pirelli "We are extremely happy with NetVault. It safeguards our data very well and is really nice and friendly to use"

—Davide Pironi, IT Operations Manager, Pirelli

Thor•lo "It's software that supports our needs today, and gives us the flexibility to expand tomorrow." —Jay Harris, Thor•lo's IT Director

Reliance Mutual Insurance "I hadn't much experience with data backup at the time of installing NetVault, but I found with NetVault you didn't need much experience; it was up and running within minutes. It was incredibly easy and the GUI is so simple, you learn as you use the product." —Glynn Head, Technical Analyst Programmer, Reliance Mutual

AT&T Canada "NetVault's virtual library feature is wonderful! It allows us to back up in a fraction of the time it would normally take. BakBone support has also been nothing short of stellar, making the transition to NetVault relatively simple and painless."

—Brian Tao, Systems Administrator, AT&T Canada

Dear Shareholders

Fiscal Year 2002 saw BakBone make unprecedented strides in technology and market share in one of the most economically challenging years in recent memory. During a year where simply treading water was all some companies hoped for, BakBone posted 98% revenue growth; nearly doubling its worldwide channel sales and substantially increasing market visibility. Best of all, we achieved this growth while controlling our expenses and increasing our cash holdings.

How did this happen? It didn't just happen—we planned for it. We made a concerted effort to control expenses, explore new markets, drive sales, hire world-class personnel and embrace new partnerships. We developed relationships with the right people to move our products, and exhaustively searched out new markets to deliver them.

As important as these reasons were in increasing sales, it is the *quality* of BakBone's products, namely NetVault and MagnaVault, which led to our success over the past year. Nothing else matters unless the products stand out from the competition. Ours do.

Market Acceptance Word of our software quality clearly spread with our customers. In fact, FY2002 saw BakBone make substantial inroads into new international and domestic markets, while winning over multiple new partners and end-users in all of our markets.

The reasons for this are many. For one, there has never been greater market demand for the type of software we produce. According to a University of California study, it will take only 2½ years to produce the same amount of data that the last 300,000 years has generated. Meanwhile, IT spending has been drastically reduced across all sectors. With budgets slashed and headcounts reduced, IT professionals are looking for a solution that will efficiently and economically manage, back up, restore and archive all of their data. Who is providing such a solution today? Answer: BakBone Software.

The Right Architecture at the Right Time With this economic backdrop, what has resonated most with our current and potential customers is the modular architecture of our software products—NetVault and MagnaVault. As opposed to *monolithic* architectures, our software is methodically designed, yet also flexible enough to work in today's varied storage environments.

Companies want choices; BakBone delivers the most comprehensive storage capabilities in the industry. Companies can no longer buy systems they can grow into—they need systems that can grow *with* them. The scalability of our software answers that market demand.

Flexibility is equally important. Today's storage market demands software that can manage the dozens of vendor products flooding the market and the hundreds of product revisions they produce throughout the year. Add to that our customers' need to get everything they can out of their legacy equipment. In either case, storage software needs to operate seamlessly across the numerous operating system and storage network configurations—from the workgroup to the enterprise. Ours does!

Our diverse range of partners, customers, OEMs and resellers indicates that NetVault and MagnaVault are proving to be the robust, scalable, flexible and cost-effective solutions that today's market demands.

The Financials FY2002 proved to be a solid year for us from a financial standpoint. Our penetration into new domestic and international markets and the overall increased acceptance of our products combined to drive impressive revenue growth throughout the World.

MTU Friedrichshafen GmbH "NetVault's support for NDMP is outstanding and it has relieved us of our storage headache. We particularly welcome the fact that it is a powerful yet easy-to-use product. Makes a refreshing change."

—Bernhard Welti, IT Manager MTU, a DaimlerChrysler Company

Ruffneck Heaters "We were amazed with the ease of installation, configuration of devices, and basic use of NetVault from the moment we downloaded the product. Needless to say we no longer have any backup issues." —Kyle Smith, Ruffneck Heaters

City of Alexandria, LA "Not only is the network administrator able to run backups faster using NetVault, but overall administrative time was reduced as well."
—Manager of Information Systems for the City of Alexandria

Ludwig-Maximilians-Universität (LMU) "From the moment I received a test CD, I realised how easy NetVault would be to both install and operate. It is simple yet so effective. Tied in with the ease-of-use factor, I particularly appreciate the local support that I have been given both from the German and UK office of BakBone." —Andreas Marx, System Administrator, Ludwig-Maximilians-Universität (LMU)

We continue to do very well in Europe, Middle East and Africa (EMEA). In fact, we posted our highest regional revenue growth here—157% over our previous fiscal year. This growth was driven by deeper penetration into existing markets and through expansion into new markets: South Africa, Israel and Southern Europe to name a few. Our Pacific Rim revenues remain strong as well. This region posted 50% revenue growth over FY2001 and achieved the highest total revenue of all of our regions.

However, I am especially happy to report that we have made great strides in North America to complement our overseas success. Growth of the domestic market took a dramatic turn upward in FY2002 providing North American revenue growth of 155% to $4.1 million. As a result, North American sales jumped from 32% in FY2001 to 41% of total revenues in FY2002. By the end of FY2003, more than half of BakBone's revenues are projected to come from North America, up almost 20 points in two years!

I am also pleased to report that our cost-containment measures implemented in FY2001 continue to pay dividends for us. In fact, our operating expenses decreased by 10% from FY2001. We remain committed to keeping operating expenses down while pushing ahead our revenues and moving purposefully toward profitability.

Our Balance Sheet Our balance sheet remains on solid ground, and has actually become stronger during the past year—a claim not all companies can make. We closed out the year with more cash in the bank, a stronger overall working capital position and less debt. Each a key factor in showing the strength of our company.

Capital Markets As I have discussed in the past, it is our intention to seek listing on a U.S. market. We have spent the past several months working toward that end and have established contact with many investment banking firms. I am pleased to say the process is going quite well but there is still work to do in attracting the best-suited banking representative while looking for overall improvement in current financial market conditions to support such a move.

We are cognizant of the stature, recognition and media coverage that comes with trading in American markets, and we are doing everything in our power to make it happen.

A Word About Sales I'm often asked how BakBone intends to continue growing in such a competitive, challenging environment. I like to point out that data generation, and the backup, restoration and archival which must accompany it, continue to grow exponentially as the transition to an information-based economy occurs. To that end, we will strive to continue to: 1) win new Value Added Resellers (VARs); 2) grow revenues with our existing VARs, and; 3) continue to establish OEM relationships.

Another key to outpacing the competition will be to keep our focus on targeting new *applications*. Our technological superiority allows us to become more quickly certified for new applications. Short certification time means quicker time-to-market and ultimately, winning additional market share.

Partnerships We continue to place the highest premium on our partnerships with all the key storage players. Partnerships or working agreements have already been obtained across the tape, optical and infrastructure spectrum including: • Brocade • Compaq • EMC • Hitachi • HP • NCR Teradata • Network Appliance • Panasonic • Pioneer • Seagate • Sony • StorageTek.

Aberdeen Group "With its modular architecture, NetVault's ease-of-use, scalability and performance, effectively implemented, can give companies the protection they need against data center stresses today as well as the flexibility they desire to handle tomorrow's new storage demands."

—David G. Hill, Research Director, Storage and Storage Management, Aberdeen Group

Enterprise Storage Group "Data protection is becoming a more difficult job for the IT administrator. BakBone's backup and recover product, NetVault, has the ability to meet today's data protection needs while having the ability to meet the needs of the future. With its unique modular architecture, NetVault's ease-of-use, scalability and performance gives companies both the protection they need as well as the flexibility they desire."—Steve Kenniston,Technology Analyst, Enterprise Storage Group

Customers During FY2002, BakBone continued to add recognizable Fortune 500 companies and industry leaders to our growing list of customers. A few of the notable account names on that list are as follows: • AT&T • Barclays Bank • DaimlerChrysler • Deutsche Telekom • FedEx • IBM • Los Alamos Laboratory • Mitsubishi • Shell Oil • Sony • Toyota.

Our Technology I've highlighted our new markets, deeper market penetration, our new customers, partners and solid financial standing. It's important to note that these things happened, in large part, because of the broad adoption of our technologically strong product offerings. Simply put: Our technology is driving our success.

NDMP Without getting too technical, I would like to say a few words about NDMP, or Network Data Management Protocol. NDMP is an open standard protocol promoted and supported by server, backup software, and backup device vendors. NDMP is the standard by which file servers and storage appliances communicate with one another in Network Attached Storage (NAS) environments. NAS, along with Storage Area Network (SAN) environments, are today's two fastest-growing storage configurations. BakBone is well positioned to play a prominent role in these key markets. In fact, BakBone, along with Network Appliance (one of the pioneers of NDMP technology), are currently co-chairing the NDMP standards committee.

To give you an idea of our position in the NAS market, there are over 40 hardware vendors in the NAS space—with Network Appliance and EMC sharing approximately 85% of the market's revenues. Because of BakBone's close relationships and certifications with both Network Appliance and EMC, we feel we are well positioned to be a dominant player in NAS architectures for years to come.

Without overstating our case, NDMP remains one of the key aspects to our present and future success. The technological merits of NetVault and MagnaVault have other benefits as well—benefits which extend to our partners, OEMs and customers who are finding that our software: 1) is faster and less expensive to install; 2) enables customers to quickly adapt and react to changing market conditions; 3) enables partners to do their own certifications and; 4) reduces product time-to-market.

Closing Thoughts If I could leave you with one thought, it would be that I remain personally committed to producing a strong return for our shareholders. The markets we're penetrating, the sales we're driving, the costs we're containing and the product technology we're leading are the necessary first steps to achieving that end. FY2002 saw revenue growth of 98% over our previous fiscal year, and with our recent developments, we are on pace for a similar level of growth in FY2003.

I would like to personally thank BakBone's shareholders for another year of financial support. We applaud your commitment to our business plan, and are pleased you share our vision of the company's future. I would also like to thank BakBone's employees and associates, who have demonstrated a willingness to go the extra mile and put in the extra hours to achieve our goals.

BakBone Software is looking forward to another successful year marked by technological progress, financial growth and increased market share.

Sincerely,

Keith Rickard
President and Chief Executive Officer

MANAGEMENT'S FINANCIAL DISCUSSION AND ANALYSIS

The following section contains forward-looking statements related to revenues, expenditures and sufficiency of capital resources. Actual results may differ from those projected in the forward-looking statements for a number of reasons, including those described in the Risks Factors section below.

