

THIS IS A PRELIMINARY PROSPECTUS RELATING TO THESE SECURITIES, A COPY OF WHICH HAS BEEN FILED WITH THE APPROPRIATE SECURITIES COMMISSION OR SIMILAR REGULATORY AUTHORITY IN CERTAIN OF THE PROVINCES OF CANADA BUT WHICH HAS NOT YET BECOME FINAL FOR THE PURPOSE OF A DISTRIBUTION TO THE PUBLIC. INFORMATION CONTAINED HEREIN IS SUBJECT TO COMPLETION OR AMENDMENT. THESE SECURITIES MAY NOT BE SOLD TO NOR MAY OFFERS TO BUY BE ACCEPTED FROM RESIDENTS OF ANY SUCH PROVINCES PRIOR TO THE TIME A RECEIPT FOR THE FINAL PROSPECTUS IS OBTAINED FROM THE APPROPRIATE SECURITIES COMMISSION OR SIMILAR REGULATORY AUTHORITY OF SUCH PROVINCES.

Preliminary Prospectus dated May 31, 1999

This prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. No securities commission or similar authority in Canada has in any way passed upon the merits of the securities offered hereunder and any representation to the contrary is an offence.

Additional Issue



MGI SOFTWARE CORP.

3,000,000 Common Shares issuable upon the exercise of Special Warrants

MGI Software Corp. ("MGI" or the "Corporation") will issue 3,000,000 common shares in the capital of MGI (the "Common Shares") upon the exercise of 3,000,000 previously issued special warrants of MGI (the "Special Warrants"). Upon exercise, each Special Warrant entitles the holder to acquire (subject to adjustment), one Common Share without payment of any additional consideration.

	<u>Price</u>	<u>Commission</u> ⁽¹⁾	<u>Net Proceeds</u> ⁽²⁾
Per Special Warrant	\$2.55	\$0.153	\$2.397
Total Offering.....	\$7,650,000	\$459,000	\$7,191,000

- (1) Commission paid to the Underwriters (as defined below) is equal to 6% of the offering price of the Special Warrants. As additional compensation under the terms of the Underwriting Agreement (as defined below), the Corporation issued to the Underwriters an aggregate of 180,000 broker special warrants (the "Broker Special Warrants"), each exercisable without payment of additional compensation to the Corporation into one compensation option (a "Compensation Option"). Each Compensation Option entitles the Underwriters to purchase, at any time until 5:00 p.m. on April 16, 2001 (being 24 months from the date of the closing of the sale of the Special Warrants), one Common Share (subject to adjustment) at a price of \$3.00 per share. No additional compensation will be payable to the Underwriters in connection with the distribution of the Broker Special Warrants or Compensation Options.
- (2) Excludes other expenses relating to this offering, estimated at \$150,000, which will be paid from the general funds of the Corporation.

This prospectus is being filed to qualify the distribution of 3,000,000 Common Shares to be issued upon exercise of the Special Warrants as well as to qualify the distribution of 180,000 Compensation Options to be issued upon exercise of the Broker Special Warrants. See "Private Placement and Plan of Distribution".

An investment in Common Shares is speculative and involves significant risk due to a number of factors. See “Risk Factors”.

After giving effect to the exercise of the Special Warrants, the price of \$2.55 paid for each Common Share through the purchase and exercise of a Special Warrant exceeds the consolidated net tangible book value per Common Share as at January 31, 1999 by \$1.98 (or 78% of the issue price). See “Dilution”.

The Common Shares are traded on The Toronto Stock Exchange (the “TSE”) under the trading symbol “MGI”. The closing price of the Common Shares on the TSE on April 15, 1999 (the last business day prior to the issue of the Special Warrants) was \$2.87, and on May 27, 1999 was \$4.05.

The Special Warrants were sold to investors on a private placement basis pursuant to an underwriting agreement (the “Underwriting Agreement”) between MGI and Nesbitt Burns Inc., Canaccord Capital Corporation and HSBC James Capel Canada Inc. (collectively, the “Underwriters”) dated April 5, 1999 at a price of \$2.55 for each Special Warrant. The price of the Special Warrants was determined by negotiation between the Corporation and the Underwriters, who arranged for investors to purchase the Special Warrants. See “Private Placement and Plan of Distribution”.

If receipts for a (final) prospectus are issued by the Ontario Securities Commission and la Commission des valeurs mobilières du Québec (“Final Receipts”), each Special Warrant which has not been exercised previously shall be deemed to have been exercised without any further action on the holder’s part, on the fifth business day after the day upon which the final receipts have been issued. If the Final Receipts have not been issued by August 4, 1999, each Special Warrant shall become exercisable, without payment of additional consideration, into one (1) Common Share plus one-half of one transferable share purchase warrant (“a Share Purchase Warrant”) and each whole Share Purchase Warrant will entitle the holder to purchase one (1) Common Share, as presently constituted, at a price of \$3.00 per Common Share until 5:00 p.m. on October 16, 2001 (being 30 months from the date of the closing of the sale of the Special Warrants). Each Special Warrant which has not been exercised previously shall be deemed to have been exercised by the Trustee, on behalf of the holder thereof and without any further action on the holder’s part, immediately prior to 5:00 p.m. on April 16, 2000. In accordance with applicable securities laws, if Common Shares and, if applicable, Share Purchase Warrants, are issued upon the exercise of Special Warrants prior to the issuance of the Final Receipts, such Common Shares and, if applicable, Share Purchase Warrants, may be subject to a hold period or other restrictions on resale. See “Private Placement and Plan of Distribution”.

Definitive certificates representing the Common Shares and, if applicable, Share Purchase Warrants, will be available for delivery within 15 days following the exercise of the Special Warrants. Certain legal matters in connection with this offering will be passed upon for the Corporation by LaBarge Weinstein, Ottawa and for the Underwriters by Goodman Phillips & Vineberg, Toronto.

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GLOSSARY OF TECHNICAL TERMS

<u>Term</u>	<u>Definition</u>
ActiveX controls	An applet based on Microsoft technologies that enables interactive content on Web pages.
Applet	A small Java program that can be embedded in an HTML page.
APS	Advanced photo system.
AVI	A type of Windows video file with the suffix of .avi.
CD	Compact Disc. The standard 12 cm plastic disc created by Philips Electronics N.V. ("Philips") and Sony Corp. to store digital information in microscopic pits which can be read by a laser beam.
CD-ROM	Compact Disc Read Only Memory. An optical storage technology that uses compact discs originally used for encyclopedias, dictionaries, and software libraries, but now often used in multimedia applications.
Codec	A technique for compressing and decompressing files, typically sound and animation files.
CPU	Central processing unit. The most powerful microprocessor chip in a PC. Also known as a microprocessor or processor, e.g., the 80386, 80486, and Pentium CPUs built by Intel Corporation.
DV	Digital video specification for all-digital video.
DVD	Digital versatile disc.
Dynamic content	Information on a Web site or Web page that changes often, usually daily and/or each time a user reloads or returns to the page. Also, content that is structured based on user input.
GUI	Graphical User Interface. That part of an operating system which permits the user to work with a computer through icons and windows.
HTML	HyperText Markup Language. The coding language used to create Hypertext documents for use on the World Wide Web.
HTTP	HyperText Transfer Protocol. The protocol for moving hypertext files across the Internet, and the most important protocol used in the World Wide Web.
IEEE	The Institute of Electrical and Electronics Engineers.
Indeo	A compression algorithm developed by Intel and used by Microsoft's Video for Windows.
Internet	The open world-wide network of computers that utilize the TCP/IP communications protocol.
Java	Java is a network-oriented programming language invented by Sun Microsystems, Inc. that is specifically designed for writing programs that can be safely downloaded to a PC through the Internet and immediately run without fear of viruses or other harm to your computer or files.
JavaScript	A scripting language for Web pages. Scripts written with JavaScript can be embedded into HTML documents.
JPEG	Joint Photographic Experts Group. A format for image files.
MAPI	Messaging Application Programming Interface. A system built into Microsoft Windows that enables different e-mail applications to work together to distribute mail.
MJPEG	Motion JPEG. Developed by the Joint Photographic Experts Group, motion JPEG is a Codec for video files. It is a variation on JPEG, this group's Codec for compressing still pictures.
MMX	A new CPU technology developed by the Intel Corporation which is the next step after the famed Pentium Processor. This new CPU chip will enable greater handling of multimedia such

<u>Term</u>	<u>Definition</u>
	as video and audio on the desktop as well as over the Internet.
MPEG	Created by the Motion Picture Experts Group, MPEG is a specification for compressing and decompressing animation or "movie" files, which are typically very large.
OEM	Original equipment manufacturer. A manufacturer/licensor of software or other computer products to purchasers or licensees which in turn typically resell that software or product under another tradename, in different packaging or combined with other products or services.
PC	Personal computer. Desktop computers based on microprocessors.
Pentium	The name given by Intel Corporation to its 586 processor.
QuickTime	A Codec scheme developed by Apple Computer Inc. for animation files, available for both Windows and Macintosh.
Server	A computer, or a software package, that provides a specific kind of service to client software running on other computers. Can refer to a particular piece of software, such as a World Wide Web server, or to the machine on which the software is running.
TCP/IP	Transmission Control Protocol/Internet Protocol. The protocols used to send messages, connect and communicate over local networks and the Internet.
3D	Three-dimensional.
USB	Universal Serial Bus. A "plug-and-play" interface between a computer and add-on devices (such as audio players, joysticks, keyboards, telephones, scanners, and printers). With USB, a new device can be added to your computer without having to add an adapter card or even having to turn the computer off.
VCR	Videocassette recorder.
Windows, Windows '95, '98 and NT	A computer operating system developed by Microsoft Corporation that provides a GUI and multi-tasking for use with personal computers and network servers.
Web	A hypertextual, graphical, global, interconnected system for accessing information contained on Web Sites located on the Internet which facilitates the jumping from one Web Site to the next by, among other methods, clicking on highlighted words or icons.
Web Site	A site located on the Web, through which information from a specific organization is made available for access by anyone in the world through the Web.
World Wide Web	The universe of hypertext servers (HTTP servers) which are the servers that allow text, graphics, sound files, etc. to be mixed together.

PROSPECTUS SUMMARY

The following is a summary only and is qualified in its entirety by the more detailed information found elsewhere in this prospectus. Unless otherwise stated, all of the dollar amounts expressed in this prospectus are stated in Canadian dollars.

Details of the Offering

Issue: 3,000,000 Common Shares issuable upon the exercise of the same number of Special Warrants previously issued by the Corporation.

Special Warrants: 3,000,000 Special Warrants were sold to investors on a private placement basis on April 16, 1999 at a price of \$2.55 per Special Warrant. If receipts for a (final) prospectus are issued by the Ontario Securities Commission and la Commission des valeurs mobilières du Québec ("Final Receipts"), each Special Warrant which has not been exercised previously shall be deemed to have been exercised without any further action on the holder's part, on the fifth business day after the day upon which the Final Receipts have been issued. If Final Receipts have not been issued by August 4, 1999, each Special Warrant shall become exercisable, without payment of additional consideration, into one (1) Common Share plus one-half of one transferable share purchase warrant (a "Share Purchase Warrant") and each whole Share Purchase Warrant will entitle the holder to purchase one (1) Common Share, as presently constituted, at a price of \$3.00 per Common Share until 5:00 p.m. on October 16, 2001 (being 30 months from the date of the closing of the sale of the Special Warrants). Each Special Warrant which has not been exercised previously shall be deemed to have been exercised without any further action on the holder's part, immediately prior to 5:00 p.m. on April 16, 2000. In accordance with applicable securities laws, if Common Shares and, if applicable, Share Purchase Warrants, are issued upon the exercise of Special Warrants prior to the issuance of the Final Receipts, such Common Shares and, if applicable, Share Purchase Warrants, may be subject to a hold period or other restrictions on resale. See "Private Placement and Plan of Distribution".

Use of Proceeds: The net proceeds of this offering, after payment of the Underwriters' fees and the expenses of this offering estimated at \$150,000, will be used by the Corporation as to approximately \$3.2 million (or approximately 45%) for marketing initiatives, as to approximately \$2.1 million (or approximately 30%) for research and development expenses and the balance as working capital for general corporate purposes. See "Use of Proceeds".

Dividend Record and Policy:

MGI has not paid any dividends on its Common Shares to date and does not anticipate that it will pay any dividends in the foreseeable future. See "Dividend Record and Policy".

Selected Financial Data

The selected financial data as at and for each of the three years ended January 31, 1999, 1998 and 1997 have been derived from the Corporation's audited Financial Statements and Notes thereto, included elsewhere in this Prospectus and incorporated by reference hereto and should be read in conjunction therewith. The Financial Statements are prepared on the basis of Canadian GAAP and are expressed in Canadian dollars. See "Management's Discussion and Analysis of Financial Position and Results of Operations."

Statements of Operations and Deficit

	Year Ended January 31		
	1999	1998	1997
	(thousands, except share data)		
Revenue	\$ 15,962	\$ 13,348	\$ 5,144
Gross profit	13,717	10,688	3,815
Expenses	22,472	17,848	8,979
Loss for the year	(8,451)	(6,950)	(7,403)
Loss per share	(0.35)	(0.35)	(0.48)
Weighted average number of common shares Outstanding	24,122,095	19,958,968	15,355,052

Balance Sheet Data

	Year Ended January 31		
	1999	1998	1997
	(thousands)		
Current assets	\$ 10,735	\$ 18,527	\$ 7,891
Capital assets	2,444	1,487	952
Liabilities	4,614	3,344	2,385
Shareholders' equity.....	8,565	16,670	6,458

Risk Factors

An investment in the Common Shares is subject to a number of risks, all of which should be carefully considered by a prospective investor. These risk factors include the competitive environment in which the Corporation operates, the Corporation's limited operating history, the dependence on acceptance of the Corporation's products and services, the importance of the development of new products, the Corporation's dependence upon the acceptance or continued popularity of certain operating systems, the fact that the Corporation anticipates incurring continued losses for a limited period of time, the risks that arise from potential future acquisitions, the Corporation's dependence upon its distribution arrangements, the Corporation's dependence on OEM partners, the Corporation's limited capital resources, the Corporation's lack of trading history, the Corporation's limited liquidity and the volatility of the trading price of the Common Shares, the existence of significant principal shareholders, the risks associated with intellectual property matters, the risks arising from the Corporation's international operations, the possibility of variations in operating results, the Corporation's dependence upon certain key personnel, the risks associated with changes in technology and the dilution that will be recognized by purchasers of securities. See "Risk Factors".

Business of the Corporation

MGI designs, develops, markets and supports products in the digital photography ("PC Photography") and digital video ("PC Video") markets in the multimedia segment of the computer software industry. MGI's products are suitable for home and business PC users.

The following is a brief description of MGI's software products: MGI PhotoSuite™ II is the next generation of MGI's

flagship PC Photography software, MGI PhotoSuite. MGI PhotoSuite is a 32-bit software program that allows users to edit, organize, share and be creative with their photographs on a personal computer (a "PC"). MGI Photosuite II offers consumers a complete web-enabled photography package. Suitable for Windows 95, 98 and NT operating systems, this software's unique architecture allows direct input from digital cameras, scanners, compact disk media such as CD-ROM, and Digital Versatile Disc ("DVD"), or the Internet. MGI PhotoSuite II is the first product of its kind to integrate Windows Internet technology at its core, taking web enablement to a new level. MGI PhotoSuite II functions as a special-interest web portal for those wanting to explore photography resources on the Internet. MGI PC Wedding Kit allows users to put their wedding photos on a PC and the Internet. MGI PhotoGallery is a CD-ROM collection of more than 500 professional quality photographs that can be used in presentations, reports and in creating Web pages on the Internet. MGI VideoWave™ II (designed for use on Pentium and Pentium II computers with Windows 95, 98 or NT operating systems) builds on the success of its award-winning predecessor, MGI VideoWave, a non-linear digital video editing solution. MGI VideoWave is software that allows users to capture and edit video and audio from any analogue source. By replacing complicated timeline interfaces with its intuitive "StoryLine" format, MGI VideoWave II simplifies the video editing process for the home and business user. The software is packed with powerful editing features that allow the user to create polished productions quickly and easily, by applying special effects, titles, transitions, audio tracks and even mixing two clips as one (i.e. chroma keying). MGI DVD MAX™ is a software-only solution that enables PC manufacturers to offer DVD playback capability without expensive dedicated hardware. MGI PURE DIVA™ is software which turns a Pentium III-based PC into a complete digital home entertainment centre by combining TV viewing and programming with digitalVCR™, DVD movie viewing, and audio CD playback. MGI, MGI PhotoSuite, MGI VideoWave, MGI PURE DIVA and digitalVCR are trademarks or registered trademarks of the Corporation. See "The Corporation" and "Business of the Corporation".

THE CORPORATION

MGI Software Corp. (“MGI” or the “Corporation”) was incorporated under the laws of the Province of Ontario on September 22, 1995. The registered and principal office of MGI is located at 50 West Pearce Street, Richmond Hill, Ontario, L4B 1E3.

On April 30, 1996 MGI amalgamated with Globex Biotechnologies Inc. (“Globex”), a reporting issuer in the Province of Ontario, and continued operating under the name MGI Software Corp. (the “Globex Amalgamation”). All references to “MGI” or the “Corporation” prior to April 30, 1996 are to the pre-amalgamation MGI and do not include Globex (unless otherwise indicated in particular instances). See “Amalgamation with Globex”.

