

**Form 51-102F3**  
**Material Change Report**

**Item 1            Name and Address of Company**

**ADVANTEX MARKETING INTERNATIONAL INC.**  
491 Eglinton Avenue West, Third Floor  
Toronto, Ontario M5N 1A8

**Item 2            Date of Material Change**

September 14, 2005

**Item 3            News Release**

On September 14, 2005, a news release in respect of the material change was disseminated through Canada NewsWire, Canadian Disclosure Network.

**Item 4            Summary of Material Change**

The material change is described in the Company's press release attached hereto as Schedule "A", which press release is incorporated herein.

**Item 5            Full Description of Material Change**

No information other than that provided in Item 4 above is presently available.

**Item 6            Reliance on subsection 7.1(2) or (3) of National Instrument 51-102**

This report is not being filed on a confidential basis.

**Item 7            Omitted Information**

No information has been omitted.

**Item 8            Executive Officer**

Allison L. Smith, President

**Item 9            Date of Report**

DATED at Toronto, in the Province of Ontario, this 15<sup>th</sup> day of September, 2005.

**ADVANTEX MARKETING  
INTERNATIONAL INC.**

Per:           *"Allison L. Smith"*            
Allison L. Smith

SCHEDULE "A"



**ADVANTEX**

**NEWS RELEASE**

**ADVANTEX ANNOUNCES FISCAL 2005 RESULTS**

For Immediate Release  
ADX: TSX

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**Toronto, September 14, 2005**, - Advantex Marketing International Inc. (TSX:ADX) is pleased to report on the Company's performance for the fiscal year ended June 30, 2005.

Highlights and important developments of the year include:

- The sale of the Samplex Group, generating initial net proceeds of \$2.2 million
- Renewal of the Company's long-term agreement with CIBC
- Renewal of the long-term agreement with United Airlines for the Mileage Plus Online Mall
- *Strong performance in Online Shopping Mall programs*
- *Suspension of our U.S. Retail pilot programs and other initiatives, resulting in cost savings*
- *Gross Contribution percentage improvement to 10.5%, from 9.0% in fiscal 2004*

"We accomplished a great deal in fiscal 2005. It is our intention to build on these accomplishments, focusing on our merchant-based programs in Canada, and our Online Shopping Malls with major U.S. airlines," said G. Randall Munger, Chairman and Chief Executive Officer of Advantex. "Leveraging the businesses in which Advantex already enjoys a leadership position is clearly the most expedient way to reach profitability. New products and services will be introduced in fiscal 2006, designed specifically to enhance and grow these programs."

**Overall Performance**

*For the fiscal year ended June 30, 2005, Sales and Fees from continuing operations were \$71.8 million, compared with Sales and Fees of \$76.6 million in fiscal 2004. The change reflects the impact of migrating certain merchants during fiscal 2005 from a Pre-Purchase model whereby the Company pre-purchases future credit card transactions to a Post-Settlement model whereby the Company does not pre-purchase future credit card*

*transactions, reducing top-line revenue while having little impact on overall profitability. Also, Sales and Fees in fiscal 2004 included \$3.3 million from the Company's discontinued Canadian Retail Program, which was terminated at the end of Q2 2004, after Air Canada repudiated its commercial agreements with Advantex as part of the airline's restructuring process under the Companies' Creditor Arrangement Act (CCAA).*

*Gross Contribution percentage for fiscal 2005 was 10.5%, compared to 9.0% in the previous year, an improvement primarily due to increased merchant transaction fee rates earned in the Online Shopping Mall business from seasonal promotional campaigns.*

The Company's Net Loss improved by \$0.8 million or 45% over the previous year, from \$1.8 million (\$0.04 per share) in fiscal 2004 to \$1.0 million (\$0.02 per share) in fiscal 2005. The improvement reflects strong performance in Online Shopping Mall programs and cost savings associated with the suspension of the U.S. Credit Card Loyalty programs and other initiatives, partially offset by a \$0.6 million severance charge, payable to the Company's President pursuant to her employment contract. Ms. Smith has agreed to defer payment of her severance on terms to be mutually agreed upon.

As at June 30, 2005, the Company had Cash and Cash Equivalents of \$3.0 million compared to \$2.4 million at June 30, 2004. The increase is mainly due to proceeds on the sale of the Samplex business, offset by cash used in continuing operations.

Working capital was \$3.0 million at June 2005 versus \$3.5 million at June 30, 2004, broken down as follows:

<u>(In millions of dollars)</u>	<u>2005</u>	<u>2004</u>
Continuing Operations	3.0	3.0
Discontinued Operations	<u>0.0</u>	<u>0.5</u>
Total Working Capital	<u>3.0</u>	<u>3.5</u>

The Board of Directors has concluded its strategic alternatives initiative to maximize value for the company's shareholders.

A Special Committee of independent directors of the Board, established to supervise the strategic initiative, considered proposals from several parties during the past year, resulting in the sale of the Samplex Group on June 30, 2005. The directors concluded that the interest expressed by several parties in the acquisition of, or merger with, Advantex would not create sufficient additional value for shareholders and therefore will not be pursued at this time.

Over the past several months, the Board discussed with Allison Smith their request for her resignation to address current and evolving corporate governance standards and practices, and their concerns regarding perceived and potential conflicts of interest arising out of her positions as President, COO and a director of Advantex, and her marital relationship with G. Randall Munger, Advantex's Chairman and Chief Executive Officer.

Ms. Smith agreed with the Board's request to relinquish her positions with the Company and to postpone her resignation pending the completion of the strategic alternatives initiative, given the possible sale or merger of the company.

As the strategic initiative is now ended and no further transactions are contemplated at this time, Ms. Smith has now agreed to continue as the President and COO of Advantex until her successor is hired, or until such earlier date as requested by the Board. She will not stand for re-election as a director at the company's annual meeting.

