Prospectus dated September 8, 1997

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 regulatory 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. These securities have not been and will not be registered under the United States Securities Act of 1933, as amended. These securities are being issued or transferred to holders of Special Warrants in connection with the exercise of such Special Warrants and, subject to certain exceptions, may not be offered or sold within the United States. See "Private Placement and Plan of Distribution".

Additional Offering

i*STAR *internet inc.

$9,000,000

4,500,000 COMMON SHARES

to be issued upon exercise of 4,500,000

Special Warrants previously issued at a price of $2.00 per Special Warrant

This Prospectus is being filed to qualify the distribution of 4,500,000 common shares ("Common Shares") of *i*STAR *internet inc.* ("*i*STAR" or the "Company") which are issuable without additional payment upon the exercise or deemed exercise of 4,500,000 special warrants (the "Special Warrants") previously issued by the Company on July 31, 1997. The outstanding Common Shares are listed on The Toronto Stock Exchange (the "TSE"). The closing price of the Common Shares on the TSE on September 4, 1997 was $1.95.

The Special Warrants were issued and sold to certain purchasers in accordance with applicable securities legislation at a price of $2.00 per Special Warrant pursuant to an underwriting agreement dated July 28, 1997 (the "Underwriting Agreement") among the Company and Lévesque Beaubien Geoffrion Inc. (the "Underwriter"). The price of the Special Warrants was determined by negotiation between the Company and the Underwriter. Each Special Warrant is exercisable for one Common Share without additional payment on certain conditions and within certain time periods. This Prospectus qualifies the distribution of the Common Shares issuable upon the exercise or deemed exercise of the Special Warrants to holders of Special Warrants in each of the Provinces of Ontario and Quebec. This Prospectus also qualifies the 200,000 Common Shares issuable upon the exercise of the Lenders' Warrants. See "Business of the Company – Recent Developments" and "Private Placement and Plan of Distribution".

The Special Warrants were issued under an indenture dated July 31, 1997. The Special Warrants will be exercised and be deemed to be exercised on the fifth business day after the date on which receipts are issued for this Prospectus by the last of the securities commissions of each of the Provinces of Ontario and Quebec (the "Securities Commissions"). If a receipt has not been issued for this Prospectus by each of the Securities Commissions at or prior to 5:00 p.m. (Toronto time) on October 31, 1997, each Special Warrant then outstanding will entitle the holder to receive 1.1 Common Shares per Special Warrant held. See "Private Placement and Plan of Distribution".

The net proceeds of the issue of the Special Warrants are being used to repay the outstanding balance on the BNS-Jefferson Credit Facility (as defined herein) with the remainder to be used to fund working capital requirements. See "Use of Proceeds".

Investment in the Common Shares is subject to a number of risk factors. See "Risk Factors". The issue price of the Special Warrants exceeds the consolidated net tangible book value per Common Share as at May 31, 1997 by $1.34, after giving effect to the issue of the Special Warrants and the Lenders' Warrants and their exchange for Common Shares, resulting in a dilution of 67.2%. See "Dilution".

	Subscription Price	Underwriter's Fees(1)	Net Proceeds to the Company(2)(3)
Per Special Warrant	$2.00	$0.12	$1.88
Total Offering	$9,000,000	$540,000	$8,460,000

(1) No additional fee will be payable to the Underwriter in connection with the issue of Common Shares upon the exercise of the Special Warrants.
(2) Before deducting estimated expenses of the issue of $250,000.
(3) The Company will not receive any additional proceeds from the issue of Common Shares upon the exercise of the Special Warrants. The Company did not, and will not receive any proceeds from the issue of the Lenders' Warrants or the issue of Common Shares upon the exercise of the Lenders' Warrants.

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ELIGIBILITY FOR INVESTMENT

Eligibility of the Common Shares for investment by purchasers to whom any of the following statutes apply is, in certain cases, governed by criteria which such purchasers are required to establish as policies or guidelines pursuant to the applicable statute (and, where applicable, the regulations thereunder) and is subject to the prudent investment standards and general investment provisions therein (including any quantitative limits on the amount and level of any of those investments):

Insurance Companies Act (Canada)
Trust and Loan Companies Act (Canada)
Pension Benefits Standards Act, 1985 (Canada)
An Act Respecting Insurance (Quebec)
An Act Respecting Trust Companies and Savings Companies (Quebec)
Supplemental Pension Plans Act (Quebec)
Pension Benefits Act (Ontario)

In the opinion of Stikeman, Elliott, counsel to the Company, and Ogilvy Renault, counsel to the Underwriter, the Common Shares issuable upon the exercise or deemed exercise of the Special Warrants will be qualified investments under the Income Tax Act (Canada) and the regulations thereunder for trusts governed by registered retirement savings plans, registered retirement income funds and deferred profit sharing plans.

PROSPECTUS SUMMARY

The following is a summary only and is qualified by and should be read in conjunction with the more detailed information and consolidated financial statements, including the notes thereto, appearing elsewhere in this prospectus. Certain terms used in this prospectus are defined in the Glossary beginning on page 65.

The Company

*i*STAR is one of the leading Canadian providers of Internet services and solutions for businesses, institutions and individuals. *i*STAR's products fall into two general categories: the network service provider ("NSP") segment and Business Solutions. NSP includes dial and dedicated Internet access services and Web hosting. Business Solutions consist of value-added solutions such as Intranets and electronic commerce that can be tailored to meet the specific needs of commercial customers. *i*STAR's primary objectives are to maintain and enhance its position as one of Canada's leading Internet solutions companies.

*i*STAR has grown significantly in a short period of time. Revenues grew from $19.4 million for the fiscal year ended May 31, 1996 to $34.0 million for the fiscal year ended May 31, 1997. The Company has approximately 66,000 dial customers, 950 dedicated customers and 400 hosted commercial Web sites. *i*STAR continues to focus on the commercial marketplace and estimates that approximately two-thirds of its revenues are derived from commercial customers.

*i*STAR has established a number of important alliances intended to maximize its competitiveness and enhance its market position. These include telecommunication services with Bell Canada, distribution agreements with original equipment manufacturers such as Patriot Computers and 3D Micro and value-added reseller agreements with companies such as Novell Networks and SHL Systemhouse. These alliances aid *i*STAR in developing and distributing comprehensive commercial solutions. *i*STAR will continue to pursue additional alliances which further enhance its market position.

Since the Company's initial public offering in November 1995, *i*STAR believes it has achieved its goals of: (i) building Canada's leading high-performance national Internet network and computing infrastructure, which includes 40 points of presence ("POP's") covering over 80% of the Canadian market and eight computer centres across Canada, (ii) achieving a critical mass of dedicated and dial access subscribers through a national sales and support organization focused on Internet access and solutions and through the completion of an aggressive acquisition strategy that led to the purchase and integration of seven leading commercially-focused, regional Internet companies, (iii) expanding its range of value-added products and services through high-quality Web site hosting, Intranets and electronic commerce solutions, (iv) establishing a high level of technical support capability by building a dial access customer service team in Toronto and a commercial services customer support team in Ottawa, both supported by a national Network Monitoring Centre, (v) strengthening its management team with some of the most experienced and knowledgeable individuals in the industry, and (vi) adding to its strategic relationships with telecommunications, computer and network industry leaders, thereby enhancing its distribution capabilities as well as its ability to offer comprehensive commercial solutions.

In addition, *i*STAR has been steadily reducing its costs. In fiscal 1996 it reduced head-count from 348 to 240. In fiscal 1997 head-count was further reduced to 214. The Company has also substantially cut network equipment leasing costs and has continued to eliminate redundant equipment costs. *i*STAR estimates that the agreement with Bell Sygma Inc., described below, will reduce its projected network costs by up to an additional 10%.

Recent Developments

On August 29, 1997, *i*STAR and Bell Sygma Inc. ("Bell"), a subsidiary of Bell Canada, signed a network provisioning agreement pursuant to which Bell will provide certain data telecommunications network products and services to the Company. As part of the transaction, Bell will defer two-thirds of the Company's telecommunication costs (up to a maximum of $20 million) during the first twenty-four months of the contract. This debt will bear no interest and, subject to the settlement of a subscription agreement with Bell referred to below, may be used by Bell to purchase Common Shares of the Company.

Management expects that the benefits to the Company from this proposed network provisioning agreement and alliance with Bell will be significant and will include the following:

- **Service Levels:** ATM technology to be provided by Bell will enable *i*STAR to significantly increase the bandwidth of its national network thereby significantly improving reliability, redundancy and performance. *i*STAR's customers will enjoy enhanced service levels as a result.

- **Cost Savings:** *i*STAR expects to realize cost savings and gross margin improvement as a result of economies of scale and the enhanced efficiency and scalability of ATM. Telecommunications are currently the Company's largest single cost.

- **Cash Flow:** Deferring the payment of up to $20 million in telecommunications will improve the Company's financial flexibility and is expected to accelerate *i*STAR's move to becoming cash-flow positive. The Company and Bell are also negotiating the terms of a subscription agreement pursuant to which Bell may subscribe for and purchase up to $20 million worth of Common Shares during the 24 month period ending June 30, 1999, which, once complete, will further assist these efforts to become cash flow positive.

See "Business of the Company – Recent Developments – Bell Canada Agreement".

On August 1, 1997, the Company and Bank of Nova Scotia, Jefferson Partners Capital Limited and Jefferson Partners Holdco Inc. (the "Lenders") entered into a loan agreement pursuant to which the Lenders have made a credit facility of $4 million available to the Company. The Company will pay interest of 8% on funds drawn on the facility. The fee payable to the Lenders for making the facility available is $40,000 and the issuance of the Lenders' Warrants.

The Offering

Issuer:	*i*STAR *internet inc.*
Issue:	4,500,000 Common Shares to be issued upon the exercise or deemed exercise of an equal number of Special Warrants. 200,000 Common Shares to be issued upon the exercise or deemed exercise of an equal number of Lenders' Warrants.
Price:	The Company will receive no additional consideration upon the exercise or deemed exercise of any of the Special Warrants. The Special Warrants were originally issued at $2.00 per Special Warrant. The Company issued the Lenders' Warrants as part payment of certain fees payable under the BNS-Jefferson Credit Facility. The Company will not receive any consideration upon the exercise or deemed exercise of the Lenders' Warrants.
Use of Proceeds:	The proceeds from this offering to the Company, after deducting the expenses of the issue payable by the Company, including the Underwriter's commission, are estimated to be approximately $8.2 million. From such net proceeds, the Company intends to repay the outstanding balance on the BNS–Jefferson Credit Facility, being $4 million. The remaining $4.2 million will be used to fund working capital requirements. See "Business of the Company – Recent Developments – BNS-Jefferson Credit Facility".
Risk Factors:	Investors should consider carefully certain risks involved in an investment in the Common Shares including: failure to achieve positive cash flow from operating activities resulting in an inability to meet working capital requirements; the competitive nature of the Internet industry; the capabilities and resources of certain of the Company's competitors; the dependence of the Company upon the continued development of the Internet access and commercial markets; the uncertainty as to the implementation and market acceptance of two of the Company's main products, electronic commerce and Intranets, which to date have not generated any significant revenue; the limited operating history of the Company; the capacity, reliability and security of the Company's network infrastructure; the dependence of the Company upon resellers and wholesalers to access relevant markets; the need for the Company to raise additional capital; the ability of the Company to successfully manage its growth and expansion; the difficulty of predicting the rate of growth of the Internet; potential changes in the Company's regulatory environment; the uncertainty as to the Company's ability to adapt to changing technology; dependence on key suppliers; dependence on key personnel; potential criminal or civil liability for certain Internet transmissions.; and dilution in the net tangible book value of the Common Shares. See "Risk Factors".

Dividend Policy: *i*STAR's current intention is to reinvest its earnings to finance the growth of its business. *i*STAR does not anticipate paying dividends on the Common Shares in the foreseeable future. See "Dividend Policy".

Selected Consolidated Financial Information

The following selected consolidated financial data is derived from and should be read in conjunction with the detailed information contained in the Consolidated Financial Statements appearing elsewhere herein.

	Year Ended May 31, 1997 (audited)	Year Ended May 31, 1996 (audited)	From June 30, 1994 to May 31, 1995 (audited)
	(in thousands of dollars, except per share amounts)		
Statement of Operations Data:			
Sales	$ 34,043	$ 19,405	$ 1,538
Cost of sales	30,558	13,596	943
Gross margin	3,485	5,809	595
Selling, general and administration expenses	32,624	22,147	1,210
Operating loss before undernoted items	(29,139)	(16,338)	(615)
Depreciation and amortization	6,519	2,947	219
Integration costs	585	1,699	-
Write-off of customer lists and goodwill	17,398	-	-
Interest and bank charges, net	113	(546)	6
Net loss	$(53,754)	$ (20,438)	$ (840)
Net loss per share	$ (2.42)	$ (1.70)	$ (0.67)

	As at May 31, 1997 (audited)	As at May 31, 1996 (audited)	As at May 31, 1995 (audited)
	(in thousands of dollars)		
Balance Sheet Data:			
Current assets	$ 23,077	$ 26,343	$ 761
Property and equipment	16,343	12,640	1,232
Customer lists and goodwill	-	16,497	-
Total assets	39,420	55,480	1,993
Current liabilities	23,098	14,167	2,263
Total liabilities	28,348	16,218	2,409
Shareholders' equity	11,072	39,262	(416)

THE COMPANY

*i*STAR *internet inc.* was amalgamated under the laws of Canada on August 10, 1995. *i*STAR's registered and principal office is located at 250 Albert Street, Suite 202, Ottawa, Ontario, K1P 6M1, telephone (613) 780-2200. The predecessor companies of *i*STAR *internet inc*., were i* internet inc., a company incorporated under the laws of Canada on June 30, 1994, and NSTN Incorporated, a company incorporated under the laws of the Province of Nova Scotia on August 15, 1989 and continued under the laws of Canada on August 8, 1995.

INDUSTRY

Background

The Internet is a global network of computer networks that is revolutionizing the way organizations and individuals throughout the world communicate and conduct business. International Data Corporation ("IDC"), an independent research company, has estimated that the number of users accessing the Web will grow to 163 million by the end of the year 2000. With such widespread acceptance, the Internet has reached a critical mass and is poised to become not only a global communication network, but also an essential business communications tool.

Evolution and Growth of the Internet

A number of fundamental developments and trends continue to drive the evolution and growth of the Internet. These trends include increasing computer and modem penetration and speed; development of the World Wide Web (the "Web") as a means of disseminating vast amounts of information; the introduction of easy-to-use navigational tools and utilities; the emergence of low-cost, high-capacity telecommunications bandwidth as a result of deregulation and competition in the telecommunications industry; and the growth in the number of informational, entertainment and commercial applications available on the Internet. Technological advances relating to the Internet have occurred and continue to occur rapidly, resulting in more robust, more complex and lower cost infrastructures, improved security and increased value-added services and content.

These factors have led to significant growth in the use of the Internet. The following tables, based upon statistics collected by IDC, show current and forecast Internet users world-wide, as well as amounts of current and forecast Internet commerce spending, for different segments.

World-wide Internet Users by Segment, 1996 and 2000

	1996	2000
	(in millions)	
Home	21.7	95.3
Small Business	8.5	33.4
Medium / Large Business	13.9	48.8
Government	1.7	6.1
Education	3.2	9.7
Total	**49.0**	**193.3**
Total Unique Users (accounting for overlap among segments)	34	139

World-wide Internet Commerce Spending by User Segment, 1996 and 2000

	1996	2000
	(in millions of U.S. dollars)	
Home	$1,356	$ 28,236
Small Business	252	23,379
Medium / Large Business	747	53,765
Government	52	4,074
Education	197	9,782
Total	$**2,603**	$**119,236**

Source: International Data Corporation, 1997

Business Use of the Internet

While a great deal of media attention has been focused on the use of the Internet by individuals, commercial users account for the largest percentage of Internet use. Further, many analysts believe that the Internet is only now entering the stage of its development in which business applications are being explored and developed, and that the Internet will become one of the pillars of transacting business in the future. As a result, commercial applications are expected to continue to drive the evolution and growth of the Internet in the years ahead.

Many large Canadian organizations are already connected to the Internet. However, management of the Company estimates that only 15% of small-and-medium size Canadian businesses currently have Internet access. Management believes that Internet usage by such businesses will increase by 5% per year to 30% by the end of the year 2000.

Increasingly, commercial users are demanding advanced, highly reliable, end-to-end Internet solutions designed specifically to meet the needs of their businesses. These include established services such as connectivity, Web site development and hosting, consulting, education services, security and other products, and also encompass rapidly growing solutions such as Intranet and electronic commerce applications. Commercial users also require knowledgeable and highly responsive sales and customer service representatives in order to maximize their Internet opportunities.

The Market for Internet Products and Services

According to Zona Research Inc., the world-wide market for Internet/Intranet products and services was approximately U.S. $5.34 billion in 1995 and estimates that the market will grow to U.S. $100 billion by the year 2000. Current uses of the Internet include electronic mail, the Web, newsgroups, and file transfer. Emerging commercial uses of the Internet include electronic commerce, Intranets and fax and paging services.

Current Uses of the Internet

- *Electronic Mail* ("e-mail"). E-mail is by far the most commonly used feature of the Internet. Any user, including subscribers to consumer on-line services, can e-mail any other user anywhere in the world for little or no cost.

- *World Wide Web.* The Web is one of the most exciting features of the Internet because of its flexibility and ease of use. The fully interactive multimedia capabilities of Web technology allow any organization to create Web sites or home pages of content which any Internet user with a Web browser can access, in most cases, at no cost. An August 1997 survey conducted by Netcraft, Ltd., a technology consulting company, found over 1.2 million Web sites. Web hosting services which offer companies and individuals the ability to locate their Web sites on *i*STAR servers are an important part of *i*STAR's product offering. See "Business of the Company".

- *Other Uses.* Other current uses of the Internet include "newsgroups", File Transfer Protocol ("FTP") and Internet Relay Chat ("IRC"). Usenet Network News is a widely-available conferencing system which supports contributions ("articles") from users all over the Internet. Articles are submitted to discussion areas ("newsgroups") which cover a wide range of subject areas. FTP permits Internet users to access and download public files from thousands of computers around the world. Free software is distributed this way and it is expected that the amount of commercial software offered remotely over the Internet will increase. An IRC permits Internet users to exchange textual messages in real-time with other users.

Emerging Commercial Uses of the Internet

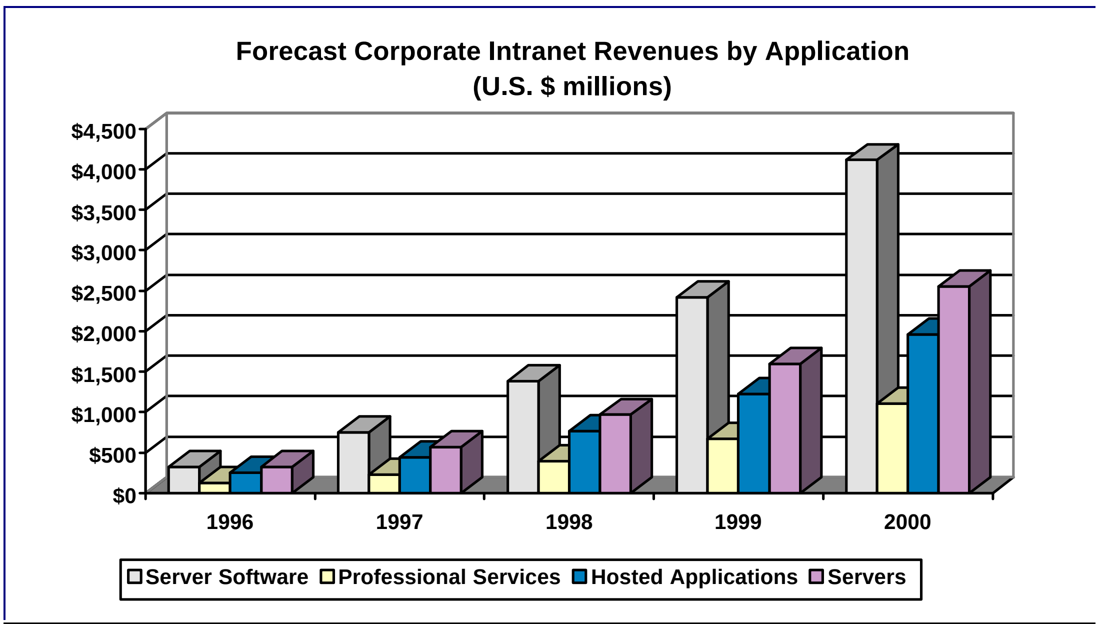
- *Electronic Commerce.* Electronic commerce has the potential to fundamentally alter the way goods and services are sold. Internet-based electronic commerce refers to a comprehensive application that permits merchants to offer goods and services for sale to the public in a secure, cost effective manner over the Internet. To customers, it represents convenient, one-stop shopping which can be done from the home.

Electronic commerce incorporates a number of different technologies and computing standards including, encryption (security) technology at both the server and browser level, user and merchant authentication processes, transaction processing capabilities for accepting and processing orders, inventory tracking and payment processing, tools to create commerce-enabled electronic storefronts, integrated product delivery systems and applications which allow merchants to track and analyze consumer navigation patterns and buying trends.