THE MULTIMEDIA SEGMENT OF THE COMPUTER SOFTWARE INDUSTRY

MGI’s PC Photography and PC Video software products compete in the multimedia segment of the computer software industry. A description of these segments of the computer software industry follows:

PC Photography

The advent of the multimedia PC has had the greatest impact on traditional photography. Developments in picture capture devices such as colour scanners and digital cameras, followed by the low cost colour printer are enabling families and businesses to assemble their own photo finishing labs with the PC serving as a darkroom. Most multimedia PCs are shipped with modems, providing ready access to telecommunications via fax and data (Internet). This communications capability has spawned additional uses and growth in digital photo distribution, web site presentation, and on-line photo processing. The combined influence of these technological agents is expected to significantly fuel digital photo usage within the coming years.

PC manufacturers were among the first to recognize the growth potential in digital photography. This market opportunity was facilitated by Intel’s push into visual computing at the chipset level and new scanner design, which allows photo capture capability to be incorporated into computers, keyboards, and camera bodies. Increasingly, PC manufacturers are including digital cameras and/or scanners as part of their solution offerings.

Eastman Kodak Company (“Kodak”), Fuji Photo Film Co., Ltd. (“Fuji”) and others have collectively taken steps to convert the photo mass market to a hybrid analogue/digital photo-finishing process called “APS” in the next few years. This new technology is designed to encapsulate the growth of digital photo usage within the traditional photo business. APS involves new cameras, new film and new processing, within existing labs. Those companies have moved to consolidate the flow of analogue photo finishing on a world scale with the result that Kodak and Fuji are now providing service bureau processing for many consumer photo-finishing centres, such as drug store chains, mass merchants and even grocery stores. This strategy allows them to control the pace of analogue-to-digital conversion, a service increasingly being sold/requested in conjunction with regular photo finishing. Finally, to infiltrate the computer industry’s charge, Kodak and others have introduced new image file, presentation, and storage (Picture CD) formats intended as industry standards.

While both Kodak and Fuji currently have leadership positions in the photography market worldwide, OEM’s in the computer industry such as Hewlett-Packard Company (“HP”) are now challenging this leadership, because film is becoming less and less important in the digital imagery world. Kodak is investing in digital photography technology and currently offers a range of digital cameras, priced from US \$199 to US \$20,000. In addition, Kodak has introduced a new Internet-based service, the Kodak PhotoNet Online, enabling customers to store their photos in digital form on the World Wide Web for on-line viewing and downloading by friends and family. Kodak is aiming to introduce a new digital photography product every six months. Products in development include scanners, software, printers and photo paper, as well as cameras that can send digital images over cellular phone lines and photo-quality fax machines.

Other major players in both the photography and electronics industries are making similar inroads into the digital market. For instance, Epson America Inc., Matsushita Electric Industrial Co., Ltd. (Panasonic), Polaroid Corp. and Sony Corp. all currently offer digital photography products to the consumer. Even the toy industry has entered the field with Nintendo Co.,

Ltd.'s GameBoy Camera and Mattel Inc.'s Barbie DigiCam, both targeted at the children's market.

Two converging market segments drive demand for MGI's digital imagery products. As these products represent an intersection of the photography/video industry and the computing industry, MGI derives market share from both sources.

For photographers and video enthusiasts, MGI's products represent a simple, affordable means to process, edit and enhance their still and motion pictures, while for PC users, MGI's products represent a means of expanding their systems' multimedia and communications capabilities.

Kodak estimates that 80 billion photographs are taken on average each year worldwide, generating US \$46 billion for the industry. Almost three billion colour film rolls are sold annually worldwide. It is estimated that there are more than 600 million 35 millimetre cameras in use around the world. Moreover, there are more than 180 million PC users worldwide, and the correlation between PC usage and camera ownership is very high.

The art of photography is rapidly converging with the computing industry. According to PictureVision, a Kodak subsidiary specializing in on-line photography services for the photo-lab industry, an increasing number of rolls of film are being digitized for use on computers. PictureVision currently digitizes more than three million images a month, and expects this number to increase to more than seven and a half million images a month shortly. According to the Photo Marketing Association International ("PMA"), 60% of U.S. camera stores plan to offer digital imaging services in the future. A recent PMA study indicates that nearly 30% of home PC users would use their computer for photography.

According to the Consumer Electronics Manufacturers Association ("CEMA"), approximately 700,000 digital cameras were sold to dealers in the U.S. in 1997, an increase from 300,000 in 1996. CEMA estimated that digital camera sales in 1998 would increase to 1.1 million. Dataquest Inc. ("Dataquest") reports that demand for consumer photo software grew 239% in 1997, exceeding the market research firm's most aggressive forecasts. More than 18 million packages were sold worldwide through retail and original equipment manufacturer ("OEM") distribution. Dataquest predicts that by the year 2002, PC owners will spend nearly US \$400 million annually on photo software.

MGI customer profiles suggest that the typical users of photo-editing software are males, married, 40 years of age and older. This customer profile is similar to that for computer users and photo hobbyists. However, there is a growing trend toward younger users, many of them women. Furthermore, MGI believes that two new developments this year, namely the sub \$1,000 multimedia/Internet PC and the sub \$200 digital camera, could ignite the photo software market and attract an even broader audience of users, including teens and children.

PC Video

The video industry is undergoing a digital revolution of its own, with the advent of the new Digital Video ("DV") specification, developed by the Digital VCR Conference ("DVC"). The DV format is a complete specification for all-digital video, and is expected to have a major impact on video products for both the consumer and business/industrial markets. So far, the standard has been adopted by more than 50 manufacturers. Providing high quality and aggressive price/performance, the new DV format is broadly supported by vendors. This technology provides a host of advantages over its analogue counterparts, including superior resolution, better colour, high-performance compression, picture stability, error correction and CD-quality sound.

Video camera users represent another significant target market. Dataquest estimates that, in 1997, four million analogue camcorders were sold to dealers in the United States. Currently, there are an estimated 70 million camcorder owners worldwide, many of whom also own a PC. With the introduction of the new DV standard, much of this market is expected to migrate to a digital format over the next few years. At present, there is a strong price discrepancy between digital camcorders, at approximately US \$1,600, and analogue camcorders, costing between US \$200 and US \$300. As the digital technology matures, prices may be expected to fall, attracting more of the consumer mass market. According to Dataquest, the consumer and small business market for video-editing software more than doubled to \$10 million in 1997 from just \$4 million in 1996. Currently, Dataquest predicts that the market will reach \$41 million by 2002; however, the market is emerging so rapidly that Dataquest must regularly revise its forecasts.

The prevalence of computer systems in the home and office, and the increasingly sophisticated multimedia capabilities of these systems further drive the market for digital imagery software. By definition, multimedia involves the creation or

playback of a combination of two or more media, at least one of which is time-sequenced, such as audio or video. With their strong visual impact, digital images, whether photos or video clips are compelling elements of the multimedia experience.

Multimedia devices such as video-capture boards, scanners and digital still cameras are also expected to rise in numbers leading to greater multimedia content on the computer. According to Dataquest, total worldwide shipments of video boards that include video-capture capability are expected to grow from an estimated approximately 15 million units in 1997 to approximately 36.4 million units in the year 2000. These estimates include shipments of a range of products of video-capture card products suitable for both consumers and professionals, cards with a TV tuner capability and adapters that combine three dimensional ("3D") graphics, video capture and graphics acceleration.

The DVD data storage format is expected to supersede the CD-ROM format in the near future. The most current multimedia PCs are already equipped with a DVD-ROM drive and Infotech Enterprises Inc. ("Infotech"), a market research firm in Woodstock, Vermont, forecasts an installed hardware base of almost 70 million units by 2000.

As a home playback medium for movies, DVD-Video is already gaining in popularity. Infotech estimates that the worldwide catalogue of DVD-Video titles in print will exceed 3,000 by year-end 1998, as compared to 732 titles in 1997.

The popularity of the Internet may be expected to drive the growth of markets for digital imagery software, as users become accustomed to capturing and transmitting photos, and video on-line. Industry analysts estimate that there are currently more than 120 million computer users with access to the Internet, representing a significant market for digital imagery software.

BUSINESS OF THE CORPORATION

MGI designs, develops, markets and supports products in the PC Photography and PC Video markets in the multimedia segment of the computer software industry. MGI's products are suitable for home and business PC users. MGI, MGI PhotoSuite, MGI VideoWave, MGI DVD MAX, MGI PURE DIVA and digitalVCR are trademarks or registered trademarks of the Corporation.

Description of Software Products

MGI currently distributes seven products: MGI PhotoSuite, MGI PhotoSuite II, MGI PC Wedding Kit, MGI PhotoGallery, MGI VideoWave, MGI VideoWave II, and MGI DVD MAX (OEM only). In addition, MGI recently introduced MGI PURE DIVA and expects to ship this product through PC OEMs in the fall. The Corporation also produces and licenses OEM versions of MGI PhotoSuite, MGI PhotoSuite II, MGI PC Wedding Kit, MGI PhotoGallery, MGI VideoWave and MGI VideoWave II.

PC Photography Products

MGI PhotoSuite II - The next generation of MGI's flagship PC Photography software, MGI PhotoSuite II, became available for wide retail distribution in September 1998. At a suggested retail price of US \$49.99, MGI PhotoSuite II offers consumers a complete web-enabled photography package. Suitable for Windows 95, 98 and NT operating systems, this software's unique architecture allows direct input from digital cameras, scanners, CD-ROMs, DVDs and the Internet.

MGI PhotoSuite II is the first product of its kind to integrate Windows Internet technology at its core, taking web enablement to a new level. MGI PhotoSuite II functions as a special-interest web portal for those wanting to explore photography resources on the Internet. Providing direct access to the web browser from within its own Dynamic HTML interface, MGI PhotoSuite II eliminates the need to switch back and forth between programs. Direct links to photo services such as Kodak's PhotoNet and Sony's ImageStation, as well as to the Lycos, Inc. on-line photo library, are embedded in the product, and navigation to any other website is simple. To capture an image found anywhere on the Internet, the user need only drag and drop the image into MGI PhotoSuite II's photo library. In addition, on the MGI PhotoSuite II homepage, users will find links to specialized photography sites for PC photography enthusiasts to share their work and discuss technique.

MGI PhotoSuite II's interface is organized into six modules, each devoted to specific tasks. The *Photos* module contains tools for capturing, editing, transforming, enhancing and adjusting pictures. The *Internet* module provides seamless access

to the Internet, which is the most extensive source for digital photos in the world. The *Projects* module provides over 500 templates for making greeting cards, calendars, collages and stationery. The *Album* component is an archive that lets users store, organize, search and retrieve photos and other multimedia content. The *Slide Show* module can produce a photo and sound presentation complete with transitions. Finally, the *Guides* module provides tips, guidance and step-by-step instructions to help users make the most of MGI PhotoSuite II's depth of functionality.

MGI PhotoSuite II can be expanded and customized to meet the needs of the individual consumer or OEM customer. The software combines Active X controls, JavaScript and Dynamic HTML into a unique and malleable web-based application. This architecture facilitates the addition or removal of particular features and functions. Upgrades can thus be delivered quickly, ensuring that the application remains current.

MGI PhotoSuite - MGI's first photography product, MGI PhotoSuite, has been widely acclaimed by industry experts, ranking sixth (6th) among top-selling software in all product categories in July 1998. MGI intends to continue marketing and supporting this original product concurrently with its new MGI PhotoSuite II software, in order to serve customers using Apple Macintosh platforms and older Windows 3.x computers.

MGI PhotoSuite enables users to edit, organize and be creative with their photos using a PC and the Internet. MGI PhotoSuite is available on both CD-ROM and floppy disks for Windows 3.x, Windows 95, 98 and NT operating systems and is also available for the Apple Macintosh by OEM distribution.

MGI PhotoSuite allows the user to work with photographs captured from the Internet, captured from other software programs, or digitized using a scanner or digital camera. It also provides multimedia file management functions for users to organize all of their photographs, graphics, sound files, music and video clips into convenient albums.

MGI PhotoSuite can make any photograph Internet-ready by reducing the resolution and converting the image file to JPEG format. Using e-mail software that supports MAPI, users can automatically attach their photos to any e-mail message or upload them to a homepage.

MGI PhotoSuite customers who use analogue film can have their images digitized through Kodak PhotoNet Online, a service that allows users to proof, store and order photos via the Internet.

MGI PC Wedding Kit - This kit allows users to put their wedding photos on a PC and the Internet. The package includes a special version of MGI PhotoSuite, free processing of film to disk and a wedding kit idea guide. Users can make their own wedding cards and invitations, albums, programs and more by combining their photos with supplied templates.

MGI PhotoGallery - This is a CD-ROM collection of more than 500 professional-quality photographs that can be used in presentations, reports and in creating Web pages on the Internet. The images are stored in low resolution format so that they can be quickly accessed and incorporated into other software programs for Windows or Apple Macintosh.

PC Video Products

Video Editing

MGI VideoWave II - Designed for use on Pentium and Pentium II computers with Windows 95, 98 and NT operating systems, MGI VideoWave II builds on the success of its award-winning predecessor, MGI VideoWave, a non-linear digital video editing solution.

By replacing complicated timeline interfaces with its intuitive "StoryLine" format, MGI VideoWave II simplifies the video editing process for the home and business user. The software is packed with powerful editing features that allow the user to create polished productions quickly and easily, by applying special effects, titles, transitions, audio tracks and even mixing two clips as one (i.e. chroma keying). All of MGI VideoWave II's sophisticated editing capabilities are executed with drag-and-drop, point-and-click simplicity.

MGI VideoWave II includes an introductory video and interactive tour that leads users through each of its powerful editing

functions, allowing the users to quickly become familiar with all aspects of video editing. The software also ships with useful “theme” video content and animated sequences for users to incorporate into their video productions.

The software includes new “cutting room” and “darkroom” modes for trimming and refining clips. Twenty-four new transitions have been added for a total of 52 transitions. A new six-track stereo audio engine provides more robust audio editing, improved quality and the ability to control a CD-ROM for audio recordings. The text titler has been enhanced and features drop shadows, outlines and anti-aliasing for creating smoother, clearer titles and credits. In addition, the overall functionality in MGI VideoWave II has been improved for faster performance and better quality results with an improved MPEG engine and MJPEG software decoder.

MGI VideoWave II makes it easy to create videos in AVI, MPEG, DV and Web video formats, for playback on computers, the Internet, output back to tape or DV devices. A new “Produce Wizard” tailors the video production process for both beginners and advanced users, and allows them to define and save production settings in templates for future use. MGI VideoWave II also provides users with better control when playing a video full screen for outputting to a VCR through a TV out card.

MGI VideoWave II is the first product in its class to offer support for both traditional analogue video capture hardware, USB cameras and the new, next generation Digital Video camcorders and PC connection standards IEEE 1394. The software is designed to enable the coexistence and cross-compatibility of both analogue and DV, so the user can work in and with both formats seamlessly, leveraging their investment in their VCR, camcorder and traditional video capture hardware, while making the transition to the new digital realm.

MGI VideoWave - This software lets users quickly and easily capture, edit and produce videos on a PC. Designed for the non-technical, general business and home user, MGI VideoWave uses a different approach to video production by eliminating the traditional timeline interface used by other video editing software products. Its unique storyline interface for video composition, “morphing” console, non-linear editing functionality and real-time preview let users combine moving pictures, animation, graphics, photos, sound, music and narration to “tell a story” in video.

MGI VideoWave features allow users to capture video and audio from any analogue source such as a video camera or videotape player, produce still images from analogue video sources or from AVI, QuickTime or MPEG movies, record video conferences, produce video for e-mail attachments or streaming on the Internet, edit video and audio, produce professional effects and titles and transitions, preview edited video and record narration. Users can produce videos in AVI, QuickTime, MPEG and Internet streaming video formats for playback on PCs, Macintosh computers and the Internet or output back to tape.

MGI VideoWave is a 32-bit program for Microsoft Windows 95 and NT operating systems. This program supports Intel Indeo and Intel MMX media enhancement technology, which speeds up the manipulation of video on Pentium-based computers. The software has built-in support for Microsoft NetShow compliant file formats, including ClearVideo from Iterated Systems, VDOLive from VDONet Corp., Web Theater from Vxtreme Inc., and VivoActive from Vivo Software, Inc., thereby offering broad capability for distributing and viewing high-quality, full-motion video over the Internet and corporate networks.

The package ships with MGI’s ActiveMovie player and MGI MPEG-1 Encoder (“MME”) in order to minimize hard disk space needs, a media library for managing video, photo and audio content, 45 built-in special and transition effects, stock videos and a tutorial.

In November 1996, Byte Magazine editors gave a pre-production version of MGI VideoWave the Best of Comdex Finalist Award, recognizing it as one of the best new multimedia software products introduced at the Comdex trade show in Las Vegas. In 1997, PC Magazine awarded two Editor’s Choice Awards to MGI VideoWave, recognizing it to be the best in its category. MGI VideoWave has also received international awards from Windows Sources magazine in Australia, SVM Multimedia magazine in France and PC Format Magazine in the United Kingdom.

DVD Playback

MGI DVD MAX - MGI’s new DVD MAX OEM product is a software-only solution that enables PC manufacturers to offer

DVD playback capability without expensive dedicated hardware.

DVDs store audio and visual data in a highly compressed form. In order for this information to become useable on the PC, it must be decoded and streamed. The usual solution is to use a dedicated hardware chip to perform these tasks. However, this approach is expensive, since each chip currently costs between US\$70 and US\$90 at wholesale, thus cutting into the narrow retail margin for computer manufacturers. Moreover, the chip becomes obsolete if new compression formats are introduced onto the market.

MGI DVD MAX offers manufacturers an efficient, cost-effective alternative. MGI DVD MAX decodes and streams compressed information at high speed, with accuracy equivalent to a hardware chip. This software uses the available bandwidth of today's powerful central processing units ("CPUs") to accomplish the task in real time. A user would notice no difference in speed or performance. Furthermore, the software could easily be updated to accommodate new compression formats.

MGI first showed a beta version of this product at Comdex/Fall '98 in Las Vegas. MGI DVD MAX is ready for global distribution with six current language editions and geographic zone support available. Ten additional language editions are scheduled for release in the first quarter of fiscal 2001.