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the consolidated financial statements and accompanying notes contained in this annual report. All amounts are expressed in United States dollars unless otherwise noted.

Overview

BakBone Software Incorporated (the Company) is an international storage management software company that develops and globally distributes high performance software solutions for the network storage and open systems markets. Our corporate headquarters are located in San Diego, California. This facility houses executive management as well as sales, marketing, engineering, customer support and administrative departments. We maintain offices in Tokyo, Japan and Poole, Dorset, United Kingdom, that concentrate on sales, marketing and administrative functions for the Asian and European regions, respectively.

We have incurred net operating losses since inception of our operations in March 2000. Our operating losses were $18.8 million, $21.7 million and $896,000 for the year ended March 31, 2002, the eleven months ended March 31, 2001 and the year ended April 30, 2000, respectively. Losses are expected to continue through the year ended March 31, 2003 as we expand our sales efforts, particularly in North America, and develop and enhance our current software product offerings. We have incurred an accumulated deficit of $41.4 million through March 31, 2002.

The Company develops and sells two main products, NetVault and MagnaVault. The following is a brief description of each product:

NetVault

NetVault is storage management application software for the backup and restoration of data that addresses the growing data storage needs of systems administrators across a wide range of storage topologies, including: direct-attached storage, network-attached storage, storage area networks and IP storage. NetVault's architecture meets the challenges of storage management for a wide variety of applications, including all of the most popular databases used by firms worldwide. NetVault is currently sold through a network of original equipment manufacturers (OEMs) and solution providers throughout North America, Europe, Middle East, Africa and the Pacific Rim.

In conjunction with the March 2000 acquisition of NetVault Holdings Ltd., we acquired and are the sole owner of the intellectual property rights for the NetVault software.

MagnaVault

MagnaVault is a comprehensive secondary storage (or near-line) management software for UNIX and Linux host operating environments. The MagnaVault family of system software products provides virtual file system support for a wide variety of CD, DVD, optical and tape storage technologies. MagnaVault is designed to maximize the performance and utility of all types of secondary storage media and provides transparent file system access to both NFS (Unix) and CIFS (Windows) clients.

In conjunction with the June 2000 acquisition of Tracer Technologies, Inc., we acquired and are the sole owner of the intellectual property rights for the MagnaVault software.

Operating Results

Our operating results for the year ended March 31, 2002 compared to the eleven months ended March 31, 2001.

Revenues

Revenues for the year ended March 31, 2002 were $9.9 million, consisting of $8.1 million in licensing revenue and $1.8 million in service revenues. Comparatively, revenues for the eleven months ended March 31, 2001 were $5.0 million, consisting of $4.2 million in licensing revenue and $789,000 in services revenue.

Licensing Revenues

Our products are sold almost exclusively through our channel partners, VARs, VADs and OEMs, in three geographic segments: Asia, North America and Europe. Asia, North America and Europe contributed $3.7 million, $3.0 million and $1.4 million, respectively, during the year ended March 31, 2002. During the eleven months ended March 31, 2001, Asia, North America and Europe contributed $2.5 million, $1.3 million and $400,000, respectively.

During the year ended March 31, 2002 and the eleven months ended March 31, 2001, our Asian operations provided 46% and 60% of total licensing revenues, respectively. Asian revenues increased $1.2 million, or 48%, due to continued market acceptance of NetVault software in Japan and to expansion into new territories including: China, Korea and Vietnam. As of March 31, 2002, these new territories were directed from one office in Tokyo, Japan.

During the year ended March 31, 2002 and the eleven months ended March 31, 2001, our North American operations provided 37% and 30% of total licensing revenues, respectively. North American revenues increased $1.8 million, or 137%, resulting primarily from the growth in our North American NetVault sales force and the increased market acceptance of NetVault. We began establishing our partner channels for NetVault in North America in July 2000 and as of March 31, 2001, we had executed partner agreements with over 50 VAR / VAD partners, and grew the number of VAR / VAD partners to 70 by March 31, 2002. Furthermore, as we first introduced NetVault in North America in August 2000, the year ended March 31, 2002 contained 12 months of NetVault sales, whereas the eleven months ended March 31, 2001 contained only eight months of NetVault sales. Average monthly sales were $252,000 and $160,000 for the year ended March 31, 2002 and the eleven months ended March 31, 2001, respectively. The increase in average monthly revenue coincides with the overall revenue growth trend in North America.

During the year ended March 31, 2002 and the eleven months ended March 31, 2001, our European operations provided 17% and 10% of total licensing revenues, respectively. These revenues resulted almost entirely from sales of NetVault and were generated from our sales office in Poole, Dorset, United Kingdom. European revenues increased $957,000, or 240%, resulting from increased sales in all regions of Europe, as well as from expansion into Israel and South Africa during the year ended March 31, 2002.

Service Revenues

Service revenues consists principally of maintenance revenues derived from the sale of customer support contracts for both NetVault and MagnaVault. These contract fees generally approximate 20% of the licensing fee. Revenues from customer support contracts are deferred and amortized on a straight-line basis over the life of the contract, generally one year. North America, Asia and Europe contributed $1.0 million, $359,000 and $379,000, respectively, for service revenues for the year ended March 31, 2002.

During the year ended March 31, 2002, service revenues generated in North America, European and Asian regions were 58%, 22% and 20% of total service revenues, respectively. During the eleven months ended March 31, 2001, service revenues generated in the North America, European and Asian regions were 40%, 35%

and 25%, respectively. The increase noted in North American service revenues as a percent of total service revenues resulted from a combination of the first full year of maintenance services being provided to North American customers and the first maintenance contract renewals.

As of March 31, 2002, NetVault and MagnaVault were supported from our offices in North America, Europe and Asia.

Cost of Revenues

Cost of revenues totaled $1.2 million and $782,000, or 13% and 16% of total revenues, during the year ended March 31, 2002 and the eleven months ended March 31, 2001, respectively. These costs consisted primarily of the direct cost of providing customer support, including salary and benefits of staff working in our customer support departments as well as associated costs of computer equipment, telephone and other general costs necessary to maintain an adequate level of customer support to our end users. Also included in cost of revenues are the direct costs of raw materials and packaging for the products shipped to customers. These costs, however, are nominal as the products shipped to customers consist of a CD, manual, printed box and other media. Product costs for these items individually and in aggregate are minimal and we have little risk of inventory obsolescence due to the small quantities of these items needed to fill our customers' orders and the short lead time to acquire additional materials. Raw material purchases are held in inventory until the sale of the related software product at which time the cost per unit sold is released to cost of revenues.

The decrease in cost of revenues as a percent of total revenues resulted from a combination of higher average revenue per client service representative, increased efficiencies in distributing and supporting our software products, and reduced customer service headcount during the year ended March 31, 2002.

Sales and Marketing Expenses

Sales and marketing expenses totaled $11.1 million and $11.7 million, or 113% and 235% of total revenues, during the year ended March 31, 2002 and the eleven months ended March 31, 2001, respectively. Sales and marketing expenditures, which consist primarily of payroll, commission, marketing and travel costs, remained relatively consistent between the two periods. However, additional resources were expended during the eleven months ended March 31, 2001 to introduce the NetVault product in North America. Our efforts to introduce NetVault and promote MagnaVault in North America during the eleven months ended March 31, 2001 led to substantial spending in advertising and public relations. We engaged in similar activities during the year ended March 31, 2002, albeit to a lesser extent.

The decrease in sales and marketing expenses as a percentage of total revenues was primarily a function of revenue growth during the year ended March 31, 2002, as total sales and marketing expense in dollars remained fairly consistent. Thus, to the extent that revenues increase, we expect that sales and marketing expense will decrease as a percentage of total revenues.

Research and Development Expenses

Research and development expenses totaled $4.1 million and $3.6 million, or 42% and 72% of total revenues, during the year ended March 31, 2002 and the eleven months ended March 31, 2001, respectively. Research and development expenses consist primarily of salary and related costs for our worldwide engineering staff. The decrease in research and development expenses as a percentage of revenues was due primarily to the increase in revenue between the year ended March 31, 2002 and the eleven months ended March 31, 2001.

The increase in total dollars spent on research and development activities during the year ended March 31, 2002 was due to increased average monthly headcount and increased expenditures related to travel, as we increased our focus on sales engineer client site visits during the year ended March 31, 2002. The majority of our

engineering efforts are carried out in the United States and United Kingdom; these locations are responsible for the ongoing development and testing of our products. Engineering efforts in Japan are minimal and relate to creating functionality and interface capabilities for users in the Asian region.

General and Administrative Expenses

General and administrative expenses totaled $5.7 million and $8.0 million, or 57% and 162% of total revenues, during the year ended March 31, 2002 and the eleven months ended March 31, 2001, respectively. General and administrative expenses consisted primarily of salary and related costs for our 29 executive and administrative employees throughout our worldwide offices as of March 31, 2002, which decreased from 32 employees as of March 31, 2001. The headcount and expense decrease was partially attributable to the departure from the company of several highly compensated individuals. In addition, during the eleven months ended March 31, 2001, we incurred higher levels of both computer systems and corporate structure related consulting fees, as well as higher intellectual property related legal fees than we did during the year ended March 31, 2002. During the eleven months ended March 31, 2001, we implemented a new accounting system and expended significant resources on securing and protecting our intellectual property.

Amortization and Impairment of Intangibles

Amortization and impairment of intangibles totaled $6.2 million and $3.2 million for the year ended March 31, 2002 and the eleven months ended March 31, 2001, respectively. We recorded intangibles of $8.5 million relating to the acquisition of Tracer in June 2000, $99,000 relating to the 25% minority interest acquisition of Tracer KK in January 2002, and $3.1 million relating to the 53% minority interest acquisition of BakBone KK in March of 2002. Pursuant to new Canadian GAAP standards, intangibles acquired in a business combination for which the acquisition date is after June 30, 2001 are not amortized. Intangibles acquired on or after July 1, 2001 are tested for impairment in the same manner as previously recorded intangibles. Intangibles acquired on or before June 30, 2001 are amortized through the initial adoption date of the new standard, or April 1, 2002 as it relates to the Company. Previously recorded intangibles were recorded at cost and amortized on a straight-line basis over three years. We assess the recoverability of intangibles by determining whether the amortization of the balance over its remaining life can be recovered through undiscounted future operating cash flows of the acquired operation. The amount of intangibles impairment, if any, is measured based on projected future discounted operating cash flows using a discount rate reflecting our average cost of funds. The assessment of the recoverability of intangibles will be impacted if estimated future operating cash flows are not achieved.