## **PART 1**

## **PART 2 OUTLOOK**

Plans are underway to leverage the Company's sales, marketing, transaction processing and data capture technology infrastructure to expand the scope and depth of the services it offers to merchants, including a Merchant Funding Program and online marketing.

### *Merchant Funding Program*

Programs that provide merchants with additional working capital based on future credit card sales are growing in popularity throughout the United States. An estimated 20,000 U.S. merchants are taking advantage of this easy access to capital. Advantex plans to introduce a Merchant Funding Program in connection with its Canadian Credit Card Loyalty programs during fiscal 2006.

Presently, Advantex offers participating merchants limited cash advances through its Canadian Credit Card Loyalty programs. The Merchant Funding Program provides participating merchants with larger cash advances based on longer periods of future credit card transactions, typically four to six months. The advances are repaid as cardholders make purchases at participating establishments; Advantex earns the difference between the discounted amount it paid for the transaction and the price paid by the cardholder. The Company plans to introduce the Merchant Funding Program beginning in fiscal 2006.

### *Online Marketing*

New online marketing programs will further broaden the scope of the Company's merchant-based programs. Advantex online marketing will enable participating merchants to increase direct communication with their customers. Targeted email campaigns, contests, sweepstakes, and customer surveys are among the new initiatives that are being planned.

Restaurants are adopting online marketing as an effective way to promote their business and increase customer traffic. Bonus offers, information about new menu items, holiday promotions, and invitations to special events can be more quickly and cost-effectively disseminated through targeted online campaigns than through other traditional media.

Online marketing and the use of the Internet by consumers continues to grow in popularity. New research shows that 70% of U.S. adults use the Internet as an information source when shopping locally for products and services.

### *Online Shopping Malls*

Advantex improved the technology platform for its Online Shopping Mall during fiscal 2005. The new Online Shopping Mall platform is expected to increase the company's speed to market of new customized mall programs and provide greater flexibility in creating and managing special promotions, both of which are important competitive advantages. New online shopping mall programs will commence in fiscal 2006.

The company expects its Online Shopping Malls to grow in terms of volume and profitability, the result of enhanced marketing support for the purpose of increasing enrolment among non-registered members, and driving purchase activity through current mall programs.

### **About Advantex Marketing International Inc.**

**PART 3** ADVANTEX MARKETING INTERNATIONAL INC. IS A LEADING MARKETING SERVICES COMPANY, SPECIALIZING IN INTEGRATED MARKETING SOLUTIONS FOR ITS MERCHANT AND CHANNEL PARTNER CLIENTS. ADVANTEX OFFERS A RANGE OF PRODUCTS AND SERVICES INCLUDING COALITION LOYALTY REWARDS PROGRAMS, ONLINE SHOPPING MALLS, DIRECT MARKETING, ONLINE AND EMAIL PROMOTION; AND DATA CAPTURE AND AWARD PROCESSING SYSTEMS. ADVANTEX LOYALTY PARTNERS INCLUDE CIBC, UNITED AIRLINES, DELTA AIR LINES, THE NEW YORK TIMES, ALASKA AIRLINES, US AIRWAYS, AND OTHER MAJOR NORTH AMERICAN CORPORATIONS, AS WELL AS A GROWING LIST OF RESTAURANTS, ONLINE RETAILERS, GOLF COURSES, SMALL INNS AND RESORTS. ADVANTEX IS A PUBLIC COMPANY, TRADED ON THE TORONTO STOCK EXCHANGE UNDER THE SYMBOL "ADX". FOR ADDITIONAL INFORMATION ON ADVANTEX, PLEASE VISIT [WWW.ADVANTEX.COM](http://WWW.ADVANTEX.COM).

**PART 4** THIS PRESS RELEASE MAY INCLUDE STATEMENTS ABOUT EXPECTED FUTURE EVENTS AND/OR FINANCIAL RESULTS THAT ARE FORWARD-LOOKING IN NATURE AND SUBJECT TO RISKS AND UNCERTAINTIES. ADVANTEX CAUTIONS THAT ACTUAL PERFORMANCE WILL BE AFFECTED BY A NUMBER OF FACTORS, MANY OF WHICH ARE BEYOND ITS CONTROL. FUTURE EVENTS AND RESULTS MAY VARY SUBSTANTIALLY FROM WHAT ADVANTEX CURRENTLY FORESEES. DISCUSSION OF THE VARIOUS FACTORS THAT MAY AFFECT FUTURE RESULTS IS CONTAINED IN ADVANTEX'S RECENT FILINGS WITH CANADIAN SECURITIES REGULATORY AUTHORITIES.

## **PART 5**

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For further information please contact:

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**ADVANTEK MARKETING INTERNATIONAL INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**AS AT JUNE 30, 2005 AND 2004**

<b>PART 6 ASSETS</b>	<b>NOTE</b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Current:			
<i>Cash and cash equivalents</i>		\$2,970,627	\$2,336,530
Accounts receivable		1,238,719	1,255,180
Purchased receivables		2,363,428	2,395,461
Assets of discontinued operations	6	-	2,640,701
Prepaid expenses and sundry assets		<u>225,069</u>	<u>190,856</u>
		<u>6,797,843</u>	<u>8,818,728</u>
Long Term:			
Capital and other assets	2	874,017	1,105,578
Deferred financing charges	3	<u>292,844</u>	<u>259,441</u>
		<u>1,166,861</u>	<u>1,365,019</u>
<b>TOTAL ASSETS</b>		<b><u>\$7,964,704</u></b>	<b><u>\$10,183,747</u></b>
<b>PART 7</b>			
<b>PART 8 LIABILITIES</b>			
Current:			
Accounts payable and accrued liabilities		\$3,803,834	\$2,858,741
Liabilities of discontinued operations	6	-	2,132,380
Deferred revenue		<u>40,427</u>	<u>371,907</u>
		3,844,261	5,363,028
<i>Long Term:</i>			
Convertible debenture payable	4	<u>3,459,695</u>	<u>3,155,256</u>
		<u>7,303,956</u>	<u>8,518,284</u>
<b>PART 9 SHAREHOLDERS' EQUITY</b>			
Capital Stock			
Class A preference shares	5	3,815	3,815
Common shares		<u>21,462,938</u>	<u>20,814,938</u>
		21,466,753	20,818,753
Contributed surplus		59,992	59,992
Equity portion of convertible debenture	4	880,308	880,308
Reserve for issuance of shares	7	-	648,000
Deficit		<u>(21,746,305)</u>	<u>(20,741,590)</u>
		<u>660,748</u>	<u>1,665,463</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b><u>\$7,964,704</u></b>	<b><u>\$10,183,747</u></b>