Digital Home Entertainment

MGI PURE DIVA - This is a breakthrough software product designed to redefine the future of digital home entertainment. By capitalizing on Intel Pentium III's processing power to digitize, compress, save and playback video content, MGI PURE DIVA provides users the ability to "enhance and personalize" their entertainment experience, whether it is TV, DVD movies or CD audio.

MGI PURE DIVA is a four-in-one applications suite, at the centre of which is MGI's digitalVCR™ whose high-level features include the following:

- pause a "live" broadcast TV;
- capture video from cameras;
- step forward play;
- instant replay on demand;
- zoom in on a particular portion of video, including frozen frame;
- access to and one-click programming through most common electronic program guides ("EPG");
- output to a television or computer monitor; and
- archive to VHS tape (analogue) or DVD-recordable (next version) (digital).

The concept for a digital video recorder and some of its accompanying features are not new. However, prior implementations have required expensive dedicated hardware. This functionality is now possible on a *consumer desktop PC* exclusively in software because the processing power and platform capabilities have reached a sufficient level to enable them.

MGI PURE DIVA will require a 500 Megahertz Pentium III processor or higher to run because of the computation-intensive demands of the applications. Management expects a platform to be a standard PC offering in Fall 1999. MGI PURE DIVA will deliver the benefits of a PC-powered entertainment environment that is fully open and upgradeable by simply accessing the Web.

Business and Marketing Strategy

MGI's main objective is to maintain and strengthen its significant international market presence in the digital imagery segment of the computer software industry. MGI intends to capitalize on the growing popularity of the powerful new generation of multimedia computer systems, devices and the Internet by offering affordable, yet technologically advanced, software applications for the consumer and OEM markets. MGI intends to focus on the expanding markets for photo and video software.

MGI's marketing strategy encompasses the following approaches:

- developing products of exceptional performance and value that anticipate and capitalize on emerging market trends and technological advancements within the computer industry;
- creating alliances with leading manufacturers in the photography, video and computer hardware industries in order to increase the distribution of MGI products through OEM sales;
- forming strategic partnerships with retailers and service providers, such as film processors, in the photography and video markets in order to increase product awareness and consumer sales among camera and camcorder users;
- cultivating a two-tier worldwide distribution network that utilizes the logistical advantages of resellers and also targets key retail chains as individual customers;
- generating brand recognition and sales through mass media advertising and special promotions;
- capturing international markets by producing multiple language editions of the software and providing regional-based support worldwide; and
- using the e-commerce capabilities of the Internet to generate sales and provide global customer support.

In connection with MGI's strategy of creating alliances with leading hardware manufacturers, on September 30, 1997, MGI entered into various agreements with Intel Corporation ("Intel") pursuant to which, among other things, Intel made a strategic equity investment in Common Shares and Warrants of MGI (see "Prior Sales"). This equity investment is a component of, and is expected to help foster, the ongoing business relationship between Intel and MGI. In connection with this investment, Intel was granted certain rights to require the Corporation to use its best efforts to register the shares of MGI held by Intel contemporaneously with other registrations being effected by the Corporation under the United States Securities Act of 1933 (the "1933 Act"). To date, no securities of MGI have been registered under the 1933 Act. Management believes that this relationship with Intel will be of significant continuing benefit to MGI as a result of Intel's position of prominence within the computer industry.

Individual Product Sales Strategy

Since each of MGI's digital imagery products is targeted to a slightly different market segment, with unique requirements and expectations, a specialized marketing strategy has been, and will continue to be developed and implemented for each product launch. MGI will carefully position and promote each new product it releases based on a thorough analysis of market conditions. In general, however, each marketing campaign will employ a combination of the tactics outlined below.

OEM Agreements

With each product release, MGI works to establish a broad user base as quickly as possible. As a crucial part of this marketing strategy, MGI produces custom versions of its software for bundling with products from leading manufacturers in the photo, video, graphics and computer hardware industries. MGI's OEM partners then market and distribute the software with their own products. This distribution tactic contributes to the creation of a substantial initial user base, which provides an ongoing market for upgrades, future enhancements and related products sold at additional cost directly to the end user by MGI.

MGI has entered into OEM agreements with a wide cross-section of manufacturers. Current OEM customers and partners include:

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| • Action Systems, a division of V&A Incorporated | • Okidata, Division of Oki America, Inc. |
| • Adaptec Inc. | • Packard Bell NEC, Inc. |
| • ATI Technologies Inc. | • Panasonic Interactive Media Company |
| • Aztech Systems Limited | • Pinnacle Systems, Inc. (a division of miroComputer Products) |
| • Boomerang Software, Inc. | • PRIMAX International B.V. |
| • Citizen America Corporation | • SANYO Electric Co., Ltd. |
| • Diamond Multimedia Systems, Inc. | • SANYO U.K. Sales Limited |
| • Digital Vision, Inc. | • ScanSoft, Inc. |
| • Ditek Software Corp. | |

- Hitachi, Ltd.
- Intel Corporation
- Iomega Corporation
- Konica USA Inc.
- Softwex Technologies Inc.
- Sony Electronics Inc.
- Vista Imaging, Inc
- Yashica Optical Division, Kyocer Electronics inc.

Marketing Alliances

MGI is forming marketing alliances with photo service providers and other companies with a stake in the emerging digital photography market. Under these co-operative agreements, the partner companies mutually promote and cross-market each other's products and services. For example, MGI has formed several such alliances with photo processing companies including Kodak Digital Processing (a division of Kodak), Wolf Camera & Video, Ritz Camera, MotoPhoto, Konica, PictureVision (a subsidiary of Kodak) and BLACK'S Photo (a division of Fuji Film Canada).

In addition, MGI has entered into an agreement with the Internet search engine specialist, Lycos, to co-develop and market to its on-line digital photo community.

Retail Channels

MGI takes a two-tier approach to retail distribution, using the networking and logistical strength of large distributors, while also dealing directly with major retail chains. As MGI's products cut across product categories, MGI pursues retail customers in both the computer and photo markets worldwide.

MGI distributes its products to more than 8,000 computer retail stores in North America, using the services of large computer industry distributors, such as Ingram Micro Inc., Merisel, Inc. and Tech Data Corporation.

Among MGI's computer retail customers in the United States are:

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|---------------------------------------|---------------------------------------|
| • CompUSA Inc. | • Media Play |
| • Computer City | • Office Depot, Inc. |
| • Fry's Electronics, Inc. | • Staples, Inc. |
| • Best Buy Co., Inc. | • MicroCenter (MicroElectronics Inc.) |
| • Electronics Boutique Holdings Corp. | • AFFES |
| • TigerDirect, Inc. | • Office Max |
| • J&R Electronics Inc. | • MCA |

Individual computer retail customers in Canada include such major chains as:

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|---------------------------------|---------------------------|
| • The Business Depot | • Camelot |
| • CompuCentre (Multimicro Inc.) | • IBM Home Computing |
| • Future Shop Ltd. | • @Computers Plus |
| • CompuSmart (Multimicro Inc.) | • Computer Systems Centre |
| • Computer City | • Electronics Boutique |

In Europe, MGI's retail distribution channels reach more than 5,000 computer industry stores. The major distributors used are Ingram Micro Inc., Isyotec, Macrotron AG, Computer 2000 Distribution Ltd., Innelec and GEM. Individual European computer retail clients include:

- | | |
|------------------------|---------------------------|
| • Boots | • Media Market |
| • Dixons Store Group | • PC World |
| • Electronics Boutique | • ProMarkt |
| • Extrapole | • Software Warehouse Plc. |
| • FNAC | • Saturn |
| • Hypermedia | • Staples, Inc. |

- Zentrale Interdiscount AG
- Karstadt AG
- Kaufhof AG
- Surcouf
- Tempo
- Vobis Microcomputer AG

Within the North American and European photo industries, MGI uses the distribution services of Kodak, Carsen Group, Beamscope and The PRO Group. In addition, the Corporation deals directly with the following photography retail chains:

- Eastman Kodak Company
- Spector
- Ritz Camera Centers, Inc.
- Wolf Camera, Inc.
- Black Photo Corporation
- Henry's
- Moto Photo, Inc.
- The Camera Shop, Inc.
- Meijer, Inc.
- Konica Quality Photo
- Fotolabo SA
- Signature Labs
- Seattle Filmworks, Inc.

Although North America and Europe represent MGI's largest markets, MGI also distributes its retail products through various channels in Australia, Japan, Southeast Asia and China.

MGI entered into an agreement with Mitsui & Co. in Japan to establish retail distribution into 200 retail stores and OEM licensing agreements with manufacturers such as Sony, JVC, Sharp and Panasonic. MGI also has established MGI "Asia" in partnership with Natural Data Asia in Taiwan, to address the Southeast Asia & Chinese markets, the fastest growing markets for PCs.

Advertising and Promotions

In order to increase market awareness and acceptance of its products, MGI conducts advertising campaigns, distributes promotional materials and conducts direct mail marketing and other promotional activities, such as participating in consumer and trade shows. MGI has also developed creative product packaging, promotional items and on-line information to promote its products. MGI solicits reviews of its products by major publications within the computer, photo and video industry. In addition to increasing market acceptance of its products, MGI promotes its corporate name and identity through its marketing strategies and investor relations efforts.

Global Marketing and Support

MGI has a market presence in more than 25 countries around the world. MGI's products are packaged and marketed in various language editions to meet the specific needs of particular geographic regions. At present, MGI's products are available in 14 language editions.

To support its worldwide distribution, MGI maintains offices and other sales presence in major cities around the world. Sales forces have been established in Amsterdam, Dallas, Frankfurt, London, Paris, Sydney, Taipei, Tokyo and Toronto.

Internet Sales

MGI's homepage on the World Wide Web supports on-line ordering and upgrade capabilities and provides detailed product information and technical support. It is linked directly to the websites of many of MGI's strategic partners, as well as numerous photography and video-editing special interest sites. MGI even hosts an affinity community discussion site, PhotoStreet, which invites digital imagery enthusiasts to exchange ideas and information. MGI also has established e-commerce relationships with Digital River, Inc., Kodak and @Home. On-line traffic generated by these connections will help to enhance MGI's profile and generate sales among Internet users.

Competition

The long-term success of any software product in the multimedia segment of the computer software industry is based principally on product features, performance, ease-of-use, reliability, hardware compatibility, brand name recognition, product reputation, levels of advertising, pricing, merchandising, training, quality of customer support, quality and timeliness

of product upgrades, and the ability of the software developer to introduce and develop new products and to upgrade existing products. Accordingly, one of the main risks facing MGI's competitive position is the introduction of similar products aimed at the same target markets, at a competitive price, by competitors that have significantly greater resources. See "Risk Factors". MGI intends to minimize this risk by releasing new products targeted at emerging markets, by releasing product enhancements for popular software platforms and by rapidly developing a large and loyal distribution, OEM and user base.

Management considers the following companies to be the principal source of current and future competition for the Corporation's software products:

PC Photography

- Adobe Systems Inc.
- Corel Corporation.
- Microsoft Corporation
- Meta Creations Inc.
- Jasc Software, Inc.
- Ulead Systems Inc.
- SoftKey Inc.
- PictureWorks Technology Inc.
- Arc Software

PC Video

- Asymetrix Corporation
- Ulead Systems Inc.
- Avid Technologies Inc.
- International Microcomputer Systems Inc. (IMSI)

DVD

- Peavey Electronics Corporation (Mediamatix)
- Zoran Corporation
- Cyberlink
- Q1 Cinemaster
- Xing
- Varo Vision
- Inter Video

Product Protection

MGI relies on a combination of contract provisions (including contracts with its employees), technical measures, copyright, trademark and trade secret laws to protect its rights with respect to its proprietary software products. However, there can be no assurance that MGI will be successful in protecting its intellectual property rights. See "Risk Factors — Risks Associated with Intellectual Property Matters".

Production Plan and Costs

Production of MGI's products involves duplicating master disks and CD-ROMs, and printing user manuals and packaging for its software products. Disk duplication and printing of user manuals and packaging materials are performed by outside sources to MGI's specifications. Such arrangements have been satisfactory to date, and products have met MGI's specifications.

Research and Development

To be competitive in the computer software industry, MGI must provide new products and modify and enhance its existing products on a continuing basis. MGI intends to maintain the competitive advantage of its technology by adapting it to incorporate emerging technologies through an ongoing research program. MGI intends to develop new product enhancements and to make such enhancements available for all popular PC platforms. As at April 30, 1999, a total of 79 of MGI's employees were devoted to research and development activities.

Product Technical Support

Providing high quality, responsive, technical support to the end users of its products will be a cornerstone to the ongoing success of MGI's business. MGI's products will generally include reference and tutorial manuals in order to minimize the number of customer support calls. MGI will also provide support through the Internet, by telephone and by fax and on all major electronic bulletin boards which will permit customers to access support effectively. In cases where MGI's products are distributed by OEMs, the OEMs will generally provide first-line technical support.

Facilities and Employees

The Corporation leases approximately 41,000 square feet of office and warehouse space at 50 West Pearce Street, Richmond Hill, Ontario, which serves as its head office facility. MGI conducts its principal software development and marketing activities from its head office facility, and it also has additional office facilities in the United States. As at April 30, 1999, the Corporation had 141 employees.

Proposed Acquisition of Live Picture, Inc. Assets

On May 19, 1999, MGI entered into a letter of intent to acquire certain assets of Live Picture, Inc., a private California company specializing in digital and Internet imaging software products ("Live Picture"), for an approximate purchase price of US\$10,000,000 comprised of cash and common shares of MGI (the "Acquisition"). Live Picture has filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code, pursuant to which third parties may also make offers to acquire these assets. Accordingly, the completion of the Acquisition is conditional upon the approval of the bankruptcy court having jurisdiction over Live Picture's bankruptcy case, and the absence of any competing third party bids to acquire these assets which is accepted by the bankruptcy court. The completion of the Acquisition is also conditional upon MGI obtaining financing from third party investors, on terms satisfactory to MGI in its sole discretion, sufficient to consummate the Acquisition and provide operating capital for the integration of the Live Picture assets into the business of MGI, and to the satisfactory completion of due diligence by MGI, in its sole discretion. The Acquisition will be financed entirely by third party investors and no proceeds of this offering will be used, directly or indirectly, in connection with the Acquisition or the integration of the Live Picture assets into the business of MGI. See "Use of Proceeds".

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

Selected Summary Financial Data

The selected financial data as at and for each of the three years ended January 31, 1999, 1998 and 1997 have been derived from the Corporation's audited Financial Statements and Notes thereto, included elsewhere in this Prospectus and incorporated by reference hereto and should be read in conjunction therewith. The Financial Statements are prepared on the basis of Canadian GAAP and are expressed in Canadian dollars. See "Management's Discussion and Analysis of Financial Position and Results of Operations."

Statements of Operations and Deficit

	Year Ended January 31		
	1999	1998	1997
	(thousands, except share data)		
Revenue	\$ 15,962	\$ 13,348	\$ 5,144

Gross profit	13,717	10,688	3,815
Expenses	22,472	17,848	8,979
Loss for the year	(8,451)	(6,950)	(7,403)
Loss per share	(0.35)	(0.35)	(0.48)
Weighted average number of common shares outstanding	24,122,095	19,958,968	15,355,052

Balance Sheet Data

	Year Ended January 31		
	1999	1998	1997
		(thousands)	
Current assets	\$ 10,735	\$ 18,527	\$ 7,891
Capital assets	2,444	1,487	952
Liabilities	4,614	3,344	2,385
Shareholders' equity.....	8,565	16,670	6,458

Liquidity and Capital Resources

As at January 31, 1999, the Corporation had cash of \$2,441 and short-term investments of \$2,027 for a total cash and short-term investments of \$4,468, compared to total cash and note receivable of \$12,567 as at January 31, 1998. The Corporation also had a credit facility of \$2,500 in place at January 31, 1999, none of which was drawn upon as at such date.

During the fiscal year ended January 31, 1999 ("Fiscal 1999") \$7,434 of cash was used to fund operating activities compared to \$7,998 used during the fiscal year ended January 31, 1998 ("Fiscal 1998"). The Corporation purchased \$1,511 of capital assets during Fiscal 1999 compared to purchases of \$1,010 during Fiscal 1998. The purchases during both years included computer equipment, office furniture and equipment and leasehold improvements.

Days sales outstanding decreased 23 days during Fiscal 1999 to 90 days from 113 days during Fiscal 1998.

Subsequent to January 31, 1999, the Corporation secured an increase in its available line of credit to \$4 million, signed a financing agreement to obtain up to \$6 million of subordinated convertible debt, and signed an underwriting agreement for the issuance of 3 million special warrants for gross proceeds of \$7,650. On May 19, 1999, MGI entered into a letter of intent to acquire certain assets of Live Picture. See note 19 in the Financial Statements attached hereto.

As at January 31, 1999, the Corporation had no outstanding commitments for capital expenditures.

Results of Operations

During Fiscal 1999, MGI incurred a net loss of \$8,451 based upon sales of \$15,962. The loss incurred during Fiscal 1999 was due primarily to increased expenditures on research and development associated with the development of MGI VideoWave II, MGI PhotoSuite II and other unreleased products. The increase in marketing expenses were related to new products released during the year and additional efforts to support continuing products.

During Fiscal 1998, MGI incurred a net loss of \$6,950 based upon sales of \$13,348 compared to a net loss of \$7,403 for the previous period based upon sales of \$5,144 in that period. The loss incurred during Fiscal 1998 was due primarily to increased expenditures on infrastructure and marketing as MGI continued to expand into retail channels throughout North America, Europe and Asia Pacific. The expenses associated with the launching of MGI VideoWave in April of 1997 and the development of MGI PhotoSuite II also contributed to increased losses during Fiscal 1998 compared to the fiscal year ended January 31, 1997.