In connection with the acquisition of Tracer, we acquired exclusive intellectual property rights to MagnaVault. Since the initial acquisition date, we have marketed and sold MagnaVault as a stand-alone software product. MagnaVault revenues were flat during the first three quarters of the year ended March 31, 2002, with a notable decrease during the fourth quarter of the year ended March 31, 2002. Based on MagnaVault's results of operations during the fourth quarter of the year ended March 31, 2002, we performed an impairment analysis of the Tracer intangibles. As of March 31, 2002, we determined that the carrying value of the Tracer intangibles exceeded fair value as determined by the estimated discounted cash flows expected to be generated by the underlying assets. Therefore, we recorded an impairment charge of $2.5 million in the accompanying consolidated statement of operations for the year ended March 31, 2002, reflecting the difference between the carrying value and discounted projected future cash flows.

Our operating results for the eleven months ended March 31, 2001 compared to the two months ended April 30, 2000.

Revenues

Revenues for the eleven months ended March 31, 2001 were $5.0 million, consisting of $4.2 million in licensing revenues and $789,000 in service revenues. Comparatively, revenues for the two months ended April 30, 2000 were $337,000, consisting of $242,000 in licensing revenues and $95,000 in service revenues. As

the results for the two months ended April 30, 2000 period consist of only two months of operations, total revenues do not provide a comparable basis of analysis. To provide a basis of comparison, the following analysis of licensing and service revenues focuses on individual revenues as a percent of total revenues for each of the applicable periods as well as an analysis of average monthly revenues.

Licensing Revenues

Asia, North America and Europe contributed $2.5 million, $1.3 million, and $398,000 in licensing revenues during the eleven months ended March 31, 2001, respectively. Geographic segments during the two months ended April 30, 2000 consisted of Asia and Europe, which provided $213,000 and $29,000 of licensing revenues, respectively.

During the eleven months ended March 31, 2001 and the two months ended April 30, 2000, our Asian operations provided 60% and 88% of total licensing revenues, respectively. The decrease in the revenue mix for the Asian operations is due to strong growth in our European sales of NetVault as well as the addition of the North American segment during the eleven months ended March 31, 2001. Average monthly licensing revenues for the Asian region for the eleven months ended March 31, 2001 were $228,000 compared to $107,000 for the two months ended April 30, 2000. This increase in average monthly licensing revenues during the eleven months ended March 31, 2001 is due to increased acceptance of the NetVault Software in Japan as well as expansion into new markets. As of March 31, 2001, Asian sales efforts were directed from one office in Tokyo, Japan, and covered all of Asia, Australia and New Zealand as opposed to a focus on Japan only during the two months ended April 30, 2000.

During the eleven months ended March 31, 2001 and the two months ended April 30, 2000, our North American operations provided 30% and 0% of total licensing revenues, respectively. Fiscal 2001 was the Company's first year of sales of both NetVault and MagnaVault in North America. NetVault licensing revenues resulted from the introduction of the NetVault software in North America in August 2000, the growth in our sales force and the increased acceptance of NetVault within the industry. We began establishing our partner channels for NetVault in North America in July 2000 and as of March 31, 2001, we had executed partner agreements with over 50 VAR / VAD partners and one OEM partner, Seagate. Licensing revenues for MagnaVault resulted from our acquisition of Tracer in June 2000, which provided us a core set of over 15 new partners and greater than 6,000 end users. Our sales efforts also focused on the existing MagnaVault customer base as a source of NetVault sales leads.

During the eleven months ended March 31, 2001 and the two months ended April 30, 2000, our European operations provided 10% and 12% of total licensing revenues, respectively. These revenues resulted almost entirely from sales of NetVault and were generated from our sales office in Poole, Dorset, United Kingdom. Average monthly licensing revenues for the European operations for the eleven months ended March 31, 2001 were $36,000 compared to $15,000 for the two months ended April 30, 2000. The increase in average monthly licensing revenues is attributable to expansion into new areas of Europe, the Middle East and Africa during the eleven months ended March 31, 2001.

In addition, sales related to our NCR Teradata agreement, dated May 1999, commenced for our European operations in March 2000 after development of the NetVault plug-in application was completed. NCR sales through March 31, 2001 were predominantly in the European market.

Service Revenues

During the eleven months ended March 31, 2001, service revenues generated in the North America, European and Asian regions were 40%, 35% and 25% of total service revenues, respectively. During the two months ended April 30, 2000, service revenues generated in the European and Asian regions were 68% and 32%, respectively.

The decline in the percentage of service revenues for the European region during the eleven months ended March 31, 2001 is partially a result of the June 2000 Tracer acquisition which provided a substantial support base in North America. Average monthly service revenues for the European region for the eleven months ended March 31, 2001 were $25,000 compared to $33,000 for the two months ended April 30, 2000. The decrease in average monthly service revenues is due to the transfer of support customers located in North America from the European region to the new North America support operations established during the eleven months ended March 31, 2001.

Asian service revenues have remained constant as a percent of total service revenues, but have grown in terms of total dollars. Average monthly service revenues during the eleven months ended March 31, 2001 were $18,000 compared to $15,000 for the two months ended April 30, 2000. The increase in average monthly service revenues is due to the addition of Tracer KK in June 2000 and growing first time sales of support services in the region during the eleven months ended March 31, 2001.

Cost of Revenues

Cost of revenues totaled $782,000 and $37,000 or 16% and 11% of total revenues during the eleven months ended March 31, 2001 and the two months ended April 30, 2000, respectively. The increase in cost of revenues as a percentage of total revenues during the eleven months ended March 31, 2001 is due to the Company's efforts to improve customer support worldwide by hiring additional support personnel to meet the support demands of growing sales worldwide.

Sales and Marketing Expenses

Sales and marketing expenses totaled $11.7 million and $301,000 or 235% and 89% of total revenues during the eleven months ended March 31, 2001 and the two months ended April 30, 2000, respectively. The increase in sales and marketing expenses as a percentage of total revenues was primarily due to costs incurred during the eleven months ended March 31, 2001 necessary to expand our worldwide sales force by 34 personnel to 51 at March 31, 2001 from 17 at April 30, 2000. The additional costs incurred in the expansion of our sales force during the eleven months ended March 31, 2001 included: salary and benefits, commissions, travel and equipment charges.

The increase in headcount was due to the hiring of a substantial number of new sales professionals in North America during the eleven months ended March 31, 2001. Headcounts for the sales departments in the United Kingdom and Japan increased, although to a lesser extent than in North America, during the same period.

Our efforts to introduce NetVault and promote MagnaVault in North America during the eleven months ended March 31, 2001 led to substantial spending in advertising and public relations. In addition, we attended an increased number of tradeshows throughout North America, Asia and Europe to promote our products and demonstrate, on a face-to-face basis with potential customers, their ease of use and speed of backup/restore of data on the many network configurations our products support.

Research and Development Expenses

Research and development expenses totaled $3.6 million and $189,000 or 72% and 56% of total revenues during the eleven months ended March 31, 2001 and the two months ended April 30, 2000, respectively. Dollars spent on research and development efforts increased between the periods due to the addition of engineers in the North American region during the eleven months ended March 31, 2001.

Our research and development expenses consist primarily of salary and related costs for our worldwide engineering staff, which grew to 42 personnel as of March 31, 2001 from 24 as of April 30, 2000. Research and development expenses also increased during the eleven months ended March 31, 2001 due to the set-up and operation of our Interoperability Lab in San Diego, California, developed to test and qualify our software products on various vendor hardware solutions.

General and Administrative Expenses

General and administrative expenses totaled $8.0 million and $759,000, or 162% and 225% of total revenues, during the eleven months ended March 31, 2001 and for the two months ended April 30, 2000, respectively. The decrease in general and administrative expenses as a percentage of total revenues was a function of revenue growth during the eleven months ended March 31, 2001 as many of the general and administrative costs are fixed costs. Thus, as revenues increase, general and administrative expenses as a percentage of total revenues decrease.

General and administrative costs increased in total dollars during the eleven months ended March 31, 2001 due to the addition of executive management and administrative personnel and the related costs of running a worldwide public company.

Furthermore, salary and related costs increased as executive and administrative employees throughout our worldwide offices grew to 32 employees as of March 31, 2001, from 12 employees as of April 30, 2000. In addition, our offices also incurred additional expenses during the eleven months ended March 31, 2001 for: facility rents, build-out and depreciation, maintenance and other related costs.

During the eleven months ended March 31, 2001, we incurred increased legal fees over the two months ended April 30, 2000 related to the identification and protection of our intellectual property, assimilation of acquired entities, public reporting of our financial results and operational information, and general corporate matters. During this period, professional fees from accounting and consulting firms were incurred in the areas of annual audit, quarterly public filings, taxes, implementation of our enterprise reporting package and other general areas.

Amortization and Impairment of Intangibles

Amortization of intangibles totaled $3.2 million and $166,000, or 64% and 49% of total revenues, for the eleven months ended March 31, 2001 and the two months ended April 30, 2000, respectively. The Company recorded intangibles of $2.9 million and $8.5 million relating to the acquisition of NetVault Holdings in March 2000 and Tracer in June 2000, respectively. The Company did not record any intangibles impairment charges during the eleven months ended March 31, 2001.

Liquidity and Capital Resources

We have financed our operations primarily through private placements and a public offering of equity instruments in the Provinces of British Columbia, Alberta and Ontario, Canada. During the year ended March 31, 2002, we raised gross proceeds of $9.7 million through the private placement of 3,000,000 Special Warrants at a price of $3.24 per Special Warrant. Additionally, during the year ended March 31, 2002, the Company completed a public offering of 7,170,400 units at a price of $0.80 per unit for gross proceeds of $5.7 million. Each unit was comprised of one common share and one-quarter common share purchase warrant. During the eleven months ended March 31, 2001, we raised gross proceeds of $4.5 million through the exercise of 3,694,934 warrants at a weighted average price of $1.23 per warrant, and we entered into a line of credit with a bank that provided us with $2.5 million in net borrowings during the year. During the year ended April 30, 2000, the Company raised gross proceeds of $26.5 million through the private placement of 6,000,000 Series A Special Warrants and 3,000,000 Series B Special Warrants at prices of $1.03 and $6.77, respectively. Net proceeds to the Company after financing costs were $24.4 million.