*(see accompanying notes)*

**ADVANTECH MARKETING INTERNATIONAL INC.  
CONSOLIDATED STATEMENTS OF LOSS**

(a) YEARS ENDED JUNE 30, 2005 AND 2004

	<b>NOTE</b>	<b><u>2005</u></b>	<b><u>2004</u></b>
<b>PART 10 REVENUE</b>			
Sales and fees		\$71,766,969	\$76,621,009
Direct costs		<u>64,214,518</u>	<u>69,691,627</u>
		7,552,451	6,929,382
<b>PART 11 OPERATING EXPENSES</b>			
Selling		4,115,438	4,845,453
General and administrative		<u>5,112,299</u>	<u>4,492,158</u>
		9,227,737	9,337,611
<b>LOSS BEFORE AMORTIZATION, INTEREST AND INCOME TAXES</b>		<u>(1,675,286)</u>	<u>(2,408,229)</u>
Amortization		395,981	470,306
Interest		<u>678,809</u>	<u>594,393</u>
		<u>1,074,790</u>	<u>1,064,699</u>
<b>LOSS BEFORE INCOME TAXES - CONTINUING OPERATIONS</b>		(2,750,076)	(3,472,928)
Realization of income tax benefits	7	_____ -	<u>1,424,000</u>
<b>NET LOSS – CONTINUING OPERATIONS</b>		(2,750,076)	(2,048,928)
<b>NET INCOME – DISCONTINUED OPERATIONS</b>	6	<u>1,745,361</u>	<u>224,846</u>
<b>PART 12 NET LOSS</b>		<u>\$ (1,004,715)</u>	<u>\$(1,824,082)</u>
<b>PART 13 EARNINGS (LOSS) PER COMMON SHARE</b>		9	
<b>PART 14</b> - CONTINUING OPERATIONS		\$(0.05)	\$(0.04)
<b>PART 15</b> - DISCONTINUED OPERATIONS			<u>0.03</u>
	<u>0.00</u>		
<b>NET LOSS PER COMMON SHARE</b>		<u><b>\$(0.02)</b></u>	<u><b>\$(0.04)</b></u>

*(see accompanying notes)*

**ADVANTEX MARKETING INTERNATIONAL INC.  
CONSOLIDATED STATEMENTS OF DEFICIT**

(a) **YEARS ENDED JUNE 30, 2005 AND 2004**

	<u>2005</u>	<u>2004</u>
<b>BALANCE AT THE BEGINNING OF THE YEAR</b>	<b>\$(20,741,590)</b>	<b>\$(18,917,508)</b>
Net Loss	<u>(1,004,715)</u>	<u>(1,824,082)</u>
<b>BALANCE AT THE END OF THE YEAR</b>	<b><u>\$(21,746,305)</u></b>	<b><u>\$(20,741,590)</u></b>

*(see accompanying notes)*

**ADVANTECH MARKETING INTERNATIONAL INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

(b) YEARS ENDED JUNE 30, 2005 AND 2004

	NOTE	<u>2005</u>	<u>2004</u>
<b>OPERATING ACTIVITIES</b>			
<b>PART 16</b>			\$(2,750,076)
NET LOSS – CONTINUING OPERATIONS			
		\$(2,048,928)	
<b>PART 17</b>			
<b>PART 18 ITEMS NOT AFFECTING CASH</b>			
Amortization of capital assets		395,981	470,306
Accretion charge	4	179,439	126,365
Amortization of deferred financing charges		<u>91,597</u>	<u>71,722</u>
		<u>(2,083,059)</u>	<u>(1,380,535)</u>
<b>PART 19 CHANGES IN NON-CASH WORKING CAPITAL ITEMS</b>			
Accounts receivable		16,461	(34,630)
Purchased receivables		32,033	216,363
Prepaid expenses and sundry assets		(34,213)	62,413
Accounts payable and accrued liabilities		945,093	(578,733)
Deferred revenue		<u>(331,480)</u>	<u>201,221</u>
		<u>627,894</u>	<u>(133,366)</u>
		(1,455,165)	(1,513,901)
<b>PART 20 FINANCING ACTIVITIES</b>			
Obligation to issue shares	7	-	648,000
<b>PART 21 INVESTING ACTIVITIES</b>			
Net proceeds on sale of business	6	2,234,863	-
Purchase of capital assets		<u>(164,420)</u>	<u>(108,014)</u>
		<u>2,070,443</u>	<u>(108,014)</u>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS -</b>			
<b>CONTINUING OPERATIONS</b>			
		615,278	(973,915)
<b>DISCONTINUED OPERATIONS</b>			
	6	18,819	52,304
Cash and cash equivalents at the beginning of the year		<u>2,336,530</u>	<u>3,258,141</u>
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>		<u>\$2,970,627</u>	<u>\$2,336,530</u>
<b>PART 22 ADDITIONAL INFORMATION</b>			
Interest paid		<u>\$403,000</u>	<u>\$400,000</u>

*(see accompanying notes)*

(a) **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended June 30, 2005 and 2004**

**1. SIGNIFICANT ACCOUNTING POLICIES**

**(a) Nature of business**

Advantex Marketing International Inc. ("the Company") is a public company for which the common shares are listed on The Toronto Stock Exchange (trading symbol ADX). The Company is a diversified marketing firm offering customer value management services. Its affinity loyalty programs influence the purchasing behaviour of large dedicated groups of consumers, to enhance customer loyalty and generate incremental revenues for program sponsors and participants.