Advances in video-processing, three-dimensional graphics and real-time audio have spawned a number of new and creative paradigms designed to enrich the overall consumer buying experience via electronic commerce. One example of this is the concept of electronic shopping "malls" which will have a number of "virtual stores" each offering interactive catalogue type shopping. IDC's research shows that the value of commerce being conducted over the Internet was approximately U.S. $2.6 billion in 1996, with more than one-third of those purchases completed on the Web itself. IDC's research also suggests that the level of commerce will grow to U.S. $119 billion in 2000.

- *Intranets.* Many analysts believe that the rise of corporate Intranets will revolutionize the information technology business, and in fact will have a greater impact on the way business is conducted than the Internet itself. Intranets are secure internal corporate networks that use the same protocols found throughout the Internet to enable employees to collaborate on work projects and share important information. By delivering critical information instantaneously to the desk tops of employees, Intranets can greatly increase the effectiveness and competitiveness of organizations. Market researcher Zona Research Inc. predicts that sales of software to run Intranet servers will rise to more than $4 billion in 1997. As well, a survey of 50 major corporations conducted by Forrester Research, an independent market research group, found that 40% of the corporations surveyed indicated that they expect increases in their information technology services budgets over the next two years.

The following graph sets out world-wide Intranet revenue forecasts of The Yankee Group, an independent market research firm, from 1996 to 2000.



Source: The Yankee Group

- *FAX and Paging over the Internet*. Work is currently being undertaken by various companies to develop the infrastructure which will allow FAX traffic to be sent efficiently over the Internet. Currently packet networks such as X.25 handle large amounts of FAX traffic. The Internet is an inherently less expensive alternative to conventional telephones and, consequently, FAX is a logical candidate for migration onto the Internet. Though technically feasible now, paging over the Internet has not yet been commercially exploited.

The Canadian Internet Market

According to a recent study performed by Nielson's Nordicity Group, a Canadian management consulting firm, approximately 23% of the Canadian population, or 7 million Canadians, have accessed the Internet. Based on studies by Nielson's Nordicity Group, IDC, and TCI/Convergence, management estimates that 10% to 13% of Canadian households currently are connected to the Internet. Management expects this percentage to rise to nearly 50% by the end of 2000. While many large organizations already have Internet access, management believes that only 15% of small-to-medium size Canadian businesses currently have such access. The Company expects that Internet use by such businesses will increase to approximately 30% by the end of the year 2000, representing a significant marketing opportunity.

The Canadian Internet market place can be divided into four broad groups of competitors: Internet Service Providers ("ISPs"); consumer on-line service providers; telecommunications companies; and cable companies. Within the ISP category, there are three subsegments: national full service solution companies such as *i*STAR; subsidiaries of U.S. based ISPs; and numerous regional and local ISPs.

The Canadian Internet industry currently is not subject to direct regulation by the CRTC, provincial regulatory agencies or any other agency, other than regulations generally applicable to businesses. The CRTC does regulate facilities-based telecommunications companies which provide transmission lines and, as a result, Internet industry participants have access to transmission facilities at discounted volume-based tariff rates. These discounts, ranging up to a 60% discount from the Bell Canada tariff rate, are available to any purchaser or user of transmission lines. Thus, with respect to the cost of transmission lines, the Company competes on a level playing field with its large competitors, while enjoying a competitive advantage relative to local/regional ISPs.

The Government of Canada has stated its commitment to create a harmonized regulatory environment aimed at fair and sustainable competition within the convergence industries of telephony, broadcast, data transmission and interactive services. The cornerstone of this policy is equal access, on a non-discriminatory basis, to transmission facilities, whether cable, telephone or wireless carriers. If successful, it is expected that the policy will result in lower prices, more innovation in new and emerging services and opportunities for enterprise partnerships and joint ventures. *i*STAR is a member of the newly-formed Canadian Association of Internet Providers. The Chair of the Association is Margo Langford, Vice President, Legal Counsel of the Company. Part of the mandate of the Association is to participate in regulatory proceedings to present the industry's perspective to the decision makers, such as the CRTC, and to promote a regulatory environment which will encourage the development of the Internet industry in Canada.

BUSINESS OF THE COMPANY

Overview and Evolution of *i*STAR

*i*STAR is one of the leading Canadian providers of Internet services and solutions for businesses, institutions and individuals. *i*STAR's products fall into two general categories: the network service provider ("NSP") segment and Business Solutions. NSP includes dial and dedicated Internet access services and Web hosting. Business Solutions consist of value-added solutions such as Intranets and electronic commerce that can be tailored to meet the specific needs of commercial customers. *i*STAR's primary objectives are to maintain and enhance its position as one of Canada's leading Internet solutions companies.

Since the Company's initial public offering in November 1995, *i*STAR believes it has achieved its goals of: (i) building Canada's leading high-performance national Internet network and computing infrastructure, which includes 40 points of presence ("POP's") covering over 80% of the Canadian market and eight computer centres across Canada, (ii) achieving a critical mass of dedicated and dial access subscribers through a national sales and support organization focused on Internet access and solutions and through the completion of an aggressive acquisition strategy that led to the purchase and integration of seven leading commercially-focused, regional Internet companies, (iii) expanding its range of value-added products and services through high-quality Web site hosting, Intranets and electronic commerce solutions, (iv) establishing a high level of technical support capability by building a dial access customer service team in Toronto and a commercial services customer support team in Ottawa, both supported by a national Network Monitoring Centre, (v) strengthening its management team with some of the most experienced and knowledgeable individuals in the industry, and (vi) adding to its strategic relationships with telecommunications, computer and network industry leaders, thereby enhancing its distribution capabilities as well as its ability to offer comprehensive commercial solutions.

*i*STAR has grown significantly in a short period of time. Revenues grew from $19.4 million for the fiscal year ended May 31, 1996 to $34.0 million for the fiscal year ended May 31, 1997. The Company has approximately 66,000 dial customers, 950 dedicated customers and 400 hosted commercial Web sites. *i*STAR continues to focus on the commercial marketplace and estimates that approximately two-thirds of its revenues are derived from commercial customers.

*i*STAR initially pursued an aggressive capital investment and acquisition strategy which resulted in an investment of approximately $28.1 million in fiscal 1996 and $11.1 million in fiscal 1997. All acquisitions have now been substantially integrated and have strengthened *i*STAR's position as one of Canada's leading Internet services and solutions companies.

Recently, the focus within the industry has been evolving from access and access-related services to comprehensive, value-added commercial solutions. Management expects commercial applications to drive the pace of growth of the Internet industry into the next century. *i*STAR believes it is among the leaders of this evolution in Canada and that it is well positioned to capitalize on the opportunities presented by the commercial marketplace.

*i*STAR has established a number of important alliances intended to maximize its competitiveness and enhance its market position. These include telecommunication services with Bell Canada, distribution agreements with original equipment manufacturers such as Patriot Computers and 3D Micro and value-added reseller agreements with companies such as Novell Networks and SHL Systemhouse. These alliances aid *i*STAR in developing and distributing comprehensive commercial solutions. *i*STAR will continue to pursue additional alliances which further enhance its market position.

*i*STAR believes that it employs many of the most experienced and knowledgeable Internet personnel in the Canadian marketplace. Management believes that services provided through the Company's Professional Services, Engineering and Operations groups, as well as its help desks are amongst the best in the Canadian Internet industry. *i*STAR's sales and marketing team has extensive computing and telecommunications experience and expertise, which in the estimation of management gives the Company a distinct advantage selling Internet solutions to commercial customers. During the course of fiscal 1997, *i*STAR announced a series of management changes including the appointment of Mr. Craig Wallace to the position of President and Chief Executive Officer. Mr. Wallace had previously been Executive Vice-President, Corporate Development. Mr. Rainer Paduch, previously President and Chief Executive Officer, remains as Vice-Chairman and Chief Technical Officer. Mr. John Brough was appointed as Executive Vice President and Chief Financial Officer. In addition, Mr. David Wilkin was appointed as Vice President, Professional Services and Mr. John Bush was appointed Vice President, Marketing. See "Directors and Officers".

As a result of these initiatives, *i*STAR's management believes it has laid the foundation necessary to execute its commercially focused Internet solutions strategy successfully and that the Company is well positioned to maintain its leading position in the Canadian Internet market.

***i*STAR's Competitive Position**

The Company's competitors fall into four broad categories: (i) Internet service providers ("ISPs"); (ii) consumer on-line service providers; (iii) telecommunications companies; and (iv) cable companies. Within the ISP category, there are three subsegments: national Canadian full service solution companies such as *i*STAR; subsidiaries of U.S.-based ISPs; and numerous regional and local ISPs. In aggregate these companies represent a sizeable competitive presence.

Unlike many of its competitors, *i*STAR is dedicated exclusively to the Internet business. As a result of its Internet focus and the combination of strengths and characteristics listed below, the Company believes it has significant competitive advantages which will enable it to continue to compete successfully. These strengths and characteristics include:

- *Substantial and Growing Customer Base.* *i*STAR is one of the leading providers of Internet services and solutions to Canadian businesses, institutions and individuals. Since the Company's initial public offering in November 1995, *i*STAR has added approximately 430 direct access commercial accounts, including several leading Canadian companies. See "Business of the Company - Customer Base". *i*STAR's substantial and growing customer base has created a high proportion of recurring subscription and service based revenue. *i*STAR's strategy is to leverage this customer base to sell its expanding suite of value-added, higher margin Internet-based solutions. These solutions are expected to drive demand for increased bandwidth and Web hosting services.

- *National Organization and Network.* *i*STAR has created a national high performance network infrastructure as well as a national organization comprised of commercially focused sales, professional services and technical support groups located in each of Canada's major telecommunications markets. This combination of strengths gives *i*STAR a significant competitive advantage by enabling it to service customers directly in local markets. In addition, these resources permit *i*STAR to offer both national services and those tailored to meet local market needs.

- *Full Suite of Commercially Based Value-Added Solutions.* *i*STAR is dedicated to meeting the needs of commercial Internet users. The Company believes that monthly recurring commercial access and related revenue currently represents two thirds of *i*STAR's total revenue. This represents an important platform from which to develop and deliver value-added, higher margin commercial solutions at a relatively low marginal cost and distinguishes *i*STAR from those of its competitors that are developing consumer offerings based on expanded access. *i*STAR is currently playing a leading role in introducing Intranet-based business applications. The Company also occupies a leadership role in developing Internet commerce and other advanced high value-added, higher margin Internet solutions for the commercial market.

- *First to Market Product Capability.* *i*STAR's knowledgeable engineering, marketing and sales professionals give it the ability to rapidly evaluate, adopt, and market new Internet related technology and market solutions. In being early to market with its Web site development and hosting and its *i*NTRANET™ and *i*COMMERCE™ solutions, management believes that the Company has gained a substantial lead on competitors in the Canadian market. With its current product offering, *i*STAR has established itself as one of the leading Canadian Internet solutions companies and, in doing so, has generated significant momentum.

- *Computing Expertise and Technical Know-how.* The Company has built an industry leading team with expertise in Internet based computing. As of May 31, 1997, the Company had approximately 57 employees in sales, telesales, marketing and product management; 78 employees in engineering (service development) and professional services; and 32 employees in customer service and technical support. These employees represented 80% of the Company’s employee count. Computing expertise, such as that possessed by *i*STAR, is a critical success factor in the commercial Internet market.

- *Alliances.* *i*STAR's established alliances serve to strengthen its competitive position by significantly broadening *i*STAR's distribution capability, reducing costs related to distribution and enhancing the image and credibility of the *i*STAR brand.

While positioned within a highly competitive and rapidly evolving industry, management believes the combination of these strengths and characteristics gives *i*STAR a significant competitive advantage in designing, implementing and supporting Internet solutions. There can be no assurance, however, that *i*STAR will be able to compete successfully against existing and future competitors or that the competitive pressures faced by the Company will not have a material adverse effect on the Company's business, results of operations and financial condition. See "Risk Factors".

The *i*STAR Strategy

*i*STAR’s strategy is to grow profitably the existing network service provider (“NSP”) segment of its business (dial, dedicated and Web hosting) while rapidly developing a Business Solutions focus. Business Solutions refers to the design, development, deployment and support of IP-based computing applications. Business Solutions are developed, delivered and supported by the Company’s Professional Services group. The Company intends to utilize its core business components to develop a wide array of solutions building blocks into products that will be integrated into its national network. These building blocks include secure connectivity, hardware, application hosting, transactional data bases, enabling technologies, and “off-the-shelf” Internet applications.

There are several key elements to the *i*STAR strategy:

- **Business Solutions.** The Company intends to build on its existing NSP infrastructure and knowledge-base to launch clearly defined Business Solutions. A successful launch of Business Solutions products is critical not only to differentiation in the market versus commodity connectivity providers but also to attainment of higher sustainable gross margins. The Company's strategy is to develop a broad base of solutions building blocks that will include "off-the-shelf" software, hardware and enabling technologies to deliver scaleable business solutions through its Professional Services group and partners. Business Solutions will make extensive use of existing offerings, including the integration of dial, dedicated and Web hosting services. Business Solutions opportunities will be targeted to Canadian-based Professional Services engagements which generate recurring revenue. The Professional Services team will focus on the mid-tier segment of the commercial market, and leverage off the Company's approximately 2,000 (including business dial) commercial customers to deliver higher value services. This strategy is expected to significantly increase monthly revenue per customer.

- **Network Service Provider Business.** The Company plans to increase its focus on the margins from its NSP business (dial, dedicated and Web hosting). Accordingly, it plans to increase the proportion of its revenue derived from telesales and channel partners. In addition, the Company also aims to reduce its telecommunications costs as a percentage of revenues. The Company's proposed network provisioning agreement with Bell Canada is central to this strategy. See "Business of the Company – Recent Developments – Bell Canada Agreement". As well, the Company plans to focus on cost reduction in every element of cost of goods sold and selling and administrative expenses related to its NSP business. At the same time, *i*STAR will continue to be a premium priced, premier supplier of Internet services.

- **Operational and Service Development Infrastructure.** The Company plans to develop the operational and service development infrastructure to successfully support seven days per week, 24 hours per day ("7 by 24") outsourced data-processing applications. Management intends to invest the necessary time, effort and resources to enhance the quality of *i*STAR's customer service, network services and billing. As well, the Company plans to shift its operational focus towards the provision of value-added Internet computing / data processing operations. This includes establishing *i*STAR equipment rooms as computing data centres, and establishing necessary procedures and processes to support 7 by 24 computing solutions.

- **Product Development Process.** *i*STAR intends to re-engineer the product development process to reduce the time required to define, develop, deliver and support new products. This initiative will support the Company's goal to be the Canadian market leader in introducing new features on a frequent basis across all product lines. In addition, *i*STAR will continually look to methods other than in-house development to deliver products; these methods will include partnering and outsourcing.

- **Key Partnerships.** The Company will attempt to establish key partnerships with clearly defined deliverables in areas such as financial, computing technology, telecommunications, business solutions and other services.

- **Efficiency and Effectiveness.** *i*STAR will focus on efficiency and effectiveness in a number of ways. These include weighing business decisions against established financial targets;

increasing revenue per employee through improved effectiveness and efficiency; evaluating every investment opportunity from the perspective of alternative, more cost effective ways of achieving the same, or similar, result; and investigating cost efficiency options in every aspect of the business.

*i*STAR's Products

*i*STAR's products fall into two distinct categories: NSP and Business Solutions. NSP includes dial access, dedicated access and Web hosting. Business Solutions is comprised of four types of services: Advanced Services, Bundled/Packaged Solutions, Consulting and Systems Integration Services, and Custom Solutions.

Network Service Provider Products

Dial

*i*STAR's dial access service consists of core Internet services such as e-mail, news and World Wide Web access. Throughout fiscal 1997, *i*STAR targeted its dial access service at "quality conscious users" - those customers who want a premium Internet service for business, entertainment and education applications. The service was primarily sold to individual buyers through the telesales team or through co-marketing programs. There were some corporate buyers, but they are a very small proportion of current dial subscribers. *i*STAR has approximately 66,000 revenue generating dial subscribers.

In fiscal 1998, *i*STAR plans to specifically target those users who are primarily motivated by business applications. Enhancements to the product line are expected to increase the functionality of the dial access to include: e-mail to fax, higher speed access (56K), and text paging. In addition, the Company intends that subscribers will be able to create separate e-mail accounts for household members and that the range of services will be extended to include bundled individual access for purchase by corporations and wholesale Internet services (such as modem pools, e-mail and news) targeted at ISPs and resellers.

Until recently, dial was mainly a stand-alone product intended to generate cash and profit for the Company. Dial now provides an entry product for individual users and small businesses to *i*STAR's Business Solutions offerings. It can provide on-demand access to e-mail, the World Wide Web, file transfers and corporate networks for organizations. It provides on-demand access to *i*STAR's hosted *i*NTRANET product and also compliments dedicated services by completing the solution.

Consistency, high quality customer service, speed and reliability are the basis on which *i*STAR's "high-end" market niche will be built and defended.

Dedicated

Dedicated access is currently *i*STAR's main entry into the commercial Internet services market. The dedicated access service includes a variety of access types, speeds and billing methods. Dedicated access is often the first service *i*STAR provides to a corporate customer. The customer's experience with *i*STAR's dedicated access service therefore determines whether or not *i*STAR becomes the customer's Internet solutions provider of choice.

Currently, dedicated access is positioned as a mature, premium access product. *i*STAR's premium price is based on network reliability, availability, throughput and connectivity to the U.S. The product offers a variety of connection speeds, which allow for easy upgrades, a complete one-stop approach and is complemented by the Company's Business Solutions offerings.

The target markets for dedicated access alone are fairly broad. While over 70% of the dedicated access business (based on connection volume) is from small to mid-size businesses, approximately 20% is from larger businesses and / or competing ISP's. Within the current product portfolio the SOHO (Small Office - Home Office), small business, mid-range business and larger businesses can be supported.

Currently, dedicated access provides basic connectivity to the Internet, allowing users to browse and to send and receive e-mail. In fiscal 1998, along with meeting connectivity requirements, the Company plans to add simple applications to the dedicated access service intended to increase the value of having an Internet connection.

Within the dedicated access market, differentiation over other ISP's is achieved by *i*STAR's reliable, national network, its 7 by 24 customer support and high throughput connectivity to the U.S. Differentiation on the basis of reliability and connectivity will also be helped by *i*STAR's proposed network provisioning agreement with Bell Canada. Bandwidth, reliability and redundancy will be significantly increased with access to Bell's ATM network. See "Business of the Company – Recent Developments – Bell Canada Agreement".

Web Hosting

Web hosting is a stand-alone product as well as a platform upon which other products such as *i*COMMERCE and *i*NTRANET can be built.

Currently there are approximately 400 *i*STAR Web customers. In fiscal 1998, the Company plans to introduce product enhancements, new services, focused channels and a strong marketing campaign that it believes will significantly increase the number of customers and revenue associated with Web customers.

The *i*STAR Web product line consists of a range of premium quality Web hosting services that provide the corporate customer with high speed availability and a reliable infrastructure. Built upon secure, brand name hardware and software platforms, *i*STAR provides a choice of operating system environments, Web server technologies and productivity tools.

A number of new services and enhancements to Web hosting services are planned for fiscal 1998. In the first half of the year, a Microsoft NT product family is expected to be introduced to meet market demand; as will a suite of shared database technologies to complement the existing Web hosting product set. Enhancements to the Unix-based services will add functionality and increase the number of virtual Web sites per server, which ultimately will decrease the unit cost of these products. During the second half of the year the Company plans to enhance the baseline set of these new products, and focus on positioning its Professional Services delivery.

*i*STAR's Web business is targeted at the business customer that is looking for an entry-level product. Generally, their initial introduction to the Internet demands quality hosting, but they are unwilling to spend a lot of money on these products. For the most part this will be the first *i*STAR experience for the customer and therefore quality of service is paramount.

*i*STAR's Web Corporate and Web Fortune products offer high-end Web hosting and legacy database integration services for the business customer requiring a broader product suite. These high-end services also provide strong platforms for Business Solutions and will be a significant source of business for the Professional Services group.

Business Solutions

*i*STAR's Business Solutions offerings consist of four types of services:

- **Custom Solutions** are complex, tailored business solutions created by the Professional Services group, often as a result of a consulting contract.

- **Consulting and Systems Integration Services** consist primarily of high quality technical consulting and systems integration across a range of areas of expertise, performed on a billable hours basis by *i*STAR's Professional Services group and solutions partners.

- **Bundled/Packaged Solutions** are products created by bundling together components into a highly replicable solutions package that can be sold with a minimal amount of customization. Examples include Internet-based PC backup services, and the Company's "Business Class" package for the small business and small office markets.

- ***i*STAR's Advanced Services** consist primarily of the Company's *i*NTRANET and *i*COMMERCE branded offerings.

*i*NTRANET

*i*STAR's *i*NTRANET portfolio consists of a set of Intranet components sufficient to deploy a basic corporate Intranet, which features an encrypted Virtual Private Network, secure e-mail and a sophisticated document repository system.

As one of *i*STAR's Business Solutions initiatives, *i*NTRANET is supported by the Professional Services group. The Group has sufficient systems integration and project management expertise to assemble *i*STAR's *i*NTRANET components, and the products and services of a limited number of solutions partners, into a completely outsourced Intranet service that is tailored to the specific needs of a small to medium-size business.