Net cash used in operating activities was $12.7 million and $18.0 million during the year ended March 31, 2002 and the eleven months ended March 31, 2001, respectively. Cash used in operating activities during the year ended March 31, 2002 resulted from a net loss of $18.8 million, partially offset by non-cash depreciation and amortization of $4.6 million and impairment of intangibles of $2.5 million. Other operating activities that

contributed to the use of cash during the year ended March 31, 2002 included increases in accounts receivable of $1.9 million and other assets of $10,000, and a decrease in accounts payable of $723,000. Providing sources of cash were increases in accrued liabilities of $647,000 and deferred revenue of $626,000. Net cash used in operating activities during the eleven months ended March 31, 2001 resulted from a net loss of $21.7 million partially offset by non-cash depreciation and amortization of $3.8 million. Other operating activities providing a significant use of cash during the eleven months ended March 31, 2001 were the increases in accounts receivable of $363,000 and other assets of $568,000, and those providing a source of cash consisted of increases in accounts payable of $190,000, accrued liabilities of $417,000 and deferred revenue of $273,000. The decrease in cash used in operating activities of $5.3 million from the eleven months ended March 31, 2001 to the year ended March 31, 2002, is due primarily to a decrease in global headcount from 162 as of March 31, 2001 to 138 as of March 31, 2002 and a decrease in general and administrative costs, including reductions in legal, accounting and consulting expenditures.

Net cash used in investing activities was $509,000 and $4.6 million during the year ended March 31, 2002 and the eleven months ended March 31, 2001, respectively. Net cash used in investing activities during the year ended March 31, 2002, consisted partially of capital expenditures of $433,000, which related primarily to the purchase of computer equipment. Cash expended in connection with the January 2002 minority interest acquisition of Tracer KK contributed $117,000 to cash used in investing activities. Net cash used in investing activities during the eleven months ended March 31, 2001 consisted partially of $1.6 million for the acquisition of Tracer in June 2000 (net of cash acquired of $800,000). Capital expenditures during the eleven months ended March 31, 2001 of $3.0 million included the purchase of an enterprise resource planning system, a customer relationship management system, a global telecommunications system, equipment and devices for interoperability testing, and the build-out of our corporate headquarters in San Diego, California and our new offices in Tokyo, Japan.

Net cash provided by financing activities was $15.1 million and $6.2 million during the year ended March 31, 2002 and the eleven months ended March 31, 2001, respectively. Cash provided by financing activities during the year ended March 31, 2002 consisted primarily of gross proceeds from special warrants of $9.7 million, gross proceeds from a public warrant offering of $5.7 million, and gross proceeds from a private placement of $332,000. The proceeds were partially offset by cash used in financing activities consisting mainly of the payment of notes payable of $812,000, the payment of equity offering costs of $507,000, and the payment of capital lease obligations of $177,000. Net cash provided by financing activities during the eleven months ended March 31, 2001 consisted primarily of proceeds of $4.5 million from the exercise of share purchase warrants. In addition, we entered into a line of credit with a bank that provided $2.5 million of net borrowings and we received $570,000 from the exercise of stock options during the eleven months ended March 31, 2001. Net cash used in financing activities during the eleven months ended March 31, 2001 consisted mainly of an $870,000 increase in restricted cash, $132,000 of capital lease payments, $288,000 of note payments and an additional $144,000 in offering costs associated with the Special Warrant offering.

The following summarizes BakBone's contractual obligations at March 31, 2002 (in thousands).

	Total	Less Than One Year	1-3 Years	4-5 Years	After 5 Years
CONTRACTUAL OBLIGATIONS:					
Long-term debt (1)	$1,950	—	1,950	—	—
Capital equipment debt	$ 255	201	54	—	—
Non-cancelable operating lease obligations	$5,040	1,440	2,434	790	376

(1) Under the long-term debt arrangement, an amount equal to 10% of the net proceeds raised from any of our financings between February 2002 and December 2003 will be paid to the credit provider in the form of principal reductions.

We currently expect to fund expenditures for capital requirements as well as liquidity needs from a combination of available cash balances, internally generated funds and financing arrangements. We believe that

existing cash and cash equivalents will be sufficient to meet our anticipated cash needs through the current fiscal year. If cash generated from operations is insufficient to satisfy our liquidity requirements, we may seek additional sources of funding. We are currently a party to a term note with a bank that matures on December 31, 2003. We are in compliance with all requirements set forth in the credit agreement. Internally generated funds may not be sufficient to cover the Company's liquidity requirements, and in that case, we may be required to obtain additional credit facilities from either our existing credit facility provider or others. Additional debt would result in increased interest expenses and could result in covenants that would restrict our operations. Additionally, a decrease in demand for our products and services could adversely affect our business, which in turn, could adversely affect our ability to renew existing, or obtain access to new credit facilities in the future and could increase the cost of such facilities. We may also seek additional sources of funding, including the public or private issuance of equity instruments, such as warrants; however, there is no guarantee that such sources will be available in amounts or on terms acceptable to us, if available at all. The sale of additional equity securities would result in immediate and potentially significant dilution to our shareholders.

Estimated future uses of cash in 2003 include capital expenditures for equipment of approximately $400,000.

At March 31, 2002, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we did not engage in trading activities involving on-exchange traded contracts. As a result, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships. We do not have relationships and transactions with persons or entities that derive benefits from their non-independent relationship with us or our related parties except as disclosed herein.

Inflation and Changing Prices

Inflation and changing prices have not had a material impact on our operations.

Foreign Currency

Our revenues result mainly from sales made in U.S. dollars, British pounds and Japanese yen. We will continue to incur operating costs mainly in U.S. dollars, British pounds, Japanese yen and, to a lesser extent, Canadian dollars. Thus, our operations are susceptible to fluctuations in currency exchange rates. We do not currently engage in hedging or other activities to reduce exchange rate risk but may do so in the future, if conditions warrant.

Risk Factors

The Company is subject to each of, and the cumulative effect of all of, the following risk factors:

- Dependence on large orders from end-user customers for a significant portion of revenues;
- Significant amounts of revenues derived from only a few customers;
- Intense competition on several fronts;
- Potential need to raise capital;
- Potential fluctuation of revenues between quarters which could cause extreme volatility in our stock price;
- Management of future growth and expansion;
- Risk of third party claims of infringement;
- Protection of proprietary information;
- Termination of existing strategic alliances and inability to develop new strategic alliances;
- Constant management of distribution channels;
- Reliance on competing equipment manufacturers as a material source of revenues;
- OEM agreements that may not result in increased product sales;
- Lack of diversification of existing product lines;
- Short product life cycle associated with software;
- Development of new and enhanced products that achieve widespread market acceptance;
- Potential for significant product defects which may result in liability or decreased sales;
- Ability to hire and retain qualified employees and key management personnel;
- Operations in foreign countries;
- Costs of integrating recently acquired companies may continue; and
- Power outages or natural disasters could disrupt our business.

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
BakBone Software Incorporated:

We have audited the consolidated balance sheets of BakBone Software Incorporated and subsidiaries (the Company) as of March 31, 2002 and 2001, and the related consolidated statements of operations, shareholders' equity, and cash flows for the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of March 31, 2002 and 2001, and the results of its operations and its cash flows for the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000, in conformity with accounting principles generally accepted in Canada.

KPMG LLP

San Diego, California
United States of America
June 5, 2002

BAKBONE SOFTWARE INCORPORATED

CONSOLIDATED BALANCE SHEETS

March 31, 2002 and 2001

(in thousands, except share data)
(in U.S. dollars)

	2002	2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,502	$ 3,815
Restricted cash (Note 7)	804	90
Accounts receivable, net of allowance for doubtful accounts of $72 and $28, respectively	3,289	1,404
Other assets	588	500
Total current assets	10,183	5,809
Capital assets, net (Notes 3 and 12)	2,762	3,736
Restricted cash (Note 7)	—	780
Intangibles, net (Notes 2 and 12)	4,784	7,831
Other assets	567	602
Total assets	$ 18,296	$ 18,758
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 645	$ 1,368
Accrued liabilities	1,938	1,121
Deferred revenue	1,297	671
Current portion of capital lease obligations (Note 11)	201	192
Current portion of notes payable (Note 9)	—	2,574
Loans from related parties (Note 10)	63	75
Total current liabilities	4,144	6,001
Capital lease obligations, excluding current portion (Note 11)	54	240
Notes payable, excluding current portion (Note 9)	1,950	188
Total liabilities	6,148	6,429
Minority interest	—	100
Shareholders' equity:		
Share capital, no par value, unlimited shares authorized, 53,121,681 and 41,747,922 shares issued and outstanding, respectively	51,861	35,843
Share capital to be issued	2,877	—
Share capital held by subsidiary	(66)	(66)
Accumulated deficit	(41,379)	(22,588)
Cumulative exchange adjustment	(1,145)	(960)
Total shareholders' equity	12,148	12,229
Commitments and contingencies		
Total liabilities and shareholders' equity	$ 18,296	$ 18,758

See accompanying notes to consolidated financial statements.

BAKBONE SOFTWARE INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

Year ended March 31, 2002,
the eleven months ended March 31, 2001,
and the year ended April 30, 2000

(in thousands, except per share and share data)
(in U.S. dollars)

	2002	2001	2000
Revenues (Note 12)	$ 9,863	$ 4,975	$ 337
Cost of revenues	1,244	782	37
Gross margin	8,619	4,193	300
Operating expenses:			
Sales and marketing	11,149	11,672	301
Research and development	4,122	3,584	189
General and administrative	5,659	8,044	759
Total operating expenses	20,930	23,300	1,249
Operating loss	(12,311)	(19,107)	(949)
Interest (expense) income, net	(108)	396	156
Amortization and impairment of intangibles (Note 2)	(6,235)	(3,203)	(166)
Foreign exchange gains, net	110	5	—
Other (expense) income, net	(359)	177	63
Minority interest	112	40	—
Net loss	$ (18,791)	$ (21,692)	$ (896)
Loss per share—basic and diluted (Note 2)	$ (0.46)	$ (0.87)	$ (0.11)
Weighted-average common shares (Note 2)	40,869,526	24,903,458	8,044,711

See accompanying notes to consolidated financial statements.