**(b) Basis of consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Advantex Dining Corporation, Advantex Marketing Corporation, Advantex Marketing International Inc. (U.S.), Advantex Marketing (Maryland) Inc., 1600011 Ontario Limited, and Advantex GP Inc. The accounts of Advantex Systems Limited Partnership have also been consolidated with those of the company (note 7).

**(c) Revenue recognition**

The Company derives its revenue from two operating groups: Advantex and Samplex. On June 30, 2005, the Samplex business was sold (note 6).

The Advantex Group provides marketing services to participating establishments and provides awards to customers who make purchases at participating establishments. There are two types of agreements with participating establishments:

- (i) The Company acquires the rights to future customer purchases at a discount from participating establishments. The Company records the entire credit card transaction as revenue and records its costs to acquire the rights as a direct cost.
- (ii) The Company does not acquire the rights to future customer purchases from participating establishments and records revenue as a percentage of customer purchases made at participating establishments. The revenue is recognized at the time that a customer purchases services or products from the member participants of these programs.

The Samplex Group derived its revenue from the sale of consumer-related themed pack programs. Revenue from theme packs was recognized when the goods were shipped.

**(d) Cash and cash equivalents**

Cash and cash equivalents include highly liquid investments redeemable at any time and are stated at cost, which approximates market value.

**(e) Purchased receivables**

The Company, under its Advantex Group, purchases the rights to receive future cash flows associated with goods and services at a discount from participating establishments. The Company continuously reviews its receivables. It sets up an estimated allowance for amounts deemed uncollectible and writes off amounts from establishments that have ceased operations.

## 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

### (f) Capital assets

Capital assets are stated at cost less accumulated amortization. Amortization is provided for at the following annual rates:

Computer equipment	-	30% on the declining balance
Furniture and equipment	-	20% on the declining balance
Leasehold improvements	-	Straight line over the term of the lease
Computer software	-	3 to 5 years straight line

### (g) Deferred financing charges

Deferred financing charges are amortized over the term of the convertible debenture payable.

### (h) Deferred Revenue

Deferred revenue is taken into income over the period to which it pertains.

### (i) Income taxes

The Company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities using enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse. The Company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

### (j) Stock option plan

The Company has a stock option plan which is described in Note 5(d). The Company uses the Black-Scholes option pricing model to determine the fair value of stock options.

Effective July 1, 2003, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants relating to stock based compensation. The Company records the fair value of employee stock options, rather than to disclose pro forma information only. This policy has been applied on a prospective basis.

### (k) Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at rates of exchange at each transaction date. Revenue and expenses are translated at the average rate of exchange for the period. Gains or losses on translation are included in earnings.

1. **SIGNIFICANT ACCOUNTING POLICIES (continued)**

(I) **Use of estimates**

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

2. **CAPITAL ASSETS**

		<u>Cost</u>		<u>Accumulated Amortization</u>		<u>Net Book Value</u>
<u>June 30, 2005</u>						
Computer equipment	\$	2,800,136	\$	2,328,745	\$	471,391
Furniture and equipment		1,097,799		899,581		198,218
Leasehold improvements		504,647		504,647		-
Computer software		<u>1,587,386</u>		<u>1,382,978</u>		<u>204,408</u>
	\$	<u>5,989,968</u>	\$	<u>5,115,951</u>	\$	<u>874,017</u>
 <u>June 30, 2004</u>						
Computer equipment	\$	2,724,954	\$	2,139,123	\$	585,831
Furniture and equipment		1,092,590		850,412		242,178
Leasehold improvements		490,396		471,578		18,818
Computer software		<u>1,498,719</u>		<u>1,239,968</u>		<u>258,751</u>
	\$	<u>5,806,659</u>	\$	<u>4,701,081</u>	\$	<u>1,105,578</u>

3. **DEFERRED FINANCING CHARGES**

		<u>2005</u>		<u>2004</u>
Initial costs incurred on debenture financing	\$	457,502	\$	457,502
Less issue costs allocated to equity (see note 4)		(105,557)		(105,557)
Additional financing costs (see note 4)		125,000		-
Less accumulated amortization		<u>(184,101)</u>		<u>(92,504)</u>
	\$	<u>292,844</u>	\$	<u>259,441</u>

The initial costs incurred for deferred financing charges relate to the convertible debenture fee as described in note 4. The amortization of deferred financing charges is included in interest expense.

#### **4. CONVERTIBLE DEBENTURE PAYABLE**

In 2003, the Company issued a \$4,000,000 senior convertible debenture (the “convertible debenture”) for net proceeds of \$3,542,498 after issuance costs of \$457,502 (see note 3). The convertible debenture bears interest at 10% per annum payable semi-annually and matures on April 25, 2008. The debenture is secured by a general security agreement over all the assets of the Company and its subsidiaries and an assignment of insurance, with certain financial covenants to be maintained. The debenture is convertible into common shares of the Company at the holder’s option in denominations of \$10,000. The conversion price at the time of issue was \$0.17 per common share (the “conversion option”) and a total of 23,529,412 common shares were issuable upon conversion of the debenture.