Currently, the *i*NTRANET portfolio consists of the following components:

- high-quality encryption (based on Timestep and ISL encryption devices) which are overlaid on *i*STAR's dedicated access services to create a Virtual Private Network service;

- a "road-warrior" encrypted dial access service based on the Company's standard dial service and ISL encryption software;

- a portfolio of firewall products which can be used in conjunction with *i*STAR's Web hosting service (or the customer's existing Web site) to provide a secure Web hosting environment for the customer's information;

- a secure e-mail offering;

- a document repository service based on OpenText's LiveLink product, and which also supports a sophisticated Intranet search engine; and,

- a range of consulting services provided by *i*STAR's Professional Services group, including user needs analysis, design, implementation project management and support services.

To date, the Company has successfully completed eight *i*NTRANET implementations and aims to complete other Intranet projects during the course of the current fiscal year. *i*STAR's *i*NTRANET offering is aggressively priced in relation to most mainstream competitors.

*i*COMMERCE

*i*COMMERCE is an emerging component of *i*STAR's Business Solutions portfolio and is designed to provide the capability for the collection of payment or purchase orders in support of business-to-business or business-to-consumer transactions.

*i*COMMERCE currently represents a method for accepting credit card payment over the Web, together with the ability for a merchant to manage the transaction from the merchant's Web site. The product will expand a merchant's range of payment vehicles, will link to the delivery and supplier ordering processes of the merchant, and will provide a product catalogue facility for the merchant. The Company plans to bundle these functions with other *i*STAR products such as Web hosting and partner programs such as bank commercial account products. These enhancements will make *i*COMMERCE a uniquely complete offering to companies wishing to do business through the World Wide Web.

The *i*COMMERCE portfolio is easily bundled and/or re-branded as part of a larger *i*STAR Business Solution or third party service. It has already proven to be a key enabling component in a number of Business Solutions projects including:

- the Province of Manitoba's flood relief project; and

- Statistics Canada's on-line purchasing system.

Network Operations and Technical Support

Underlying *i*STAR's product portfolio is a sophisticated computing and telecommunications infrastructure.

*i*STAR operates 40 points of presence ("POP") from coast to coast. Eight of these are "Class One" computing machine rooms featuring raised floors, and large air conditioning systems. The balance of the POPs are small facilities that contain, for the most part, only communications equipment.

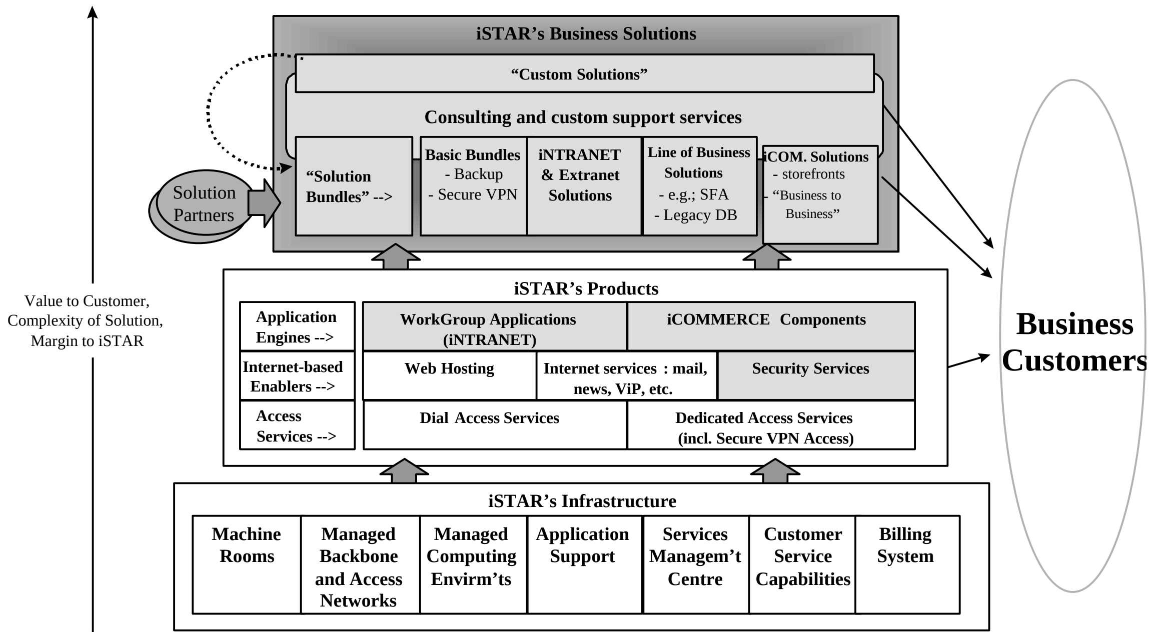
The Class One machine rooms are the main POPs and are interconnected by T3 and ATM (Toronto/Vancouver) facilities presently leased from *f*ONOROLA Inc. ("Fonorola") or AT&T Canada Long Distance Services Company. Under the proposed network provisioning agreement with Bell Canada, the main POPs will be interconnected by Bell Canada's ATM network within the next six months. The smaller POPs are linked to the main POPs through either point-to-point T1 or Frame Relay links depending on the capacity required by the customers served by the POP. T3 links from Toronto, Vancouver and Montreal connect *i*STAR's network to the Internet via network access points in the U.S.

The backbone of *i*STAR's Internetwork is hierarchical and built on Cisco Systems routing technology. Border routers concentrate all dedicated and dial access traffic onto core routers where it is routed to the POPs and from the exchange points to the Internet. Dial access is primarily based on state of the art technology provided by USRobotics.

*i*STAR's Class One machine rooms house the complex computing environments through which *i*STAR provides user authentication, e-mail, Internet news, Web hosting, security and firewall services, document repository services and electronic commerce transaction services. For the most part, these services are based on SUN Sparc processors running the Unix operating system and industry standard application software.

*i*STAR believes that effective network and technical support are important factors in the choice by users of an Internet access provider. Accordingly, the Company has dedicated substantial resources to building a high quality support infrastructure. *i*STAR has established a national help desk, providing service 24 hours a day, 7 days a week, 365 days a year. The help desk is staffed by personnel specializing in dial access functionality, including Internet browser technology and common Internet e-mail, FTP, Newsgroup and other applications, and supplemented by Web-supported Internet training and documentation. In support of its dedicated access service, *i*STAR has established a national technical support centre also staffed by specialists. Standard support responds to customer inquiries from 8:00 a.m. to 8:00 p.m. Eastern time, Monday through Friday. At other times, if needed, dedicated access customers can page an on-call technical support person. *i*STAR has retained other firms and businesses to assist the Company in performing and delivering these services. This outsourcing of services and support has been implemented successfully and has allowed the Company to keep its head count low.

The diagram below depicts, as discussed above, the multi-layers of *i*STAR's business, from the most complex level of expertise, custom solutions, to the supporting infrastructure at the base.


Value to Customer, Complexity of Solution, Margin to iSTAR
iSTAR's Business Solutions
"Custom Solutions"
Consulting and custom support services
Solution Partners
"Solution Bundles" -->
Basic Bundles - Backup - Secure VPN
iNTRANET & Extranet Solutions
Line of Business Solutions - e.g.; SFA - Legacy DB
iCOM. Solutions - storefronts - "Business to Business"
iSTAR's Products
Application Engines -->
WorkGroup Applications (iNTRANET)
iCOMMERCE Components
Internet-based Enablers -->
Web Hosting
Internet services : mail, news, ViP, etc.
Security Services
Access Services -->
Dial Access Services
Dedicated Access Services (incl. Secure VPN Access)
iSTAR's Infrastructure
Machine Rooms
Managed Backbone and Access Networks
Managed Computing Envirm'ts
Application Support
Services Managem't Centre
Customer Service Capabilities
Billing System
Business Customers

Acquisitions

In fiscal 1996, the Company undertook a number of acquisitions in order to augment its internal resources, accelerate the growth of its customer base, increase its geographic coverage and network capacity, and expand its product and service offerings. In addition, the operations of NSTN, a six year old Internet service provider focused on dial access in Eastern Canada, were integrated with those of i*internet, the predecessor company to *i*STAR.

- ARNet. Effective September 1, 1995, *i*STAR acquired the customer base and certain network and other assets of ARNet, the provincial Internet network, from the Alberta Research Council ("ARC"), a government of Alberta agency for a total purchase price of $600,000 payable by way of usage credits.

- InfoRamp Inc. ("InfoRamp"). On September 14, 1995, the Company acquired all the shares of lnfoRamp for a total purchase price of $4,330,500 payable partly in cash and partly by the issuance of Common Shares. InfoRamp, based in Toronto, was a leading Ontario dial-up Internet service provider, and also provided Internet service to many high profile organizations such as the Toronto STAR and RBC Dominion Securities Inc.

- MIND LINK! Communications Corporation ("MIND LINK"). On October 25, 1995, the Company acquired all the shares of MIND LINK for an aggregate purchase price of $3,500,000 payable partly in cash and partly by the issuance of Common Shares and warrants. MIND LINK, based in Vancouver, was one of British Columbia's oldest and largest Internet dial up service providers, having operated for over a decade. MIND LINK supplied Internet dial up access and services, Web server hosting and other consulting and professional services to more than 7,000 subscribers. MIND LINK also provided Internet service to many high profile organizations such as BC Gas, BC Rail and the Insurance Corporation of British Columbia.

- CRS Online Ltd. ("CRS Online"). On December 20, 1995, the Company acquired all the assets of CRS Online, an Internet service provider in Mississauga, Ontario, from Delrina Corporation for a total purchase price of $1,136,375 payable by the issuance of Common Shares.

- Wimsey Information Services Inc. ("Wimsey"). On December 22, 1995, the Company acquired all the assets of Wimsey for an aggregate purchase price of $1,831,569 payable partly in cash and the assumption of specific liabilities and partly by the issuance of warrants. Wimsey has been a pioneer in the creation and maintenance of interactive secure Web sites for such customers as Molsons Brewery, the British Columbia Automotive Association, Homelife Realty and the Vancouver Stock Exchange.

- Aurora Net Inc. ("Aurora Net"). On December 22, 1995, the Company acquired all the shares of Aurora Net for an aggregate purchase price of $972,000 payable partly in cash and by the issuance of warrants. Aurora Net sold both access and Internet system integration services in British Columbia.

- Magi Data Consulting Inc. ("Magi Data"). On February 8, 1996, the Company acquired all the shares of Magi Data for an aggregate purchase price of $3,055,761 payable partly in cash and partly by the issuance of Common Shares and warrants. Magi Data sold access and professional Internet Services to corporations, individuals and governments in

Ontario and Quebec. Notable government customers included the CRTC and the Solicitor General.

The Company has substantially completed all integrations of the operations of these acquisitions in order to allow economies of scale and scope. During the fourth quarter of fiscal 1997, the Company decided to write-off $17.4 million in respect of the unamortized portion of customer lists and goodwill carried on the Company's balance sheet from these acquisitions. The reasons which led to the need for this write-off include the fact that former management of these acquired businesses, most of whom continued as management of *i*STAR following the acquisitions, have left the Company, largely in fiscal 1997. All of these individuals had particular expertise in the consumer-oriented dial market. However, as the Company shifted its focus away from that market to the corporate oriented dedicated access and higher margin business solutions market, none of these individuals remained necessary to the long term development of the Company since they did not have expertise in the business segment in which the Company is now focusing. In addition, as the dial subscriber market became more competitive, most of the customers acquired from these predecessor companies left *i*STAR for other service providers. The Company has focused on replacing its departing dial customers with corporate clients for its business solutions products and with other dial customers who are willing to pay a higher price for *i*STAR 's premium products. As these dial customer departures occurred and the Company began to focus on the dedicated access and higher margin business solutions market, management became of the view that the value previously associated with "customer lists and goodwill" was no longer sustainable. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Fiscal 1997 Compared to Fiscal 1996 – Customer Lists and Goodwill Write-off".

In addition, during fiscal 1998 the Company plans on acquiring a small, Internet-oriented professional services company that compliments and expands upon *i*STAR's focus market and present skill sets. The Company anticipates this acquisition will increase its head count by approximately 20 to 25 employees. By adding a professional services firm, *i*STAR will accelerate its drive to build a national Professional Services presence.

Customer Base

The Company's customer base has grown to approximately 66,000 dial customers, 950 dedicated customers and 400 hosted Web sites. The Company estimates that revenue from commercial customers accounts for approximately two-thirds of *i*STAR's total revenue. No single customer accounts for more than five per cent of the Company's consolidated revenue. The following is a list of selected *i*STAR commercial customers.

Aerospace and Defence	**Services**
• Air Canada • Canadian Marconi Company • Thomson-CSF Systems Canada	• BDO Dunwoody • Canadian Bar Association • Canadian Automobile Association • Children's Aid Society, Region of Peel • Coopers & Lybrand • Ernst & Young • Hill & Knowlton Canada Limited • Insurance Bureau of Canada • McMillan Binch • RBC Dominion Securities Inc. • Royal LePage • SHL Learning Technologies • Stikeman, Elliott
Computer Hardware and Software • CGI Group Inc. • Corel Corporation • Symantec Corp. • Digital Equipment Computer Users Society • E.D.S. of Canada, Ltd. • Fulcrum Technologies Inc. • GEAC Computer Corporation • Hitachi Data Systems • Information Systems Management Corp. • QNX Software Systems Ltd. • Simware Inc.	
Government • Alberta Public Works • Canada Mortgage & Housing Corporation • Canada Post Corporation • City of Calgary • City of Halifax • Dept. of National Defence • Embassy of Japan • Environment Canada • Industry Canada • International Development Research Centre • Revenue Canada • Worker's Compensation Board (Nova Scotia)	**Energy, Chemicals & Pharmaceuticals** • Alberta Natural Gas Company Ltd. • Canadian Copper Refinery (Noranda Mines) • Hydro-Quebec • Novacor Chemicals Ltd. • Ontario Hydro • Petro-Canada Inc. • Shell Canada • TransAlta Utilities
Media and Communications • AT&T Canada Long Distance Services Company • City TV • Cirque du Soleil • Clearnet Inc. • Ericsson Canada Inc. • Mitel Corporation • Nortel • Northern Telephone • Quebec Telephone • Rogers Communications Inc. • Southam Inc. • The Globe and Mail • The Movie Network • Toronto STAR Newspaper Ltd.	**Other** • The Bank of Nova Scotia • C.D. Howe Institute • Cadillac-Fairview • Canadian Figure Skating Association • Canadian National Rail • Dominion Textile Inc. • Kmart Canada Limited • Molson Breweries • Pratt & Whitney • Sobeys Inc.

Sales

As of May 31, 1997, the Company employed a 33-person sales force, including a six-person telesales force located in Halifax. The sales staff are located in cities across Canada including Vancouver, Ottawa, Toronto, Montreal and Halifax. Also, as of such date, the Company employed 12 people in marketing. Excluding the Professional Services group, the Company plans to hold the sales and marketing head count relatively flat during the current fiscal year.

The Company is refocusing its sales force away from NSP products and towards Business Solutions. It is the Company's objective to generate an increasing proportion of its NSP revenues from telesales and channel driven sales in order to remain cost efficient.

*i*STAR is a recognized leader in the Canadian Internet industry. This leadership position is the result of being the first ISP in Canada to structure itself to serve the quality-conscious segment of the corporate Internet access market when this sector was just starting to emerge by uniquely positioning the Company between the telecommunications carriers and regional ISP's. *i*STAR has been able to distinguish itself from the telecommunications carriers on the basis of its Internet focus and expertise, while elevating itself above the regional ISP's on the basis of the Company's national backbone.

Marketing

The Company's primary target market consists of businesses ranging in size from 200 to 2,000 employees which may wish to outsource all or a portion of their Internet-related information technology requirements. The Company believes that such businesses are not currently effectively serviced by its competitors. In addressing this target market, the Company's strategy is to offer a complete set of solutions, as part of its Business Solutions offerings, rather than discrete products.

The Company's near term objectives include improving *i*STAR's time to market in launching relevant new products and packaging existing products. Specifically, *i*STAR intends to re-engineer the product development process to increase the speed of product development by implementing processes to reduce the time invested to define, develop, deliver and support new products and/or solutions.

Properties

*i*STAR's head office is located in Ottawa, where the Company currently leases approximately 21,900 square feet under a lease that expires in 2005. The Company also leases space in Vancouver (5,700 square feet), Calgary (4,000 square feet), Edmonton (2,700 square feet), Winnipeg (1,200 square feet), Toronto (12,000 square feet), Montreal (4,500 square feet) and Halifax (5,050 square feet). Included in each of these leases is space for *i*STAR's completed machine room which is secure and has power and air conditioning. The machine room houses digital equipment which is monitored and controlled for productivity and responsiveness from the 24 hour support of the National Operations Centre in Ottawa.

In addition to the above, *i*STAR has sublet to the end of the lease term approximately 12,000 square feet which it formerly occupied in Dartmouth, Nova Scotia; and has sublet to the end of the lease term 6,515 square feet, formerly occupied by MIND LINK in New Westminster, B.C.

The Company has also lawfully terminated its lease obligations for 3,000 square feet of space, formerly occupied by Magi Data in Nepean, Ontario.

Employees

As of May 31, 1997, *i*STAR employed 208 full-time and term employees, including 57 in sales, telesales, marketing and product management, 78 in engineering, operations and professional services, 32 in customer service and technical support, and 41 executive, general and administrative functions. None of *i*STAR's employees are represented by a labour union.

Recent Developments

Bell Canada Agreement

In July 1997, *i*STAR and Bell Canada signed a term sheet summarizing the terms of a proposed network provisioning agreement (the "NPA") to be entered into between the parties pursuant to which Bell Canada would assume certain of the management and operation of the Company's data telecommunications network (collectively, "network services"). The NPA was signed by the Company and Bell Sygma Inc. ("Bell"), a subsidiary of Bell Canada, on August 29, 1997.

Under the terms of the arrangement, the Company has awarded Bell the tender to provide to *i*STAR certain data telecommunications network products and services selected by the Company, including backbone, local access equipment, Internetworking technology and network management services. The arrangement provides for the migration of the Company's private point-to-point network onto a fully managed, highly available public ATM/Frame Relay network architecture; the location of most of the Company's POPs into central offices of Stentor; consolidation of local network access into high-speed facilities; and the upgrading of the Cisco Systems router technology used by *i*STAR.

The fees payable by the Company for network services provided by Bell under the proposed arrangement during the 24 month period commencing July 1, 1997 will be paid as to approximately one-third in cash. The remaining two-thirds of such charges, up to a maximum of $20 million, will be deferred by Bell on an interest-free basis until July 1, 1999, after which such amounts shall be paid by the Company on an interest-free basis in 36 equal monthly installments. The deferred amount will not bear any interest until the earlier of (i) the occurrence of an event of default, (ii) the assignment of the NPA or certain changes of control of the Company (discussed below), or (iii) termination of the NPA.

The NPA has a term of five years commencing on July 1, 1997 and may not be terminated by either the Company or Bell during the first 18 months. Thereafter, either party may terminate the NPA on six month's notice.

Under the terms of the NPA, Bell has the right to nominate one member for election to the board of directors of the Company. The Company may assign the NPA to a third party without Bell's prior consent in the context of a sale of all or substantially all of the Company's assets, provided the third party does not provide, and is not affiliated with a person who provides, telecommunication services (a "competitor"). If the NPA is assigned to a competitor in connection with such a sale or a competitor acquires a controlling interest in the Company, Bell will have the right to renegotiate the payment terms or demand immediate payment of any deferred amounts, at its option.

The Company is obligated to pay Fonorola, under the terms of the Company's supply agreement with Fonorola, an amount which has not been finally determined but which is anticipated by the Company to be no more than $1.8 million resulting from the early termination of that agreement. Under the NPA, Bell has agreed to pay 50% of this amount, up to a maximum of $898,000, 1/60 of which will be included in each monthly invoice for certain network services sent to the Company during the term of the NPA.

Management expects that the benefits to *i*STAR from the NPA and its alliance with Bell will be significant and will include the following:

- **Service Levels:** ATM technology will enable *i*STAR to significantly increase the bandwidth of its national network thereby significantly improving reliability, redundancy and performance. *i*STAR's customers will enjoy enhanced service levels as a result.

- **Cost Savings:** *i*STAR expects to realize significant cost savings and gross margin improvement as a result of economies of scale and the enhanced efficiency and scalability of ATM. Telecommunications costs are currently the Company's largest single cost.

- **Cash Flow:** Deferring the payment of up to $20 million in telecommunications costs will improve the Company's financial flexibility and is expected to accelerate *i*STAR's move to becoming cash-flow positive. The Company and Bell are also negotiating the terms of a subscription agreement (as described below) pursuant to which Bell may subscribe for and purchase up to $20 million worth of Common Shares during the 24 month period ending June 30, 1999, which, once complete, will further assist these efforts to become cash flow positive.

The Company anticipates that conversion to the Bell network will be completed in 4 to 6 months.