Revenue

During Fiscal 1999, total revenue increased to \$15,962 from \$13,348, representing an increase of approximately 20%. The increase was primarily due to increased product sales of approximately 8% and development services revenues of \$1,526 earned during the year. During Fiscal 1998, retail sales through distributors continued to account for the majority of sales revenues of MGI.

Cost of Sales and Expenses

Gross margin for Fiscal 1999 increased 6% to 86% compared to a gross margin of 80% during Fiscal 1998.

Marketing and selling expenses for Fiscal 1999 increased \$1,589 to \$13,199 compared to \$11,610 for the previous period. Marketing and selling costs include advertising space in magazines, trade publications and mail order catalogues, as well as expenses incurred for direct mail programs and trade shows. The increase was primarily due to additional marketing and selling costs associated with supporting new products released during the year and an increase in sales and customer support staff. During Fiscal 1998, marketing and selling expenses increased \$7,063 to \$11,610 as compared to \$4,547 for the previous period. The increase reflects the expenses incurred by the Corporation in entering new markets. More specifically, additional sales and public relations staff were hired to achieve increased sales. As well, marketing and promotional budgets were increased in order to establish wider distribution of MGI's products and to support the launch of additional products. MGI had also increased its presence at trade shows over the previous two fiscal years.

Research and development expenses for Fiscal 1999 increased \$1,722 to \$6,480 compared to \$4,758 for the previous year. The majority of the costs relate to salary expenses and fees paid to subcontractors for the development of existing and new software. The significant increase reflected the Corporation's investment in research and development during the year. During Fiscal 1998, research and development expenses increased \$3,027 to \$4,758 as compared to \$1,731 for the previous period. The significant increase in research and development expenses during Fiscal 1998 was due to an increase in salary expenses as the number of the Corporation's employees continued to grow. MGI's need for a greater number of employees was due to the expansion of the Corporation's product development department, the development of its OEM business and the overall expansion of its business on a world-wide scale.

Administration expense for Fiscal 1999 increased \$827 to \$2,143 compared to \$1,316 for the previous year. The increase was primarily due to additional staff required to support the growth experienced over the past two years, the strengthening of the Corporation's management team, and increased premises costs.

Amortization expense for Fiscal 1999 increased \$184 to \$659 compared to \$475 for the previous year. The increase was attributable to increased amortization on capital assets acquired during Fiscal 1999. During Fiscal 1998 amortization expense decreased \$1,082 to \$475 as compared to \$1,557 for the previous year. The decrease was due to management's decision to write-off certain software acquisitions as at January 31, 1997.

During Fiscal 1999 and Fiscal 1998, MGI's activities were focused primarily on continuing to establish an infrastructure and implementing the business plans developed by MGI's management team. Results for the first half of Fiscal 1999 included the effect of significant management focus being directed towards a merger agreement entered into with Discreet Logic Inc. This merger was not completed and the merger agreement was terminated. MGI's results for the remainder of Fiscal 1999 and Fiscal 1998 were in line with management's expectations.

The Year 2000

The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure, which could affect an entity's ability to conduct normal business operations. During Fiscal 1999, the Company assessed its products, internal operating systems, and suppliers to minimize any impact of the Year 2000 issue. The Company has determined that the Year 2000 risks to its customers using the Company's products are low. The Company is in the process of converting and upgrading operating systems and software applications, which are not Year 2000 compliant. The Company is in the process of completing formal communication with significant suppliers to determine the extent to which the Company is exposed to

those third parties' failure to remedy their own Year 2000 issues. The Company expects to have completed this review in the early part of the third quarter of Fiscal 2000. To date no third party issues have been identified.

The Company expects to implement successfully the systems and programming changes necessary to address the Year 2000 issues, and does not believe that the cost of such actions will have a material adverse effect on its financial condition or results of operations. However, there can be no assurance that the systems of other companies on which the Company relies will not be adversely effected by the Year 2000 issue.

PRINCIPAL SHAREHOLDERS

The following table sets forth the name of every person or corporation who, to the knowledge of management of MGI, beneficially owned, directly or indirectly, or exercised control and direction over more than 10 percent of the voting securities of MGI as at April 30, 1999, without taking into consideration the Common Shares being qualified for distribution under this prospectus upon exercise of the Special Warrants.

<u>Name and Address</u>	<u>Type of Ownership</u>	<u>Number of Common Shares</u>	<u>Percentage of Class</u>
Oren Asher ⁽¹⁾ Thornhill, Ontario	beneficial and of record	2,817,423	11.57%

- (1) Oren Asher may also be considered to be the beneficial owner of 145,416 Common Shares registered in the name of his children, and also holds options to purchase an additional 200,000 Common Shares. Taking his children's holdings into account (but not giving effect to the exercise of any of the options held by him or the exercise of the Special Warrants), Mr. Asher is the beneficial owner of 12.17% of the issued and outstanding Common Shares. Taking his children's holdings into account (but not giving effect to the exercise of any of the Special Warrants), and giving effect to the exercise of the options held by him, Mr. Asher would be the beneficial owner of 12.99% of the class.

The directors and senior officers of MGI, as a group, beneficially owned, directly or indirectly, or exercised control and direction over 3,375,854 Common Shares, being 13.9% of the issued and outstanding Common Shares of MGI as at April 30, 1999 (which percentage does not give effect to the exercise of the Special Warrants). In addition, the directors and senior officers of MGI, as a group, hold options under the Corporation's stock option plan (the "Stock Option Plan") to purchase an additional 1,130,000 Common Shares. See "Stock Option Plan".

PROMOTER

Oren Asher was significantly involved in the creation of the Corporation and took the initiative in founding and organizing its business. Accordingly, Mr. Asher may be considered to be a promoter of the Corporation. See "Principal Shareholders", "Directors and Officers", "Compensation of Executive Officers and Directors", "Stock Option Plan" and "Prior Sales".

DIRECTORS AND OFFICERS

The names of the directors and officers of MGI, their municipalities of residence and the position in MGI held by them are as follows:

<u>Name and Municipality of Residence</u>	<u>Office</u>
Oren Asher Thornhill, Ontario	Chairman and Director
Anthony DeCristofaro ⁽¹⁾⁽²⁾ Woodbridge, Ontario	President, Chief Executive Officer and Director

Joel Goldman King City, Ontario	Director
Harvey Goldberg ⁽¹⁾⁽²⁾ Thornhill, Ontario	Director
Dennis Bennie ⁽¹⁾⁽²⁾ North York, Ontario	Director
C. Rowland Hanson Seattle, Washington	Director
Kenneth J. Killin Toronto, Ontario	Chief Financial Officer

(1) Indicates member of the Audit Committee.

(2) Indicates member of the Compensation Committee.

PRINCIPAL OCCUPATIONS AND BACKGROUND OF MANAGEMENT TEAM

Oren Asher, Chairman and Director

Mr. Asher has been the Chairman of MGI since January 2, 1996. Prior to that, Mr. Asher was President of Ditek Software Corp., a graphics software development company which he founded in 1985 and which specializes in computer-aided design and drafting (CADD). Born and educated in Israel, Mr. Asher graduated from the Institute of Science and Technology ORT, in Israel.

Anthony DeCristofaro President, Chief Executive Officer and Director

Mr. DeCristofaro has been the President and Chief Executive Officer of MGI since December 27, 1995, and has more than 20 years of experience in the high-technology industry. Prior to joining MGI, Mr. DeCristofaro was Vice President and General Manager of AST Canada, a computer hardware company in Toronto. From 1987 to 1991, Mr. DeCristofaro was General Manager of NEC Canada, a computer hardware company. Mr. DeCristofaro has also served on several boards, including Delrina Corporation (a computer software company) from 1988 to 1992 and AST Canada from 1995 to 1997. Born in Toronto, Mr. DeCristofaro holds an Advanced Business Administration degree from York University.

Harvey Goldberg, Director

Mr. Goldberg has been a Director of MGI since April 30, 1996. He is the Executive Vice President of Toymax Inc., a toy manufacturing corporation, and the President of Toymax (H.K.) Limited, a toy manufacturing and international distribution corporation. Mr. Goldberg has held positions with Toymax for more than the past five years.

Dennis Bennie, Director

Currently the Chief Executive Officer of XDL Capital Corp., Mr. Bennie established this private venture capital firm in November 1996 to focus exclusively on investing in and working with emerging Internet companies and related technologies. Prior to this, Mr. Bennie co-founded Delrina Corporation where he was the Chairman and CEO from 1988 until November 1995 at which time Delrina was sold to Symantec Corporation. Prior to this, Mr. Bennie co-founded Ingram Micro Inc., Canada, which is currently this country's largest software distributor.

C. Rowland Hanson, Director

Mr. Hanson became a director of MGI on June 30, 1997. Mr. Hanson currently is, and has been for the past five years, the president and founder of C.R.H. & Associates, a Seattle-based company which provides management consulting services in strategic planning, marketing, communications and general business development. Prior to that, Mr. Hanson served as Vice-President of Corporate Communications at Microsoft where he participated in developing and implementing the original branding strategy for Microsoft which included the naming and launching of Windows. Mr. Hanson has served on several boards, including Delrina Corporation and PackageNet. Mr. Hanson holds an MBA from Wharton Business School and a BA in business and a BS in Sociology from Loyola University.

Joel Goldman, Director

Mr. Goldman has been a director of MGI since April 30, 1996 and was the Chief Financial Officer from October 2, 1995 to September 1998. Currently, Mr. Goldman is an independent consultant. Prior to his involvement with MGI, Mr. Goldman served five years as the Controller for Toronto-based manufacturer Jaltex Inc. and its predecessor, Jaltex Jewellery of Canada Limited. Prior to that, Mr. Goldman worked eight years in public practice with Laventhol and Horvath, Chartered Accountants. Born in Toronto, Mr. Goldman holds a BA in Economics from York University and earned his Chartered Accountant designation in 1982.

Kenneth Killin, Chief Financial Officer

Mr. Killin has been the Chief Financial Officer of MGI since September, 1998. He was Vice President, Finance and Administration and Chief Financial Officer of JetForm Corporation from 1994 to 1998. Prior to that, Mr. Killin was employed by Crowntek Business Centres Inc., a microcomputer reseller and distributor, from 1988 to 1994 in various financial and operation executive positions.

Israel Ben-Ishai, Vice President of Engineering

Mr. Ben-Ishai joined MGI in November 1998, bringing with him 20 years of research and product development experience. Eleven years of Mr. Ben-Ishai's career were spent with Bell Northern Research and Nortel Networks, as Director of Technology of the Toronto Laboratory. Most recently, Mr. Ben-Ishai was an executive team member at Certicom Corp., a TSE listed company and leading provider of cryptographic technology. Mr. Ben-Ishai graduated with an M.Sc. in Electronics Engineering from Politenico di Milano in 1977. In 1992, he completed the Executive Program at Queen's University in Kingston, Ontario.

COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

Compensation of Executive Officers

Summary Compensation Table

The following table and notes set forth the actual compensation or awards to Anthony DeCristofaro, Oren Asher, Kenneth Killin and Israel Ben-Ishai, being the only named executive officers of the Corporation who earned more than \$100,000 in salary and bonus in Fiscal 1999.

	Annual Compensation			Long Term Compensation Awards	All Other Compensation ⁽¹⁾
Name and Principal Position	Year Ended Jan 31	Salary (\$)	Bonus (\$)	Securities Under Options Granted (#)	
Anthony DeCristofaro, President and Chief Executive Officer	1999	125,000	198,301	-	-
	1998	125,000	160,324	-	-
	1997	125,000	99,649	-	-
Oren Asher, Chairman	1999	151,800 ⁽²⁾	-	-	-
	1998	151,800 ⁽²⁾	-	-	-
	1997	103,621 ⁽³⁾	-	-	-
Kenneth Killin, Chief Financial Officer	1999	180,000 ⁽⁴⁾	22,663	110,000	-
Israel Ben-Ishai Vice-President of Engineering	1999	210,000 ⁽⁵⁾	5,054	200,000	-

- (1) Does not include perquisites or other personal benefits, the value of which did not exceed \$10,000 in any of the three financial years ended January 31.
- (2) Amount was paid as a consulting fee to a company owned by Mr. Asher
- (3) Includes amounts paid as salary and consulting fees to a company owned by Mr. Asher.
- (4) Base Salary is annualized. Mr. Killin joined the Corporation in September 1998 and earned \$68,909 in the year ended January 31, 1999.
- (5) Base Salary is annualized. Mr. Ben-Ishai joined the Corporation in December 1998 and earned \$35,000 in the year ended January 31, 1999.

Option Grants During the Most Recently Completed Financial Year

The following table provides information concerning options granted to the named executive officers during the fiscal year ended January 31, 1999.

Name	Securities Under Options Granted (#)	% of Total Options Granted to Employees in Financial Year	Exercise or Base Price (\$/Security)	Market Value of Securities Underlying Options on the Date of Grant (\$/Security)	Expiration Date
Anthony DeCristofaro	-	-	-	-	-
Oren Asher	-	-	-	-	-
Kenneth Killin	110,000	12.10	1.30	1.30	September 14, 2003
Israel Ben-Ishai	200,000	22.00	1.36	1.36	November 10, 2003

Options Exercised and Year-End Option Values

The following table provides information concerning the number and value at January 31, 1999 of unexercised options held by the above-named executive officers. In the table, “in-the-money” options are those where the exercise price was less than the market price of the Common Shares at January 31, 1999.

Name	Unexercised Options at January 31, 1999 (#)		Value ⁽¹⁾ of Unexercised In-the-Money Options at January 31, 1999 (\$)	
	Exercisable	Non-Exercisable	Exercisable	Non-Exercisable
Anthony DeCristofaro	300,000	-	675,000	-
Oren Asher	200,000	-	450,000	-
Kenneth Killin	27,500	82,500	53,625	160,875
Israel Ben-Ishai	-	200,000	-	378,000

⁽¹⁾ Value is based on the difference between the option exercise price and the fair market value at January 29, 1999, the last trading day prior to fiscal year-end (\$3.25 share), multiplied by the number of shares underlying the option.

Compensation of Directors

Directors are eligible to participate in the Corporation’s Stock Option Plan. See “Stock Option Plan”. The Corporation pays annual premiums of approximately \$22,980 in respect of directors’ and officers’ liability insurance.

Executive Contracts

The Corporation has entered into an agreement with Mr. DeCristofaro pursuant to which he was hired as the President and Chief Executive Officer of the Corporation effective December 27, 1995 (the “DeCristofaro Agreement”). The DeCristofaro Agreement provides that it may be terminated by the Corporation with or without cause upon payment to Mr. DeCristofaro of compensation equal to 18 months’ base salary at the rate of \$125,000 per year and one year’s bonus based on the preceding 12 months’ sales, at the current rate of bonus. The DeCristofaro Agreement further provides that in the event of a change of control of the Corporation resulting in the resignation of Mr. DeCristofaro, Mr. DeCristofaro shall give 3 months’ notice of such resignation and receive a lump-sum payment of an amount that is equal to 1.5 times his then-current annual salary plus bonuses. Pursuant to the DeCristofaro Agreement, Mr. DeCristofaro receives a salary of \$125,000 per annum, exclusive of bonuses, benefits and other compensation. In addition to the annual base salary, Mr. DeCristofaro was entitled to receive an annual bonus equal to 2% of the gross sales (net of returns and bad debts) of all software products by the Corporation throughout the world for Fiscal 1997, which resulted in him receiving a bonus of \$99,660. Mr. DeCristofaro was entitled to receive an annual bonus equal to 1% of the gross sales of all software products by the Corporation throughout the world (net of returns and bad debts) for Fiscal 1998, as well as 0.5% of gross sales based on meeting budgeted losses, which resulted in him receiving a bonus of \$160,324. Mr. DeCristofaro was entitled to receive an annual bonus equal to 1% of the gross sales of all software products by the Corporation throughout the world (net of returns and bad debts) for Fiscal 1999, as well as 0.5% of gross sales based on meeting budgeted losses, which resulted in him receiving a bonus of \$198,301. Mr. DeCristofaro also has been granted options to purchase 300,000 Common Shares of the Corporation at a price of \$1.00 per share, which options expire on January 27, 2006. Mr. DeCristofaro is also reimbursed for all expenses incurred from time to time in connection with the carrying out of his duties.

The Corporation entered into an employment/consulting agreement with Mr. Asher pursuant to which he was retained to provide research and development services to the Corporation effective January 2, 1996 (the “Asher Agreement”). The Asher Agreement has the same terms and conditions as the DeCristofaro Agreement except that it does not contain any bonus

provisions and, in the event of termination, Mr. Asher is entitled to compensation equal to 18 months' base salary. Mr. Asher currently receives consulting fees from the Corporation, which amounted to \$151,800 for Fiscal 1999. Mr. Asher also has been granted options to purchase 200,000 Common Shares at a price of \$1.00 per share, which options expire on January 27, 2001.

The Corporation entered into an agreement with Mr. Killin pursuant to which he was hired as the Chief Financial Officer of the Corporation effective September 14, 1998 (the "Killin Agreement"). The Killin Agreement has terms and conditions similar to the DeCristofaro and Asher Agreements. The Killin Agreement provides that it may be terminated by the Corporation with or without cause upon payment to Mr. Killin of compensation by the Corporation equal to 18 months' base salary. The Killin Agreement further provides that in the event of a change of control of the Corporation resulting in the resignation of Mr. Killin within one year of such change in control, Mr. Killin shall give 3 months' notice of such resignation and receive a lump-sum payment of an amount that is equal to 2 times his then-current annual salary. Pursuant to the Killin Agreement, Mr. Killin receives a salary of \$180,000 per annum, exclusive of bonuses, benefits and other compensation. In addition to the annual base salary, Mr. Killin is entitled to receive a bonus of \$60,000 based on performance, which resulted in him receiving a bonus of \$22,663 for Fiscal 1999. During Fiscal 1999, Mr. Killin was also granted options to purchase 110,000 Common Shares at a price of \$1.30 per share, which options expire on September 14, 2003. Mr. Killin is also reimbursed for all expenses incurred from time to time in connection with the carrying out of his duties.