BAKBONE SOFTWARE INCORPORATED

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Year ended March 31, 2002,
the eleven months ended March 31, 2001,
and the year ended April 30, 2000

(in thousands, except share data)
(in U.S. dollars)

	Share Capital		Share Capital to be Issued		Share Capital Held by Subsidiary	Accumulated Deficit	Special Warrants	Cumulative Exchange Adjustment	Total Shareholders' Equity
	Shares	Amount	Shares	Amount					
BALANCE, MAY 1, 1999	5,662,429	$ 17,460	—	$ —	$—	$ —	$ —	$ —	$17,460
Issued in private placements, net of issuance costs	2,860,000	496	—	—	—	—	—	—	496
Exercise of stock options	550,600	159	—	—	—	—	—	—	159
Exercise of warrants	2,350,001	201	—	—	—	—	—	—	201
Sale of special warrants, net of issuance costs	—	—	—	—	—	—	24,357	—	24,357
Issued to acquire NVS	15,625,000	(209)	—	—	—	—	—	—	(209)
NVS share capital	—	9	—	—	—	—	—	—	9
Issued to acquire BakBone KK	375,000	(31)	—	—	—	—	—	—	(31)
Elimination of Net Resources share capital	—	(18,025)	—	—	—	—	—	—	(18,025)
Cumulative exchange adjustment	—	—	—	—	—	—	—	(285)	(285)
Net loss	—	—	—	—	—	(896)	—	—	(896)
BALANCE, APRIL 30, 2000	27,423,030	60	—	—	—	(896)	24,357	(285)	23,236
Exercise of stock options	303,958	570	—	—	—	—	—	—	570
Conversion of special warrants and remaining issuance costs	9,726,000	24,213	—	—	—	—	(24,357)	—	(144)
Exercise of warrants	3,694,934	4,536	—	—	—	—	—	—	4,536
Issued to acquire Tracer	600,000	6,464	—	—	—	—	—	—	6,464
Share capital held by subsidiary	—	—	—	—	(66)	—	—	—	(66)
Cumulative exchange adjustment	—	—	—	—	—	—	—	(675)	(675)
Net loss	—	—	—	—	—	(21,692)	—	—	(21,692)
BALANCE, MARCH 31, 2001	41,747,922	35,843	—	—	(66)	(22,588)	—	(960)	12,229
Exercise of stock options	13,000	9	—	—	—	—	—	—	9
Sale of special warrants, net of issuance costs	—	—	—	—	—	—	9,706	—	9,706
Conversion of special warrants	3,000,000	9,706	—	—	—	—	(9,706)	—	—
Issued in public share offering, net of issuance costs	7,170,400	5,212	—	—	—	—	—	—	5,212
Issued in private placement, net of issuance costs	440,834	322	—	—	—	—	—	—	322
Exercise of warrants	749,525	769	—	—	—	—	—	—	769
Issued to acquire remaining interest in BakBone KK	—	—	2,100,000	2,877	—	—	—	—	2,877
Cumulative exchange adjustment	—	—	—	—	—	—	—	(185)	(185)
Net loss	—	—	—	—	—	(18,791)	—	—	(18,791)
BALANCE, MARCH 31, 2002	53,121,681	$ 51,861	2,100,000	$2,877	$ (66)	$(41,379)	$—	$(1,145)	$12,148

See accompanying notes to consolidated financial statements.

BAKBONE SOFTWARE INCORPORATED

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000

(in thousands) (in U.S. dollars)

	2002	2001	2000
Cash flows from operating activities:			
Net loss	$(18,791)	$(21,692)	$ (896)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	4,637	3,788	185
Impairment of intangibles	2,508	—	—
Minority interest	(112)	(40)	—
Loss on disposal of capital assets	443	13	—
Gain on sale of non-operating subsidiaries	(119)	—	—
Unrealized loss on investment	76	—	—
Changes in assets and liabilities, net of effects of acquisitions:			
Accounts receivable, net	(1,885)	(363)	72
Other assets	(10)	(568)	(148)
Accounts payable	(723)	190	(221)
Accrued liabilities	647	417	444
Deferred revenue	626	273	(1)
Net cash used in operating activities	(12,703)	(17,982)	(565)
Cash flows from investing activities:			
Capital expenditures	(433)	(3,011)	(193)
Cash expenditures related to acquisitions, net of cash acquired	(117)	(1,614)	(2,454)
Proceeds from sale of capital assets	41	26	—
Net cash used in investing activities	(509)	(4,599)	(2,647)
Cash flows from financing activities:			
Payments of capital lease obligations	(177)	(132)	(2)
Proceeds from notes payable	—	2,500	—
Payments of notes payable	(812)	(288)	—
Proceeds from issuance of special warrants	9,734	—	26,095
Proceeds from public offering	5,681	—	—
Proceeds from private placement	332	—	—
Offering costs related to equity financings	(507)	(144)	(2,099)
Proceeds from exercise of stock options	9	570	129
Proceeds from exercise of warrants	769	4,536	162
Payments of related party loans	(12)	—	(53)
Decrease (increase) in restricted cash	66	(870)	—
Net cash provided by financing activities	15,083	6,172	24,232
Effect of exchange rate changes on cash and cash equivalents	(184)	(511)	(285)
Net (decrease) increase in cash and cash equivalents	1,687	(16,920)	20,735
Cash and cash equivalents, beginning of period	3,815	20,735	—
Cash and cash equivalents, end of period	$ 5,502	$ 3,815	$20,735
Cash paid during the period for:			
Interest	$ 291	$ 77	$ —
Income taxes	$ —	$ —	$ —
Supplemental disclosures of cash flow information-businesses acquired:			
Fair value of assets acquired, net of cash acquired	$ —	$ 688	$ 1,423
Liabilities assumed	$ —	$ 970	$ 1,777
Acquisition consideration classified in accrued liabilities	$ 170	$ —	$ —
Non-cash investing and financing activities:			
Equipment acquired under capital leases	$ —	$ 555	$ —
Investment received from sale of non-operating subsidiaries	$ 126	$ —	$ —
Share capital issued in connection with acquisitions	$ —	$ 6,509	$ 240
Share capital to be issued in connection with acquisitions	$ 2,877	$ —	$ —

See accompanying notes to consolidated financial statements.

BAKBONE SOFTWARE INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2002 and 2001

(in U.S. dollars)

(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 storage management solutions to the open systems markets, providing data protection and management solutions scalable from workgroup to enterprise. The Company's corporate headquarters are located in San Diego, California.

The Company, formerly Net Resources Incorporated (Net Resources), was originally incorporated in the Canadian Province of British Columbia under the Company Act. In November 1992, the Company continued from British Columbia to the Province of Alberta where it engaged in mineral exploration activities. These exploration activities were ceased during 1999 due to declining prices in the mineral markets, and the mining assets were written off. On March 13, 2000, the Company changed its name to BakBone Software Incorporated.

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.

On March 16, 2000, the Company acquired 100% of NVS Holdings Inc. (NVS). This acquisition resulted in a reverse takeover of the Company by NVS as the greater proportion of the voting shares of the Company were held by NVS shareholders after the acquisition. Concurrent with the reverse takeover of the Company, the merged entity acquired NetVault Holdings Limited, NetVault Limited and an aggregate 47% of NetVault Corporation (BakBone KK). At the time of this acquisition, NetVault Holdings Limited was a non-operating private shell while NetVault Limited and NetVault Corporation had substantive operations. In regards to these acquisitions, the Company determined that the operations of the acquired companies were not material during the period from March 1, 2000 through the actual date of the acquisition and as such assigned a convenience date of March 1, 2000 for accounting purposes.

On June 9, 2000, the Company acquired all of the issued and outstanding common shares of Tracer Technologies, Inc. and its 50% ownership of the common shares of Tracer Technologies Japan Corporation (collectively Tracer), for cash and acquisition costs totaling $1.6 million (net of cash acquired of $800,000) and 600,000 common shares of the Company valued at $6.5 million on the date of acquisition. Of the 600,000 shares issued, 122,340 shares were issued to a trust beneficially owned by the family of a former director of the Company. The acquisition was accounted for by the purchase method of accounting, and accordingly, the operating results of Tracer have been included in the accompanying consolidated financial statements of the Company from the date of acquisition. The excess of purchase price over the fair value of the net assets acquired of $400,000 was $8.5 million and is being amortized on a straight-line basis over three years, the expected useful life (Note 2(e)). In order to retain certain principals of Tracer as employees, the Company issued stock options to acquire 250,000 common shares at an exercise price of $4.06 ($6.00 Canadian) per share. One of the principals is a relative of a former director of the Company and received options to acquire 62,500 common shares. The former director also indirectly received 3,060 common shares of the Company through his ownership in Tracer Technologies Japan Corporation (Tracer KK), one of the former shareholders of Tracer. (See Note 2(e) for discussion related to Tracer intangibles impairment).

In January 2002, the Company acquired an additional 25% of Tracer KK in exchange for $100,000 in cash and contingent consideration, consisting of $100,000 in cash and 30,000 shares of the Company's common stock. The issuance of contingent consideration is dependent upon the seller maintaining employment with the Company, as defined in the acquisition agreement. The excess of purchase price over the fair value of net assets

acquired was $99,000. In March 2002, the Company acquired the remaining 25% of Tracer KK for nominal consideration. Both acquisitions were accounted for by the purchase method of accounting. Following the March 2002 acquisition, Tracer KK is a wholly-owned subsidiary of the Company.

In March 2002, the Company acquired the remaining 53% of BakBone KK for 2,100,000 common shares of the Company, valued at $2.9 million at the time of acquisition, and $170,000 in cash, of which $120,000 will be paid in twelve equal monthly installments commencing April 1, 2002, and the remaining $50,000 upon the earlier of the Company's next financing or March 31, 2004. The 2,100,000 shares will be issued during fiscal 2003. The acquisition was accounted for by the purchase method of accounting and the excess of purchase price over the fair value of the net assets acquired was $3.1 million.

(2) Significant Accounting Policies

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada.

The Company has reviewed the currency used for financial reporting purposes and has determined U.S. dollars to be the reporting currency, as the majority of the Company's revenues and expenses for the year ended March 31, 2002 are denominated in U.S. dollars. In the opinion of management, U.S. dollars will remain the reporting currency as operations in the U.S. are expected to continue to represent the majority of revenues and expenses in future periods. As a result of this change in reporting currency from Canadian dollars and for comparison purposes, the consolidated financial statements for all prior periods have been translated to U.S. dollars.