The Company has also agreed with Bell to use best efforts to reach an agreement with Bell (the "Subscription Agreement" on or before October 29, 1997 on terms pursuant to which Bell may subscribe for and purchase Common Shares during the 24 month period ending on June 30, 1999, to a maximum of $20 million. The purchase price of the Common Shares will be $2.10 per Common Share for the first $10 million worth of Common Shares purchased and $3.00 per Common Share for the next $10 million worth of Common Shares purchased, subject, in each case, to adjustment of the purchase price in certain circumstances. However, there can be no assurance that agreement will be reached between the Company and Bell on the terms of the Subscription Agreement.

BNS – Jefferson Credit Facility

On August 1, 1997, the Company entered into a loan agreement with The Bank of Nova Scotia, Jefferson Partners Capital Limited and Jefferson Partners Holdco Inc. (the "Lenders"), pursuant to which the Lenders made available to the Company a credit facility of $4 million (the "BNS–Jefferson Credit Facility"). The amount of the loan was available in three tranches: the first tranche of $750,000 was advanced on August 1, 1997, the second tranche of $1.25 million was advanced on August 8, 1997 and the third tranche of $2 million was advanced upon execution of the NPA. The Company will pay 8% interest on any funds drawn on the facility. The fees payable to the Lenders consist of (i) $40,000; and (ii) the issuance of 200,000 warrants convertible into Common Shares at no additional cost to the Lenders (the "Lenders' Warrants"). The BNS-Jefferson Credit Facility is secured by existing security in favour of The Bank of Nova Scotia and by a general security agreement and general assignment of book debts in favour of Jefferson. In addition, the Company's rights to the proceeds of the Special Warrants held in escrow have been assigned to the Lenders. See "Private Placement and Plan of Distribution". The Company will repay any amount outstanding under the BNS–Jefferson Facility out of the proceeds of the Special Warrants upon the release of such proceeds from escrow. See "Use of Proceeds".

SELECTED CONSOLIDATED FINANCIAL INFORMATION

The selected quarterly information for the year ended May 31, 1997 has been derived from the unaudited consolidated financial statements of the Company. In the opinion of management, this information reflects all adjustments necessary to fairly present this information when read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this Prospectus. The results of operations for any quarter are not necessarily indicative of the results to be expected for any future period.

	Year Ended May 31, 1997 (audited)	Year Ended May 31, 1996 (audited)	From June 30, 1994 to May 31, 1995 (audited)	Quarter Ended May 31, 1997 (unaudited)	Quarter Ended February 28, 1997 (unaudited)	Quarter Ended November 30, 1996 (unaudited)	Quarter Ended August 31, 1996 (unaudited)
	(in thousands of dollars, except per share amounts)						
Statement of Operations Data:							
Sales	$ 34,043	$ 19,405	$ 1,538	$ 10,093	$ 9,124	$ 7,478	$ 7,348
Cost of sales	30,558	13,596	943	8,117	8,243	7,702	6,496
Gross margin	3,485	5,809	595	1,976	881	(224)	852
Selling, general and administration expenses	32,624	22,147	1,210	7,627	9,062	8,754	7,181
Operating loss before undernoted items	(29,139)	(16,338)	(615)	(5,651)	(8,181)	(8,978)	(6,329)
Depreciation and amortization	6,519	2,947	219	1,688	1,578	1,456	1,797
Integration costs	585	1,699	-	585	-	-	-
Write-off of customer lists and goodwill	17,398	-	-	17,398	-	-	-
Interest and bank charges, net	113	(546)	6	91	(13)	32	3
Net loss	$ (53,754)	$ (20,438)	$ (840)	$ (25,413)	$ (9,746)	$ (10,466)	$ (8,129)
Net loss per share	$ (2.42)	$ (1.70)	$ (0.67)	$ (1.03)	$ (0.40)	$ (0.50)	$ (0.43)

	As at May 31, 1997 (audited)	As at May 31, 1996 (audited)	As at May 31, 1995 (audited)
	(in thousands of dollars)		
Balance Sheet Data:			
Current assets	$ 23,077	$ 26,343	$ 761
Property and equipment	16,343	12,640	1,232
Customer lists and goodwill	-	16,497	-
Total assets	39,420	55,480	1,993
Current liabilities	23,098	14,167	2,263
Total liabilities	28,348	16,218	2,409
Shareholders' equity	11,072	39,262	(416)

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

The following discussion and analysis by management of the results of operations and financial condition of the Company should be read in conjunction with the disclosure contained throughout this Prospectus, including the consolidated financial statements and notes thereto.

General

In fiscal 1996, *i*STAR completed seven acquisitions of ISPs in various parts of Canada in order to expand its network capacity, products and services and geographic coverage. The operations of all of these companies were substantially integrated by the end of fiscal 1997.

Fiscal 1997 Compared to Fiscal 1996

Revenues increased 75% to $34.0 million in 1997 from $19.4 million in 1996. The Company incurred a net loss of $53.8 million ($2.42 per share) compared to a net loss of $20.4 million ($1.70 per share) in the prior year. A non-recurring write-off of customer lists and goodwill, lower gross profit margins and higher selling, general, and administrative expenses, both in the first half of fiscal 1997, were the primary reasons for the higher loss.

Sales

*i*STAR's revenue stream is derived from its two product offerings: NSP, which includes dial access, dedicated access and Web-hosting, and Business Solutions, which includes professional services, hardware and software sales, and *i*NTRANETs. The Company's NSP product accounted for the majority of the revenue during 1997 as products and markets for Business Solutions were only actively marketed during the second half of 1997.

Total revenue was $34.0 million in 1997, up 75% from the $19.4 million generated in 1996. Dial revenue increased to $16.3 million from $7.5 million in fiscal 1996, an increase of 117%. This reflects the fact that the bulk of the companies acquired by *i*STAR in fiscal 1996 had significant dial customer bases and in fiscal 1997 the Company recognized a full year of this revenue. Dedicated revenue grew to $12.6 million from $8.1 million in fiscal 1996, an increase of 56%. Significant expenditures in late 1996 and early fiscal 1997 were incurred building the Company's eight machine rooms. These machine rooms, as well as several new T3 corridors, created much needed network capacity. With the combined upgrades in place the Company was able to sign up many new and increasingly larger corporate dedicated access customers. Web revenue increased to $800,000 in fiscal 1997. In fiscal 1996 these revenues were insignificant and not separately identified. During fiscal 1997, several new servers and product enhancements were offered which generated this incremental revenue.

Business Solutions revenues improved in fiscal 1997 but the bulk of the resources and strategies required to effectively grow these revenues were not in place until the fourth quarter of fiscal 1997. With the resources in place to deliver these revenues, Business Solutions is expected to deliver an increasingly large proportion of total revenue. For example, fourth quarter revenues from Business Solutions were $1.8 million which was double the third quarter revenue of almost $900,000. Professional services revenue increased to $2.3 million from $1.6 million in fiscal 1996, an increase of 44%. Hardware and software sales were down to $1.7 million from $2.2 million in fiscal 1996, a decrease of 23%. This was due to the fact that in fiscal 1996 the Company completed a large contract with the Ontario Telephone Association which included the delivery of significant sales in equipment to each one of the Association's members.

During 1997 the Company focused on migrating the customer bases from acquisitions completed in 1996. Dedicated and dial customers, which made up 85% of 1997 revenues, have grown to approximately 950 and 66,000 subscribers, respectively.

*i*STAR also completed an audit of the Company's database during 1997 to ensure only active billed customers are reported in the Company's subscriber counts. This audit allowed the Company to remove any inactive customer data from the various client data bases which were obtained from the acquisitions.

Cost of Sales

*i*STAR's cost of sales is made up of three components: the cost of providing access to the Internet; the cost of goods and services resold; and the cost of supporting customers.

Total cost of sales for 1997 was $30.6 million compared to $13.6 million in 1996, an increase of 125%. The major reason for the growth in cost of sales was that 1997 included a full year of network and telecommunication infrastructure costs. In 1996 these costs were incurred only during the latter part of the fiscal year.

The cost of providing access to the Internet has two components: network leases and telecommunication charges. Network leasing charges relate to the operating lease costs of equipment used in the Company's machine rooms and on customer sites. This cost was $8.1 million in 1997 compared to $3.1 million in 1996, an increase of 161%. A significant portion of the equipment on lease in 1997 was placed in production in late 1996, which resulted in lease charges for only part of that year. The majority of the Company's acquisitions were completed in the third quarter of fiscal 1996 and significant upgrades to the Company's machine rooms and the backbone network took place in the third and fourth quarters of that year.

Telecommunication charges relate to the costs of *i*STAR's backbone network, local loop circuits between the Company's machine rooms and the customers premises, and related installation charges. In 1997 these costs were $17.2 million, up 95% from $8.8 million in 1996. These expenditures resulted in substantial improvements to the Company's backbone network, including new T3 corridors between Vancouver and Calgary, Calgary and Edmonton, Montreal and Halifax, and Toronto and Kitchener. The increase in network capacity provided by the new T3 corridors will allow faster, more efficient service for customers as well as additional capacity for subscriber growth.

The cost of goods and services resold relate to dial software costs, subcontractors for Professional Service engagements and the cost of equipment resold to customers. This cost was $2.5 million in 1997 compared to $1.7 million in 1996. The main reason for this increase is the increase in software costs related to the growth in dial sales in 1997 to $16.3 million from $7.5 million in 1996. 1997 also included Professional Service sales of $2.3 million compared to $1.6 million in 1996. This increase in revenue was delivered in part by subcontractors, which contributed to the rise in this expense category.

In 1997 the Company outsourced its customer support, at a cost of $2.9 million, to achieve better efficiencies. In 1996 customer support was provided by internal staff, and the costs were reflected in selling and administrative expenses.

Gross Margin

The overall gross margin declined in 1997 to 10% compared to 30% in 1996. As indicated above, 1997 included a full year of costs related to overall network expansion which were only present towards the end of 1996. Gross margin on a quarterly basis has continually improved since the end of the second quarter of fiscal 1997. Quarterly margins for fiscal 1997 were as follows: first quarter 12%, second quarter (3%), third quarter 10% and fourth quarter 20%.

Selling, General and Administration Expenses

Selling, general and administration ("SG&A") expenses consist mainly of salaries, general administrative expenses, occupancy costs, advertising and promotion and consulting costs and expenses related to bad debts. In 1997, SG&A costs were $30.7 million (excluding bad debts) compared to $20.8 million in 1996, an increase of 48%. The main reason for this increase is the recognition of a full year of costs including all of the acquired companies' costs. SG&A (excluding bad debts) as a percentage of sales in 1997 was 90% compared to 107% in 1996, an improvement of 17%. Several cost control measures such as a revamped purchase order system with graduating levels of approval, employee hiring controls and limits on other general and administrative per diem expenses were implemented in the third quarter of 1997. The results of these controls are evidenced by the reduction in SG&A (excluding bad debts) from $8.6 million in the third quarter to $7.1 million in the fourth quarter, a reduction of 17%.

A discussion of the major items in SG&A follows.

Employee expenses increased to $15.1 million from $9.3 million in 1996, an increase of 62%. In 1997 these costs improved to 44% of sales compared to 48% in 1996. During 1997, staffing reorganizations were made to bring employment costs into line with the level of revenue generation. The outsourcing of certain user support functions also improved this ratio.

General and administrative expenses were $9.0 million in 1997 compared to $5.1 million in 1996. These costs represented 27% of sales in 1997 compared to 26% in 1996. This area was largely the focus, in the second half of fiscal 1997, of the cost control measures mentioned above and these costs are expected to be reduced further in fiscal 1998.

Advertising and promotion costs were $3.4 million in 1997 compared to $2.8 million in 1996, an increase of 21%. In 1997 these costs were 10% of sales compared to 14% in 1996. In 1997 the Company continued to promote itself through ad campaigns and trade shows.

Consulting costs were $2.4 million compared to $3.6 million in 1996, a decrease of 33%. 1996 included several costs related to consultants for assistance in establishing sales channels, market analysis and organization of the *i*STAR network. Many of those costs were one time expenditures. In 1997 cost control was imperative and consulting costs were significantly scrutinized and reduced.

Bad Debts

In 1997 bad debts were $1.9 million compared to $1.4 million in 1996, an increase of 36%. These costs were 6% of sales in 1997, slightly better than the 1996 level of 7%. During 1997 several efforts were made to ensure all delinquent accounts receivable were collected, including hiring temporary staff to make collection calls and the use of collection agencies. The increased focus has not only improved cash receipts but identified areas where customers should be disconnected thereby avoiding further costs for the Company to support delinquent customers.

Integration Costs

During 1997 *i*STAR completed the integration of the companies it acquired in 1996. Previously, the customers of the MIND LINK acquisition had not been migrated in order to maintain a unique bulletin board service built by the predecessor company. In 1997 the decision was taken to migrate this last subsidiary to the *i*STAR network, which resulted in unavoidable one-time costs. These integration costs related to a task force required to handle the transition, severance pay for displaced staff, increased user-support costs and a bad debt write-off relating to accounts receivable from companies acquired in 1996. Total integration costs in 1997 were $0.6 million compared to $1.7 million in the prior year.

Depreciation and Amortization

Depreciation and amortization costs relate mainly to the capital equipment employed in the Company's machine rooms, internal infrastructure and the amortization of customer lists and goodwill related to acquisitions. Depreciation and amortization was $6.5 million in 1997 compared to $2.9 million in 1996. This large increase is attributable to higher capital investment in 1997, as well as the inclusion of a full year of depreciation.

Customer Lists and Goodwill Write-off

Included in 1997 results is a non-recurring write-off of $17.4 million for the unamortized portion of customer lists and goodwill carried on the Company's balance sheet. It is the policy of management to review the valuation of customer lists and goodwill on an ongoing basis. As a result of a number of factors involving changes in the industry and the evolution of the Company from a provider of access products to a provider of Internet business solutions, the Company determined that the value of its goodwill was permanently impaired and, accordingly, should be written off. In particular, the value of the customer lists and goodwill included both the management expertise and the value of the customer lists acquired over the last two years as a result of the Company's acquisitions in the consumer oriented dial market. Since the dial subscriber market has become a commodity business, management believed that the value associated with its customer lists and goodwill was permanently impaired and could not be supported by the expected revenue stream from the customers acquired in these acquisitions. Indicative of this shift is the fact that, although most of the former owners or other key management personnel whose expertise was used in creating the companies acquired by *i*STAR continued as management employees with *i*STAR for a period of time following those acquisitions, none of these people remain as management. All of these departures resulted from the reorganization by the Company of its staffing requirements as the Company shifted its focus away from the consumer-oriented dial market to the corporate-oriented dedicated access and higher margin business solutions market. The Company has compensated for these departures by adding other management individuals with expertise in the business solutions segment of the market. In addition, as the dial subscriber market became more competitive, most of the customers acquired from these predecessor companies left *i*STAR for other service providers. The Company has focused on replacing its departing dial customers with corporate clients for its business solutions products and with other dial customers who are willing to pay a higher price for *i*STAR's premium products. As these dial customer departures occurred and the Company began to focus on the dedicated access and higher margin business solutions market, management became of the view that the value previously associated with "customer lists and goodwill" was no longer sustainable.

On an overall basis, the continuing net cash usages, net losses, loss of management and increased competition in the marketplace for consumer-oriented dial subscribers did not support the existence of the value of the customer lists and goodwill from the purchased companies.

Interest Expense

Net interest expense during 1997 was $113,000 compared to net interest income of $546,000 in 1996. The increase in interest expense was attributable to two factors. The first was the lower level of cash available for investment in 1997; 1996 results included $35.5 million in proceeds from the Company's initial public offering as well as $11 million from an earlier special warrant offering. Although these funds were earmarked for acquisitions in 1996, they earned interest income. During 1997 cash levels were bolstered with a $9.5 million investment by Bank of Nova Scotia and $14.5 million from a secondary offering of Common Shares. Total cash available for investments, however, was less than that of 1996, and thus earned less interest income. The second reason for the increased interest expense relates to the recognition of a full year of implicit interest on capital leases as opposed to only a partial year, in 1996.

Net Loss

Acquisitions completed in 1996 led to a substantial increase in revenues during 1997. However, increased cost of sales and SG&A expenses as well as significant non-cash expenses – depreciation and amortization and a non-recurring write-off of customer lists and goodwill associated with completed acquisitions – resulted in a higher loss. The net loss for 1997 totaled $53.8 million or $2.42 per share compared to $20.4 million or $1.70 per share in 1996.

Fiscal 1996 Compared to Fiscal 1995

Sales

Sales for the fiscal year ended May 31, 1996 were $19.4 million, which is an increase of $17.9 million, or 1,193%, over sales of $1.5 million for the eleven months ended May 31, 1995. This dramatic growth is a result of the acquisitions of seven ISP's in 1996 as well as strong sales achieved during the course of the year.

Cost of Sales

The cost of sales increased by $12.7 million, from $0.9 million for the eleven months ended May 31, 1995 to $13.6 million for the year ended May 31, 1996. Gross margins decreased from 39% in 1995 to 30% in 1996 due to the creation of an inventory of network ports and leased lines and price reductions in response to competitive pressures. This capacity was created intentionally in anticipation of significant subscriber growth and to service customers on a national basis.

Selling, General and Administration

Selling, general and administration expenses increased by $20.9 million, from $1.2 million for the eleven months ended May 31, 1995 to $22.1 million for the year ended May 31, 1996. These costs increased as a percentage of sales, from 79% in 1995 to 114% in 1996.

In an effort to achieve profitability, the Company implemented a cost-containment program to reduce its SG&A expenses. This cost-containment program included: reducing head count from 348 to 245; shifting the emphasis of its advertising and promotional efforts on to regional markets, resulting in lower monthly expenditures as a percentage of sales; reviewing all outside consultants providing services to the Company which resulted in significant savings; instituting a number of cost containment measures, including tying officer compensation to performance against expense budgets and requiring that all expenses, with the exception of minor incidental expenses, and all purchase orders be approved by at least one of four senior executive officers.

Integration Costs

The integration of its seven acquisitions cost *i*STAR more than $1.6 million. Integration costs included severance costs accrued at year end of $405,000, redundant salaries and related expenses of $948,000, rent for duplicate offices of $97,000, and human resources, logistical and legal consultants for the layoffs of $249,000.

In addition to these integration costs, the Company incurred significant capital and operating costs to replace equipment owned by companies acquired by *i*STAR that proved to be incompatible with the *i*STAR national network system. Although these costs are not included as "integration costs", they arose as a result of the integration of the companies acquired by *i*STAR.

The total amount invested in the *i*STAR network in fiscal 1996 was approximately $6.0 million in property and equipment. In addition, the Company procured $16 million of telecommunications and computing equipment through operating and capital leases.

Depreciation and Amortization

Depreciation and amortization expense consists principally of expense associated with the costs of hardware that support expansion and upgrade of the Company's POPs, as well as the costs of other fixed assets, software costs and customer lists and goodwill arising from acquisitions completed during the year. Depreciation and amortization costs were $200,000 for the eleven months ended May 31, 1995 and $2.9 million for the year ended May 31, 1996, an increase of $2.7 million. A significant portion of this increase relates to the amortization of customer lists and goodwill in connection with the acquisitions.

Other Interest and Bank Charges

Net interest revenue for fiscal 1996 was $546,000 compared to $6,000 of interest expense and no significant interest revenue in fiscal 1995. The increase in interest revenue in 1996 was primarily due to the investment of proceeds from the Company's initial public offering. The increase in interest expense was due to the implicit interest on capital lease payments for computer and network equipment.

Liquidity and Capital Resources

1997 was another year of rapid growth for *i*STAR, which required substantial working capital to finance operations, product development, network expansion and capital investment.

These working capital requirements were satisfied primarily through the issuance of Common Shares, and through lease financing from financial institutions and bank borrowings.

Working Capital

At the end of 1997 the Company had $8.6 million in net cash and marketable securities compared to $16.7 million at the end of 1996. The primary reason for the decline is that a portion of the $35.5 million of net proceeds from the Company's initial public offering was held at the end of 1996.

During fiscal 1997 the Company raised approximately $24 million in equity capital, net of underwriters' fees and expenses. In September 1996, $9.5 million was raised through the issuance of 2.4 million Common Shares to Bank of Nova Scotia. In November 1996 the Company issued 2.9 million units, each unit consisting of one Common Share and one-half Common Share purchase warrant, for net proceeds of $14.5 million. During fiscal 1996 *i*STAR raised approximately $57.2 million in net equity capital.

Cash used during 1997 totalled $37.7 million: $26.6 million to fund operations, $8.6 million towards the purchase of property and equipment, and $2.5 million related to 1996 acquisitions. In 1996 cash used was $46.0 million: $17.9 million to fund operations, $10.1 million for the purchase of property, plant and equipment, and $18 million to fund acquisitions.

Fiscal 1998 is expected to be another year of expansion that will require additional working capital, although it is expected the Company will become cash flow positive towards the end of fiscal 1998. Subsequent to year end, the Company undertook several steps to meet those working capital needs.

On July 10, 1997, the Company announced an agreement with Bell Canada to supply telecommunication facilities and services over five years. The arrangement will transfer the Company's backbone network to Bell's ATM network which will significantly increase *i*STAR's network bandwidth while improving network reliability, redundancy and performance. The agreement should accelerate the Company's objective of becoming cash flow positive by the last month of fiscal 1998. As part of the arrangement Bell will defer two-thirds of *i*STAR's telecommunications costs during the first twenty-four months of the contract. The long-term debt bears no interest and, subject to the settlement of the terms of a Subscription Agreement with Bell, may be used to purchase equity of *i*STAR. Monthly telecommunication charges from Bell are to be paid on a two-thirds deferral basis (up to $20 million), one-third cash basis. The agreement also positively affects cashflow from operations in that telecommunication costs will be reduced by up to 10% from what they would have been without the arrangement.