The Corporation entered into an agreement with Mr. Ben-Ishai pursuant to which he was hired as the Vice President of Engineering of the Corporation effective December 1, 1998 (the "Ben-Ishai Agreement"). The Ben-Ishai Agreement provides that it may be terminated by the Corporation without cause upon payment to Mr. Ben-Ishai of compensation by the Corporation equal to 12 months' base salary. The Ben-Ishai Agreement further provides that in the event of a change of control of the Corporation resulting in Mr. Ben-Ishai reporting to any person other than the President of the new entity, he will have the option of staying with the new entity or leaving and accepting a lump-sum payment of an amount that is equal to 12 months' base salary. In addition to the annual base salary, Mr. Ben-Ishai is entitled to receive a bonus of \$30,000 based on performance, which resulted in him receiving a bonus of \$5,054 for Fiscal 1999. During Fiscal 1999, Mr. Ben-Ishai was also granted options to purchase 200,000 Common Shares at a price of \$1.36 per share, which options expire on November 10, 2003.

STOCK OPTION PLAN

The purpose of the MGI Stock Option Plan is to provide officers, directors and key employees of the Corporation with the opportunity to acquire an increased proprietary interest in MGI, to encourage and reward efforts to further the development and growth of MGI and to assist MGI in attracting and retaining personnel.

The Stock Option Plan is administered under the supervision of the Board of Directors. Subject to the provisions of the Stock Option Plan, the Board of Directors has the power to grant options to "service providers" of the Corporation, including: (a) any employee or insider of the Corporation or any of its subsidiaries, and (b) any other person or company engaged to provide ongoing management or consulting services for the Corporation or any entity controlled by the Corporation. The Board of Directors also determines the time when, and the manner in which, each option is exercisable and the duration of the exercise period, provided that the period for which an option is exercisable is not greater than 10 years from the date of granting the option. The maximum number of shares which may be issued to any one insider and his or her associates under the Stock Option Plan and any other share compensation arrangements, within a one-year period, shall be 5% of the shares outstanding at the time of the issuance on a non-diluted basis. As approved by the shareholders of the Corporation, the maximum number of Common Shares issuable under the Stock Option Plan is 3,821,526 subject to adjustment. The option price per Common Share is to be determined by the Board of Directors at the time an option is granted and it must not be less than the market value of the Common Shares at the time of grant.

In order to permit the continued grant of options to attract and retain talented individuals in accordance with the purposes of Stock Option Plan, the Board of Directors approved an amendment to the Stock Option Plan (the "Amendment") to increase the total maximum number of common shares reserved for the issuance under the Stock Option Plan by 950,000 to 4,771,526. The new specified maximum number of shares that may be issuable under the Stock Option Plan would represent approximately 17.49 % of the issued and outstanding common shares at the date hereof (assuming the conversion of all Special Warrants into 3,000,000 Common Shares). Pursuant to The Toronto Stock Exchange Policy, the Amendment is being presented for approval by the Corporation's shareholders at the Corporation's annual and special meeting scheduled

for June 1, 1999 (the “Special Meeting”).

As at April 30, 1999, options to purchase a total of 3,775,750 Common Shares have been granted pursuant to the Stock Option Plan, of which 3,118,425 are outstanding as follows:

<u>Holder</u>	<u>Number of Options</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
Executive Officers (4 persons)	500,000	\$1.00	Jan. 27, 2001
	110,000	\$1.30	Sept. 14, 2003
	200,000	\$1.36	Nov. 10, 2003
Directors who are not Executive Officers (4 persons)	140,000	\$1.00	Jan. 27, 2001
	105,000	\$2.30	Apr. 30, 2002
	25,000	\$2.15	May 30, 2002
	50,000	\$2.30	June 30, 2002
Others	671,000	\$1.00	Jan. 27, 2001
	14,875	\$1.50	July 31, 2001
	2,000	\$3.00	July 31, 2001
	30,000	\$1.50	Aug. 31, 2001
	3,000	\$3.20	Sept. 30, 2001
	25,000	\$1.50	Nov. 13, 2001
	54,500	\$1.50	Nov. 30, 2001
	25,500	\$1.50	Dec. 31, 2001
	3,000	\$2.95	Dec. 31, 2001
	5,000	\$1.50	Jan. 31, 2002
	69,000	\$1.50	Feb. 28, 2002
	82,500	\$1.50	Mar. 31, 2002
	2,000	\$2.60	Mar. 31, 2002
	24,350	\$1.50	Apr. 30, 2002
	350	\$2.30	Apr. 30, 2002
	20,000	\$1.50	May 30, 2002
	24,000	\$2.15	May 30, 2002
	10,000	\$1.50	June 30, 2002
	34,750	\$2.30	June 30, 2002
	4,500	\$4.00	Aug. 29, 2002
	18,500	\$1.50	Aug. 30, 2002
	42,000	\$1.50	Oct. 31, 2002
	11,000	\$4.10	Oct. 31, 2002
	43,100	\$1.50	Nov. 30, 2002
	4,000	\$3.86	Nov. 30, 2002
	32,000	\$1.50	Dec. 31, 2002
	500	\$3.95	Dec. 31, 2002
	10,000	\$1.50	Jan. 30, 2003
	60,000	\$3.30	Jan. 30, 2003
	21,000	\$1.50	Feb. 27, 2003
	1,000	\$1.50	Mar. 31, 2003
	35,500	\$1.50	Apr. 30, 2003
	7,000	\$4.20	Apr. 30, 2003
	13,000	\$1.50	May 29, 2003
	18,000	\$1.50	June 30, 2003
	75,000	\$2.30	June 30, 2003
	40,000	\$1.50	July 31, 2003
	70,000	\$1.40	Aug. 31, 2003

<u>Holder</u>	<u>Number of Options</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
Others (cont'd)	22,000	\$1.35	Sept. 30, 2003
	80,000	\$1.06	Oct. 13, 2003
	44,000	\$1.40	Oct. 31, 2003
	75,000	\$1.75	Nov. 30, 2003
	9,500	\$2.30	Dec. 31, 2003
	10,000	\$3.00	Jan. 23, 2004
	41,500	\$3.25	Jan. 29, 2004
	12,500	\$3.15	Feb. 26, 2004
	20,000	\$3.04	Mar. 31, 2004
	67,000	\$3.44	Apr. 30, 2004

The 500,000 options which were granted to the executive officers expiring on January 27, 2001, have vested as to 75% on April 30, 1997 and the final 25% have vested on April 30, 1998. The 110,000 options granted to the executive officers expiring on September 15, 2003, have vested as to 25% on December 13, 1998, and shall vest as to an additional 25% on December 13 of each of the next three years. The 200,000 options granted to the executive officers expiring on November 11, 2003, shall vest as to 25% on November 11, 1999 and as to an additional 25% on November 11 of each of the next three years. The options granted to directors who are not executive officers vest over a period of 3 or 4 years. The options granted to others are subject to various vesting requirements.

As at April 30, 1999, 657,325 of the options granted pursuant to the Stock Option Plan have been exercised by employees of the Corporation.

SHAREHOLDER RIGHTS PLAN

The Board of Directors unanimously adopted a Shareholder Rights Plan (the "Rights Plan" or the "Plan") by a resolution dated April 23, 1999. The provisions of the Rights Plan are set out in a shareholder rights plan agreement (the "Rights Agreement") dated and effective as of April 23, 1999, between the Corporation and The Trust Company of Bank of Montreal as Rights Agent. Under the Rights Plan, shareholders of the Corporation have received, for each common share issued and outstanding at 5:00 p.m. (Toronto time) on April 23, 1999, one right to purchase one additional common share (a "Right"), under the circumstances and on the terms described in the Agreement. All capitalized terms used without definition under the heading "Shareholder Rights Plan" have the meanings ascribed to them in the Rights Agreement.

In order to continue beyond the date of the Special Meeting, the Plan must be confirmed by resolution passed by a majority of the votes cast by Independent Shareholders (generally, shareholders other than the Offeror or Acquiring Person, their Associates and Affiliates, and Persons acting jointly or in concert with the Offeror or Acquiring Person) who vote in respect of the Plan at the Special Meeting.

The Board of Directors implemented the Rights Plan to ensure that, to the extent possible, in the context of a bid for control of the Corporation through an acquisition of the Corporation's common shares, shareholders will be treated equally and fairly and will be positioned to receive full value for their shares.

The Rights Plan does not affect the rights of holders of outstanding voting shares of the Corporation to requisition a meeting of shareholders, in accordance with the provisions of applicable corporate and securities legislation, or to enter into agreements with respect to voting their common shares. The definitions of "Acquiring Person" and "Beneficial Ownership" have been developed to minimize concerns that the Plan may be inadvertently triggered or triggered as a result of an overly-broad aggregating of holdings of institutional shareholders and their clients. The Rights Plan does not interfere with the day-to-day operations of the Corporation nor does the initial issuance of the Rights in any way alter the financial condition of the Corporation, impede its business plans or alter its financial statements.

INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

The following sets forth the interest of management and other related parties in material transactions affecting the

Corporation since the date of its incorporation. Other than as set out below, no insider of the Corporation, or associate or affiliate thereof, had any material interest, direct or indirect, in any transaction since the date of MGI's incorporation or has any material interest, direct or indirect, in any proposed transaction which has or will materially affect the Corporation:

- (1) Pursuant to an agreement dated October 3, 1995 between MGI and Ditek (the "Ditek PhotoSuite Agreement"), MGI acquired from Ditek all of its rights in and to PhotoSuite (then known as PhotoWorks) in exchange for certain securities of MGI. Because Oren Asher is associated with both MGI and Ditek as well as being an executive officer of both companies, and because Mr. Goldman, the Chief Financial Officer of MGI, owns a minority interest in Ditek, the Ditek PhotoSuite Agreement constitutes a material transaction with a related party. The Corporation's determination that the consideration payable to Ditek was fair and reasonable in the circumstances was based in part upon the result of an independent valuation of PhotoSuite arranged for by the Corporation;
- (2) On September 27, 1996, the Corporation entered into an agreement to purchase from Ditek all rights, title and interest to certain 3D modelling software for an amount of \$1,564,287 plus 5% of all net receipts from sales or leases of the technology for a period of four years. In consideration, the Corporation issued an aggregate of 471,429 common shares and paid cash consideration of \$150,000. This transaction took place under subsection 85(1) of the Income Tax Act and was recorded on the books of the Corporation at a nominal value, being the carrying amount in the books of the transferor except to the extent of the cash consideration received. See Note 15 to the Financial Statements. The registered and principal office of Ditek is 60 West Wilmot Street, Richmond Hill, Ontario L4B 1M6;
- (3) During Fiscal 1999, C.R.H. & Associates, a consulting company of which Mr. Hanson is the president, received from the Corporation approximately \$27,000 as compensation for services it provided to MGI. C.R.H. & Associates has been providing consulting services to MGI since June 30, 1997;
- (4) During Fiscal 1999, Mr. Bennie received consulting fees equal to \$10,000; and
- (5) During Fiscal 1999, the Corporation made lease payments for the Corporation's leased premises in an aggregate amount of \$102,000 to a company controlled by Mr. Asher and a relative of Mr. DeCristofaro. In January 1999, the leased premises were sold by that company to an unrelated third party, subject to the Corporation's lease.

CAPITALIZATION

The following table sets forth the capitalization of the Corporation as at January 31, 1999 and as at April 30, 1999 reflecting the sale of 3,000,000 Special Warrants by the Corporation at a price of \$2.55 per Special Warrant and the application of the net proceeds therefrom, after deducting the underwriting fee and estimated offering expenses payable by the Corporation.

	<u>January 31, 1999</u> (audited)	<u>April 30, 1999</u> (unaudited)
Convertible	-	\$ 3,000,000 ⁽¹⁾
Debenture.....		
Shareholders' Equity:		
Common Shares: unlimited number of shares		
authorized, 24,279,412 outstanding as at January		
31, 1999 and 24,349,912 outstanding as at April	\$ 32,365,000	32,501,000 ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾
30, 1999		
Special Warrants	-	7,041,000
Deficit as at January 31, 1999	(23,800,000)	(23,800,000)
Total Capitalization	<u>\$ 8,565,000</u>	<u>\$ 18,741,000</u>

- (1) The Covington Debenture (as hereinafter defined) is convertible into up to 923,077 common shares. In addition, up to 148,000 common shares (subject to adjustment) are issuable upon the exercise of 148,000 warrants issued to C.I. Covington Fund at \$3.25 per common share.
- (2) In addition, options granted under the Stock Option Plan of MGI to purchase an aggregate of 3,118,425 Common Shares were outstanding at April 30, 1999.
- (3) An additional 180,000 Common Shares (subject to adjustment) are issuable pursuant to the exercise of compensation options. As additional compensation in respect of the special warrant offering to which this prospectus relates, the Underwriters were issued 180,000 Broker Special Warrants exercisable for compensation options which expire on April 16, 2001. Each compensation option is exercisable into one common share, subject to adjustment, at an exercise price of \$3.00.
- (4) In addition, up to 1,022,757 common shares (subject to adjustment) are issuable upon the exercise of 1,022,757 common share purchase warrants issued to Intel Corporation, at the lower of (i) \$3.95 per common share and (ii) the higher of the then current market price of the common shares and \$3.20 per common share.

DESCRIPTION OF SHARE CAPITAL

The authorized share capital of MGI consists of an unlimited number of Common Shares and an unlimited number of Class A Voting Special Shares. As at April 30, 1999 there were 24,349,912 Common Shares issued and outstanding, and 1,170,757 Warrants, each Warrant being exercisable for one Common Share (subject to adjustment). The Covington Debenture (as hereinafter defined), convertible into up to 923,077 Common Shares, was also issued and outstanding. There were also 180,000 Common Shares (also subject to adjustment) issuable upon the exercise of the Compensation Options to be issued on the exercise of Broker Special Warrants, and 3,118,425 options to purchase Common Shares outstanding pursuant to the Stock Option Plan. In addition, the 3,000,000 Special Warrants exercisable for a like number of Common Shares, subject to adjustment, were issued and outstanding. All Common Shares are entitled to participate equally in any dividends declared thereon, and on liquidation or distribution of the assets of the Corporation. All of the outstanding Common Shares are fully paid and non-assessable and each Common Share has one vote per share at all meetings of shareholders.

AMALGAMATION WITH GLOBEX

On April 30, 1996, MGI amalgamated with Globex, a reporting issuer in the Province of Ontario, and it continued operating under the name MGI Software Corp. Pursuant to an amalgamation agreement dated January 23, 1996, as amended (the "Amalgamation Agreement") between MGI and Globex, on April 30, 1996 the shareholders of MGI (pre-amalgamation) received one Common Share of the post-amalgamation entity for each common share previously held in MGI and the Globex shareholders received one Common Share of the post-amalgamation entity for each fifteen common shares previously held in Globex. In respect of any common shares in MGI (pre-amalgamation) which had been authorized and reserved for issuance pursuant to any warrants, options, convertible debentures or subscription agreements outstanding on April 30, 1996 (collectively, the "Purchase Rights"), pursuant to the terms of the Amalgamation Agreement an equal number of Common Shares of the post-amalgamation entity were deemed to be duly authorized and reserved for issuance pursuant to such Purchase Rights. Upon the valid exercise or completion of any such Purchase Rights the post-amalgamation entity will issue, in lieu of the common shares in MGI (pre-amalgamation) which would otherwise have been issuable upon such exercise or completion, an equal number of Common Shares of the post-amalgamation entity. The assets and liabilities held by Globex prior to the Globex Amalgamation do not form any material part of the assets and liabilities of the post-amalgamation entity.

TRADING HISTORY OF COMMON SHARES

Prior to September 25, 1997, the Common Shares traded on the Canadian Dealing Network ("CDN") under the trading symbol "MGIS" where trading commenced on May 10, 1996. On September 25, 1997, the Common Shares were listed and posted for trading on The Toronto Stock Exchange (the "TSE") under the trading symbol "MGA" (which was subsequently changed to "MGI" on September 30, 1997). The following table sets forth the reported high and low sale prices and volume of trading of the Common Shares as reported by the CDN and the TSE, as applicable, for the periods indicated, since the commencement of trading activity on May 10, 1996:

	Price Range		Trading Volume
	<u>High</u>	<u>Low</u>	
Fiscal Year ended January 31, 1998			
First Quarter.....	\$3.00	\$1.90	708,179
Second Quarter	\$3.50	\$2.10	1,474,461
Third Quarter	\$6.75	\$3.10	6,162,901
Fourth Quarter	\$4.60	\$3.00	1,569,354
Fiscal Year ended January 31, 1999			
First Quarter.....	\$5.45	\$3.30	10,796,924
Second Quarter	\$4.00	\$1.65	3,095,246
Third Quarter	\$2.29	\$0.92	1,941,775
Fourth Quarter			
November 1998	\$1.87	\$1.30	770,542
December 1998.....	\$2.45	\$1.50	885,195
January 1999	\$3.35	\$2.02	1,493,802
Fiscal Year ended January 31, 2000			
First Quarter			
February 1999	\$3.59	\$2.76	944,917
March 1999	\$3.50	\$2.80	973,642
April 1999	\$3.49	\$2.40	1,021,587

The trading history of the shares of Globex prior to the Globex Amalgamation has not been set forth above it is not relevant to the trading of the shares of the post-amalgamation entity. See “Amalgamation with Globex”.