In order to facilitate the tax assisted financing described in note 6, the consent of the holder of the Company’s convertible debenture was required and received in December 2003. In consideration for giving such consent, the conversion price per common share was reduced from \$0.17 to \$0.15 and, as a consequence, the number of common shares issuable upon conversion of the debenture was increased from 23,529,412 to 26,666,666 shares. The Company derived the fair value of the conversion option and the adjustment to the conversion option using the Black-Scholes option pricing model.

The fair value of the conversion option at the time of issue of the debenture was determined to be material. As a result, the convertible debenture was bifurcated into debt and equity portions and the debt portion of the convertible debenture is being accreted to its face value at maturity over the term of the debt by way of a charge to interest expense.

The fair value of the adjustment to the conversion option in December 2003 was determined to be \$369,093. Accordingly, the equity portion of the convertible option was increased by this amount and the convertible debenture payable was decreased by this amount. In addition, \$35,100 of deferred financing charges were reclassified to the equity portion of convertible debenture. The amortization of deferred financing charges and accretion of the debt portion of the convertible debenture were adjusted on a prospective basis beginning January 1, 2004.

In July 2004, certain of the financial covenants under the convertible debenture agreement were amended in exchange for the issuance of 500,000 warrants to debenture holders with each warrant entitling the holder to purchase one Advantex common share at \$0.25 per share. The debenture holders had the right to require the Company to repurchase the warrants for a payment of \$0.25 per warrant (\$125,000 in total), exercisable before November 15, 2004. All of the debenture holders exercised this right. The Company satisfied its obligation to repurchase the warrants by increasing the principal amount of the convertible debenture by \$125,000 and increasing deferred financing charges by the same amount. The conversion price associated with this amount is \$0.13 per common share and the additional number of common shares which may be issued upon conversion is 961,538, increasing the total number of common shares which may be issued upon conversion to 27,628,204; the fair value of the equity portion of the conversion option was not recorded because the amount was determined to be nominal.

The Company met its financial covenants under the convertible debenture agreement as at June 30, 2005.

Interest expense relating to the accretion of the convertible debenture was \$179,439 (2004 - \$126,365).

Convertible Debenture Payable:	Debt Portion	Equity Portion
<b>Balance as at June 30, 2003</b>	<b>\$ 3,397,984</b>	<b>\$ 546,315</b>
Fair value adjustment	(369,093)	369,093
Additional portion of issue costs allocated	-	(35,100)
Accretion charge	126,365	-
<b>Balance as at June 30, 2004</b>	<b>3,155,256</b>	<b>880,308</b>
Additional convertible debenture issued	125,000	-
Accretion charge	179,439	-
<b>Balance as at June 30, 2005</b>	<b>\$ 3,459,695</b>	<b>\$ 880,308</b>

The following factors and assumptions were used in the Black-Scholes option pricing model to determine the fair value of the adjustment to the conversion option in 2004:

Common share price	\$ 0.16
Exercise price of conversion option	\$ 0.15
Expected life of conversion option	4.3 years
Expected volatility of common share price	26 %
Risk free rate of return	4.42%

## 5. CAPITAL STOCK

### (a) Authorized

Class A preference - 500,000 shares non-voting, non-participating, redeemable (at stated capital amount), 8% (of stated capital amount) non-cumulative dividend rate

Class B preference - Unlimited number of shares, issuable in series with rights, privileges, restrictions and conditions determined by the Board of Directors at time of issue

Common - Unlimited number of shares

### (b) Issued Class A preference

459,781 shares	\$ <u>2005</u> <u>3,815</u>	\$ <u>2004</u> <u>3,815</u>
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### (c) Issued common

		<u>Amount</u>
Balance as at June 30, 2003 and 2004	50,493,831	\$ 20,814,938
Issue of common shares in 2005 (note 7)	<u>8,000,000</u>	<u>648,000</u>
Balance as at June 30, 2005	<u>58,493,831</u>	\$ <u>21,462,938</u>

Subsequent to the year end, on July 12, 2005, the Company issued 500,000 common shares to CIBC in consideration of the signing of a long-term agreement to continue Advantex's merchant-based loyalty programs and the agreement to cancel CIBC's rights to additional Incentive Warrants under a

previous agreement (note 5(f)(i)). Under the terms of the private placement, the common shares are subject to a resale restriction of four months.

**(d) Stock options**

The Company has a stock option plan for directors, officers, employees and consultants. The maximum number of shares reserved for issuance under the plan is 6,599,700. The options are non-assignable; the option price is to be fixed by the Board of Directors (but may not be less than the closing price on the day immediately preceding the date of the grant of the option); the term of the options may not exceed 5 years, and payment for the optioned shares is required to be made in full on the exercise of the option. The options are subject to various vesting provisions, determined by the Board of Directors, ranging from immediately to 5 years.

A summary of the status of the Company's stock option plan as at June 30, 2005 and 2004, and changes during the years ending on those dates is presented below:

	2005		2004	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at the beginning of the year	3,407,500	\$0.58	3,841,000	\$0.62
Granted	1,700,000	0.24	1,242,500	0.14
Forfeited and expired	(2,180,000)	0.57	(1,676,000)	0.34
Outstanding at the end of the year	2,927,500	0.40	3,407,500	0.58
Options exercisable at the end of the year	2,392,500		2,124,500	

Of the total stock options issued in 2005, 1,500,000 were issued to certain directors at an exercise price of \$0.25 per common share and an expiry date of June 20, 2009; these options are exercisable at any time.