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, BakBone Software, Inc., NVS, BakBone Software Ltd. (formerly NetVault Holdings Ltd.), BakBone Acquisition Corp. (formerly Tracer Technologies, Inc.), BakBone KK and Tracer KK. All intercompany transactions and accounts have been eliminated in consolidation.

Prior to the March 2002 acquisitions, upon which BakBone KK and Tracer KK became wholly-owned subsidiaries of the Company, the Company recorded entries to account for the minority interests in the net income or loss of BakBone KK and Tracer KK. As the minority interest parties were not legally liable to fund BakBone KK and Tracer KK's net losses, the Company did not record their minority interest share of BakBone KK and Tracer KK's net losses to the extent it would result in a minority interest receivable. In conjunction with the March 2002 acquisitions, all minority interest liabilities were eliminated.

(b) Foreign Currency

The accounts of the Company's foreign subsidiaries are translated into U.S. dollars using the current rate method whereby monetary items are translated at the rate of exchange in effect at the balance sheet date, and revenue and expense items are translated at the average exchange rate during the reporting period. Foreign currency translation gains and losses are included as a separate component of shareholders' equity.

Certain transactions of the Company's foreign subsidiaries are carried out in currencies other than the subsidiaries' local currency. Gains or losses resulting from these transactions are included in results of operations as incurred.

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of money market instruments, commercial paper and other highly liquid investments with original maturities of three months or less from the date of purchase. Cash and cash equivalents subject to restriction are classified as restricted cash (Note 7).

(d) Capital Assets

Capital assets are recorded at cost and depreciated 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	Shorter of estimated useful life or life of lease

(e) Intangibles and Impairment

Pursuant to a new Canadian GAAP standard (Canadian Institute of Chartered Accountants Handbook Section 3062, *Goodwill and Other Intangible Assets)*, intangibles acquired in business combinations for which the acquisition date is after June 30, 2001 are not amortized. Intangibles acquired on or after July 1, 2001 are tested for impairment in the same manner as previously recorded intangibles. Intangibles acquired on or before June 30, 2001 are amortized through the initial adoption date of the new standard, or April 1, 2002 as it relates to the Company. The Company assesses the recoverability of intangibles by determining whether the amortization of the balance over its remaining life can be recovered through undiscounted future operating cash flows of the acquired operation. The amount of intangibles impairment, if any, is measured based on projected discounted future operating cash flows using a discount rate reflecting the Company's average cost of funds. The assessment of the recoverability of intangibles will be impacted if estimated future operating cash flows are not achieved. Previously recorded intangibles were recorded at cost and amortized on a straight-line basis over three years.

Intangibles, net of accumulated amortization, were $4.8 million and $7.8 million as of March 31, 2002 and 2001, respectively.

During the quarter ended March 31, 2002, the Company determined the carrying value of certain intangibles were impaired. The impaired intangibles were originally recorded in connection with the Company's acquisition of Tracer. In recent months, the operating results of Tracer's core product have declined to a level indicating potential impairment. The Company determined that the carrying value of the Tracer intangibles exceeded the fair value. The Company used the present value of estimated cash flows in order to assess the fair value of the intangible. An impairment loss was recorded for the amount by which the carrying value of the intangible exceeded the fair value of the intangibles. The Company recorded an impairment charge of $2.5 million as a component of "amortization and impairment of intangibles" in the accompanying consolidated statement of operations for the year ended March 31, 2002.

(f) Revenue Recognition

The Company derives revenue from licensing its software and from the sale of customer support services (maintenance) and professional services. Professional services include training and consulting services. The

Company sells almost exclusively through a network of partners and all sales are based on a published master price list with set discounts given to partners based on their specific contract with the Company.

Vendor specific objective evidence exists for the software element and the professional services element in that the Company sells each element separately, based on the established prices in the master price list. The prices for professional services are based on set hourly rates. Vendor specific objective evidence exists for the maintenance element in that the maintenance agreements include technical support for a one year period, with an option to renew the agreements for a period of one or more years, and the annual renewal fee ranges generally from 18% to 22% of the software license fee. As vendor specific objective evidence exists for each element, the Company uses separate element accounting. The Company has standard payment terms, which it offers to all of its customers, and does not offer any extended payment terms. In addition, the Company's sales agreements do not contain stock balancing rotation rights.

The Company recognizes software license revenue upon meeting certain defined criteria including: the receipt of an executed written contract or purchase order, delivery of the product to the customer, determination that the software license fees are fixed and determinable, and determination that collection of the software license fees is probable. If any of the criteria are not met, the Company defers recognition of the software license revenue until the criteria are met. The Company recognizes revenue from professional services as the services are performed. The Company recognizes revenue from maintenance contracts ratably over the related contract period.

(g) Cost of Revenue

Cost of revenue includes material, packaging, shipping and other production costs. Cost of revenue also includes salaries, benefits and overhead costs associated with employees providing support services.

(h) Product Development Costs

Product development costs related to research, design and development of software applications are charged to expense as incurred. To date, completion of working models of the Company's applications and the general release of the products have substantially coincided. As a result, the Company has not capitalized any application development costs as such costs have been insignificant.

(i) Loss per Share

During the year ended March 31, 2002, the Company retroactively adopted the new Canadian standard relating to the computation of earnings per share (Canadian Institute of Chartered Accountants Handbook Section 3500, *Earnings Per Share*). Under the new standards, contingently issuable shares are considered outstanding common shares and included in the computation of basic earnings per share only as of the date that all conditions necessary for their issuance have been satisfied. Previously, all contingently issuable shares were included in the computation of basic earnings per share, regardless of contingency satisfaction. All earnings per share calculations for prior periods have been retroactively restated to reflect the new standards.

Basic earnings or loss per share is calculated using the weighted-average number of common shares outstanding. Diluted earnings or loss per share is calculated similar to basic earnings or loss per share except that the weighted-average shares outstanding are increased to include additional shares from the assumed exercise of potential common shares, if dilutive. For the year ended March 31, 2002, the eleven months ended March 31,

2001, and the year ended April 30, 2000, 10,561,095, 14,579,746 and 25,727,066 potential common shares, respectively, were excluded from the computations of diluted loss per share as their effect was anti-dilutive.

(j) Stock-Based Compensation

The Company's stock-based compensation arrangements are described in Note 5. No compensation expense is recognized for these plans when stock options are issued to employees and consultants for services rendered.

(k) Income Taxes

The Company applies the asset and liability method of accounting for deferred income taxes, under which future income tax assets and liabilities are determined based on temporary differences and are measured using the current, or substantially enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against deferred income tax assets if it is more likely than not that the assets will not be realized.

(l) Financial Instruments and Market Risk

Cash and cash equivalents, restricted cash, accounts receivable, accounts payable, accrued liabilities, notes payable and loans from related parties constitute financial instruments. The carrying value of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities approximates their fair value given the relatively short periods to maturity. The carrying value of notes payable approximates its fair value because its interest rates and other terms are comparable to those currently available to the Company in the marketplace. The fair value of loans from related parties cannot be ascertained due to the related party nature of the debt.

The Company is exposed to the risks that arise 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.

During the year ended March 31, 2002 and the eleven months ended March 31, 2001, no single customer represented more than 10% of total revenues. During the year ended April 30, 2000, the Company had sales to four customers that represented 13%, 12%, 11% and 11% of total revenues, respectively.

(m) Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in Canada requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Areas where significant judgment are made include, but are not limited to: allowance for doubtful accounts, deferred income tax asset valuation allowance, revenue recognition, capital assets and intangibles valuation, and contingencies. Actual results could differ from those estimates.

(3) Capital Assets

Capital assets consisted of the following at March 31, 2002 and 2001 (in thousands):

	Cost	Accumulated depreciation	Net book value
March 31, 2002:			
Computer equipment and software	$2,833	$ 959	$1,874
Furniture and fixtures	523	154	369
Leasehold improvements	620	101	519
	$3,976	$1,214	$2,762
March 31, 2001:			
Computer equipment and software	$3,126	$ 452	$2,674
Furniture and fixtures	468	46	422
Leasehold improvements	684	44	640
	$4,278	$ 542	$3,736

(4) Equity

Public Offering

In December 2001, the Company completed a public offering of 7,170,400 units at a price of $0.80 per unit for gross proceeds of $5.7 million, excluding issuance costs of $469,000. Each unit was comprised of one common share and one-quarter common share purchase warrant. Each full share purchase warrant entitled the holder to purchase one common share at $1.04 and expires 120 days from the closing of this offering. As of March 31, 2002, 612,025 of the purchase warrants had been exercised, resulting in gross proceeds of $637,000. In connection with the offering, the Company issued 250,000 Agent Options to a third party who assisted in the offering. The Agent Options entitle the holder thereof to purchase, at a price of $0.99, one common share and expire in December 2002.

Private Offerings

In February 2002, the Company completed a private offering of 440,834 units at a price of $0.75 per unit for gross proceeds of $332,000; excluding issuance costs of $10,000. Each unit was comprised of one common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to purchase one common share at $0.75 and expires one year from the closing of the offering. The parties to the offering consisted of various members of Company management and employees.

In May 2001, the Company completed a private placement of 3,000,000 Special Warrants at a price of $3.24 per Special Warrant for proceeds of $9.7 million, excluding issuance costs of $28,000. Each Special Warrant was exercisable, for no additional consideration, into one common share and one-half share purchase warrant upon receipt of the final prospectus filed in the provinces of Alberta and British Columbia. Each full share purchase warrant entitled the holder to purchase one common share at $4.84. All of the 1,500,000 purchase warrants, which resulted from this private placement, expired unexercised in November 2001.