PRIOR SALES

From May 1, 1998 to April 30, 1999, other than the offering of Special Warrants to which this prospectus relates and the options issued in connection with MGI’s Stock Option Plan, MGI has issued or sold the following securities:

Date of Issue	No. and Type of Security	Price per Security	Gross Cash Consideration
May 21, 1998	92,500 Common Shares	\$1.00	\$92,500 ⁽¹⁾
July 14, 1998	43,750 Common Shares	\$1.00	\$51,875 ⁽¹⁾
July 16, 1998	5,000 Common Shares	\$1.00	\$5,000 ⁽¹⁾
July 24, 1998	5,000 Common Shares	\$1.00	\$5,000 ⁽¹⁾
November 11, 1998	2,000 Common Shares	\$1.00	\$2,000 ⁽¹⁾
November 18, 1998	37,500 Common Shares	\$1.00	\$37,500 ⁽¹⁾
November 24, 1998	37,500 Common Shares	\$1.00	\$37,500 ⁽¹⁾
January 8, 1999	4,000 Common Shares	\$1.00	\$4,000 ⁽¹⁾
January 20, 1999	3,825 Common Shares	\$2.30	\$8,798 ⁽¹⁾
January 20, 1999	2,125 Common Shares	\$2.54	\$5,388 ⁽¹⁾
January 25, 1999	32,500 Common Shares	\$1.00	\$32,500 ⁽¹⁾
February 1, 1999	6,250 Common Shares	\$2.30	\$14,375 ⁽¹⁾
February 10, 1999	20,000 Common Shares	\$1.00	\$20,000 ⁽¹⁾
February 11, 1999	1,750 Common Shares	\$2.30	\$4,025 ⁽¹⁾
February 18, 1999	2,500 Common Shares	\$2.95	\$7,375 ⁽¹⁾
March 15, 1999	40,000 Common Shares	\$2.25	\$90,000 ⁽¹⁾
April 16, 1999	3,000,000 Covington Debenture	Issued at Par	\$3,000,000 ⁽²⁾

(1) Issued in connection with the MGI Stock Option Plan. See “Stock Option Plan”.

(2) Issued for cash consideration. See “Prior Sales — Covington Debenture”. As additional compensation, the Corporation issued 135,000 purchase warrants to C.I. Covington Fund, each exercisable to purchase one Common Share at a price of \$3.30 per Common Share and 13,000 purchase warrants to C.I. Covington Fund, each exercisable to purchase one Common Share at a price of \$3.30 per Common Share after May 31, 2000 if the Corporation has not drawn down the \$3,000,000 Standby Facility.

Covington Debenture

On April 16, 1999, MGI issued \$3,000,000 aggregate principal amount of debentures (the “Covington Debenture”) to C.I. Covington Fund (“Covington”). The Covington Debenture bears interest at a fixed rate of 6% per annum, calculated and payable monthly, in arrears, with the first payment due May 31, 1999. The Covington Debenture is convertible into Common Shares at \$3.25 per Common Share until November 30, 2000, and at \$4.25 for the remainder of the three year term. The investment by Covington also includes a \$3,000,000 standby facility (the “Standby Facility”), which will be disbursed to the Corporation on satisfaction by the Corporation of certain performance criteria on or before May 31, 2000.

As additional consideration to Covington for making the investment, the Corporation granted to Covington (i) 135,000 purchase warrants, each exercisable to purchase one Common Share at a price of \$3.30 per Common Share until April 16, 2002, and (ii) 13,000 purchase warrants, each exercisable to purchase one Common Share at a price of \$3.30 per Common Share at any time after May 31, 2000 until April 16, 2002 if the Corporation has not drawn down the Standby Facility. If the Standby Facility is drawn down on or before May 31, 2000, the Corporation will issue to Covington, as additional consideration for the Standby Facility, 135,000 purchase warrants, each exercisable to purchase one Common Share at a price equal to the closing price quoted on the TSE on the day the warrants are issued, plus 15%.

DIVIDEND RECORD AND POLICY

Since the date of its incorporation, MGI has not paid any dividends on its outstanding Common Shares and it does not anticipate that it will pay any dividends in the foreseeable future.

DILUTION

After giving effect to this offering (after deducting the Underwriters’ fees and the estimated expenses of this offering), assuming that 3,000,000 Common Shares are issued upon the exercise of the Special Warrants without giving effect to the issuance of the 180,000 Common Shares issuable upon the exercise of the Compensation Options, the effective price of \$2.55 paid for each Common Share through the purchase of a Special Warrant exceeds by \$1.98 (or 78% of the issue price) the consolidated net tangible book value per Common Share as shown in the balance sheet of the Corporation as at January 31, 1999, as set out below:

Issue price	\$2.55
Net tangible book value per Common Share as at January 31, 1999	\$ 0.35
Increase in net tangible book value per Common Share attributable to the issuance of 3,000,000 Common Shares	\$ 0.22
Net tangible book value per Common Share as at January 31, 1999 after giving effect to the exercise of the Special Warrants	\$ 0.57
Dilution to subscribers	\$ 1.98
Percentage of dilution in relation to the issue price	78 %

USE OF PROCEEDS

The net proceeds of this offering, after payment of the Underwriters’ fees and the expenses of this offering estimated at \$150,000, will be used by the Corporation as to approximately \$3.2 million (or approximately 45%) for marketing initiatives, as to approximately \$ 2.1 million (or approximately 30%) for research and development expenses and the balance as working capital for general corporate purposes. Marketing and sales expenditures will consist of expenses incurred in connection with the design and production of point-of-purchase promotional materials to be distributed to retailers, the

purchase of advertising space in magazines, fees and related expenditures for attending at trade shows, the design and printing of brochures, specification sheets and presentation materials and expenses incurred in connection with direct mail programs. Research and development expenditures will consist mainly of salaries and fees paid to programmers relating to the development of new software and the enhancement of existing software.

PRIVATE PLACEMENT AND PLAN OF DISTRIBUTION

Pursuant to an agreement dated April 5, 1999 (the "Underwriting Agreement") between Nesbitt Burns Inc., Canaccord Capital Corporation and HSBC James Capel Canada Inc. (collectively, the "Underwriters"), MGI agreed to issue and sell, and the Underwriters agreed to purchase, by way of private placement, 3,000,000 Special Warrants at a price of \$2.55 each.

Pursuant to the Underwriting Agreement, MGI agreed to pay to the Underwriters a fee equal to 6% of the gross proceeds from the issue and sale of the Special Warrants, to reimburse the Underwriters for certain fees and expenses relating to this offering and to indemnify the Underwriters against certain liabilities. As additional compensation under the terms of the Underwriting Agreement, the Corporation issued to the Underwriters an aggregate of 180,000 broker special warrants ("Broker Special Warrants"), each exercisable without payment of any additional compensation to the Corporation into one compensation option (a "Compensation Option"). Each Compensation Option entitles the holder thereof to purchase, until 5:00 p.m. on April 16, 2001 (being 24 months from the date of the closing of the sale of the Special Warrants), one Common Share (subject to adjustment) at a price of \$3.00 per Common Share. No additional compensation will be payable to the Underwriters in connection with the distribution of the Broker Special Warrants or Compensation Options.

Pursuant to the Underwriting Agreement, MGI agreed that it will not, for a period of 30 days from August 4, 1999 without the consent of Nesbitt Burns Inc. (such consent not to be unreasonably withheld), sell or issue any Common Shares or securities convertible into or exchangeable for Common Shares, other than pursuant to the sale of the Special Warrants, Share Purchase Warrants, Broker Special Warrants and Compensation Options, and other than:

- (i) Common Shares issued upon the exercise of warrants, debentures or options which were outstanding on April 5, 1999;
- (ii) Common Shares and options issued as employee incentives;
- (iii) Common Shares issued in connection with, or issuable upon the exercise or conversion of securities in connection with, any securities outstanding as at January 25, 1999; and
- (iv) Common Shares issued upon the exercise of the securities to be issued in connection with the Covington Debenture.

Pursuant to a separate agreement, Mr. Oren Asher has agreed not to sell, without the consent of the Underwriters, any Common Shares or securities convertible into Common Shares held by him on April 5, 1999 until 30 days after the date upon which Final Receipts (as defined below) for this prospectus are issued by the Ontario Securities Commission and la Commission des valeurs mobilières du Québec.

The Special Warrants were issued under a special warrant indenture (the "Special Warrant Indenture") dated as of April 16, 1999 between the Corporation and The Trust Company of Bank of Montreal, as trustee (the "Trustee"). Each Special Warrant entitles the holder, upon exercise, to acquire one Common Share (subject to adjustment) without any additional payment during the period commencing on April 16, 1999 and ending at 5:00 p.m. (Toronto time) on the date which is the earlier of: (i) the day which is the fifth business day after the day upon which final receipts for this prospectus (the "Final Receipts") are issued by the Ontario Securities Commission and la Commission des valeurs mobilières du Québec, and (ii) April 17, 2000.

Upon the issuance of the Final Receipts, each Special Warrant which has not been exercised previously shall be deemed to have been exercised without any further action on the holder's part immediately prior to 5:00 p.m. on the fifth business day following the issue of the Final Receipts. If the Final Receipts have not been issued by August 4, 1999 each Special Warrant shall become exercisable, without payment of additional consideration, into one (1) Common Share (also subject to adjustment) plus one-half of one transferable share purchase warrant (a "Share Purchase Warrant"), and each whole Share Purchase Warrant will entitle the holder to purchase one Common Share at a price of \$3.00 per Common Share until 5:00

p.m. on October 16, 2001 (being 30 months from the date of the closing of the sale of the Special Warrants). Any Special Warrants which have not been exercised previously shall be deemed to have been exercised without any further action on the holder's part, immediately prior to 5:00 p.m. on April 16, 2000.

The Special Warrants were issued pursuant to exemptions in from the registration and prospectus requirements of applicable securities legislation in the Provinces of Ontario and Quebec. This prospectus is being filed to qualify the Common Shares and if applicable, Share Purchase Warrants, to be issued upon exercise of the Special Warrants as well as to qualify the distribution of the Compensation Options to be issued upon exercise of the Broker Special Warrants. In accordance with applicable securities laws, if the Special Warrants are exercised prior to the issuance of the Final Receipt, the Common Shares and, if applicable, Share Purchase Warrants, issued upon such exercise may be subject to a hold period or other restrictions on resale.

ESCROW ARRANGEMENTS

Pursuant to an escrow agreement dated May 15, 1996 as amended by an amending agreement dated August 9, 1996 (the "Escrow Agreement") among Oren Asher, Dvora Asher, MGI and The Trust Company of Bank of Montreal (the "Escrow Agent"), Mr. and Mrs. Asher placed an aggregate of 3,940,524 Common Shares in escrow, representing approximately 75.5% of the Common Shares beneficially owned by them. As of April 30, 1999, 40% of the escrowed shares have been released. 10% of such shares were released on May 12, 1997 (the "Initial Release Date") and 30% of such shares were released on the first anniversary of the Initial Release Date, in accordance with the terms of the Escrow Agreement. A further 30% of the shares are to be released on each of the next two anniversaries of the Initial Release Date. The Escrow Agreement complies with the requirements of Policy Statement 5.9 of the Ontario Securities Commission.

RISK FACTORS

An investment in the Common Shares should be considered speculative due to the risk factors set out below, all of which should be carefully considered by a prospective investor.

Competitive Environment

The PC software industry in which MGI competes is extremely competitive and it is characterized by frequent and rapid changes in technology and customer preferences. The competition in this industry is expected to increase and intensify. MGI competes with other software vendors for access to distribution channels, retail shelf space and the attention of customers. Competition is generally based on product positioning, features and functionality, ease of use, quality of customer support, timeliness of product upgrades and price, among other factors. As the market for MGI's software products continues to develop and other software vendors expand their product lines to include products that compete with those of MGI, competition will continue to intensify. Similarly, if MGI acquires or enters markets for new products that are competitive with those of other software vendors, it will also encounter new competition. Aside from the programming time and expertise necessary to develop computer software, there are relatively few barriers to entry into these markets. There can be no assurance that MGI's products will either be successful or gain market acceptance. In addition, MGI may encounter competition from other technologies. A number of competitors and potential competitors of MGI possess significantly greater financial, technical, marketing, sales and other resources than MGI.

Microsoft Corporation's Windows 95, 98 and NT operating systems and other operating systems include an increasing array of basic utilities. There can be no assurance that this will not adversely affect sales of similar products of MGI. In the event that Microsoft or other operating system manufacturers decide to include enhanced versions of such basic utilities in future operating systems or to sell such software on a stand-alone basis, MGI's sales could be materially adversely affected.

Limited Operating History

The Corporation was incorporated in September of 1995 and it has a limited operating history upon which an evaluation of the Corporation and its prospects can be based. The Corporation and its prospects must be considered in light of the risks, expenses and difficulties that may be encountered by companies in the emerging market for digital imaging and video editing software. There can be no assurance that the Corporation will be successful in addressing such risks, or that it will be

successful in increasing its revenues. As a result of the foregoing factors, the Corporation expects that it may continue to incur significant losses for a limited period of time. As of January 31, 1999, the Corporation had an accumulated deficit of \$23,800,000 including amortization of software acquisitions of \$1,871,098. See “Management’s Discussion and Analysis of Operating Results”.

The individuals comprising the Corporation’s senior management are in the process of integrating as a management team. The future profitability of the Corporation will depend to a significant extent upon the ability of the management team to expand the Corporation’s operations and to exploit product marketing and market opportunities.

Dependence on Acceptance of Products and Services

The Corporation’s profitability will depend upon the development of widespread acceptance of its software products. Failure of these products to achieve significant market acceptance and usage, or failure by MGI to develop new software products and enhancements for current products, would adversely affect the Corporation’s business, operating results and financial condition. There can be no assurance that the Corporation’s products will receive widespread market acceptance. Although the Corporation’s strategy of distributing its products through OEM channels is intended to promote the rapid development of familiarity with the Corporation’s products, there can be no assurance that the Corporation will be successful in implementing this strategy, that it will receive the necessary support from OEMs, or that it will be able to capitalize on such opportunities. See “Business of the Corporation — Marketing Strategy”.

Importance of New Products

One factor contributing to the short life span of PC software has been rapid technological change. Software companies must continue to develop, market, support or acquire new products or upgrade existing products on a timely basis to sustain growth rates, revenues and profitable operations. Companies must create or acquire innovative new products reflecting technological changes in hardware and software, as well as translate current products for new hardware and software formats in order to gain and maintain a viable market for their products. In particular, PC hardware is advancing steadily in power and functionality, thereby expanding the market for increasingly complex and flexible software products. This also has resulted in generally longer periods for the research and development of new products and a greater degree of unpredictability in the time necessary to develop products. It is expected that this trend will continue and it may become more pronounced in the future. If MGI is unable to develop or acquire new products to gain market acceptance, and as revenues decrease from products reaching the end of their natural life cycle, the results of operations will be adversely affected. In addition, there can be no assurance that MGI will not experience delays in the development of its products which could result in a loss of competitiveness, or that its OEM partners will not experience delays in product launches.

Dependence on Operating Systems

Although MGI is developing versions of its products which operate on platforms other than Microsoft’s Windows operating systems, MGI derives most of its current sales from versions of products designed to operate on PCs using the Windows operating environment. MGI expects that Windows-based versions of its products will continue to dominate sales in the near term. MGI has devoted, and will continue to devote, substantial efforts to the development of software products that are designed to operate on Windows 95, 98 and NT operating systems. Should Windows 95, 98 or NT operating systems, or MGI’s products not achieve timely market acceptance, or should MGI be unable in a timely manner to develop and market products that operate under Windows 95, 98 or NT operating systems, or their updated versions, MGI’s future revenues could be adversely affected.

Uncertainty about the adoption rate of Microsoft’s products and MGI’s products may also affect future revenues of MGI. It is also possible that other operating systems will gain market acceptance, which would require MGI to develop new products to function under such operating systems. The ability to develop such new products and their success in the marketplace cannot be assured.

Anticipated Continuing Losses

MGI anticipates that it will incur a net loss in the quarter ending April 30, 1999. MGI may continue to incur losses in the future, and management expects that losses will continue to be incurred for the immediate future.

Acquisitions and Integration of Operations

MGI is continuously looking to acquire other companies or assets, such as those pursuant to the proposed Live Picture acquisition. Acquisitions involve a number of risks, including the diversion of management's attention to pursuing the acquisition, assimilating the operations and personnel of the acquired companies or assets, the potential loss of key employees and the difficulty of unifying two corporate images.

Dependence upon Distributors and Distribution Arrangements

The Corporation has entered into certain distribution arrangements and informal relationships with retail software vendors and photo retail chains. The Corporation believes that these arrangements and relationships are important to the successful promotion of its products.

Sales to a relatively small number of distributors account for a substantial percentage of the revenues of MGI. It is likely that sales through distributors will continue to constitute a significant portion of the Corporation's sales. Agreements with distributors are generally non-exclusive, and they may be terminated by either party without cause. Such distributors are not, and will not, be within MGI's control. They also are not obligated to purchase products and also may represent other vendors' product lines. There can be no assurance that these distributors will continue their current relationships with MGI on the same basis, or that they will not give higher priority to the sale of other products, which could include products of competitors. Additionally, certain distributors and resellers have experienced financial difficulties in the past. There can be no assurance that distributors that account for significant sales of MGI's products will not experience financial difficulties in the future. Any such problems could lead to reduced sales and could adversely affect operating results of MGI. There can be no assurance that MGI will be able to continue to obtain adequate distribution channels for all of its products in the future.

The channels of distribution in the software industry have become increasingly concentrated during the past several years, particularly with respect to PC software chain stores and software distributors. With the increasing concentration in the channels of distribution and the high percentage of sales of MGI's products accounted for by distributors, customers may have substantial strength in negotiating favourable terms of sale, including price discounts. There can be no assurance that the Corporation will be successful in developing and maintaining a competitive position in these markets. See "Business of the Corporation — Competition" and "Business of the Corporation — OEM and Distribution Arrangements".