The following table summarizes information about stock options outstanding at June 30, 2005:

Range of Exercise Prices	Number Outstanding	Options Outstanding		Options Exercisable	
		Weighted-Average Remaining Contractual Life (years)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$0.13 to 0.48	2,327,500	3.62	0.22	1,819,500	0.24
\$0.82 to 1.08	530,000	0.42	1.07	515,000	1.07
\$1.30	70,000	0.03	1.30	58,000	1.30
\$0.13 to 1.30	2,927,500	2.96	0.40	2,392,500	0.44

The number of stock options which are available for future issuance as at June 30 is:

	<u>2005</u>	<u>2004</u>
Maximum number reserved for issuance	6,599,700	6,599,700
Less: Forfeited and expired since inception	(1,869,000)	(1,869,000)
Less: Outstanding at end of year	<u>(2,927,500)</u>	<u>(3,407,500)</u>
Number of options available for future issuance	<u>1,803,200</u>	<u>1,323,200</u>

The Company calculated the fair value of the stock options issued during 2005 and 2004, using the Black-Scholes option pricing model and determined their value to be immaterial. Accordingly, no expense has been recorded in these financial statements upon the issue of these options. The assumptions used in the model were:

	<u>2005</u>	<u>2004</u>
Expected life of stock option	5 years	5 years
Expected volatility of common share price	10%	10%
Risk free rate of return	4.4%	4.4%

**(e) Shareholders' Rights Plan**

The rights become exercisable and permit shareholders to purchase common shares from the Company at 50% of the then current market price if any entity acquires or announces an intention to acquire 20% or more of the common shares, other than with the approval of the Board of Directors or pursuant to the "Permitted Bid" procedures, as defined by the Rights Plan. The rights plan expires on July 10, 2007.

**(f) Warrants**

The following table summarizes information about outstanding warrants to purchase common shares at June 30, 2005:

<u>Exercise Price</u>	<u>Number Outstanding</u>		<u>Remaining Contractual Life (yrs.)</u>	
\$0.93	51,789	(i)	0.51	January 2, 2006
\$0.32	124,185	(i)	1.51	January 2, 2007
\$1.08	15,000,000		0.61	February 6, 2006
<u>\$1.07</u>	<u>15,175,974</u>		<u>0.62</u>	

- i) On February 6, 2001, the Company agreed to issue up to 55,000,000 Incentive Warrants to Air Canada and CIBC, allocated on a 50:50 basis. Incentive warrants may be issued on March 1 of each year in respect of the prior calendar year. A total of 175,974 warrants have been issued for prior calendar years. The fair value of these warrants was calculated to be a nominal amount, and no expense has been recorded in these financial statements on the issue of these warrants. Additional incentive warrants to purchase up to 54,824,026 Advantex common shares may be awarded to the entities based on their contribution to the growth of the Company from new programs over the period ending on December 31, 2005. The number of warrants issued each calendar year is based on the contribution from new programs that the two entities make to Advantex annual revenue growth. The exercise price of the earned incentive warrants is based on the prevailing market price at the end of each calendar year. No incentive warrants were issued with respect to the 2004 calendar year and no incentive warrants are expected to be issued in the future.

On July 12, 2005, the Company and CIBC signed a supplementary agreement in which CIBC

waived its right to any additional Incentive Warrants. Accordingly, the additional Incentive Warrants which may be awarded was reduced to 27,412,013, all in respect of Air Canada.

- ii) On December 6, 2001, the Company created a retailer/sponsor warrant plan where a maximum of 950,000 shares are currently reserved for issuance under the plan. The warrants are non-assignable, the warrant price is to be fixed by the Board of Directors, the term of the warrants may not exceed 5 years and payment for the common shares is required to be made in full on the exercise of the warrants. No warrants under this plan were outstanding as at June 30, 2005.
- iii) In connection with the convertible debenture payable, the Company issued 1,000,000 compensation warrants to the agent to purchase 1,000,000 common shares at an exercise price of \$0.17 per common share. These options expired during fiscal 2005.

**(g) Convertible debentures**

The debentures payable are convertible into common shares of the Company, as described in note 4.

**6. DISCONTINUED OPERATIONS**

The Company sold its Samplex business on June 30, 2005 by way of an asset sale as it was determined not to be core to the Company's objectives. Results of the operations of the Samplex business have been classified as discontinued operations for the years ended June 30, 2004 and 2005. Under the terms of the sale agreement, the purchaser acquired substantially all of the net assets of Samplex including accounts receivable, inventory and accounts payable and accrued liabilities.

The following table provides additional information with respect to amounts included in the financial statements as discontinued operations:

**Assets and Liabilities – Discontinued Operations**

	<u>2005*</u>	<u>2004</u>
Accounts receivable	\$ 1,079,099	\$ 852,453
Inventory	1,758,132	1,788,248
Other assets	<u>13,258</u>	<u>-</u>
Assets	<u>2,850,489</u>	<u>2,640,701</u>
Accounts payable and accrued liabilities	2,612,022	1,968,965
Deferred income	<u>73,180</u>	<u>163,415</u>
Liabilities	<u>2,685,202</u>	<u>2,132,380</u>
Net assets	<u>\$ 165,287</u>	<u>\$ 508,321</u>

\*The fiscal 2005 column represents the value of assets and liabilities sold on June 30, 2005.