The Company's capital structure was also strengthened in July 1997 by the raising of $9 million in equity. Specifically, 4,500,000 Special Warrants were issued at a price of $2.00 per Special Warrant. Each Special Warrant is convertible without further payment into Common Shares of the Company on a one-for-one basis. The net proceeds from the sale of the Special Warrants are being held in escrow until a receipt is issued by the appropriate Canadian securities regulatory authorities for a final prospectus qualifying the issue of the underlying Common Shares.

In order to ensure adequate cash resources until the Special Warrant proceeds are released from escrow and the benefits from the Bell agreement begin to be realized, the Company entered into the BNS-Jefferson Credit Facility. The amount of this credit facility is $4 million, which has been fully drawn and will be repaid out of the proceeds of the Special Warrant financing.

Capital Expenditures

The Company purchased $8.6 million of property and equipment in 1997. Approximately $6.1 million was for equipment, the use of which normally would be obtained through operating leases. The majority of the capital expenditures relate to machine room expenditures and customer premise routers. The Company also obtains use of other equipment through operating lease commitments, the cost of which is shown in the Company's cost of sales. Other equipment which the Company obtained under operating lease commitments in 1997 amounted to a capital value of approximately $1.5 million.

Equipment which is expected to be purchased or financed through capital leases in fiscal 1998 is expected to be approximately $1.7 million. Use of other equipment with a capital value amounting to $16 million is expected to be obtained through operating lease commitments. This equipment will be used to support dedicated and dial subscriber growth, *i*NTRANET revenues and general network expansion.

Network Cost Escalation

*i*STAR's large infrastructure build-up is essentially completed. As described above, capital expenditures are expected to increase but this growth will be driven by increased revenues. The Company re-negotiated its existing lease arrangement in the fourth quarter of 1997. The re-negotiated leases resulted in cost reductions of approximately $1.0 million dollars in 1997 and are expected, in fiscal 1998, to generate a further $2.0 million in cost reductions for specific equipment leased as at February 28, 1997.

Telecommunications costs are the single greatest expense in the Internet access business. The proposed NPA with Bell announced in July 1997 will also have a positive impact on expenses in the short term. It is expected that as a result of this agreement projected fiscal 1998 telecommunication costs will be reduced by up to 10%.

Inflation

Inflation has not materially affected *i*STAR's business during the past two fiscal years.

Outlook

Fiscal 1997 was a year of transition in which the assets, people, customers, products and cultures from acquisitions made by the Company during 1996 were combined into one focused company with clear product distinctions. Although the Company experienced a $35.8 million operating loss (before integration costs and the write-off of customer lists and goodwill), the structure for a sound business organization has now been set. During fiscal 1998 *i*STAR's results are expected to improve due to a sharper focus on higher-margin revenues that result from the Business Solutions products, as well as from continuing revenue growth from core access products.

The Company will achieve several benefits from its proposed arrangement with Bell. The most significant will be reduced expenses and related demands on cash expenditures. Furthermore, the arrangement will also give *i*STAR the ability to refocus some of its network and human resources on higher-margin areas, such as Web hosting and Business Solutions, without incurring additional employment costs.

The Company is also committed to controlling expenses. The controls implemented in 1997 reduced monthly overhead expense, excluding bad debts, from a high of $3.0 million to $2.4 million by the end of 1997. The Company expects to maintain this level of overhead in fiscal 1998 while increasing sales. This is expected to help improve *i*STAR's overall financial performance and allow the Company to move towards profitability.

DESCRIPTION OF SHARE CAPITAL

The authorized capital of the Company consists of an unlimited number of Common Shares. As of the date hereof, 26,836,396 Common Shares were issued and outstanding, of which 2,220,869 are held by a wholly-owned subsidiary of the Company. See Note 10(b) of the Consolidated Financial Statements. In addition, the Company has issued options and warrants to various parties. See "Prior Sales" and "Outstanding Options".

Common Shares

Each Common Share entitles the holder to one vote at meetings of the shareholders of the Company and to receive dividends if, as and when declared by the board of directors of the Company. All dividends which the board of directors of the Company may declare and pay will be declared and paid in equal amounts per share on all Common Shares. Holders of Common Shares will participate in any distribution of the net assets of the Company upon its liquidation, dissolution or winding-up on an equal basis per share. There are no pre-emptive, redemption, purchase or conversion rights attaching to the Common Shares.

CAPITALIZATION

The following table and notes set forth the capitalization of *i*STAR as at the dates indicated. This table should be read in conjunction with the *i*STAR Consolidated Financial Statements and the notes thereto contained elsewhere in this prospectus.

	Amount Outstanding as at May 31, 1997 (audited)	Amount Outstanding as at July 31, 1997 (unaudited)	Amount Outstanding as at July 31, 1997 as adjusted[1] (unaudited)
		(in thousands of dollars)	
Debt:[2][3]			
Bank indebtedness	$ 3,500	$ -	$ -
Capital lease obligations (including current portion)	7,679	6,739	6,739
	11,179	6,739	6,739
Shareholders' equity:			
Common shares (authorized: unlimited)	83,015 (24,614,979 shs.)[4]	83,020 (24,615,527 shs.)	91,630 (29,315,257 shs.)
Warrants[5]	218 (46,940 wts.)	213 (46,392 wts.)	213 (46,392 wts.)
Special Warrants	-	8,210 (4,500,000 wts.)	-
Contributed surplus[6]	2,871	2,871	2,871
Deficit	(75,032)	(75,032)[7]	(75,432)[7]
Total shareholders' equity	11,072	19,282	19,282
Total capitalization[8]	$ 22,251	$ 28,021	$ 26,021

(1) Adjusted to give effect to the exercise or deemed exercise of the Special Warrants and the Lenders' Warrants.
(2) See notes 9 and 10 to the Consolidated Financial Statements for details of the Company's debt.
(3) See note 11 to the Consolidated Financial Statements for details of the Company's operating lease commitments.
(4) An additional 2,220,869 Common Shares are held by a wholly-owned subsidiary of the Company.
(5) See notes 10, 18(b) and 18(c) to the Consolidated Financial Statements for details of the warrants.
(6) See note 10(e) to the Consolidated Financial Statements for details of the contributed surplus.
(7) As at May 31, 1997.
(8) As at the date hereof, the Company has outstanding 3,605,644 options to acquire Common Shares. See "Options to Acquire Common Shares".

DIRECTORS AND OFFICERS

The following table sets forth the name and municipality of residence, the position held with *i*STAR and the principal occupation of each of the directors and officers of *i*STAR:

Board of Directors and Officers

Name of Municipality of Residence	Position with the Company	Principal Occupation
JACK O. KIERVIN Oakville, Ontario	Chairman[2][3]	Chairman, Jefferson Partners Capital Limited

Name of Municipality of Residence	Position with the Company	Principal Occupation
RAINER N. PADUCH Ottawa, Ontario	Director, Vice-Chairman and Chief Technology Officer(2)	Chief Technology Officer of the Company
DENNIS BENNIE Toronto, Ontario	Director(1)	Chief Executive Officer, XDL Capital Corporation
ROBERT L. BROOKS Oakville, Ontario	Director(1)	Executive Vice President, Investment Banking, The Bank of Nova Scotia
DAVID FOLK Toronto, Ontario	Director	President and Chief Executive Officer, Jefferson Partners Capital Limited
DAVID A. GALLOWAY Toronto, Ontario	Director (2)(3)	President and Chief Executive Officer of Torstar Corporation
GRAHAM W. SAVAGE Toronto, Ontario	Director(1)(3)	Principal and Managing Director of Parkview Capital Partners Inc.
DAVID WEBSTER Carleton Place, Ontario	Director(2)	President and Chief Executive Officer of Software Kinetics Ltd.
CRAIG WALLACE Thornhill, Ontario	President and Chief Executive Officer	President and Chief Executive Officer of the Company
JOHN A. BROUGH Toronto, Ontario	Executive Vice President and Chief Financial Officer	Executive Vice President and Chief Financial Officer of the Company
JOHN BUSH Nobleton, Ontario	Vice President, Marketing	Vice President of the Company
DENIS CHOQUETTE Town of Mount Royal, Quebec	Vice President, Corporate Development	Vice President of the Company
STEVE DOSWELL Toronto, Ontario	Vice President, National Sales	Vice President of the Company
MARGO LANGFORD Ottawa, Ontario	Vice President, Legal Counsel	Vice President of the Company
MEL MULLIGAN Carp, Ontario	Vice President, Human Resources	Vice President of the Company
DAVID RALSTON Toronto, Ontario	Executive Vice President , Operations	Executive Vice President, Operations of the Company

(1) Member of Audit Committee
(2) Member of Compensation Committee
(3) Member of Corporate Governance Committee

Directors and Management

Jack O. Kiervin - Chairman. Mr. Kiervin is Chairman of Jefferson Partners Capital Limited, the investment organization he co-founded in 1992. From 1987 to 1991, he was President and Chief Executive Officer of Lincoln Capital Corporation. Mr. Kiervin is also Chairman of Wescam Inc. and sits on the boards of a number of private Canadian companies. Mr. Kiervin has a Masters degree in political science.

Rainer N. Paduch - Director, Vice-Chairman and Chief Technology Officer. Mr. Paduch founded *i*internet* Inc. in June 1994. Prior to that, he was employed by *fONOROLA* from September 1991 to June 1994, serving most recently as Vice-President Technology where he jointly led the team that designed the advanced services *fONOROLA* network. From September 1986 to September 1991, he was Director of Application Engineering for Newbridge Networks Corporation. Mr. Paduch is a member of the Association of Professional Engineers of Ontario and has spent 17 years in the high technology and telecommunications community working for such other companies as Canadian Marconi, SHL Systemhouse and Mitel. Mr. Paduch studied fibre optic signal transmission and graduated with a Masters of Engineering degree from McGill University.

Dennis Bennie - Director. Mr. Bennie is Chief Executive Officer of XDL Corporation, a venture capital company. Mr. Bennie co-founded Delrina Corporation in 1988 as Chairman and Chief Executive Officer and led the merger of Delrina into Symantec Corporation forming the largest supplier of PC communications software in the world. Prior to Delrina, Dennis Bennie co-founded Ingram Software Canada in 1982. In 1978, Mr. Bennie co-founded Mission Electronics, a company specializing in quality home entertainment products throughout the world. Dennis Bennie practiced as a Chartered Accountant from 1976 to 1978.

Robert Brooks - Director. Mr. Brooks is Executive Vice-President, Investment Banking at The Bank of Nova Scotia. He has been with The Bank of Nova Scotia since 1968.

David Folk - Director. Mr. Folk is Chief Executive Officer and a director of Jefferson Partners Capital Limited, the investment organization he co-founded in 1992. From 1987 to 1991, he was Vice-President and Head of Merchant Banking at Lincoln Capital Corporation. Mr. Folk holds a business degree from the University of Western Ontario and is a director of Wescam Inc. and a number of private companies.

David A. Galloway - Director. Mr. Galloway has been President and Chief Executive Officer of Torstar Corporation since September 1988. Mr. Galloway joined Torstar Corporation in 1980. He became Executive Vice-President of Harlequin Enterprises Limited in 1981 and President and Chief Executive Officer for Harlequin Enterprises world wide the following year. Mr. Galloway has held the title of Chairman of Harlequin Enterprises since 1990 and is a director of Clearnet Communications Inc.

Graham W. Savage - Director. Mr. Savage is Principal and Managing Director of Parkview Capital Partners Inc.. Mr. Savage was Senior Vice-President Finance, Chief Financial Officer and Director of Rogers Communications Inc. from 1989 to 1996. Mr. Savage joined the Rogers group of companies in 1975, he was appointed Vice-President, Investment Planning in 1978 and Senior Vice-President, Investments in 1986.

David Webster **-** Director. Mr. Webster is the President of Software Kinetics Limited and has held this position since 1981. From 1989 to 1995, Mr. Webster also was President and Chief Executive Officer of NSTN until its amalgamation with *i*internet* Inc. Mr. Webster has more than 23 years of industry experience including management of other high technology companies.

Craig Wallace - President and Chief Executive Officer. Mr. Wallace initially joined *i*STAR as Executive Vice President Corporate Development in June 1996 and was appointed President and Chief Executive Officer in January 1997. Prior to joining the Company, Mr. Wallace was employed by Microsoft Canada Inc. for over 6 years where he held the following positions: Director, Enterprise Customer Unit, Director of Marketing and National Sales Manager. Mr. Wallace holds a Bachelor of Commerce degree from the University of Toronto and a Chartered Accountant designation.

John A. Brough **-** Executive Vice President and Chief Financial Officer. Mr. Brough joined the Company in October 1996 as Executive Vice President and Chief Financial Officer. Prior to joining the Company, he was Chief Financial Officer and a director of Markborough Properties Inc. Mr. Brough holds a degree in Economics from the University of Toronto and is a member of the Canadian and Ontario Institutes of Chartered Accountants. Mr. Brough is a director of Kinross Gold Corporation.

John Bush – Vice President, Marketing. Mr. Bush joined the Company in January 1997 bringing over 11 years of telecommunications experience gained through progressively senior positions held at ACC TelEnterprises, AT&T Canada and The Fax Network. Prior to joining the Company, Mr. Bush was Vice-President, Marketing for ACC TelEnterprises, an international telecommunications company. Mr. Bush holds a degree in Business and Economics from the University of Western Ontario.

Denis Choquette – Vice President, Corporate Development. Mr. Choquette is responsible for identifying and developing *i*STAR's strategic relationships with other key businesses to bring the next generation of Internet-based products and services to market. Mr. Choquette initially joined the Company as Vice President, Eastern Region Sales responsible for Quebec, New Brunswick, Prince Edward Island, Nova Scotia and Newfoundland sales territories. Mr. Choquette has more than 14 years experience in the telecommunications and information technology sectors. Mr. Choquette began his career with IBM Canada Limited and prior to joining the Company held the position of Quebec Regional Manager with AT&T Paradyne. Mr. Choquette holds a Business degree completing his post graduate studies in M.I.S. and Finance.

Steve Doswell – Vice President, National Sales. Prior to his current role as Vice President National Sales, Mr. Doswell has held positions as Vice-President Ontario Region Sales, Sales Channels Manager and Toronto Branch Manager for the Company. He brings to *i*STAR over 15 years experience in a variety of sales, marketing, business development and management roles in the private sector. Prior to joining the Company in 1994, Mr. Doswell was responsible for marketing and sales management in North America, South American and Australia with Boart Canada Inc. Mr. Doswell holds an MBA and a degree in Commerce.

Margo Langford – Vice President, Legal Counsel. Ms. Langford brings over 15 years experience in the communications related industries of broadcasting, public relations and entertainment. Prior to joining the Company, Ms. Langford worked for multi-national sound recording companies as an international advisor on intellectual property litigation and criminal piracy cases. Ms. Langford holds an LL.B from the University of Ottawa and is called to the Ontario Bar.

Mel Mulligan – Vice President, Human Resources. Mr. Mulligan is responsible for the provision of national human resource and office management related strategies and services. Prior to joining the Company, Mr. Mulligan was a human resource consultant to a number of high technology companies. Mr. Mulligan was employed with Spar Aerospace Limited for a number of years in progressive human resource roles, most recently Leader, Organizational Development responsible for all aspects of human resources management which included a number of business acquisitions and organizational redesign projects. Prior to working in human resources management, Mr. Mulligan worked for both Spar and Northern Telecom Limited in program and manufacturing management roles and has an education background in both computer science and business commerce.

David Ralston - Executive Vice President, Operations. Prior to joining the Company, Mr. Ralston was Vice-President, Health & Services Sector of Bell Canada (Signature Service). From 1989 to 1992, Mr. Ralston was Director, National Accounts of Bell Canada (National Systems Group). Mr. Ralston brings more than 13 years of the telecommunications and networking experience in the public and private sectors to his new position. Mr. Ralston holds an undergraduate business degree from McGill University and has done graduate work in Artificial Intelligence at the University of Ottawa.

Committees of the Board of Directors

The board of directors of the Company has established audit, compensation and corporate governance committees. The audit committee consists of Dennis Bennie, Graham W. Savage and Robert L. Brooks and is responsible for reviewing the Company's financial statements and its internal controls, reviewing the work of the Company's independent auditors and reporting thereon to the board of directors. The compensation committee consists of David A. Galloway, Jack O. Kiervin, David Webster and Rainer Paduch and is responsible for reviewing the level and form of compensation payable to the executive officers of the Company and making recommendations with respect thereto to the board of directors. The compensation committee is also responsible for making recommendations to the board of directors with respect to the granting of stock options pursuant to the Company's stock option plan. The corporate governance committee consists of Jack O. Kiervin, David A. Galloway and Graham Savage and is responsible for administering the corporate governance guidelines set by the board of directors.

EXECUTIVE COMPENSATION

In order to provide an explanation of the Company's executive compensation program, the following tables are presented below: (i) the Summary Compensation Table; (ii) the Option Grant Table; and (iii) the Option Exercise and Year-End Values Table.

Summary Compensation Table

The following table sets forth information concerning the compensation of each person serving as Chief Executive Officer during fiscal 1997 and each of the four other most highly compensated executive officers of the Company.

Summary Compensation Table

		Annual Compensation			Long Term Compensation			
					Awards		Payouts	
Name and Principal Position	**Year**	**Salary ($)**	**Bonus ($)**	**Other Annual Compensation ($)**	**Securities Under Options/SARS Granted**	**Restricted Shares or Restricted Share Units ($)**	**LTIP Payouts ($)**	**All Other Compensation ($)**
Craig Wallace [1] President and Chief Executive Officer	1997	170,000	-	12,000	275,000	-	-	-
	1996	-	-	-	-	-	-	-
Rainer Paduch[2] Vice Chairman and Chief Technology Officer	1997	175,000	-	7,200	-	-	-	-
	1996	150,008	-	5,700	85,000	-	-	-
David Ralston Executive Vice President Operations	1997	172,654	-	9,600	60,000	-	-	-
	1996	37,692[3]	-	2,031	90,000	-	-	-
Steve Doswell Vice President National Sales	1997	112,692	-	7,200	50,000	-	-	-
	1996	214,589[4]		5,700	40,000	-	-	-
Denis Choquette Vice President Corporate Development	1997	108,000	-	12,411	40,000	-	-	-
	1996	48,461[5]	-	2,608	40,000[6]	-	-	-
Jerry Van Olst Vice President Customer Service	1997	105,000	15,000[7]	7,200	30,000	-	—	-
	1996	9,615[8]	-	692	40,000[9]	-	—	-

(1) Mr. Wallace was appointed Chief Executive Officer in January 1997.
(2) Mr. Paduch served as Chief Executive Officer until January 1997.
(3) Mr. Ralston joined the Company in March 1996
(4) Salary includes base salary and commissions.
(5) Mr. Choquette joined the Company in January 1996.
(6) Options granted upon Mr. Choquette joining the Company.
(7) Initial performance based hire signing bonus.
(8) Mr. Van Olst joined the Company in May 1996.
(9) Options granted upon Mr. Van Olst joining the Company.

The following table sets forth information concerning the grant of stock options to each of the named executive officers during the period from June 1, 1996 to May 31, 1997.

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Option Grants During the Period from June 1, 1996 to May 31, 1997 Individual Grants

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
Craig Wallace	125,000 150,000	9.4	$2.60 $7.95	$2.60 $7.95	March 20, 2002 May 30, 2001
David Ralston	60,000	4.5	$2.80	$2.80	March 14, 2002
Steve Doswell	40,000[(1)] 50,000	6.8	$6.37 $2.80	$4.95 $2.80	October 30, 2001 March 14, 2002
Denis Choquette	40,000	3.0	$2.80	$2.80	March 14, 2002
Jerry Van Olst	40,000[(1)] 30,000	5.3	$6.37 $2.80	$4.95 $2.80	October 30, 2001 March 14, 2002

(1) Issued pursuant to certain amendments to the Company's stock option plan. See "Options to Acquire Common Shares".

Option Exercise and Year-End Values Table

The following table sets forth information with respect to each of the named executive officers concerning the exercise of stock options during the period from June 1, 1996 to May 31, 1997 and concerning unexercised stock options held at May 31, 1997.

Aggregated Option Exercises During the Period from June 1, 1996 to May 31, 1997 and Option Values at May 31, 1997

Name	Securities Acquired on Exercise	Aggregate Value Realized ($)	Unexercised Options/SAR's at FY-End Exercisable/Unexercisable		Value of Unexercised in-the-Money Options/SAR's at FY-End ($) Exercisable/Unexercisable
Craig Wallace	Nil	Nil	56,944	218,056	Nil
Rainer N. Paduch	Nil	Nil	51,666[(1)]	33,334	Nil
David Ralston	Nil	Nil	37,495	112,505	Nil
Steve Doswell	Nil	Nil	2,777	87,223	Nil
Denis Choquette	Nil	Nil	17,777	62,223	Nil
Jerry Van Olst	Nil	Nil	1,666	68,334	Nil

(1) Includes 25,000 securities under options not under the Plan, granted August 10, 1995.