Dependence on OEM Partners

The Corporation has entered into, and intends to continue to enter into, relationships with OEMs of both hardware and software for the distribution of its products. Such OEMs are not, and will not be, within MGI's control. There can be no assurance that any OEMs will continue their current relationships with MGI on the same basis, or that MGI will be successful in securing relationships with additional OEMs. Further, there can be no assurance that OEM partners will not experience delays in launching their products, which could adversely affect the Corporation. See "Business of the Corporation — OEM and Distribution Arrangements".

Limited Capital Resources

The net proceeds to the Corporation of the offering of Special Warrants to which this prospectus relates may not be sufficient to meet all of the Corporation's current and future capital requirements. There can be no assurance that the Corporation will not require significant additional sources of financing, or that such financing will be available on satisfactory terms. See "Management's Discussion and Analysis of Operating Results — Liquidity and Capital Resources".

Lack of Trading History, Limited Liquidity and Volatility of Trading Price

There can be no assurance that a liquid market for the Common Shares will develop or be sustained. The trading price of the Common Shares may be highly volatile and it could be subject to wide fluctuations in response to quarterly variations in operating results, announcements of technological innovations or new products by the Corporation or its competitors, changes in financial estimates by securities analysts or other events or factors. Further, the financial markets have experienced significant price and volume fluctuations that have particularly affected the market prices of equity securities of many high technology companies and that often have been unrelated to the operating performance of such companies.

Principal Shareholders

Upon completion of the distribution of the Common Shares issuable upon the exercise of the Special Warrants, the present directors, executive officers, other insiders and their respective affiliates collectively will own beneficially approximately 12.3 % of the outstanding Common Shares. In particular, Oren Asher and members of his immediate family will own beneficially an aggregate of 2,962,839 Common Shares, representing approximately 10.8% of the voting securities of MGI. As a result, these shareholders would be able to exercise significant influence over all matters requiring shareholder approval, including the election of directors and the approval of significant corporate transactions.

Risks Associated with Intellectual Property Matters

The Corporation's business is highly dependent upon its ability to protect its intellectual property rights. Effective trademark protection may not be available in every country in which the Corporation's products are distributed. The Corporation has not registered all of its copyright interests. There can be no assurance that other parties will not assert infringement claims against the Corporation in the future, or that any such assertions will not result in costly litigation. Additionally, these claims may require the Corporation to obtain a licence to use the intellectual property rights of third parties which may not be available on reasonable terms, if at all. Further, there can be no assurance that the steps taken by the Corporation to protect its proprietary rights will be adequate to protect it from all such claims, or that third parties will not infringe or misappropriate the Corporation's trademarks, copyrights and similar intellectual property rights.

Existing copyright and patent laws do not afford complete protection from infringement by third parties. As the number of software products in the industry increases and the functionality of these products further overlaps, MGI believes that software developers will become increasingly subject to infringement claims. Although such claims may ultimately prove to be without merit, they can be time consuming and expensive to defend. Moreover, there has been an increase in the number of patents issued in the United States and Canada relating to computer software and, accordingly, the risk of patent infringements in the industry can be expected to increase, resulting in a potential for an increase in patent infringement claims against MGI.

MGI periodically obtains licenses to use or copy software written or supplied by third parties for use in the Corporation's products. If such licenses are terminated or MGI's use of such third party software is otherwise enjoined, there can be no assurance that any necessary licenses or rights could be obtained on terms satisfactory to MGI to allow continued use of such third party software which may be necessary for the functionality or features of the Corporation's products.

International Operations

MGI expects that it may derive a significant percentage of its revenue from sales outside of North America. These revenues are subject to the risks normally associated with international operations, including currency conversion risks, taxation, limitations on the repatriation of earnings, slower and more difficult accounts receivable collection, greater difficulty and expense in administering business abroad, complications in complying with foreign laws and the necessity of obtaining requisite export licences, which on occasion may be delayed or difficult to obtain. In addition, while U.S. and Canadian copyright law, international conventions and international treaties provide some protection against unauthorized duplication of software, the laws of some foreign jurisdictions do not protect proprietary rights to the same extent as the laws of the United States and Canada. Software piracy has been, and can be expected to be, a persistent problem for the "shrink-wrap" software industry, and these problems are particularly acute in certain international markets.

Variations in Operating Results

A variety of factors may cause period-to-period fluctuations in MGI's operating results, including the integration of operations resulting from acquisitions of companies, products or technologies, revenues and expenses related to the introduction of new products or new versions of existing products, changes in selling process, delays in purchases in anticipation of upgrades to existing products or introduction of new products, currency fluctuations, dealer and distributor order patterns, general economic trends or a slowdown of PC sales and seasonality.

Key Personnel

The loss of the services of any of the executive officers, software developers or other key employees of the Corporation could have a material adverse effect on the business, operating results or financial condition of the Corporation. The Corporation currently has "key man" insurance only in respect of its President and Chief Executive Officer. The success of the Corporation is highly dependent upon its continuing ability to identify, hire, train, retain and motivate highly qualified management, technical and sales and marketing personnel. Competition for such personnel is intense and there can be no assurance that the Corporation will be able to attract, assimilate or retain such personnel in the future.

Changes in Technology

The market for the Corporation's products is characterized by rapid technological developments, evolving industry standards and customer demands as well as the possibility of new and competitive product introductions and enhancements.

Dilution

Purchasers of the Special Warrants will suffer immediate and substantial dilution in the net tangible book value of their investment. See "Dilution".

LEGAL PROCEEDINGS

There are no legal proceedings involving MGI or its assets as of the date of this prospectus which management of MGI believes to be material to the Corporation, nor are any such proceedings known by MGI to be contemplated.

MATERIAL CONTRACTS

Except for contracts made in the ordinary course of business, the only material contracts which have been entered into by the Corporation in the two years preceding the date of this Prospectus are:

1. the Agency Agreement dated September 29, 1997 between the Corporation and Gordon Capital Corporation, Canaccord Capital Corporation and Griffiths McBurney & Partners, whereby the Corporation agreed to issue and sell, and the Agents agreed to use their best efforts to arrange for the purchase by way of private placement, of 3,500,000 Special Warrants.
2. the Special Warrant Indenture made as of September 29, 1997 between the Corporation and the Trust Company of Bank of Montreal as Warrant Agent;
3. subscription agreements between the Corporation and purchasers of the Special Warrants dated September 29, 1997;
4. the Subscription Agreement dated as of September 30, 1997 between the Corporation and Intel Corporation referred to under "Prior Sales";
5. the Warrant Agreement providing for the issuance of Common Share purchase warrants (the "Warrants") dated as of September 30, 1997 between the Corporation and Intel Corporation referred to under "Prior Sales"; and

6. an Investor Agreement dated as of September 30, 1997 among the Corporation, Oren Asher, Dvora Asher and Intel Corporation to provide for certain rights and obligations with respect to Intel Corporation's acquisition of the Common Shares and Warrants.

7. the Underwriting Agreement referred to under "Private Placement and Plan of Distribution";

8. the Special Warrant Indenture referred to under "Private Placement and Plan of Distribution";

9. subscription agreements between the Corporation and purchasers of the Special Warrants dated and accepted by the Corporation on April 16, 1999 referred to under "Private Placement and Plan of Distribution";

10. the Covington Debenture referred to under "Prior Sales"; and

11. The Rights Agreement referred to under "Shareholder Rights Plan";

Copies of the above agreements may be inspected during normal business hours at the head office of the Corporation at 50 West Pearce Street, Richmond Hill, Ontario L4B 1E3 during the course of distribution of the securities qualified hereunder and for 30 days thereafter.

LEGAL MATTERS

Certain legal matters in connection with this offering will be passed upon on behalf of the Corporation by LaBarge Weinstein, Ottawa, and on behalf of the Underwriters by Goodman Phillips & Vineberg, Toronto.

AUDITORS, REGISTRAR AND TRANSFER AGENT

The auditors of MGI for the years ended January 31, 1999, 1998 and 1997 were PricewaterhouseCoopers LLP, Chartered Accountants, 5700 Yonge Street, Suite 1900, North York, Ontario, M2M 4K7. The registrar and transfer agent for the Common Shares of MGI is The Trust Company of Bank of Montreal at its office in Montreal.

PURCHASERS' STATUTORY RIGHTS

Securities legislation of the province of Ontario provides purchasers with the right to withdraw from an agreement to purchase securities within two business days after receipt or deemed receipt of a prospectus and any amendment. In several of the provinces and territories, securities legislation further provides a purchaser with remedies for rescission or, in some jurisdictions, damages where the prospectus and any amendment contains a misrepresentation or is not delivered to the purchaser, provided that such remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province or territory. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province for the particulars of these rights or consult with a legal advisor.

CONTRACTUAL RIGHT OF ACTION FOR RESCISSION

In the event that a holder of a Special Warrant who acquires a Common Share upon the exercise of the Special Warrant as provided for in this prospectus is or becomes entitled under applicable securities legislation to the remedy of rescission by reason of this prospectus or any amendment thereto containing a misrepresentation, such holder shall be entitled to rescission not only of the holder's exercise of its Special Warrant but also of the private placement transaction pursuant to which the Special Warrant was initially acquired, and the holder shall be entitled in connection with such rescission to a full refund of all consideration paid on the acquisition of the Special Warrant. In the event such holder is a permitted assignee of the interest of the original Special Warrant subscriber, such permitted assignee shall be entitled to exercise the rights of rescission and refund as if such permitted assignee was the original subscriber. The foregoing is in addition to any other right or remedy available to a holder of a Special Warrant under section 130 of the Ontario Act or otherwise at law and is subject to the defences, limitations and other provisions of such legislation.

MGI Software Corp.

Financial Statements

January 31, 1999, 1998 and 1997

March 4, 1999

(except for note 19(a), which is as at March 22, 1999, note 19(b), which is as at March 31, 1999, note 19(c), which is as at April 5, 1999 and note 19(d), which is as at May 19, 1999.)

Auditors' Report

To the Directors of MGI Software Corp.

We have audited the balance sheets of **MGI Software Corp.** as at January 31, 1999, 1998 and 1997 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance 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.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at January 31, 1999, 1998 and 1997 and the results of its operations and its cash flows for the years then ended in accordance with generally accepted accounting principles.

Chartered Accountants

MGI Software Corp.

Balance Sheets

As at January 31, 1999, 1998 and 1997

(in thousands of dollars)

	1999 \$	1998 \$	1997 \$
Assets			
Current assets			
Cash	2,441	1,754	4,413
Short-term investments	2,027	—	—
Note receivable (note 4)	—	10,813	—
Accounts receivable			
Trade	4,789	4,504	2,558
Other	362	355	320
Prepays and other assets	335	555	307
Inventories	781	546	293
	10,735	18,527	7,891
Capital assets (note 5)	2,444	1,487	952
	13,179	20,014	8,843
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities (note 14)	4,009	3,344	2,310
Current portion of long-term debt (note 6)	167	—	—
Current portion of capital leases (note 7)	28	—	—
Due to related party (note 15)	—	—	75
	4,204	3,344	2,385
Capital leases (note 7)	77	—	—
Long-term debt (note 6)	333	—	—
	4,614	3,344	2,385
Shareholders' Equity			
Capital stock (note 8)	32,365	32,019	12,172
Special warrants (note 8(a))	—	—	2,685
Deficit	(23,800)	(15,349)	(8,399)
	8,565	16,670	6,458
	13,179	20,014	8,843

Approved by the Board of Directors

(signed) Anthony DeCristofaro Director

(signed) Oren Asher Director

MGI Software Corp.

Statements of Operations and Deficit

For the years ended January 31, 1999, 1998 and 1997

(in thousands of dollars, except per share amounts)

	1999 \$	1998 \$	1997 \$
Revenue	15,962	13,348	5,144
Cost of sales	2,245	2,660	1,329
	13,717	10,688	3,815
Expenses			
Marketing and selling	13,199	11,610	4,547
Research and development (note 9)	6,480	4,758	1,731
Administration	2,143	1,316	1,144
Foreign exchange	(9)	(311)	—
Amortization of capital assets	659	475	1,557
	22,472	17,848	8,979
Loss before undernoted items	(8,755)	(7,160)	(5,164)
Interest income	304	210	124
Write-off of purchased software (note 5)	—	—	(2,363)
Loss for the year	(8,451)	(6,950)	(7,403)
Deficit – Beginning of year	(15,349)	(8,399)	(677)
Reorganization costs (note 2)	—	—	(319)
Deficit – End of year	(23,800)	(15,349)	(8,399)
Loss per share	(0.35)	(0.35)	(0.48)
Weighted average number of common shares outstanding	24,122,095	19,958,968	15,355,052

MGI Software Corp.

Statements of Cash Flows

For the years ended January 31, 1999, 1998 and 1997

(tabular amounts in thousands of dollars)

	1999 \$	1998 \$	1997 \$
Cash flows			
Operating activities			
Loss for the year	(8,451)	(6,950)	(7,403)
Items not affecting cash			
Amortization of capital assets	659	475	1,557
Write-off of purchased software included in capital assets	—	—	2,363
Net change in non-cash working capital amounts relating to operations (note 11)	358	(1,523)	(785)
	<u>(7,434)</u>	<u>(7,998)</u>	<u>(4,268)</u>
Financing activities			
Issue of common shares – net of issue costs	346	17,162	6,261
Issue of special warrants – net of issue costs	—	—	2,685
Retirement of debentures	—	—	(1,500)
Proceeds from long-term debt	500	—	—
	<u>846</u>	<u>17,162</u>	<u>7,446</u>
Investing activities			
Purchase of capital assets	(1,511)	(1,010)	(991)
Decrease (increase) in note receivable	10,813	(10,813)	—
Increase in investments	(2,027)	—	—
Reorganization costs	—	—	(262)
	<u>7,275</u>	<u>(11,823)</u>	<u>(1,253)</u>
Increase (decrease) in cash resources during the year	687	(2,659)	1,925
Cash – Beginning of year	<u>1,754</u>	<u>4,413</u>	<u>2,488</u>
Cash – End of year	<u>2,441</u>	<u>1,754</u>	<u>4,413</u>

Capital assets

During the year, capital assets were acquired at an aggregate cost of \$1,616,000, of which \$105,000 were acquired by means of capital leases. Cash payments of \$1,511,000 were made to purchase capital assets.

Interest income and expense

Included in cash flows from operating activities are interest expense on long-term debt of \$9,000 (1998 – \$nil; 1997 – \$nil) and interest income of \$304,000 (1998 – \$210,000; 1997 – \$124,000).

1 Nature of operations

MGI Software Corp. (the company) was incorporated on September 22, 1995 under the laws of the Province of Ontario to develop, market and support multimedia products in the digital photography, video editing, three-dimensional graphics and page layout markets of the personal computer software industry. The company's products are primarily directed toward retail consumers but are also suitable for small businesses, companies and governments. To date, the company's primary markets have been Europe, United States and Asia Pacific.

2 Reorganization

Effective April 30, 1996, MGI Software Corp. , a private company, amalgamated with Globex Biotechnologies Inc. (Globex), a public company whose shares are traded on the Canadian Dealer Network, and continued operations under the name of MGI Software Corp. The amalgamation was effected pursuant to the provisions of the Ontario Business Corporations Act and involved the issuance of shares of the amalgamated company to the former shareholders as follows: (a) one common share of the amalgamated company for each 15 shares of Globex; and (b) one common share of the amalgamated company for each common share of the predecessor MGI Software Corp. (predecessor MGI).

The amalgamation resulted in the shareholders of the predecessor MGI holding 98.4% of the common shares of the amalgamated company. Accordingly, the transaction has been recorded in these accounts using the principles of purchase accounting whereby predecessor MGI is considered to have acquired Globex in exchange for shares. Prior to the amalgamation, Globex was inactive and without assets and accordingly the substance of the amalgamation is a capital reorganization of the Company. The consideration of \$207,000, attributed to the 206,433 common shares issued to the shareholders of Globex (note 8), liabilities assumed of \$57,000 and legal costs incurred in the amount of \$55,000, was charged directly to deficit in the amount of \$319,000 as a capital reorganization cost.

3 Summary of significant accounting policies

Revenue recognition

Revenue from sale of merchandise is recognized at the time of shipment to the customer, net of provision for returns. Royalties and licence fees are recognized as earned in accordance with the terms of the related agreements.

Revenue from the sale of development services is recognized as the services are performed under the terms of the contract using the percentage of completion method.

Investments

Investments are valued at the lower of cost and market value. At the year-end, fair market value approximated the recorded cost.

Inventories

Inventories are valued at the lower of cost and net realizable value. Cost is determined on the weighted average cost basis.

Capital assets

Capital assets are recorded at the lower of cost, net of accumulated amortization, and net recoverable amount. Amortization charges are calculated on the following bases using the following annual rates:

Furniture and equipment	20% declining balance
Computer equipment	30% declining balance
Leasehold improvements	over the useful life or remaining lease term
Computer software	straight-line over 3 years
Trademarks and patents	straight-line over 20 years

Research and development

Research costs are expensed as incurred. Development costs are expensed as incurred unless a project meets the criteria under generally accepted accounting principles for deferral and amortization. The company has not deferred any development costs to date.

Government assistance is available to the company through the Industrial Research Assistance Program (IRAP) and income tax investment credits.

IRAP funds qualified research and development activities on preapproved projects. IRAP assistance is recorded as a reduction of research and development expenses in the year in which it is claimed.