During the year ended April 30, 2000, the Company raised $6.2 million and $20.3 million through a private placement of 6,000,000 Series A Special Warrants, at a price of $1.03 per warrant, and 3,000,000 Series B Special Warrants, at a price of $6.77 per warrant, respectively, excluding issuance costs of $2.1 million. Each

Series A Special Warrant was exercisable, for no additional consideration, into one common share and one-half Series A Warrant upon receipt of the final prospectus in each of the respective provinces in Canada. Each Series B Special Warrant was exercisable, for no additional consideration, into 1.1 common shares and 0.55 Series B Warrant upon receipt of the final prospectus in each of the respective provinces in Canada. Each full Series A Warrant and Series B Warrant entitled the holder to purchase one common share of the Company at a price of $1.23 and $10.23 per common share, respectively. In addition, the Company issued 250,000 Series A Broker Warrants and 260,995 Series B Broker Warrants in conjunction with the Series A and B Special Warrants issuance. Of the Series A Broker Warrants, 200,000 were exercisable, at no cost, into one Series A Broker Option entitling the holder thereof to purchase one common share at a price of $1.09. The remaining 50,000 Series A Broker Warrants were exercisable, at no cost, into one Series A Broker Option entitling the holder thereof to purchase, at a price of $1.09, one common share and one-half Series A Warrant. Each Series B Broker Warrant was exercisable, at no cost, into one Series B Broker Option entitling the holder thereof to purchase, at a price of $6.75, one common share and one-half Series B Warrant. The Company did not receive any proceeds from the issuance of the Series A Broker Warrants and Series B Broker Warrants.

On March 16, 2000, 426,000 Series C Special Warrants were issued to a third-party consultant for services rendered prior to the issuance date. Of the total Series C Special Warrants, 300,000 were issued directly to the consultant with the balance issued to two former directors of the Company in repayment of an aggregate of 126,000 common shares owed by the consultant to those individuals. Each Series C Special Warrant was exercisable, at no cost, into one common share upon receipt of the final prospectus in each of the respective provinces in Canada. The Company did not receive any proceeds from the issuance of the Series C Special Warrants.

The Company received receipt of the final prospectus in each of the provinces of Alberta and British Columbia in July 2000, and receipt of the final prospectus from the province of Ontario in December 2000. Upon receipt, the Company allocated the net proceeds from the Special Warrants to share capital. In connection with the receipt of the final prospectus, the Company issued, upon exercise of the Series A and Series B Special Warrants, 3,000,000 Series A Warrants and 1,650,000 Series B Warrants, respectively. In addition, the Series A Broker Warrants and Series B Broker Warrants were exercised and the Company issued 250,000 Series A Broker Options and 260,995 Series B Broker Options, respectively. During the year ended March 31, 2001, the Company issued 50,000 Series A Warrants and 39,000 Series B Warrants in connection with the exercise of 250,000 Series A Broker Options and 78,000 Series B Broker Options, respectively.

Warrant activity is summarized as follows:

	Number of special warrants	Number of other warrants	Total warrants	Weighted-average exercise price
Balance at May 1, 1999	—	2,735,000	2,735,000	$0.13
Issued	9,936,995	—	9,936,995	—
Exercised for cash	—	(2,350,001)	(2,350,001)	0.08
Expired	—	(62,499)	(62,499)	0.12
Balance at April 30, 2000	9,936,995	322,500	10,259,495	0.02
Issued	—	5,249,995	5,249,995	4.39
Exercised for no consideration	(9,936,995)	—	(9,936,995)	—
Exercised for cash	—	(3,694,934)	(3,694,934)	1.23
Expired	—	(35,566)	(35,566)	8.82
Balance at March 31, 2001	—	1,841,995	1,841,995	9.88
Issued	3,000,000	3,983,434	6,983,434	1.39
Exercised for no consideration	(3,000,000)	—	(3,000,000)	—
Exercised for cash	—	(749,525)	(749,525)	1.03
Expired	—	(3,341,995)	(3,341,995)	7.62
Balance at March 31, 2002	—	1,733,909	1,733,909	$0.97

All warrants outstanding as of March 31, 2002 were exercisable.

Escrowed Shares

In March 2000, in connection with the NVS acquisition, 10,425,000 common shares were deposited in escrow, of which one-third were scheduled to be released on September 16, 2000, March 16, 2001 and September 16, 2001. In July 2000, in order to obtain receipt of the final prospectus from the Province of Ontario, the Company entered into an additional escrow agreement covering 5,285,686 common shares, of which 4,956,686 related to March 2000 escrowed shares and were re-deposited under this escrow agreement. These common shares were to be released in three equal installments on July 13, 2001, July 13, 2002 and July 13, 2003.

In January 2002, in connection with the acquisition of 25% of the minority interest in Tracer KK, 30,000 shares were deposited in escrow, of which one-third are to be released on January 15, 2003, January 15, 2004 and January 15, 2005. The release of shares is contingent upon the seller of the shares maintaining employment with the Company, as defined in the acquisition agreement.

The total common shares released during the year ended March 31, 2002 and the eleven months ended March 31, 2001 were 3,584,667 and 3,645,542, respectively. As of March 31, 2002, 3,553,791 common shares remained in escrow.

(5) Stock-Based Awards

The Company has a stock option plan (the Plan) pursuant to which the Board of Directors of the Company may grant nontransferable stock options to purchase common shares of the Company to directors, officers, employees, advisors and consultants. As of March 31, 2002, March 31, 2001 and April 30, 2000, 4,596,042,

3,809,042 and 3,328,704 common shares, respectively, 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). The options vest generally over four years and are exercisable for a maximum term of ten years.

The Company's options are denominated in Canadian dollars as the underlying stock is listed on the Toronto Stock Exchange (TSE). Per share amounts stated below have been translated to U.S. dollars at the rate of exchange in effect at the balance sheet date unless otherwise noted.

On August 17, 2001, the Company announced a voluntary Option Cancel and Regrant Program (Program) for its employees. Under the Program, the Company's employees were given the opportunity, if they so chose, to cancel outstanding stock options previously granted to them in return for an equal number of replacement options at a later date. The replacement options were granted on March 1, 2002 at the then fair market value. As the replacement options were not granted within six months of the cancellation date, variable plan accounting is not required for the replacement options.

In October 2000, the Company repriced 1,698,000 stock options from $11.82 to $7.74.

A summary of the status of the Company's stock option plan is as follows:

	Number of options	Weighted-average exercise price
Outstanding at May 1, 1999	490,667	$0.24
Granted	2,472,504	7.62
Exercised	(550,600)	0.29
Cancelled	(71,667)	1.12
Outstanding at April 30, 2000	2,340,904	8.00
Granted	2,059,000	9.35
Exercised	(303,958)	1.88
Cancelled	(760,908)	9.00
Outstanding at March 31, 2001	3,335,038	8.40
Granted	2,716,464	2.26
Exercised	(13,000)	0.69
Cancelled	(3,282,689)	6.68
Outstanding at March 31, 2002	2,755,813	$2.62
Exercisable at March 31, 2002	1,940,064	$2.84

The following table summarizes information regarding stock options outstanding and exercisable at March 31, 2002:

	Options outstanding			Options exercisable	
Exercise prices	Number outstanding	Average remaining contractual life (years)	Weighted-average exercise price	Number exercisable	Weighted-average exercise price
$0.60 to $0.75	432,400	3.2	$0.68	363,817	$0.67
$0.96 to $1.06	1,030,108	9.8	0.97	517,404	0.96
$2.76 to $3.07	547,400	2.0	2.82	457,135	2.77
$3.54 to $4.33	450,501	4.2	3.72	376,909	3.75
$7.74 to $8.90	295,404	5.3	7.86	224,799	7.89
	2,755,813		$2.62	1,940,064	$2.84

During the year ended March 31, 2002, the Company granted 2,664 stock options to a consultant with a per share price of $4.33. These options were fully vested upon grant and related to past services rendered.

During the eleven months ended March 31, 2001, the Company granted 475,000 stock options to advisors at prices ranging from $3.86 to $8.15 per share. Of the stock options granted, 25,000 were fully vested upon grant, 350,000 vest generally over one year based on the terms of the consulting agreements and 100,000 were to vest based on specified performance milestones. However, these milestones were not met, and none of the 100,000 stock options vested.

During the year ended April 30, 2000, in order to attract and retain certain sales and executive employees, NVS issued 675,000 restricted common shares (the incentive shares) as additional compensation to existing and targeted employees. Upon the acquisition of NVS on March 16, 2000, the incentive shares were exchanged for restricted common shares of the Company. The incentive shares are subject to vesting over a three to four-year period and will be distributed to each employee only if employed on each of the associated vesting dates.

During the year ended April 30, 2000, as consideration for services rendered, the Company granted 722,000 advisor options to advisors and consultants (the advisors options) at prices ranging from $0.60 to $8.90 per share. Of the advisor options granted, 572,000 were fully vested upon grant and related to past services rendered, with the remaining 150,000 advisor options vesting based on performance milestones specified in the consulting agreement. The related milestones were not met by the end of the contractual period and none of the 150,000 advisor options vested.

(6) Income Taxes

For the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000, there was no provision for current or deferred income taxes. The income tax effects of the temporary differences that give rise to significant portions of the Company's deferred tax assets as of March 31, 2002 and 2001 are presented below by tax jurisdiction (in thousands):

	Canada	United States	United Kingdom	Japan	Total
March 31, 2002:					
Deferred tax assets:					
Accruals	$ 507	$ 264	$ 1	$ 28	$ 800
Net operating losses	542	10,929	1,205	135	12,811
	1,049	11,193	1,206	163	13,611
Less valuation allowance	(1,049)	(11,193)	(1,206)	(156)	(13,604)
Deferred tax assets	—	—	—	7	7
Deferred tax liabilities—capital assets	—	—	—	(7)	(7)
Net deferred tax assets	$ —	$ —	$ —	$ —	$ —
March 31, 2001:					
Deferred tax assets:					
Accruals	$ —	$ 117	$ —	$ —	$ 117
Net operating losses	234	6,493	812	71	7,610
	234	6,610	812	71	7,727
Less valuation allowance	(234)	(6,610)	(812)	(65)	(7,721)
Deferred tax assets	—	—	—	6	6
Deferred tax liabilities—capital assets	—	—	—	(6)	(6)
Net deferred tax assets	$ —	$ —	$ —	$ —	$ —

The Company has established a valuation allowance against its deferred tax assets due to the uncertainty surrounding the realization of such assets. Management periodically evaluates the recoverability of the deferred tax assets. At such time as it is determined that it is more likely than not that the deferred tax assets are realizable, the valuation allowance will be reduced.