Compensation of Directors

Each director of the Company who is not also an employee of the Company receives an annual retainer of $5,000 for service on the board of directors and a fee of $500 for each meeting of the board of directors or board committee attended. Each chairman of a board committee receives an annual retainer of $3,000. The chairman of the board of directors and each chairman of a board committee receives a fee of $1,000 for each meeting attended.

Employment Agreements

The Company has entered into an employment agreement with Craig Wallace, President and Chief Executive Officer with *i*STAR, which provides for an annual salary of $170,000 plus a performance bonus of up to 100% of the annual salary. For the first three years of his employment with the Company, *i*STAR has guaranteed a minimum bonus award of $90,000 per annum to Mr. Wallace provided he remains in the employ of the Company on the bonus date. Mr. Wallace also received 150,000 options to purchase *i*STAR shares at the market price of the shares on the date of the agreement. In the event of termination of employment without cause, the Company has agreed to provide him with one year's base salary in lieu of notice. Should Mr. Wallace be terminated from the Company with cause, he shall not be entitled to notice or to severance pay. In the event of a change of control of the Company which reduces or impedes Mr. Wallace's ability to realize value in the public equity markets for the 150,000 *i*STAR stock options that he received under the employment agreement, the Company has agreed to purchase these stock options for the difference between $815,000 and the then value of the stock options. Under the agreement, the amount payable shall decline, on a straight line basis, by 25% per annum on each anniversary date from the commencement of Mr. Wallace's employment with the Company. The agreement restricts Mr. Wallace from competing with the Company for a period of 18 months after the termination of his employment with the Company.

The Company has entered into an employment agreement (the "Paduch Employment Agreement") with Rainer Paduch, Vice Chairman and Chief Technology Officer of *i*STAR, which provides for a minimum annual salary of $135,000 in 1996. The employment agreement expires on August 10, 2005. As of December 1, 1995, Mr. Paduch's salary increased to $175,000 per annum. Under the terms of the agreement, Mr. Paduch agreed to devote his full time and attention to carrying out the duties of his position. He also agreed to assign to the Company any present or future rights he may have in any invention made or conceived by him. In the event that Mr. Paduch's employment is terminated for cause or at his own discretion, Mr. Paduch's entitlement to salary and benefits will cease as of the effective date of termination. The Company also can terminate Mr. Paduch's employment without cause by making a lump sum payment to him of an amount equal to two years' base salary. Mr. Paduch is subject to a non-competition agreement with the Company pursuant to which he may not compete with the Company for a period of two years upon his ceasing to be a shareholder of the Company.

The Company also has entered into an employment agreement with David Ralston, Executive Vice President, Operations of *i*STAR, which provides for an annual salary of $140,000 plus a potential performance bonus of up to 100% of the annual salary. Mr. Ralston's annual salary later was increased and currently is set at $170,000. In the event of termination of employment without cause, the Company has agreed to provide Mr. Ralston with one year's compensation to be determined based on the previous year's compensation. Mr. Ralston may not compete with the Company for 18 months after the termination of his employment with the Company.

The Company also has entered into an employment agreement with Mr. Doswell which provides for an annual salary of $140,000 plus a potential performance bonus with eligibility and approval reviewed annually by the compensation committee. In the event of termination of employment without cause, the Company has agreed to provide Mr. Doswell with six month’s base salary continuance. Mr. Doswell may not compete with the Company for 6 months after the termination of his employment with the Company.

The Company also has entered into an employment agreement with Mr. Choquette which provides for an annual salary of $137,000 plus a potential performance bonus with eligibility and approval reviewed annually by the compensation committee. In the event of termination of employment without cause, the Company has agreed to provide Mr. Choquette with twelve month’s base salary continuance. Mr. Choquette may not compete with the Company for 12 months after the termination of his employment with the Company.

The Company also entered into an employment agreement with Mr. Jerry Van Olst, former Vice President Customer Service, providing for an annual salary of $100,000 plus a potential performance bonus annually defined and approved by the compensation committee. Mr. Van Olst’s annual salary later was increased to $110,000. Mr. Van Olst resigned from the Company in September 1997. Mr. Van Olst may not compete with the Company for 12 months after the termination of his employment with the Company.

The Company has entered into an employment agreement with John Brough, Executive Vice President and Chief Financial Officer of *i*STAR. The agreement provides for a base annual salary of $160,000 plus a potential bonus of up to 100% of the annual salary. Under the terms of the agreement, Mr. Brough agreed to devote his full time and attention to carrying out the duties of his position. Mr. Brough was granted 150,000 options to purchase *i*STAR shares. In the event that Mr. Brough's employment is terminated for cause or at his own discretion, his entitlement to salary and benefits will cease as of the effective date of termination. The Company can terminate Mr. Brough's employment without cause or notice by making a payment to him of an amount equal to one year's base salary plus benefits.

Directors' and Officers' Insurance

The Company has purchased liability insurance for the directors and officers of the Company. The aggregate annual premium for such insurance is approximately $127,000, no part of which is payable by the directors and officers of the Company. The annual insurance coverage under the policy is limited to $10 million per policy year. There is a $50,000 deductible provision for any claim made against the Company, but no deductible for claims made against any director or officer of the Company.

Key Man Insurance

The Company maintains key man insurance on Rainer Paduch in the amount of $2 million.

Indebtedness of Directors and Officers

The Company has assisted certain employees of the Company by providing interest-free loans for the purpose of exercising options to purchase Common Shares. The aggregate amount of such loans to all employees outstanding as at the date hereof is $66,500.

OPTIONS TO ACQUIRE COMMON SHARES

On September 19, 1995, the board of directors of the Company adopted a stock option plan (the "Plan") for directors, senior officers and other employees of the Company. The Plan was approved by shareholders of the Company on October 26, 1995. In October 1996, certain amendments to the Plan were approved by shareholders, raising the aggregate number of Common Shares reserved for issuance under the Plan from 1,725,000 Common Shares to 2,400,000 Common Shares and providing for the repricing of certain options previously granted. Employees and directors holding options have been offered the choice, until October 1997, to exchange options previously granted to them on a one-for-one basis for options with an exercise price of $6.37 each. Increasing the aggregate number Common Shares allowed the Company to grant Common Shares to all full time employees in March 1997 with the goal of aligning employees' interests with those of shareholders and further ensuring that all members of the Company work together to enhance share value.

The aggregate number of Common Shares authorized for issuance to any one person under the Plan (whether pursuant to options issued under the Plan or otherwise) may not exceed 5% of the Common Shares outstanding from time to time (on a non-diluted basis). The exercise price of the options shall be determined by the board of directors of the Company but shall not be less than the latest closing price for the Common Shares of the Company on a stock exchange on which the Common Shares of the Company are listed. Generally, options granted expire 3-5 years from the date of grant or such lesser period of time as the board of directors may approve. Options may be exercised in whole or in part any time after a date specified by the board of directors, upon 3 days notice to the Company. The options for directors, senior officers and employees granted on a five year basis vest over a three year period, as to one thirty-sixth each month commencing the month after the date of the grant of the options. The options for employees granted on a five year basis vest over a five year period, as to one-fifth each year commencing at the first anniversary of the date of the grant of the options. If an option holder ceases to be an employee of the Company by reason of death or voluntary resignation, or if an option holder who is a director ceases to be a director of the Company, vesting of options automatically ceases on the date of such death, voluntary resignation or ceasing to be a director and no options held by such holder may be exercised following the first anniversary of such date. If an option holder who is an employee is terminated for cause, no option held by such holder may be exercised and the option holder shall have no rights to any Common Shares in respect of such options following the date of notice of such termination. If an option holder who is an employee is terminated otherwise than for cause, for purposes of determining vesting, the employment of such option holder shall be deemed to be continued for such agreed upon or court-ordered period during which the employee has been granted salary in lieu of notice and options granted to such employee shall continue to vest during such period and any vested options would be exercisable until their expiry date.

OUTSTANDING OPTIONS

The following table summarizes the outstanding options in respect of Common Shares as at the date hereof:

	Common Shares under Options Granted [1]	Exercise Price ($ per Common Share)	Expiry Date	Market Value of the Common Shares on the date of Grant ($)
Executive Officers of *i*STAR (6 persons)	30,750	12.00	August 10, 2000	2.00
	20,000	12.00	September 19, 2000	3.40
	140,000	8.50	March 4, 2001	8.50
	150,000	7.95	May 30, 2001	7.95
	30,000	6.65	April 29, 2001	6.65
	80,000	6.37	October 30, 2001	4.95
	180,000	2.80	March 14, 2002	2.80
	125,000	2.60	March 20, 2002	2.60
	15,750	12.00	August 10, 2000	2.00
	20,000	2.10	June 5, 2002	2.10
Directors and Executives of *i*STAR other than above noted Executive Officers (12 persons)	20,000	12.00	September 19, 2000	3.40
	130,000	8.50	March 4, 2001	8.50
	20,000	6.75	April 9, 2001	6.75
	68,750	6.37	October 30, 2001	4.95
	150,000	4.10	September 23, 2001	4.10
	210,000	2.80	March 14, 2002	2.80
	90,000	2.45	April 1, 2002	2.45
Employees of *i*STAR	20,000	8.50	March 4, 2001	8.50
	12,500	8.25	May 13, 2001	8.25
	10,000	7.95	May 30, 2001	7.95
	2,000	6.75	April 9, 2001	6.75
	20,000	6.37	October 30, 2001	4.95
	385,950	2.80	March 14, 2002	2.80
	2,000	2.48	April 7, 2002	2.48
	3,500	2.45	April 1, 2002	2.45
	11,000	2.25	May 5, 2002	2.25
	3,000	2.20	May 20, 2002	2.20
	10,000	2.65	July 14, 2002	2.65
	7,000	2.60	July 20, 2002	2.60

Others:				
John Albright	4,444	12.00	September 19, 2000	3.40
	5,750	12.00	August 10, 2000	2.00
Osamah Arafat	13,750	12.00	September 13, 2000	3.40
Eric Carroll	5,000	12.00	September 19, 2000	3.40
John Cryer	6,000	8.50	March 4, 2001	8.50
John Cryer	2,000	6.75	April 9, 2001	6.75
Laura Dierker	4,000	8.50	March 4, 2001	8.50
Michael Dow	6,111	12.00	September 19, 2000	3.40
David Ellis	11,666	12.00	September 19, 2000	3.40
David Ellis	6,076	12.00	August 10, 2000	2.00
David Ellis	20,000	8.50	March 4, 2001	8.50
Jefferson Partners Capital Incorporated	5,000	12.00	August 10, 2000	2.00
Stuart Lombard	13,750	12.00	September 13, 2000	3.40
Thomas Marrocco	6,111	12.00	September 19, 2000	3.40
Mike Martineau	11,111	12.00	September 19, 2000	3.40
Mike Martineau	5,333	8.50	March 4, 2001	8.50
Michael Patterson	3,333	12.00	September 19, 2000	3.40
Tracy Reiter	4,333	8.50	March 4, 2001	8.50
Gary Rubinoff	2,750	12.00	August 10, 2000	2.00
Barry Wilson	3,819	7.95	May 30, 2001	7.95
TOTAL	2,107,537			

(1) Of the total of 2,107,537 Common Shares issued under options granted, 2,047,537 have been granted pursuant to the Plan.

Other Options

Pursuant to the prospectus of the Company dated October 29, 1996, the Company has issued 1,450,000 warrants to purchase Common Shares at a price of $6.75 per Common Share. The warrants expire on November 12, 1997.

On September 24, 1996, the Company issued 366,750 warrants to purchase Common Shares to The Bank of Nova Scotia. See “Prior Sales”. As at the date hereof, 48,107 warrants are outstanding. The warrants expire on September 28, 1998.

EMPLOYEE SHARE OWNERSHIP PROGRAM

On October 26, 1995, the board of directors of the Company established an employee share ownership program (the "Share Ownership Program") to enable eligible employees of the Company to acquire Common Shares of *i*STAR in the open market. Only employees who have completed at least three months of continuous service with the Company are eligible to participate in the Share Ownership Program and participation is entirely voluntary.

Participants contribute a minimum of $20.00 bi-weekly and a maximum of the lesser of $25,000 in any calendar year or 6% of the participant's salary, which includes base salary and commissions. The Company contributes to the Share Ownership Program in respect of a participant an amount equal to one-third of the contributions of the participant. All contributions are held in a trust account for each participant and must be invested by the account trustee solely in Common Shares of *i*STAR. These shares may be acquired only in open market transactions and may not be acquired directly from the Company.

Generally, participants may not transfer any shares purchased by the trustee for the participant for a period of one year following such purchase. These transfer restrictions do not apply, however, if there is a bona fide offer from a third party to acquire all of the issued and outstanding shares of the Company, or upon the termination of the employment of the participant.

PRINCIPAL SHAREHOLDERS

To the knowledge of the Company, no person owns beneficially, directly or indirectly, or exercises control or direction over more than 10% of the outstanding Common Shares as of the date hereof.

To the knowledge of the Company and based on information provided by them, the directors and senior officers of *i*STAR and their associates owned on the date hereof, beneficially or of record, directly or indirectly, or exercised control or direction over 1,367,209 Common Shares (representing approximately 5.6% of the outstanding Common Shares (excluding the 2,220,869 Common Shares indirectly held by the Company), approximately 4.7% after giving effect to the exercise or deemed exercise of the Special Warrants and the Lenders' Warrants).

INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

David Webster, a director of the Company, is also a director of and indirectly owns approximately 14% of Software Kinetics, a systems engineering company with which the Company has a strategic alliance. Rainer Paduch, a director and Chief Technology Officer of the Company, is also a director and owns approximately 3.4% of MilkyWay, a software distributor with which the Company has a strategic alliance. The Company has a consulting agreement with Jefferson Partners Capital Incorporated ("Jefferson") under which the Company pays a monthly consulting fee to Jefferson of $11,250. During fiscal 1997, the Company paid consulting fees of $244,549 (1996 - $517,904) to Jefferson. Jack Kiervin is a director of *i*STAR and is the Chairman of Jefferson. David Folk is a director of *i*STAR and is the President and Chief Executive Officer of Jefferson. The Company has entered into a credit facility agreement with The Bank of Nova Scotia and Jefferson. Robert Brooks is a director of *i*STAR and is the Executive Vice President, Investment Banking of The Bank of Nova Scotia.

ESCROW ARRANGEMENTS

In connection with *i*STAR's initial public offering, Jefferson, Whitepine Software Inc. and Rainer Paduch (the "Escrowed Shareholders") entered into an agreement (the "Escrow Agreement") with *i*STAR and Montreal Trust Company of Canada (the "Escrow Agent"), pursuant to which the Escrowed Shareholders deposited with the Escrow Agent 2,137,958 Common Shares, 1,285,632 Common Shares and 1,076,950 Common Shares, respectively (collectively, the "Escrow Shares").

10% of the Escrow Shares were released to the Escrowed Shareholders on August 14, 1996 (the "Initial Release"), 20% of the Escrow Shares will be released on each of the first, second and third anniversaries of the Initial Release, and the remaining 30% of the Escrow Shares will be released on the fourth anniversary of the Initial Release. As part of a statutory arrangement, the Escrow Shares of Jefferson were distributed to its shareholders (the "Jefferson Shareholders") on a pro rate basis on May 29, 1997. As of the date hereof, the Jefferson Shareholders, Whitepine Software Inc. and Rainer Paduch have 1,924,163 Common Shares, 1,157,069 Common Shares and 969,255 Common Shares deposited in escrow, respectively. Any release, other than in accordance with the above, shall only be made with the prior consent of the applicable securities regulatory authorities. The Escrow Shares may be pledged as security for indebtedness subject to the terms of the Escrow Agreement.

PRICE RANGE AND TRADING VOLUME

The Common Shares are listed on the Toronto Stock Exchange (the "TSE") under the symbol "WWW". The following table sets forth the reported high and low prices and trading volumes of the Common Shares on the TSE for the periods indicated:

	High	Low	Volume
1995			
November 27 – November 30	$17.75	$16.50	5,269,467
December – February 1996	$17.25	$8.63	8,845,805
1996			
March – May	$8.75	$5.50	5,048,378
June – August	$7.60	$3.40	5,660,276
September – November	$6.70	$3.85	8,078,410
December – February 1997	$4.75	$2.06	5,701,081
1997			
March	$3.10	$2.25	756,263
April	$2.50	$1.32	928,542
May	$2.53	$1.95	1,011,420
June	$2.35	$1.95	667,200
July	$3.95	$1.95	4,025,044
August (1 –15)	$2.50	$2.15	238,900

On August 15, 1997, the closing price of the Common Shares on the TSE was $2.20.

PRIOR SALES

The only sales by the Company of Common Shares or securities convertible into or carrying rights to acquire Common Shares during the preceding twelve months were as follows:

(1) On September 27, 1996, 2,072,275 Common Shares were issued for $4.10 per Common Share and warrants exercisable for up to 366,750 Common Shares at $4.10 per Common Share were issued pursuant to a purchase and subscription agreement dated September 27, 1996 between the Company and The Bank of Nova Scotia. On November 20, 1996, The Bank of Nova Scotia exercised 318,643 of these warrants. The Bank of Nova Scotia has the right to nominate one member for election to the Company's board of directors for so long as The Bank of Nova Scotia holds 5% or more of the outstanding Common Shares. It also has a pre-emptive right, for a period of two years, to maintain its percentage interest in the voting securities of the Company at the price at which such voting securities are issued by the Company, which right may be satisfied by the Company through the issuance of shares from treasury or through the delivery of a like number of shares;

(2) On November 12, 1996, 2,900,000 Common Shares and 1,450,000 warrants to purchase Common Shares at an exercise price of $6.75 per Common Share were issued pursuant to the prospectus of the Company dated October 29, 1996;

(3) On November 20, 1996, 318,643 Common Shares were issued for $4.10 per Common Share pursuant to the exercise of 318,643 warrants to purchase Common Shares by The Bank of Nova Scotia;

(4) On July 31, 1997, 4,500,000 Special Warrants were issued pursuant to the Underwriting Agreement at a price of $2.00 per Special Warrant. See "Private Placement and Plan of Distribution"; and

(5) On August 1, 1997, 100,000 Lenders' Warrants were issued pursuant to the BNS–Jefferson Credit Facility. See "Business of the Company - Recent Developments – BNS-Jefferson Credit Facility".

PRIVATE PLACEMENT AND PLAN OF DISTRIBUTION

Pursuant to the Underwriting Agreement, the Company sold a total of 4,500,000 Special Warrants at $2.00 per Special Warrant. The Special Warrants were sold to certain purchasers on a private placement basis pursuant to prospectus exemptions under applicable securities legislation. The Common Shares issuable on the exercise or deemed exercise of the Special Warrants will be qualified for distribution under this Prospectus.

The Special Warrants and the Common Shares issuable upon exercise of the Special Warrants have not been and will not be registered under the United States Securities Act of 1933, as amended (the "1933 Act"), and, subject to certain exceptions, may not be offered or sold within the United States.

The Special Warrants were created and issued under a special warrant indenture dated July 31, 1997 (the "Special Warrant Indenture") between the Company and Montreal Trust Company of Canada ("Montreal Trust"), as trustee (in such capacity, the "Trustee"). In the event that (i) the Underwriter has not been provided with notarial copies of receipts issued for this Prospectus, and given notice thereof to the Escrow Agent (as defined below), or (ii) the Company has not delivered notice to the Trustee and the Escrow Agent that a definitive NPA with Bell has been executed, in either case on or before the earlier of (i) October 24, 1997 and (ii) the date on which a written notice is provided by the Underwriter to the Company that the Underwriter has been made aware that a definitive NPA with Bell will not be executed on or before October 24, 1997 (the "Retraction Date"), the holders of the Special Warrants shall be entitled to a refund of the purchase price, and any interest earned thereon, of any or all of the Special Warrants held by them upon the return of the Special Warrant certificates in respect of such refunded Special Warrants and a refund election form before 5:00 p.m. (Toronto time) on October 31, 1997 (if the Retraction Date is October 24, 1997) or the fifth business day following the Retraction Date (if the Retraction Date is prior to October 24, 1997). Subject to the preceding sentence, each Special Warrant will be exercised or deemed exercised for one Common Share without additional cost on the fifth business day following (and subject to) the qualification for distribution of the Common Shares issuable on the exercise of the Special Warrants pursuant to receipts issued for the (final) prospectus by the Securities Commissions on or before October 31, 1997.

If a receipt has not been issued for this Prospectus by each of the Securities Commissions on or prior to October 31, 1997, each Special Warrant then outstanding will entitle the holder to receive 1.1 Common Shares per Special Warrant held. If a receipt for this Prospectus is not issued by the Securities Commissions on or before July 31, 1998, any Special Warrants which have not been exercised shall be deemed for all purposes to have been exercised by the holders thereof immediately prior to 5:00 p.m. (Toronto time) on the fourteenth day after such date. Subject to applicable securities legislation and regulations, a holder of Special Warrants may, prior to any deemed exercise thereof, exercise any or all of the then outstanding Special Warrants then held by it.