Income tax investment credits are accounted for using the cost reduction method and accordingly are deducted from the related research and development expenses in the year of expenditure, provided there is reasonable assurance they will be realized.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate prevailing at the balance sheet date. Non-monetary assets and liabilities and transactions are translated at exchange rates prevailing at the respective transaction dates. Exchange gains and losses are included in the statement of operations and deficit.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Financial instruments

Financial instruments are initially recorded at historical cost. If subsequent circumstances indicate that a decline in the fair value of a financial asset is other than temporary, the financial asset is written down to its fair value. Unless otherwise indicated, the fair values of financial instruments approximate their recorded amounts. The fair values of cash on deposit with commercial banks, note receivable, accounts receivable, and accounts payable and accrued liabilities approximate recorded amounts because of the short period to receipt or payment of cash.

4 Note receivable

On January 8, 1998, the company purchased a commercial note from a corporation in the amount of \$10,813,000. This note, bearing interest at a rate of 4.41% per annum, was repaid on February 5, 1998.

5 Capital assets

	1999		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	
Furniture and equipment	818	245	573
Furniture and equipment under capital lease	105	2	103
Computer equipment	1,531	618	913
Leasehold improvements	831	144	687
Computer software	390	379	11
Trademarks and patents	166	9	157
	3,841	1,397	2,444
	1998		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	
Furniture and equipment	515	115	400
Computer equipment	1,113	322	791
Leasehold improvements	260	67	193
Computer software	356	253	103
	2,244	757	1,487

	1997		
	Cost \$	Accumulated amortization \$	Net \$
Furniture and equipment	257	42	215
Computer equipment	495	102	393
Leasehold improvements	203	18	185
Computer software	290	131	159
	1,245	293	952

During the year ended January 31, 1997, management determined that computer software costs carried in the company's books in the amount of \$2,363,000 should be written off and the loss charged to operations.

6 Long-term debt

	\$
Royal Bank, interest at prime plus 1.125%, due February 2002, repayable in monthly instalments of \$13,889, secured by a general security agreement covering all of the assets of the company other than real property	500
Less: Current portion	167
	333

7 Capital lease obligations

The following schedule of future minimum lease payments on capital leases, together with the balance of obligations, set out by fiscal year:

	\$
2000	32
2001	32
2002	32
2003	29
	125
Less: Imputed interest	20
	105
Less: Current portion	28
	77

8 Capital stock

Authorized

An unlimited number of common shares

An unlimited number of Class A voting, special shares

Issued

	1999 \$	1998 \$	1997 \$
24,279,412 (1998 – 23,963,712; 1997 – 17,907,630) common shares	32,365	32,019	12,172

The common share transactions are as follows:

	1999		1998		1997	
	Number of shares	Amount \$	Number of shares	Amount \$	Number of shares	Amount \$
Issued, beginning of year	23,963,712	32,019	17,907,630	12,172	13,110,768	5,911
Issued during the year						
For cash upon private placement (a)	–	–	1,022,757	2,766	–	–
On conversion of debentures (b)	–	–	–	–	650,000	715
Upon exercise of purchase warrants for cash (b)	–	–	–	–	650,000	975
On reorganization (note 2)	–	–	–	–	206,433	207
Purchase of computer software, licences and rights (note 15)	–	–	–	–	471,429	–
On conversion of special warrants (c)	–	–	4,700,000	16,536	2,744,000	4,289
On exercise of broker compensation warrants (c)	–	–	137,200	343	–	–
On exercise of employee stock options (d)	315,700	346	196,125	202	75,000	75
	24,279,412	32,365	23,963,712	32,019	17,907,630	12,172

- a) On September 30, 1997, the company issued 1,022,757 common shares for cash of \$2,765,999 pursuant to the terms of a subscription agreement. In addition, the same number of common share purchase warrants were issued for an aggregate consideration of \$1.00. Each warrant entitles the holder to purchase one common share of the company, subject to adjustment, at the lower of: (i) \$3.95 per common share; and (ii) the higher of the then current market price of the common shares of the company and \$3.20 per common share. These common share purchase warrants expire on September 30, 2000. As at the year-end, all purchase warrants remained outstanding.

- b) On October 21, 1995, the company issued \$1,500,000 aggregate principal amount of debentures, payable on demand, bearing interest at 5.7% per annum, payable quarterly, in arrears. The debentures were convertible at any time at the option of the holder into units on the basis of one unit for each \$1.10 principal amount of debentures. Each unit consisted of one share and one half of one common share purchase warrant. On February 26, 1996, the company retired an aggregate principal amount of \$785,000 of the debentures for cash and the issuance of an additional one-half of one warrant upon the exercise of the conversion rights attached to the debentures. On April 30, 1996, the remaining debentures in the amount of \$715,000 were converted into an aggregate of 650,000 common shares and 650,000 warrants. Each warrant was convertible into one common share for cash of \$1.50. On June 4, 1996, 200,000 warrants were exercised and on December 31, 1996 all remaining warrants were exercised.
- c) On May 15, 1996, the company issued 2,744,000 special warrants at \$1.75 each for net proceeds of \$4,289,000 (net of issue costs of \$513,000). On August 19, 1996, the special warrants were converted into 2,744,000 common shares without additional consideration. As additional compensation, the company issued 137,200 broker special warrants. Each broker special warrant was converted into an option to purchase one common share at a price of \$2.50 per share. The options were exercised and converted into 137,200 common shares.

On January 16, 1997, the company issued 1,200,000 special warrants at \$2.50 each for net proceeds of \$2,685,000 (net of issue costs of \$315,000). On February 25, 1997, the special warrants were converted into 1,200,000 common shares without additional consideration.

On September 29, 1997, the company issued 3,500,000 special warrants at \$4.25 each for net proceeds of \$13,851,273 (net of issue costs of \$1,024,000). On December 8, 1997, the special warrants were converted into 3,500,000 common shares without additional consideration. As additional compensation, the company issued 175,000 broker special warrants. Each broker special warrant was converted into a compensation option to purchase one common share at a price of \$5.25 per share, which expired on December 29, 1998.

- d) The company has an incentive plan under which options to purchase common shares may be granted to its directors, officers, employees and service providers at the discretion of the Board of Directors. Each option under the incentive plan allows for the purchase of one common share and expires not later than ten years from the date granted. On October 30, 1998, the Board of Directors adopted a resolution authorizing the company to amend the exercise prices of outstanding options held by certain employees and subcontractors of the company (excluding options held by former and current directors and officers of the company) at prices greater than \$1.50 to \$1.50. The repriced options subscribed will be fully vested as of September 30, 2001. As at January 31, 1999, the company had stock options outstanding as follows:

Class of option holder	Fiscal year issued	Number of options issued	Expiry	Exercise price \$
Employees	1996	580,000	January 2001 – January 2006	1.00
	1997	284,375	April 2001 – April 2006	1.00 – 3.65
	1998	563,000	February 2002 – January 2003	1.50 – 4.20
	1999	573,500	September 2002 – January 2004	1.00 – 4.20
Directors who are not executive officers	1996	140,000	January 2001	1.00
	1998	180,000	April 2002 – June 2002	2.15 – 2.30
Executive officers	1996	500,000	January 2001	1.00
	1999	<u>310,000</u>	September 2003 – November 2003	1.30 – 1.36
		<u>3,130,875</u>		

The options are subject to various vesting requirements as outlined in the plan.

9 Research and development

	1999 \$	1998 \$	1997 \$
Gross research and development expenses	6,600	4,976	1,823
IRAP funding	(120)	(218)	–
Investment tax credits	–	–	(92)
Research and development expenses, net	<u>6,480</u>	<u>4,758</u>	<u>1,731</u>

The IRAP funding received or receivable amounted to \$120,000 (1998 – \$218,000; 1997 – \$nil). At January 31, included in accounts receivable were IRAP receivables of \$40,000 (1998 – \$29,000; 1997 – \$nil).

Investment tax credits are calculated at the rate of 20% for qualifying research and development expenditures and can be offset against future taxes payable within the tax carry-forward period of ten years.

10 Income taxes

The company's income tax provision has been determined as follows:

	1999 \$	1998 \$	1997 \$
Loss for the year	8,451	6,950	7,403
Combined basic federal and provincial income tax recovery at 44.62%	3,771	3,101	3,303
Provincial research and development deduction	412	218	43
Unrecorded benefit of non-capital losses	(4,183)	(3,319)	(3,346)
	—	—	—

The company has incurred losses for accounting purposes, the tax benefit of which has not been included in these accounts. These losses are available to be applied as a deduction against taxable income earned in the future and are summarized approximately as follows:

	Federal \$	Provincial \$
Tax losses expiring in		
2002	200	300
2003	400	1,900
2004	2,200	6,300
2005	3,800	6,600
2006	2,500	5,500
	9,100	20,600
Excess of amounts booked for accounting purposes over amounts claimed for tax (timing differences), not subject to expiry		
Amortization of capital assets	4,400	—
Scientific research and development expenditures	9,800	8,400
Share issue costs	1,100	1,100
Other	650	650
	15,950	10,150
Less: Timing differences, the tax benefit of which has been recognized in the accounts	—	(500)
	15,950	9,650
Losses for accounting purposes carried forward	25,050	30,250

The provincial losses exceed federal losses principally due to enhanced provincial scientific research and development incentives.

The company has federal investment tax credits available to reduce future income taxes otherwise payable of \$2,963,000 which expire between 2005 and 2009. The benefit of these tax credits have not been recorded. Investment tax credits are calculated at the rate of 20% for qualifying research and development expenditures and can be offset against future taxes payable within a tax carry-forward period of ten years.

11 Net change in non-cash working capital amounts relating to operations

	1999 \$	1998 \$	1997 \$
Accounts receivable			
Trade	(285)	(1,946)	(2,205)
Other	(7)	(35)	(92)
Prepays and other assets	220	(248)	(296)
Inventories	(235)	(253)	(231)
Accounts payable and accrued liabilities	665	959	2,021
Due from related party	—	—	75
Liabilities issued on reorganization	—	—	(57)
	<u>358</u>	<u>(1,523)</u>	<u>(785)</u>

12 Segmented information

The company's operations are located in Canada with two principal operating segments, software development and development services, across geographically diverse markets.

Geographic information

	1999 \$	1998 \$	1997 \$
Revenue by geographic area			
Canada	1,271	251	266
United States	10,437	8,333	3,143
Europe	2,687	3,818	1,251
Asia Pacific	1,567	946	484
	<u>15,962</u>	<u>13,348</u>	<u>5,144</u>

Operating segments

	1999		
	Product \$	Development services \$	Total \$
Revenue	14,436	1,526	15,962
Cost of sales	2,245	—	2,245
	12,191	1,526	13,717
Expenses	21,971	501	22,472
	(9,780)	1,025	(8,755)
Interest income	304	—	304
Net income (loss) for the year	(9,476)	1,025	(8,451)
Total assets	12,475	704	13,179

The company's operations during fiscal 1998 and 1997 were in one principal operating segment, software development. Accordingly, no comparative operating segment information is presented.

13 Operating line of credit

The company's bank line of credit of \$2,500,000 bears interest at the bank's prime rate plus 3/4% and is secured by substantially all of the assets of the company. At January 31, 1999, 1998 and 1997, no amounts were drawn on this line of credit.

14 Financial obligations

The company is obligated under operating leases for the rental of facilities. Minimum future rental payments under the company's current leases in effect as at January 31, 1999, which expire on December 31, 2008, are approximately as follows:

	\$
2000	352
2001	354
2002	294
2003	303
2004	312
Thereafter	1,698

15 Related party transactions

Research and development fees are paid to a company controlled by a significant shareholder. The total fees paid in 1999 were \$151,800 (1998 – \$151,800; 1997 – \$8,950).

During the year, payments relating to the rental of facilities were made to a company controlled by a significant shareholder and a party related to a senior officer. Included in administration expense is fair market value rent of \$102,000. As at January 31, 1999, \$55,000 of this amount was included in accounts payable and accrued liabilities. This amount was paid subsequent to the year-end. In January 1999, the facilities were sold to a third party.

In fiscal 1997, computer software was acquired from a company related by virtue of common shareholdings, as follows:

	\$
Cash payment	150,000
Issuance of 471,429 common shares recorded at a nominal value, being the carrying amount of the assets acquired in the books of the transferor	<u>—</u>
Book value of computer software acquired	<u>150,000</u>

16 Credit and currency risks

Concentrations of credit risk on trade accounts receivable are indicated in the following table by the percentage of the total balance receivable by individual customers. At January 31, 1999, three customers accounted for 66% (1998 – 76%; 1997 – 54%) of total accounts receivable, as follows:

	1999 %	1998 %	1997 %
First customer	36	50	19
Second customer	20	14	18
Third customer	10	12	17

Substantially all of the company's revenue is denominated in foreign currencies and accordingly is exposed to the risk of currency fluctuation.

17 Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

18 Contingency

The company has received correspondence alleging the company's infringement of certain technology rights. Management believes that the allegations are without merit and, however resolved, will not have a material adverse effect on the company's financial position. No amount has been provided in these financial statements in respect of these allegations. Loss, if any, sustained upon ultimate resolution will be accounted for prospectively in the year of settlement in the statement of operations.

19 Subsequent events

- a) On March 22, 1999, the company amended its banking agreement increasing the line of credit to \$4 million (see note 13).
- b) On March 31, 1999, the company signed a financing agreement to obtain up to \$6 million of subordinated convertible debt (the debt) comprised of a \$3 million convertible debenture and a \$3 million standby facility. The company anticipates receiving the \$3 million convertible debenture on or about April 16, 1999. Under the terms of the standby facility, the company has the right to access an additional \$3 million in the future if certain requirements are met. The debt is for a term of three years, bears interest at 6% per annum, and is convertible into common shares of the company at a price of \$3.25 for the first 18 months following disbursement and at \$4.25 for the balance of the term of the debt. As additional compensation, the company shall issue 135,000 warrants to purchase common shares of the company for each \$3 million advanced. The term of the warrants shall be three years and the exercise price will be at a 15% premium to the market price on the date the funds are advanced. If, at the end of the term, the company is not publicly listed on NASDAQ then the company may be required to make a payment of \$800,000 (pro rata to the outstanding balance) at the lender's discretion, in exchange for the lender's convertibility rights. An additional 13,000 warrants to purchase common shares of the company shall be issued which will be exercisable after May 31, 2000 if the Company does not draw down the standby facility on or prior to that date. The term of the warrants shall be 3 years and the exercise price shall be at a 15% premium to the market price on the date the funds are advanced.

- c) On April 5, 1999, the company signed an underwriting agreement for the issuance of 3 million special warrants at a price of \$2.55 for gross proceeds of \$7,650,000. These special warrants are convertible into one common share for each special warrant at the earlier of: (i) the issuance of the receipt(s) for a final prospectus; and (ii) 12 months after the closing date, without payment of additional consideration. If the receipt(s) for a final prospectus is not received within 110 days following the closing date, each special warrant holder will receive an additional one-half common share purchase warrant without payment of additional consideration. Each whole share purchase warrant will entitle the holder to purchase one common share at a price of \$3.00 per common share on the date which is thirty months from the closing date. In connection with the underwriting agreement, commissions of \$459,000 will be paid to the underwriters. As additional compensation under the agreement, the company will issue to the underwriters an aggregate of 180,000 broker special warrants. Each broker special warrant will entitle the holder to receive one compensation option without payment of additional consideration. Each compensation option will entitle the holder to purchase one common share at a price of \$3.00 per common share within two years from the closing date.
- d) On May 19, 1999, the company entered into a letter of intent to acquire certain assets of Live Picture, Inc. for an approximate purchase price of US\$10,000,000 comprised of cash and common shares of the company. Live Picture has filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code, pursuant to which third parties may also make offers to acquire these assets. Accordingly, the completion of this acquisition is conditional upon the approval of the bankruptcy court having jurisdiction over Live Picture's bankruptcy case, and the absence of any competing third party bids to acquire these assets which is accepted by the bankruptcy court. The completion of this acquisition is also conditional upon MGI obtaining financing from third party investors, on terms satisfactory to the company in its sole discretion, sufficient to consummate this acquisition, and to the satisfactory completion of due diligence by the company in its sole discretion.

CERTIFICATE OF THE CORPORATION

Dated: May 31, 1999

The foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part XV of the Securities Act (Ontario) and the regulations thereunder.

(Signed) ANTHONY DECRISTOFARO
President and
Chief Executive Officer

(Signed) KENNETH J. KILLIN
Chief Financial Officer

On behalf of the Board of Directors

(Signed) OREN ASHER
Director

(Signed) DENNIS BENNIE
Director

CERTIFICATE OF THE PROMOTER

Dated: May 31, 1999

The foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part XV of the Securities Act (Ontario) and the regulations thereunder.

(Signed) OREN ASHER

CERTIFICATE OF THE UNDERWRITERS

Dated: May 31, 1999

To the best of our knowledge, information and belief, the foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part XV of the Securities Act (Ontario) and the regulations thereunder.

NESBITT BURNS INC.

BY: (SIGNED) W.J. BLAIR AGNEW

CANACCORD CAPITAL CORPORATION

HSBC JAMES CAPEL CANADA INC.

BY: (SIGNED) STEVE MULLIE

BY: (SIGNED) ROD N. BAKER

The following includes the name of every person or company having an interest, either directly or indirectly, to the extent of not less than 5% in the capital of:

NESBITT BURNS INC.: A wholly-owned subsidiary of The Nesbitt Burns Corporation Limited, a majority-owned subsidiary of a Canadian chartered bank.

CANACCORD CAPITAL CORPORATION: The following interests are held indirectly through Canaccord Investment Ltd. and Canaccord Holdings Ltd.: Peter M. Brown (through the MacLachlan Investments Corporation), Michael G. Greenwood (directly and through 728541 Alberta Ltd.), Dennis N. Burdett (directly and through 558853 B.C. Ltd.) and Michael W. Murphy (directly and through 517387 B.C. Ltd.).

HSBC JAMES CAPEL CANADA INC.: A wholly-owned subsidiary of a Canadian chartered bank.