## Statements of Income - Discontinued Operations

	<u>2005</u>	<u>2004</u>
Revenue	\$ 5,638,839	\$ 5,778,675
Expenses	<u>5,963,055</u>	<u>5,553,829</u>
Net income (loss)	(324,216)	224,846
Gain on sale of business	<u>2,069,577</u>	-
Net income – discontinued operations	<u>\$ 1,745,361</u>	<u>\$ 224,846</u>

## Statements of Cash Flows - Discontinued Operations

	<u>2005</u>	<u>2004</u>
Net Income - discontinued operations	\$ 1,745,361	\$ 224,846
Gain on sale of business	<u>(2,069,577)</u>	-
Funds provided by (used in) discontinued operations	<u>(324,216)</u>	<u>224,846</u>
Changes in non-cash working capital balances		
Assets of discontinued operations	(209,787)	(97,492)
Liabilities of discontinued operations	<u>552,822</u>	<u>(75,050)</u>
	<u>343,035</u>	<u>(172,542)</u>
<b>Cash provided by discontinued operations</b>	<b><u>\$ 18,819</u></b>	<b><u>\$ 52,304</u></b>

The gain on the sale of the Samplex business was determined as follows:

Consideration received	\$ 2,549,864
Less: financing and other related costs	<u>(315,000)</u>
Net proceeds on sale of business	2,234,864
Less: Net assets sold	<u>(165,287)</u>
Gain on sale of business	<u>\$ 2,069,577</u>

The Company is entitled to receive additional consideration during the next year based on the occurrence of certain events. The amounts cannot be reasonably estimated and consequently are not included in these financial statements

## 7. TAX ASSISTED FINANCING

### *Description of the Transaction*

On December 31, 2003 the Company completed a tax assisted financing which raised gross cash proceeds of \$2,400,000. Pursuant to a series of transactions, certain assets (computer hardware and software) of the Information Technology Support Division (the "Support Division") of the Company's wholly owned subsidiary, Advantex Dining Corporation ("Advantex Dining"), were acquired by a limited partnership, Advantex Systems Limited Partnership ("ASLP"). The aggregate acquisition price was \$12,000,000 in exchange for cash of \$1,200,000, a short term promissory note of \$1,200,000, the assignment of long term promissory notes from investors of \$8,760,000 (the "Investor Notes" as described below) and \$840,000 of limited partnership units of ASLP. The Support Division continued to provide its services to Advantex Dining and is managed by the general partner of ASLP, Advantex GP Inc., which is a wholly-owned subsidiary of the Company.

Pursuant to an offering by way of private placement of Class A units ("Class A Units") of the Madison Grant Limited Partnership III (the "Offering Partnership") which closed on December 31, 2003, investors subscribed for Class A Units for an aggregate subscription price of \$12,000,000 (comprised of \$3,240,000 in cash and \$8,760,000 in Investor Notes). The Offering Partnership then subscribed for \$11,160,000 Units of ASLP. The Offering Partnership satisfied its obligations under the acquisition above by paying \$1,200,000 in cash and \$1,200,000 in a promissory note receivable and assigning the Investor Notes of \$8,760,000. The balance of \$840,000 in cash was used by the Offering Partnership to pay the fees and expenses of the offering.

In order to facilitate the above transactions, the consent of the holder of the Company's convertible debenture was required (see note 4).

Subsequent to the closing of the financing, a director and officer of the general partner of the Offering Partnership was elected as a director of the Company.

In March 2005, the Company purchased the Offering Partnership's interest in ASLP in exchange for an assignment of the Investor Notes and the issuance of 8,000,000 shares, as described below.

*Accounting and Tax Treatment for the Transaction*

The sale of the assets by Advantex Dining in 2003 was not accounted for as a divestiture since the transactions were between related parties and it was intended that, through a series of transactions, the ASLP units and therefore the Support Division would be reacquired under the Call Option Agreement. Accordingly, neither the gain on sale of the assets nor the Investor Notes of \$8,760,000 were recognized in these consolidated financial statements and the above transactions have been accounted for on the basis of their substance rather than their legal form. The financial position and results of operations of ASLP was consolidated with those of the Company.

The net proceeds of \$2,072,000 (\$2,400,000 net of financing costs of \$328,000) consisted of two components: i) a deposit against the future issuance of up to 8 million common shares of the Company pursuant to a Call Option Agreement and ii) proceeds related to the realization of previously unrecognized income tax losses. Management anticipated that the Call Option would be exercised and that up to 8 million shares would be issued at that time. Management estimated the fair value of the common shares reserved for issuance at \$648,000. This amount was computed using a weighted average market price for the shares at the date of the transaction, discounted by 25% to reflect the time value of money from the date of the transaction to the date that the call option was expected to be exercised, the inherent volatility of the share price during that period and the risk that the shares may not be fully issued. The balance of \$1,424,000 was recorded as a realization of income tax benefits. The sale of assets gave rise to income for income tax purposes. This income was absorbed by non-capital losses that had not previously been recognized for accounting purposes.

In March 2005, the Company exercised its right to purchase all of the issued and outstanding units of ASLP held by the Offering Partnership. The units were purchased in exchange for an assignment of the promissory notes totalling \$8,760,000 and the issuance of 8,000,000 common shares of the Company (note 5(c)). Upon completion of the acquisition, a marketing agreement among the Company, the Offering Partnership and ASLP was terminated and, accordingly, the Company's financial commitment for marketing and promotion thereunder was also terminated. The Company transferred the amount recorded as Reserve of Issuance of Share of \$648,000 to common shares.

## 8. FINANCIAL INSTRUMENTS

### (a) Credit risk

Credit risk arises from the possibility that counterparties will be unable to discharge their obligations. The Company routinely assesses the financial strength of its merchants and as a consequence, believes that its accounts receivable and purchased receivable credit risk exposure is limited.

### (b) Currency Risk

The Company is exposed to foreign exchange risk as a portion of its revenues is earned in U.S. dollars and it has assets and liabilities that will be settled in U.S. dollars. Foreign exchange risk arises due to fluctuations in foreign currency rates, which could affect the Company's financial results.

Included in the undernoted accounts are the following:

(expressed in US dollars)	2005	2004
Cash and cash equivalents	\$ 717,251	\$ 1,548,832
Accounts receivable	508,268	435,541
Accounts payable	371,351	85,785

### (c) Fair value

The carrying value of cash and cash equivalents, accounts receivable, purchased receivables, accounts payable and accrued liabilities and deferred revenue approximate their fair value due to the short term maturity of these instruments.

The stated value of the convertible debenture payable approximates its fair value, as its interest rate is representative of current market rates for loans with similar terms, conditions and maturities.