The net aggregate proceeds of the sale of the Special Warrants were placed in escrow pursuant to an escrow and custodial agreement (the "Escrow and Custodial Agreement") dated July 31, 1997, as amended by amending agreements dated September 3 and 4, 1997, among the Company, Montreal Trust, as escrow agent (in such capacity, the "Escrow Agent") and the Underwriter.

In the event that receipts are issued for this Prospectus by the Securities Commissions prior to the Retraction Date, the net aggregate proceeds of the sale of the Special Warrants, together with interest thereon, shall be released to the Company. In the event that a receipt has not been issued for this Prospectus by each of the Securities Commissions prior to the Retraction Date, the net aggregate proceeds, together with interest thereon, shall be released to the Company after all obligations to holders of Special Warrants, including any refund obligations, have been satisfied.

Upon payment of dividends on the Common Shares, the Company is required to deposit with the Escrow Agent an amount equal to the dividend per Common Share multiplied by the number of Special Warrants then outstanding. Holders of Special Warrants are entitled to receive, upon exercise or deemed exercise of a Special Warrant, payment of an amount equal to the dividend paid on one Common Share and all interest actually earned thereon.

This Prospectus also qualifies for distribution the Common Shares issuable upon the exercise or deemed exercise of the Lenders' Warrants. The Lenders' Warrants were created and issued under a lenders' warrant indenture dated August 1, 1997 (the "Lenders' Warrant Indenture") between the Company and Montreal Trust. Each Lenders' Warrant will be exercised or deemed exercised for one Common Share without additional cost on the fifth business day following (and subject to) the qualification for distribution of the Common Shares issuable on the exercise of the Lenders' Warrants pursuant to receipts issued for this Prospectus by the Securities Commissions on or before October 31, 1997.

If a receipt has not been issued for this Prospectus by each of the Securities Commissions at or prior to October 31, 1997, each Lenders' Warrant will entitle the holder to receive 1.1 Common Shares per Lenders' Warrant held. If a receipt for this Prospectus is not issued by the Securities Commissions on or before August 1, 1998, any Lenders' Warrants which have not been exercised shall be deemed for all purposes to have been exercised by the holder thereof immediately prior to 5:00 p.m. (Toronto time) on August 1, 1998. Subject to applicable securities legislation and regulations, a holder of Lenders' Warrants may, prior to any deemed exercise thereof, exercise any or all of the then outstanding Lenders' Warrants then held by it.

The Company is responsible for all costs and expenses associated with the operation and administration of the Special Warrant Indenture, the Escrow and Custodial Agreement and the Lenders' Warrant Indenture.

In connection with this offering, the Underwriter may over-allot or effect transactions which stabilize or maintain the market price of the Common Shares at levels other than those which might otherwise prevail on the open market. Such transactions, if commenced, may be discontinued at any time.

The Company has agreed not to offer, sell or otherwise dispose of any Common Shares or any securities convertible into or exercisable for Common Shares prior to the expiration of 90 days after the earlier of (i) the date on which a receipt for this Prospectus is issued by the last of the Securities Commissions and (ii) the Retraction Date.

USE OF PROCEEDS

The proceeds to the Company from the offering of the Special Warrants, after deducting the expenses of the issue payable by the Company, including the Underwriters' commission, are estimated to be approximately $8.2 million. From such net proceeds, the Company intends to repay the outstanding balance of the BNS–Jefferson Credit Facility, being $4 million. The remaining $4.2 million will be used to fund working capital requirements. See "Business of the Company – Recent Developments – BNS-Jefferson Credit Facility".

DILUTION

Special Warrant holders who acquire Common Shares will be subject to immediate dilution with respect to the price per Special Warrant compared to the consolidated net tangible book value of the Company per Common Share as at May 31, 1997. The following table sets forth the dilution per Common Share on a fully-diluted basis as at May 31, 1997:

Price per Special Warrant		$2.00
Net tangible book value as at May 31, 1997	$0.43	
Increase in net tangible value attributable to the offering(1)	0.23	
Net tangible book value after giving effect to the offering		0.66
Dilution to subscribers		$1.34
Percentage dilution in relation to offering price		67.2%

(1) After deducting the expenses of the offering and fees payable to the Underwriter. See "Use of Proceeds" and "Private Placement and Plan of Distribution".

DIVIDEND POLICY

*i*STAR has not in the past declared or paid dividends on the Common Shares. *i*STAR's current intention is to reinvest its earnings to finance the growth of its business. *i*STAR does not intend to pay dividends on its Common Shares in the foreseeable future.

MATERIAL CONTRACTS

Except for the contracts entered into in the ordinary course of business, the only material agreements or other contractual arrangements entered into by or on behalf of *i*STAR within the two years preceding the date of this prospectus are:

(a) the InfoRamp Share Purchase Agreement described under "Business of the Company – Acquisitions";

(b) the MIND LINK Share Purchase Agreement described under "Business of the Company – Acquisitions";

(c) the Wimsey Share Purchase Agreement described under "Business of the Company – Acquisitions";

(d) the CRS Asset Purchase Agreement described under "Business of the Company – Acquisitions";

(e) the Aurora Net Share Purchase Agreement described under "Business of the Company – Acquisitions";

(f) the Magi Data Share Purchase Agreement described under "Business of the Company - Acquisitions";

(g) the Escrow Agreement described under "Escrow Arrangements";

(h) the Option Plan described under "Options to Acquire Common Shares";

(i) the warrant indenture dated November 12, 1996 between the Company and Montreal Trust Company of Canada referred to under "Outstanding Options";

(j) the Purchase and Subscription Agreement between the Company and The Bank of Nova Scotia referred to under "Prior Sales";

(k) the Network Provisioning Agreement described under “Business of the Company – Recent Developments”;

(l) the BNS-Jefferson Credit Facility described under “Business of the Company – Recent Developments”;

(m) the Underwriting Agreement described under "Private Placement and Plan of Distribution";

(n) the Special Warrant Indenture described under “Private Placement and Plan of Distribution”;

(o) the Escrow and Custodial Agreement described under “Private Placement and Plan of Distribution”; and

(p) the Lenders’ Warrant Indenture described under “Private Placement and Plan of Distribution”.

Copies of each of the foregoing agreements may be examined during normal business hours at the principal office of *i*STAR, 250 Albert Street, Suite 202, Ottawa, Ontario, at any time during the course of the distribution of the Common Shares offered hereby.

RISK FACTORS

This is a speculative offering. The purchase of the Common Shares offered hereby involves a number of significant risk factors. Prospective investors should carefully consider each, and the cumulative effect of all of the risk factors set forth below.

Losses; Accumulated Deficit; Negative Cash Flow

*i*STAR has incurred net annual losses in each fiscal period since inception and has an accumulated deficit as at May 31, 1997 of approximately $75 million. The Company expects that it will continue to have negative earnings before depreciation and amortization until the end of the fourth quarter of fiscal 1998. Although the Company has experienced significant revenue growth in recent periods, there can be no assurance that the Company can continue to generate substantial revenue growth, or that any revenue growth that is achieved can be sustained. Accordingly, there can be no assurance that the Company will achieve or sustain profitability. If the Company cannot achieve profitability or positive cash flow from operating activities, it may not be able to meet its working capital requirements, which could result in bankruptcy of the Company. There can be no assurance that upon bankruptcy the Common Shares would have any value.

Competition; New Entrants

The market for Internet services is intensely competitive. The Company expects competition to persist and to intensify in the future as the markets for the Company's products continue to develop and as additional competitors enter each of its markets. Many Canadian telephone companies ("telcos") offer both dial and dedicated access services and some are engaging in aggressive price discounting to gain market share. Certain telcos have applied to the CRTC for permission to bundle their long distance telephone services with their Internet services. Other telcos may follow in these practices. A number of foreign ISPs have also commenced operations in Canada and may benefit from greater economies of scale than the Company. Many of these competitors have already gained significant market share, including Bell, UUNet Canada and a number of Stentor companies in the direct access market, and America Online, Compuserve and TotalNet in the dial access market. Certain companies also offer or have announced plans to offer Web site hosting services (Bell), Intranet services (Digital, Bell and IBM) and electronic commerce products (Bell and IBM).

The Company's products are the subject of intense industry interest and the Company is aware of numerous Internet Service Providers, telcos, computer companies, software developers and other companies that are focussing significant resources on developing and marketing products and services that will compete with the Company's products and services. Numerous releases of products and services that will compete with those of the Company can be expected in the near future. Other competitors may also emerge in these areas. To remain competitive, the Company may be forced to match prices and reduce costs.

In addition, many of the foregoing competitors have greater market presence, engineering and marketing capabilities and financial, technological and personnel resources than those available to the Company. Such competitors may be able to develop and adapt more quickly to new or emerging technologies and changes in customer requirements, take advantage of acquisition and other opportunities more readily, and devote greater resources to the marketing and sale of their products than can the Company. The Company's market position in the Canadian Internet access and commercial solutions markets could be adversely affected as competition increases and the market evolves.

Dependence Upon Development and Expansion of the Internet Access Market

A substantial majority of the Company's sales to date have been derived from the sale of Internet access products and services. The Company's success will continue to depend partly upon the development and expansion of the market for such products and services. This market has only recently developed. If it fails to grow further, grows more slowly than anticipated, or continues to be subjected to intense competitive pressures, the Company's business, financial condition and results of operations could be adversely affected.

Dependence Upon the Development and Expansion of the Commercial Internet Solutions Market

The Company's success in the solutions component of the Internet/Intranet commercial market will depend upon the continued development and expansion of the commercial market for Internet solutions and the networks that comprise the Internet as well as the extent to which Internet connectivity becomes critical to the achievement of the objectives of the Company's commercial customers. Certain key issues concerning the extensive use of the Internet by commercial customers, including data security, network reliability, ease and cost of access and quality of service remain unresolved and may impact the growth of Internet use by commercial customers. In particular, numerous published reports have indicated that a perceived lack of security of commercial data, such as credit card numbers, has significantly impeded commercial exploitation of the Internet to date, and there can be no assurance that encryption or other technologies will be developed that satisfactorily address these security concerns. The failure of the market for business-related Internet solutions to continue to develop could adversely impact the Company's business, financial condition and results of operations.

Unproven Acceptance of the Company's Electronic Commerce and Intranet Applications

To date, the Company's electronic commerce and Intranet applications have not generated any significant revenues. Although management believes that these two products will be very attractive to commercial customers, the marketing of such products is just beginning and there is no guarantee that the Company will be able to introduce these products within the expected time frames or that such products will gain market acceptance or that, if market acceptance is achieved, the Company will be able to maintain such acceptance for a significant period of time. Neither can there be any assurance that commerce over the Internet or the adoption of Intranets will become widespread. *i*STAR has developed alliances with certain organizations in connection with its Intranet and electronic commerce products and services, including an alliance with three Canadian chartered banks in respect of *i*COMMERCE. There can be no assurance that such alliances can be maintained. The failure to maintain such alliances could have a material adverse effect upon the Company's ability to market successfully its Intranet and electronic commerce products and services. Further, it is not yet clear that *i*STAR will be able to successfully undertake Intranet and electronic commerce products and services without developing additional strategic alliances and partners.

Limited Operating History

The Company has a limited operating history. Although the Company has experienced significant growth, in view of the Company's short operating history, the rapidly changing nature of the Internet access and solutions markets and the uncertainty of acceptance of the Company's current products and products planned or in development, there can be no assurance of sustained growth or future profitability.

Dependence Upon Market Channels and Alliances

*i*STAR plans to grow the dial and dedicated connection businesses as the Company believes it will reach profitability only if it can generate higher revenues. As a result, the Company is dependent on its three channels to market: distributors such as Novell Networks; telesales, both internal and external to the Company; and direct sales staff. There can be no assurance that the strategic distribution alliances developed by the Company can be maintained.

Government Regulation

The Company is not currently subject to direct regulation by the CRTC or Provincial regulatory agencies, or any other agency, other than regulations applicable to businesses generally. Changes in the regulatory environment relating to the Internet access industry, including regulatory changes which directly or indirectly affect telecommunication costs or increase the likelihood or scope of competition from regional telephone companies or others, could have a positive or an adverse effect on the Company's business. Further, there can be no assurance that the Government of Canada will continue to safeguard adequately against non-compensatory pricing by the telcos and the cable companies, nor that the other services those companies offer will not cross-subsidize their Internet offerings. *i*STAR may be forced to lower prices to remain competitive. In addition, while *i*STAR has investigated providing Internet services over satellite, cable modem, wireless or LMCS (known as "wireless cable"), it is currently dependent on leased telephone lines over which it offers its backbone service. The Company would be impacted negatively by increases in the cost of the underlying telecommunications lines.

Dependence Upon Leased Facilities

The Company has leased over $20 million worth of computer and telecommunications equipment for periods up to 30 months at implicit rates of interest ranging from 8% to 14%. The expansion of telecommunications traffic through the Company's network and communications infrastructure will continue to require the leasing of additional equipment. There is no assurance that further leasing facilities will be forthcoming from Comdisco, GE Capital Leasing or other lessors to support such expansion.

Future Capital Needs

*i*STAR may need to raise funds through public or private debt or equity financing in the event that the Company's estimates of operating losses and capital requirements change, or prove inaccurate, or in order for the Company to respond to unanticipated competitive pressures or to take advantage of unanticipated opportunities. There can be no assurance that additional financing will be available on terms favourable to the Company, or at all. If adequate funds are not available or are not available on acceptable terms, the Company may not be able to continue its network expansion to take advantage of market opportunities, to develop new products or otherwise to respond to competitive pressures or continue to be viable. Such inability could have a material adverse effect on the Company's business, financial condition and results of operations.

Risk of Damage, Interruption or System Failure; Security Risk

The Company's operations are dependent on its ability to protect its network infrastructure against damage from fire, earthquakes, severe flooding, power loss, telecommunications failures and similar events. While it maintains eight computer rooms which are partially capable of backing up each other, a significant portion of the Company's computer equipment, including components critical to the operation of its Internet backbone, are located at the Company's leased facilities in Ottawa and Toronto. Some ISPs have experienced interruptions in service as a result of the accidental or intentional actions of Internet users. Interruptions of *i*STAR's service may occur in the future. There may also be incidents of hackers bypassing firewalls and obtaining access to unencrypted information. Despite industry-standard network security in use by the Company, unauthorized use of the Company's network could jeopardize the security of confidential information stored in the computer systems of the Company and its customers, which may result in liability of the Company to its customers or deter potential subscribers. The Company is dependent on routing, switching and processing equipment primarily from Cisco, Sun Microsystems and U.S. Robotics which is evolving and being upgraded continually. Similarly *i*STAR is intending to use MilkyWay firewalls for Intranets and an Open Market software engine for electronic commerce transaction processing. *i*STAR is at risk that such equipment, and software running over it, may not be available in sufficient quantities nor operate according to its specifications. The failure of the Company to adequately manage service disruptions resulting from physical damage to its network, or breaches of or failures in the network's integrity, could have a material adverse impact on the Company's business, financial condition and results of operations.

Dependence on Key Personnel

The Company's success will depend upon the continued service of its senior management team and its technical, marketing and sales personnel. The Company's employees may voluntarily terminate their employment with the Company at any time, and competition for qualified employees in the Internet industry is intense. The senior executives do, however, have employment agreements with the Company. Although these employment agreements contain non-competition and non-disclosure agreements, there can be no assurance that these provisions will be enforceable in whole or in part. The loss of the services of key personnel could have a material adverse effect upon the Company's business, financial condition and results of operations. Programs are in place to retain and motivate employees. The Company maintains key man insurance on Rainer Paduch in the amount of $2 million.

Liability for Information Retrieval from the Internet

The law relating to the liability of on-line service providers for information carried on or disseminated through the facilities of their networks is currently unsettled. *i*STAR could be held liable for copyright and trademark infringement or have a criminal penalty or civil liability imposed for transmitting certain types of information and content, such as indecent or obscene communications. *i*STAR has implemented a process for managing content complaints in accordance with the Canadian Association of Internet Providers' Code of Conduct.

Need to Manage Growth and Expansion

The rapid growth of the Company's business and its products and services has placed, and is expected to continue to place, significant demands on the Company's managerial, operational and accounting resources. Demands on the Company's operational and accounting information systems and controls, including its billing, accounts receivable and payable tracking and other accounting systems, have grown rapidly with the Company's expanding customer base. In the past, the Company has experienced difficulties in billing its customers and pursuing delinquent accounts receivable balances. *i*STAR has taken significant actions to upgrade and improve its accounting systems and controls and billings/receivables but additional actions may be required as the Company grows.

Increasing demands for the Company's Internet solutions and related customer support services have created demands on the product development, engineering and customer services personnel. The Company has in the past experienced difficulties making installations on a timely basis and providing adequate customer support. Although the Company has hired additional support and customer service personnel, engaged backup service bureaus and established a Network Management Center available 24 hours a day, 7 days a week, 365 days a year, customer service continues to require diligent review.

Risks of Technology Trends and Evolving Industry Standards

The Internet industry is characterized by rapidly changing technology and evolving industry standards, changes in customer needs, emerging competition and frequent new product and service introductions. The Company's future success will depend, in part, on its ability to effectively use leading technologies, to continue to develop its technical expertise, to enhance its current services and to develop new services which meet changing customer needs on a timely and cost-effective basis. There can be no assurance that the Company will be successful in effectively using new technologies, identifying and developing new products or enhancing its existing services on a timely basis or that such new technologies, products or enhancements will achieve market acceptance.

Dilution

Special Warrantholders who acquire Common Shares will suffer an immediate and substantial dilution in the net tangible book value of the Common Shares with respect to the price per Special Warrant. See "Dilution".

LEGAL MATTERS

The only material legal proceeding involving the Company or its property as at the date of this prospectus involves a lawsuit commenced by Chrism Technology Inc. ("Chrism") in the

Ontario Court of Justice (General Division) against the Company in April of 1996. The action alleges breach of contract and claims damages in the amount of $5 million, together with an accounting of profits made as a result of an alleged breach of the exclusivity provision of the contract. *i*STAR and Chrism had entered into a contract in 1995 in which they agreed to work together to define, design, develop, implement and market real estate related services on the Internet to RE/MAX Ontario-Atlantic Inc. *i*STAR agreed to set up a master RE/MAX home page and to provide Internet services to RE/MAX brokers and agents. In its lawsuit, Chrism alleges, among other things, that *i*STAR did not have the technical capability to fulfil its obligations to Chrism and misrepresented its capabilities. *i*STAR has filed a statement of defence and has counterclaimed against Chrism for breach of contract, defamation and intentional interference with *i*STAR's economic relations. *i*STAR has counterclaimed for damages in excess of $6.5 million. *i*STAR believes that it fulfilled its obligations under the contract. Documents have been exchanged and plaintiff's discoveries are nearly complete. Accordingly, the Company is not yet in a position to assess the likelihood of success of the action or of the Company's counterclaim. No other material proceedings are known by the Company to be contemplated.

Certain other legal matters relating to the issue and sale of the Common Shares offered and qualified hereby will be passed upon on behalf of the Company by Stikeman, Elliott and on behalf of the Underwriter by Ogilvy Renault.

AUDITORS, TRANSFER AGENT AND REGISTRAR

The auditors of the Company are KPMG, Chartered Accountants, located at Ottawa, Ontario.

The registrar and transfer agent for the Common Shares is Montreal Trust Company of Canada, at its principal office in Toronto. Montreal Trust Company of Canada is the Trustee under the Special Warrant Indenture and the Lenders' Warrant Trustee under the Lenders' Warrant Indenture.

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 a Special Warrant as provided for in this Prospectus is or becomes entitled to the remedy of rescission by reason of this Prospectus or any amendment thereto containing a misrepresentation, under a subscription agreement between such holder and the Company, such holder shall be entitled to rescission not only of the holder's exercise of its Special Warrant(s) but also for the private placement transaction pursuant to which the Special Warrant(s) was initially acquired, and shall be entitled, in connection with such rescission, to a full refund of all consideration paid on the acquisition of the Special Warrant(s). In the event the 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 granted hereunder as if the 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 Securities Act (Ontario) or otherwise at law.

PURCHASERS' STATUTORY RIGHTS

Securities legislation in certain of the provinces 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, 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, but such remedies must be exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province. 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 adviser.

GLOSSARY

Term	**Definition**
ATM	Asynchronous Transfer Mode. An information transfer standard which is one of a general class of packet technologies which relays traffic by way of an address contained within the first five bytes of a standard fifty-three byte-long packet or cell. The ATM format can be used by many different information systems, including LANs, to deliver traffic at varying rates, permitting a mix of data, voice and video.
backbone	A centralized high-speed network that connects smaller, independent networks.
bandwidth	The number of bits of information which can move over a communications medium in a given amount of time.
CRTC	Canadian Radio-television and Telecommunications Commission.
Comdex	A series of major computer shows held across North America.
DB2	IBM mainframe relational database.
dedicated telephone circuits	Telecommunications lines dedicated or reserved for use by particular customers along predetermined routes.
electronic mail or e-mail	An application that allows a user to send or receive text messages to or from any other user with an Internet address, commonly termed an e-mail address.
firewall	A gateway between two networks that buffers and screens all information that passes between such networks.
Frame Relay	An interface standard that defines how computing devices connect to a data network which is optimized for the transport of data packets. Though similar in concept to X.25, frame relay shifts responsibility for data integrity away from the network and onto the end computing devices. The shift is possible due to the inherently reliable nature of today's digital transmission networks.
FTP	File Transfer Protocol. A protocol that allows file transfer between two computers.
help desk	A toll-free telephone service provided by *i*STAR for the purpose of answering technical questions of customers.
home page	A Web site's introductory information page.
host	A computer with direct access to the Internet.
HTML	Hypertext Markup Language used to produce Web pages. It is a method of presenting information where selected words can be "expanded" to provide other information about the word.