A reconciliation of the expected income tax benefit to the actual income tax expense reported in the consolidated statements of operations is as follows (in thousands):

	2002	2001	2000
Computed expected income tax benefit at Canadian statutory income tax rate of 41.1%, 41.7% and 43.2% for 2002, 2001 and 2000, respectively	($7,727)	($9,053)	$(387)
Foreign tax rate differential	518	1,039	54
Permanent differences	(867)	13	—
Nondeductible intangibles	2,193	652	—
Unrecognized recoveries from losses	5,883	7,349	333
Actual income tax expense	$ —	$ —	$ —

The net change in the total valuation allowance for the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000, was an increase of $6.0 million, $7.3 million and $390,000, respectively. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of deferred taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected deferred taxable income, and tax planning strategies in making this assessment. Based on the level of historical operating results and projections of deferred taxable income, management has determined that it is more likely than not that the portion of deferred tax assets not utilized through the reversal of deferred tax liabilities will not be realized. Accordingly, the Company has recorded a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be realized.

The Company has Canadian non-capital losses of CDN$2.1 million at March 31, 2002 that are available to apply against future Canadian taxable income. These losses begin to expire in 2007.

BakBone Software, Inc. has net operating loss carryforwards of $27.5 million at March 31, 2002 that are available as reductions to its taxable income in future years. These carryforwards will begin to expire in 2020.

NetVault Holdings Ltd. has trade loss carryforwards of UK£2.8 million at March 31, 2002 that are available as reductions to its taxable income in future years. These carryforwards generally have an indefinite carryforward period.

BakBone KK has net operating loss carryforwards of ¥42.6 million at March 31, 2002 that are available as reductions to its taxable income in future years. These carryforwards will begin to expire in 2003.

(7) Restricted Cash

During the eleven months ended March 31, 2001, in conjunction with a facility lease, the Company entered into a standby letter of credit with a bank whereby $650,000 was deposited into an investment account to collateralize the letter of credit. The letter of credit has a loan-to-value ratio of 1.2 to 1, and as a result, the restricted cash amount related to the letter of credit has been adjusted to $780,000. As the lease requires the Company to maintain the letter of credit until January 2003, the related restricted cash amount has been classified as short-term as of March 31, 2002.

The Company maintains credit cards for use by certain executives for business–related expenses. In order to obtain the credit cards, the issuing bank required the Company to cash-secure the total credit limits. As of March 31, 2002 and 2001, $24,000 and $90,000 were deposited into an investment account at the issuing bank. As the Company may terminate the credit card agreement at any time, the related restricted cash amounts have been classified as short-term.

(8) Retirement Plans

During the eleven months ended March 31, 2001, the Company established a voluntary deferred contribution plan for employees in the United States (the U.S. Plan) in accordance with the provisions of the Internal Revenue Code Section 401(k). The U.S. Plan allows participants to contribute up to 15% of their annual salary, subject to certain limitations, as provided by federal law. Each year, the Company's Board of Directors determines the amount, if any, of the Company's matching contributions. There were no matching contributions to the U.S. Plan during the year ended March 31, 2002 or the eleven months ended March 31, 2001.

The Company maintains a voluntary defined contribution plan for employees in the United Kingdom (the U.K. Plan). The U.K. Plan allows participants to defer a minimum of 3% of their annual salary with a maximum contribution ranging from 17.5% to 40% of salary, depending on the age of the participant. In addition, the U.K. Plan calls for the Company to annually match 5% of each participant's salary; these matching contributions vest immediately. During the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000, the Company contributed $149,000, $76,000 and $5,000, respectively, to the U.K. Plan.

The Company currently maintains no retirement plans for employees working in Japan.

(9) Line of Credit and Notes Payable

The Company has entered into credit agreements with banks in the ordinary course of business. In February 2001, the Company obtained an unsecured line of credit, which bore interest at 10%. In February 2002, the Company renegotiated and executed an agreement modifying its existing line of credit. Under the modified agreement, the line of credit was converted to a term loan, maturing December 31, 2003, and the interest rate was reduced to 7.5%. Furthermore, the Company agreed to principal reductions in amounts equal to 10% of the net proceeds raised from any financings from the date of the agreement until maturity. Upon execution of the modified agreement, the Company paid $781,000 in principal and interest to the lender.

During February and March of 2002, the Company paid all principal and interest due under notes, which were entered into between Tracer KK and a Japanese bank between February 1997 and March 2000. The notes, payable in Japanese yen, were paid in two installments of $146,000 and $43,000, made in February and March 2002, respectively. As of March 31, 2002, the Company has no further commitments to the Japanese bank.

As of March 31, 2002, the amount due under the Company's credit facilities was $1.95 million, all of which was classified as long-term.

(10) Related Party Transactions

A director of the Company is a partner of a law firm that provides legal services to the Company. During the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000, the Company paid the associated law firm $120,000, $270,000 and $190,000, respectively, relating to the services rendered.

A director of the Company has provided certain consulting and legal advice to the Company. During the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000, the Company paid the director $155,000, $62,000 and $68,000, respectively, relating to the services rendered.

A former director of the Company provided certain consulting and investor relation services to the Company. During the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000, the Company paid the former director $41,000, $70,000 and $88,000, respectively, relating to the services rendered.

Prior to the acquisition of BakBone KK, two former directors and officers of the Company provided loans to BakBone KK. The loans have no maturity date and are interest-free. At March 31, 2002 and March 31, 2001, the balance owed to these individuals totaled $63,000 and $75,000, respectively.

(11) Commitments and Contingencies

(a) Litigation

The Company is involved in litigation and claims, which arise from time to time in the normal course of business. In the opinion of management, based in part on the advice of legal counsel, any liability that may arise from such contingencies would not have a significant adverse effect on the consolidated financial position, results of operations or liquidity of the Company.

(b) Leases

The Company leases certain facilities and equipment under noncancelable operating and capital leases. Future minimum lease payments for years ending March 31 are as follows (in thousands):

	Capital leases	Operating leases
2003	$224	$1,440
2004	55	1,403
2005	—	1,031
2006	—	540
2007	—	250
Thereafter	—	376
Total minimum lease payments	279	$5,040
Less amount representing interest	(24)	
Present value of net minimum lease payments, including current portion of $201	$255	

Rent expense for the year ended March 31, 2002, the eleven months ended March 31, 2001 and the year ended April 30, 2000 approximated $1.6 million, $1.2 million and $30,000, respectively.

The Company has an operating lease for a facility that is currently idle. The Company plans to utilize the facility to support the growth of its operations and headcount during the year ended March 31, 2003. However, as the facility will most likely remain idle through at least October 2002, the Company recorded a liability and a corresponding expense in the accompanying statement of operations during the year ended March 31, 2002 in the amount of $212,000, representing the present value of the future lease payments up to and including October 2002.

(12) Segment Information

Management has determined that the Company operates in two segments, which are the Company's two product lines, NetVault and MagnaVault. Revenues are generated from the licensing of software and sale of support services. Total assets, capital expenditures, depreciation and amortization, interest income and operating expenses are not disclosed by operating segment as they are not specifically related to a particular product line. The following table represents a summary of revenues of the product line operating segments for the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000 (in thousands):

	2002	2001	2000
Revenues			
Licensing:			
NetVault	$6,894	$2,378	$242
MagnaVault	1,201	1,808	—
Total	8,095	4,186	242
Service:			
NetVault	1,218	530	95
MagnaVault	550	259	—
Total	1,768	789	95
Total revenues	$9,863	$4,975	$337

The following table represents a summary of revenues by major geographic region for the year ended March 31, 2002, the eleven months ended March 31, 2001, and the year ended April 30, 2000 (in thousands):

	2002	2001	2000
Revenues			
Licensing:			
Europe	$1,355	$ 398	$ 29
Asia	3,714	2,512	213
North America	3,026	1,276	—
Total	8,095	4,186	242
Service:			
Europe	379	278	65
Asia	359	198	30
North America	1,030	313	—
Total	1,768	789	95
Total revenues	$9,863	$4,975	$337

The following table represents a summary of capital assets and intangibles by major geographic region as of March 31, 2002 and 2001 (in thousands):

	Europe	Asia	North America	Total
Identifiable assets as of March 31, 2002:				
Capital assets, net	$ 431	$ 261	$2,070	$2,762
Intangibles, net	$ 821	$ —	$3,963	$4,784
Identifiable assets as of March 31, 2001:				
Capital assets, net	$ 508	$ 339	$2,889	$3,736
Intangibles, net	$1,706	$ —	$6,125	$7,831

(13) Subsequent Events

In April 2002, 1,177,075 purchase warrants, which were issued in connection with the December 2001 public offering, were exercised at $1.04 per share, resulting in gross proceeds of $1.2 million. Of the 1,792,600 purchase warrants issued in connection with the December 2001 public offering, 612,025 were exercised during the year ended March 31, 2002 and 3,500 expired unexercised in April 2002.

Board of Directors

Archie J. Nesbitt
Director

Fred G. Moore
Director

Harry Brayne
Director

Keith Rickard
Director

J.G. (Jeff) Lawson
Director

Neil M. MacKenzie
Director

Officers

Keith Rickard
President and Chief Executive Officer

John Fitzgerald
Chief Financial Officer

Fabrice Helliker
Vice President of Engineering

Peter Eck
Vice President of Marketing

Randy Batterson
Vice President of Strategic Alliances and OEM

Michael Sannes
Vice President of Customer Support

Andrew Unsworth
Managing Director EMEA

Howard Weiss
Managing Director Pacific Rim

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This annual report contains forward-looking statements reflecting management's current forecast of certain aspects of the company's future. It is based on current information that we have assessed, but which by its nature is dynamic and subject to rapid and even abrupt changes. Forward-looking statements may include statements by BakBone Software regarding:

- Growth projections for the company, including revenues and net income
- The projected rollout of upgraded versions of our products.

BakBone's actual results could differ materially from those stated or implied by our forward-looking statements due to risks and uncertainties associated with our business, including, but not limited to:

- Our dependence on projected purchases by our major customers
- Our ability to establish and maintain contractual arrangements with storage-centric value-added resellers ("channel partners")
- Competition in all aspects of our business
- Changes in product or service profit margins due to pricing changes driven by variations in customer demand, competition, or unforeseen factors
- The effect of general economic, credit and capital market conditions on our business
- Our failure to compete or successfully operate planned expansion projects.

Our forward-looking statements should be considered in the context of these and other risk factors disclosed in our most recent report filed with the Canadian Securities Administrators, which is available on the SEDAR disclosure system (www.sedar.com), or with the United States Securities and Exchange Commission, which is available on the EDGAR disclosure system (www.sec.gov/edgar).

All future written and oral forward-looking statements made by us or on our behalf are also subject to these factors. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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