### (d) Interest rate risk

The company is exposed to price risk on the convertible debenture payable as this amount is subject to a fixed interest rate.

## 9. LOSS PER COMMON SHARE

Loss per share is calculated on the basis of net loss divided by the weighted average number of common shares outstanding for the year. Diluted loss per share is calculated using the treasury stock method, giving effect to the exercise of all dilutive instruments. Diluted loss per share information has not been presented as the effect of potential exercise of the convertible debenture, stock options and warrants would be anti-dilutive.

## 10. INCOME TAXES

The Company has \$17,918,000 (2004 - \$16,438,000) of non-capital losses available to be applied against future taxable income. The losses expire as follows:

Year ending June	2006	300,000
	2007	2,116,000
	2008	3,869,000
	2009	1,959,000
	2010	2,356,000
	2011	1,177,000
	2012	981,000
	2013 - 2019	5,160,000

The tax effect of these losses and other temporary differences give rise to future income tax assets against which a valuation allowance has been applied as follows:

	<u>2005</u>	<u>2004</u>
Tax effect of:		
Non-capital losses carried forward	\$ 6,472,000	\$ 5,937,000
Capital assets	23,000	24,000
Deferred financing charges	26,000	97,000
Research and development	116,000	116,000
Other	<u>17,000</u>	<u>22,000</u>
	6,654,000	6,196,000
Valuation allowance	<u>(6,654,000)</u>	<u>(6,196,000)</u>
Future income taxes	\$ _____	\$ _____

## 11. LEASE COMMITMENT

The Company is committed to minimum rental payments under existing leases for equipment and premises for the next five years as follows:

Year ending June 30,	2006	222,000
	2007	201,000
	2008	184,000
	2009	11,000
	2010	2,000

## 12. RELATED PARTY TRANSACTIONS

The following transactions are in the normal course of business and are measured at the exchange amount of consideration established and agreed to by the related parties:

- (i) In April 2004, the Company entered into a financial advisory agreement with Quorum Funding Corporation to assist the Company in developing strategic alternatives and in arranging future financing. Under the agreement as amended, Quorum Funding earned a base fee and may also earn a success fee paid in cash of the greater of US\$300,000 and the sum of 5.25% of the transaction value less any base fees previously paid, contingent upon the closing of a financing transaction. A financing transaction includes the raising of equity or debt, an acquisition or disposition of a business or assets of a business or a merger of the Company with another company. With respect to a financing transaction that is a private placement, Quorum shall only be paid by the Company a cash fee equal to 5.25% of the gross proceeds of the sale of the Common Shares less any base fee previously paid. The agreement with Quorum expired on October 31, 2004 and was extended until June 30, 2005, at which time it terminated. An independent committee of the Board of the Company was established to manage the process.

The Chief Executive Officer of Quorum Funding was a director of the Company for the period from August 28, 2003 to June 20, 2005. Quorum Funding (SME) Corporation, a wholly owned subsidiary of Quorum Funding Corporation, manages Ontario SME Corporation. Ontario SME Corporation exercises control or direction over the voting rights attached to 6,700,000 common shares of the Company.

Total fees paid to Quorum during 2005 were \$354,000 (2004 - \$35,000) and includes a fee of \$250,000 related to the sale of Samplex (see note 6). The fee was shared on a 50:50 basis with an unrelated party.

- ii) The following related parties are holders of the convertible debenture described in note 4:

(2)	Title	<b><u>Principal Amount</u></b>
	Chief Executive Officer and director	\$ 75,000
	President and director	75,000
	Director	150,000

- iii) The Company engages a law firm to provide legal and tax services. A director of the Company is a partner with the law firm. During 2005, the Company paid \$212,487 for services provided by this firm (2004 - \$357,500) and \$33,170 was payable at June 30, 2005 (2004 - \$51,500).

### 13. ECONOMIC DEPENDENCE

A significant portion of the Company's current revenue is dependent upon its offline value added loyalty program agreement with CIBC under which Aeroplan Miles are awarded to holders of certain CIBC Visa credit cards. The Company purchases Aeroplan Miles from CIBC which in turn purchases Aeroplan Miles from Aeroplan LP, a subsidiary of ACE Aviation Holdings Inc.

The agreement with CIBC was renewed in July 2005, on similar terms, for an additional term ending on December 31, 2009. The agreement may be renewed for a further three years upon mutual agreement. If CIBC terminates its offline value added loyalty program agreement with the Company, this could materially and adversely affect the Company. However, CIBC can only terminate such agreement with the Company if the Company is in material breach thereof. In the event that the agreement expires or is terminated by the Company as a result of a breach by CIBC, CIBC is not entitled to offer a similar offline program to its Visa cardholders for a period of six months and the Company will be entitled to offer such cardholders a similar replacement program on the Company's behalf.

As part of Air Canada's CCAA restructuring in 2004, Air Canada and CIBC entered into a new contract under which CIBC is entitled to purchase Aeroplan Miles which will be available to support the CIBC Aerogold ADVANTEX Benefit program respecting restaurants, golf courses, and small inns and resorts. If Aeroplan Miles cease to be available for award in respect of purchases by holders of CIBC Visa credit cards, the Company has agreed to offer to such cardholders the same rewards as CIBC offers to them as a replacement for Aeroplan Miles, so long as the per unit cost of such rewards to the Company is the same or less than the Company's per unit cost of Aeroplan Miles.

As part of the restructuring, Air Canada advised the Company that effective December 31, 2003 it was repudiating its online and retail reward program agreements with Advantex and its agreement to permit Advantex to award Aeroplan Miles under the CIBC Aerogold ADVANTEX Benefit program for purchases at participating retail outlets. The termination of these agreements had minimal adverse impact on the Company's operations.