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Term	**Definition**
Internet	An open global network of interconnected commercial, educational and governmental computer networks which utilize a common communications protocol, TCP/IP.
Intranet	A TCP/IP based network and Web site which is securely isolated from the Internet by a firewall and serves the internal needs of a company or institution.
ISDN	Integrated Services Digital Network. A digital network that combines voice and digital network services through a single medium, making it possible to offer customers digital data services as well as voice connections.
ISP	Internet service provider.
Kbps	Kilobits per second. A measure of digital information transmission rates. One kilobit equals 1,000 bits of digital information.
LAN	Local Area Network. A data communications network designed to interconnect personal computers, workstations, minicomputers, file servers and other communications and computing devices within a localized environment.
Mbps	Megabits per second. A measure of digital information transmission rates. One megabit equals 1,000 kilobits.
modem	A piece of equipment that connects a computer to a transmission line (typically a telephone line.)
multicast	A point to multipoint narrow casting (private) or broadcasting (public) distribution method for constant bit information such as radio or video.
network	A collection of distributed computers which share data and information through inter-connected lines of communication.
Netscape	Refers to both a company and the publicly available World Wide Web browser produced by that Company.
on-line services	Commercial information services that offer a computer user access through a modem to a specified slate of information, entertainment and communications menus. These services are generally closed systems, though many are now offering full Internet access.
Points of presence or POPs	An interlinked group of modems, routers and other computer equipment, located in a particular city or metropolitan area, that allows a nearby subscriber to access the Internet through a local telephone call or using a short-distance permanent data circuit.
protocol	A formal description of message formats and the rules two or more machines must follow in order to exchange such messages.

Term	Definition
router	A device that receives and transmits data packets between segments in a network or different networks.
server	Software that allows a computer to offer a service to another computer. Other computers contact the server program by means of matching client software. In addition, such term means the computer on which server software runs.
TCP/IP	Transmission Control Protocol/Internet Protocol. A compilation of network and transport-level protocols that allow computers with different architectures and operating system software to communicate with other computers on the Internet.
T1	A data communications line capable of transmission speeds of 1.54 Mbps.
T3	A data communications line capable of transmission speeds of 45 Mbps.
Web or World Wide Web	A network of computer servers that uses a special communications protocol to link different servers throughout the Internet and permits communication of graphics, video and sound.
Web sites or Web pages	A site located on the Web, written in the HTML or SGML language. See "home page", above.
Windows	A computer operating system developed by Microsoft Corp. that provides a graphical user interface and multitasking capabilities for use with personal computers.
Web server	The computer system that runs Web software, used to create custom Web sites, Web pages, and home pages.
workflow	An application feature added to an Intranet to control and support document distribution through licensed software.

AUDITORS' REPORT

We have audited the consolidated balance sheets of *i*STAR *internet inc.* as at May 31, 1997 and 1996 and the consolidated statements of operations and deficit and changes in financial position for the years ended May 31, 1997 and 1996 and for the period from the date of incorporation on June 30, 1994 to May 31, 1995. 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years ended May 31, 1997 and 1996 and for the period from the date of incorporation on June 30, 1994 to May 31, 1995 in accordance with generally accepted accounting principles.

Ottawa, Canada KPMG

July 10, 1997, except for note 18, which is as at August 29, 1997. Chartered Accountants

*i*STAR *internet inc.*

Consolidated Balance Sheets

May 31, 1997 and 1996
(In thousands of dollars)

	1997	1996
Assets		
Current assets:		
Cash and marketable securities (note 3)	$ 12,073	$ 16,733
Accounts receivable (note 4)	10,027	8,595
Inventory	371	284
Other assets (note 5)	606	731
	23,077	26,343
Property and equipment (note 6)	16,343	12,640
Customer lists and goodwill (notes 2 and 7)	-	16,497
	$ 39,420	$ 55,480
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank indebtedness (note 8)	$ 3,500	$ -
Accounts payable and accrued liabilities	14,829	10,310
Deferred revenue	1,630	1,858
Current portion of capital lease obligations	3,139	1,999
	23,098	14,167
Capital lease obligations (note 9)	4,540	1,730
Deferred leasehold inducements	710	321
Shareholders' equity:		
Share capital (note 10)	83,015	55,656
Share purchase warrants (note 10(d))	218	2,013
Contributed surplus (note 10(e))	2,871	2,871
Deficit	(75,032)	(21,278)
	11,072	39,262
Commitments (note 11)		
Contingencies (note 12)		
	$ 39,420	$ 55,480

See accompanying notes to consolidated financial statements
On behalf of the Board:

(Signed) Jack O. Kiervin, Director

(Signed) Robert L. Brooks, Director

*i*STAR *internet inc.*

Consolidated Statements of Operations and Deficit

Years ended May 31, 1997 and 1996, and the period from June 30, 1994 to May 31, 1995
(In thousands of dollars, except per share amounts)

	1997	1996	1995
Sales	$ 34,043	$ 19,405	$ 1,538
Cost of sales	30,558	13,596	943
Gross margin	3,485	5,809	595
Selling, general and administration expenses	32,624	22,147	1,210
Operating loss before undernoted items	(29,139)	(16,338)	(615)
Depreciation and amortization	6,519	2,947	219
Interest and bank charges, net (note 9)	113	(546)	6
Operating loss before non-recurring charges	(35,771)	(18,739)	(840)
Integration costs	585	1,699	-
Write-off of customer lists and goodwill (note 7)	17,398	-	-
Net loss	(53,754)	(20,438)	(840)
Deficit, beginning of period	(21,278)	(840)	-
Deficit, end of period	$ (75,032)	$ (21,278)	$ (840)
Net loss per share (note 14)	$ (2.42)	$ (1.70)	$ (0.67)

See accompanying notes to consolidated financial statements

*i*STAR *internet inc.*

Consolidated Statements Of Changes In Financial Position

Years ended May 31, 1997 and 1996 and the period from June 30, 1994 to May 31, 1995
(In thousands of dollars)

	1997	1996	1995
Cash provided by (used in):			
Operations:			
Net loss	$(53,754)	$(20,438)	$ (840)
Add non-cash items:			
Depreciation and amortization	6,519	2,947	219
Write-off of customer lists and goodwill	17,398	-	-
Non-cash operating working capital	3,286	(381)	1,642
	(26,551)	(17,872)	1,021
Financing:			
Common shares and warrants issued, net of issue costs	25,564	57,245	424
Capital lease obligations, net	3,950	3,457	68
Due from related parties	-	(373)	-
Payments on long-term debt, net	-	(578)	-
Contributed surplus	-	2,871	-
	29,514	62,622	492
Investing:			
Purchase of property and equipment	(8,635)	(10,158)	(1,451)
Acquisition of companies and businesses	(2,488)	(17,921)	-
	(11,123)	(28,079)	(1,451)
Increase (decrease) in cash position	(8,160)	16,671	62
Cash position, beginning of period	16,733	62	-
Cash position, end of period	$8,573	$16,733	$ 62

Cash position is defined as cash and marketable securities less bank indebtedness.

See accompanying notes to consolidated financial statements.

*i*STAR *internet inc.* provides advanced Internet services for businesses, institutions, and individuals. The Company provides customers with a range of networking expertise and Web-based products and services including business solutions with high-speed connection to the Internet through a national backbone network.

1. Summary of significant accounting policies:

(a) Basis of consolidation:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated on consolidation.

(b) Marketable securities:

Marketable securities are stated at cost, which approximates market value.

(c) Inventory:

Inventory is stated at the lower of cost and net realizable value.

(d) Property and equipment:

Property and equipment is stated at cost. Depreciation and amortization are provided on the straight-line basis using the following annual rates:

Asset Type	Rate
Computer and network equipment	33%
Computer software	50%
Furniture and equipment	20%
Leasehold improvements	16.67%
Trade show equipment	50%

(e) Customer lists and goodwill:

Customer lists and goodwill represent the excess of the purchase price of acquired companies and businesses over the fair value assigned to the identifiable net assets acquired. Customer lists and goodwill are being amortized on a straight-line basis over a 12 year period. On an ongoing basis, management reviews the valuation and amortization of customer lists and goodwill, taking into consideration any events and circumstances which might have impaired fair value. The amount of customer lists or goodwill impairment, if any, is measured based on management's estimate of fair value.

1. Summary of significant accounting policies (continued):

(f) Leases:

Leases are classified as either capital or operating in nature. Capital leases are those which substantially transfer the benefits and risks of ownership to the lessee. Assets acquired under capital leases are depreciated at the same rates as those described in note 1(d). Obligations recorded under capital leases are reduced by rental payments net of imputed interest.

(g) Deferred leasehold inducements:

The Company amortizes deferred leasehold inducements on a straight-line basis over the terms of the respective leases.

(h) Revenue recognition:

Revenues from dial-up access, direct connect, consulting and training services are recognized at the time services are rendered. Billings in advance of services are recorded as deferred revenue and recognized at the time services are rendered. Revenue from the sale of software, including sales to distributors and resellers, is recognized when the products are installed.

2. Acquisitions of companies and businesses:

On August 10, 1995, the Company amalgamated with NSTN Incorporated (NSTN), an Internet service provider operating primarily in Eastern Canada. This transaction has been accounted for by the purchase method with the results of operations of NSTN included in the Company's financial statements from the date of amalgamation.

During fiscal 1996, the Company acquired eight other companies and businesses engaged in providing Internet services. These acquisitions have been accounted for by the purchase method and the results of operations have been included from the respective dates of acquisition.

The total consideration provided by the Company in exchange for all the issued and outstanding shares of the companies and business assets acquired is as follows:

(All tabular amounts in thousands of dollars)

2. Acquisitions of companies and businesses (continued):

		May 31,1996
Net identifiable assets acquired:		
Non-cash current assets	$	2,001
Property, plant & equipment		3,241
Bank indebtedness		(295)
Due to related parties		(373)
Current liabilities		(3,789)
Long term debt		(613)
		172
Customer lists and goodwill		17,454
		$17,626
Consideration provided:		
Cash	$	8,094
Common shares (3,507,976.5 shares)		4,648
Contributed surplus		2,871
Performance warrants		2,013
	$	17,626

During 1997, additional common shares and share warrants in the amount of $2,089,606 were recorded for these acquisitions. At May 31, 1996, this consideration was contingent on certain events that were resolved during 1997. The additional consideration was recorded as an increase to customer lists and goodwill.

3. Cash and marketable securities:

Cash and marketable securities includes marketable securities of $6,281,663 (1996 - $14,676,792). The marketable securities mature within 30 days and bear interest at rates ranging from 2.75% to 3.05% (1996 - 4.75% to 5.05%).

4. Accounts receivable:

Included in accounts receivable is an allowance for doubtful accounts of $1,902,251 (1996 - $1,139,095).

(All tabular amounts in thousands of dollars)

5. Other assets:

	1997	1996
Prepaid expenses	$ 495	$ 520
Employee loans	111	211
	$ 606	$ 731

6. Property and equipment:

	Cost	Accumulated depreciation and amortization	1997 Net book value	1996 Net book value
Property under capital leases:				
Computer equipment	$ 10,510	$ 2,359	$ 8,151	$ 3,597
Furniture and equipment	536	107	429	536
Computer and network equipment	8,908	3,894	5,014	6,497
Computer software	1,862	649	1,213	445
Furniture and equipment	1,170	342	828	757
Leasehold improvements	803	167	636	634
Trade show equipment	204	132	72	174
	$ 23,993	$ 7,650	$ 16,343	$ 12,640

Cost and accumulated depreciation and amortization at May 31, 1996 amounted to $15,398,828 and $2,759,034, respectively.

7. Customer lists and goodwill:

Management has evaluated that there has been a permanent impairment in the fair value of customer lists and goodwill in that the future benefit is unlikely. This is due to many factors including the evolution of the Company from a provider of primarily access-related products to a provider of business solutions products and services. Therefore, the entire balance of $17,398,250 has been written off.

(All tabular amounts in thousands of dollars)

8. Bank indebtedness:

Bank indebtedness comprises an operating loan in the amount of $3,500,000 that was repaid in June 1997 (note 18(c)).

9. Capital lease obligations:

	1997	1996
1997	$ -	$ 2,294
1998	3,676	1,485
1999	3,345	200
2000	1,757	145
2001	67	83
Total minimum lease payments	8,845	4,207
Less amount representing interest at an average rate of 9.3%	1,166	478
Present value of minimum lease payments	7,679	3,729
Current portion of obligations under capital leases	3,139	1,999
	$ 4,540	$ 1,730

Included in interest and bank charges is interest on capital lease obligations of $276,254 (1996 - $202,119; 1995 - $4,458).

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10. Share capital:

The number of shares and amounts per share in these financial statements have been retroactively adjusted to give effect to a 2.5 for 1 share split, pursuant to articles of amendment filed on November 9, 1995.

(a) Authorized:

The Company has an unlimited number of authorized common shares.

(All tabular amounts in thousands of dollars)

10. Share capital (continued):

(b) Issued:

The Company's common share transactions are as follows:

	Number of Shares		Amount
Issued for cash	1,818,787.5	$	424
Balance, May 31, 1995	1,818,787.5		424
Issued:			
For cash in initial public offering, net of issue costs	3,275,980.0		35,508
On conversion of special warrants, net of issue costs	6,000,000.0		11,078
For acquisitions	3,507,976.5		4,648
For cash	2,661,212.5		3,156
On conversion of options	300,000.0		600
To employees, directors	1,295,814.0		242
Balance, May 31, 1996	18,859,770.5	$	55,656
Issued:			
For cash in public and private offerings, net of issue costs	5,290,918.0		23,720
On conversion of share purchase warrants	289,853.5		2,008
On conversion of performance and litigation awards	174,437.0		1,631
Balance, May 31, 1997	24,614,979.0	$	83,015

On May 29, 1997, the Company issued 2,220,869 common shares in exchange for all of the outstanding shares of a corporation in which two of the Company's directors were shareholders. The only asset of this corporation is 2,220,869 *i*STAR *internet inc*. common shares issued in previous periods. As a result of this transaction the Company indirectly holds *i*STAR *internet inc*. shares. These shares have been removed from the transaction summary provided above.

(c) Stock options:

At May 31, 1997, 2,070,537 options exercisable between $2.20 and $12.00 were outstanding. These options may be exercised between one month and 5 years from the date of grant.

(d) Warrants:

On September 24, 1996, the Company issued 366,750 warrants in connection with a private offering. At May 31, 1997, 48,107 warrants are outstanding and exercisable at a price of $4.10 per warrant until September 28, 1998.

On October 29, 1996, the Company issued 1,450,000 warrants in connection with the public offering. At May 31, 1997, these warrants are outstanding and exercisable at a price of $6.75 until November 12, 1997.

10. Share capital (continued):

(d) Warrants (continued):

At May 31, 1997, the Company has warrants outstanding and exercisable into 46,940 common shares relating to 1996 acquisitions.

(e) Contributed surplus:

The statutory amalgamation on August 10, 1995 of the Company and NSTN Incorporated resulted in contributed surplus of $2,871,199.

11. Commitments:

The Company is committed to payments under operating leases for office space and office equipment. Annual payments are: 1998 - $923,478; 1999 - $929,662; 2000 - $932,802; 2001 - $865,675; 2002 - $655,186; and $2,138,236 thereafter.

The Company is also committed to payments under operating leases for computer and network equipment. Annual payments are: 1998 - $3,420,247; 1999 - $3,230,011; and 2000 - $2,383,576.

12. Contingencies:

(a) The Company is the defendant and counter-claimant in a claim arising from the normal course of business. Since this claim is in its early stages, legal counsel cannot determine what the outcome will be. However, management expects that the financial impact arising from this claim will not be material.

(b) The Company has $2,875,000 of letters of credit outstanding in favour of three of its major suppliers.

13. Income taxes:

The Company has income tax losses of approximately $58,600,000 (1996 - $21,400,000; 1995 - $810,000) which include tax losses acquired on the acquisition of certain subsidiaries. These losses are generally available to reduce future taxable income up to 2004. The benefit of these losses has not been recognized in these financial statements.

14. Net loss per share:

The net loss per share figures are calculated based on the weighted average number of common shares outstanding of 22,224,230 shares (1996 - 12,053,453 shares; 1995 – 1,259,760 shares).

The potential exercise of stock options and warrants would not have a dilutive impact on the net loss per common share.

15. Related party transactions:

During the year ended May 31, 1997, the Company purchased $1,003,740 (1996 - $1,814,829; 1995 - $nil) of software, hardware and management services from a corporation in which a Company director is a shareholder.

The company paid consulting fees of $244,549 (1996 - $517,904; 1995 - $nil) to a corporation in which two of the Company's directors are shareholders.

During the year the Company purchased $982,374 (1996 - $618,278; 1995 - $240,000) of software and hardware from a corporation in which one of the corporation's shareholders is a director of the Company.

During the year, the Company purchased $63,036 (1996 - $nil; 1995 - $nil) of financial services from a corporation that is a shareholder and holds a seat on the board of directors of the Company. The Company also sold $252,688 (1996 - $nil; 1995 - $nil) of services to this corporation.

Included in accounts receivable as at May 31, 1997 are amounts due from related parties of $168,465 (1996 - $81,456). Included in accounts payable and accrued liabilities as at May 31, 1997 are amounts due to related parties of $473,198 (1996 - $828,705).

16. Segmented information:

Management has determined that the Company operates in one dominant industry segment, being commercially-focused Internet products, and in one dominant geographic segment, being Canada.

17. Financial instruments:

The carrying values of cash and marketable securities, accounts receivable, bank indebtedness, accounts payable and accrued liabilities and capital lease obligations approximate their fair values.

18. Subsequent events:

(a) Network Provisioning Agreement:

On August 29, 1997, the Company signed a networking provisioning agreement (NPA) with Bell Sygma Inc. to supply the Company with telecommunications facilities and services over five years. The fees for certain services performed by Bell Sygma Inc. between July 1, 1997 and June 30, 1999, up to $20,000,000, do not have to be paid prior to July 1, 1999 and are interest free. After this date, Bell Sygma Inc. has the right to demand repayment of the deferred fees on an interest free basis over the next three years in equal monthly installments.

The Company is obligated to pay Fonorola Inc. an amount which has not been finally determined but which is anticipated by the Company to be no more than $1,800,000, resulting from the early termination of the Company's supply agreement with Fonorola Inc. Under the NPA, Bell Sygma Inc. has agreed to pay 50% of this amount, which it will include in invoices to the Company in equal monthly amounts over the next five years.

(b) Special warrants:

On July 31, 1997, the Company issued 4,500,000 special warrants at a price of $2.00 each for proceeds of $9,000,000. Each special warrant is convertible without further payment into common shares of the Company on a one-for-one basis. The proceeds from the issuance of the special warrants will be held in escrow until a receipt is issued by the appropriate Canadian securities regulatory authorities for a final prospectus qualifying the issue of the underlying common shares. The receipt is expected to be issued on or before October 31, 1997. In the event that a receipt is not issued by this date, each special warrant will become exchangeable without additional payment for 1.1 common shares.

(c) Credit facility:

On August 1, 1997, the Company entered into a loan agreement with The Bank of Nova Scotia, Jefferson Partners Capital Limited and Jefferson Partners Holdco Inc. for up to $4,000,000. As at August 8, 1997, $2,000,000 was advanced and another $2,000,000 was advanced upon execution of the Network Provisioning Agreement (note 18(a)). The principal portion of the fees payable to the lenders for this facility is 200,000 warrants convertible into common shares for no additional consideration. This credit facility is secured by existing security in favour of The Bank of Nova Scotia and by a general assignment of book debts in favour of Jefferson Partners Capital Limited. The proceeds of the Special Warrants (note 18(b)) will be used to repay any amount outstanding under this facility.

CERTIFICATE OF THE COMPANY

Dated: September 8, 1997

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. This prospectus does not contain any misrepresentation likely to affect the value or the market price of the securities to be distributed, within the meaning of the securities laws of Quebec.

(Signed) CRAIG WALLACE
President and Chief Executive Officer

(Signed) JOHN A. BROUGH
Chief Financial Officer

On Behalf of The Board of Directors

(Signed) JACK O. KIERVIN
Director

(Signed) Robert L. Brooks
Director

CERTIFICATE OF THE UNDERWRITER

Dated: September 8, 1997

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 or referred to in this prospectus as required by Part XV of the Securities Act (Ontario) and the regulations thereunder. To our knowledge, this prospectus does not contain any misrepresentation likely to affect the value or the market price of the securities to be distributed, within the meaning of the securities laws of Quebec.

LÉVESQUE BEAUBIEN GEOFFRION INC.

By: (Signed) James A. McKinnell

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

LÉVESQUE BEAUBIEN GEOFFRION INC.: a wholly-owned subsidiary of Lévesque Beaubien and Company Inc., a majority-owned subsidiary of a Canadian bank.