

## Preliminary Prospectus dated January 28, 2000

*This prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. No securities commission or similar authority in Canada has in any way passed upon the merits of the securities offered hereunder and any representation to the contrary is an offence. 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 to holders of Special Warrants of 01 Communique Laboratory Inc. in connection with the exercise of such Special Warrants and this prospectus does not constitute an offer to sell or a solicitation of an offer to buy any of these securities in the United States. See "Plan of Distribution".*

### New Issue

## **01 COMMUNIQUE LABORATORY INC.** **\$4,400,000** **6,285,714 Common Shares and** **3,142,857 Common Share Purchase Warrants**

This prospectus qualifies for distribution 6,285,714 common shares ("Common Shares") and 3,142,857 Common Share purchase warrants ("Warrants") of 01 Communique Laboratory Inc. (the "Company") issuable upon the exercise or deemed exercise of 6,285,714 previously issued special warrants ("Special Warrants") of the Company. The Special Warrants were issued by the Company on December 7, 1999 (the "Closing Date") at the price of \$0.70 per Special Warrant for aggregate gross proceeds of \$4,400,000. The offer and sale of the Special Warrants was made by Taurus Capital Markets Ltd. (the "Agent") on behalf of the Company by way of private placement pursuant to an agency agreement (the "Agency Agreement") dated as of December 7, 1999 between the Company and the Agent. The offering price per Special Warrant was determined by negotiation between the Company and the Agent. See "Plan of Distribution".

	<u>Price to the Public</u>	<u>Agent's Fee</u> <sup>(1)(2)</sup>	<u>Net Proceeds to the Company</u> <sup>(3)</sup>
Per Special Warrant . . . . .	\$0.70	\$0.0525	\$0.65
Total . . . . .	\$4,400,000	\$330,000	\$4,070,000

- (1) No additional commission or fee will be payable to the Agent in connection with the issuance of the Common Shares and Warrants on the exercise of the Special Warrants.
- (2) In addition to the cash compensation noted above, the Agent received non-assignable compensation warrants ("Compensation Warrants") of the Company entitling it to acquire, upon exercise thereof and without payment of any additional consideration, 628,571 compensation options ("Compensation Options") of the Company. Each Compensation Option will entitle the Agent to purchase a unit (a "Compensation Unit") at a price of \$0.70 per unit at any time prior to 5:00 p.m. (Toronto time) on December 7, 2001. Each Compensation Unit will consist of one Common Share (a "Compensation Share") and one-half of one Common Share purchase warrant (a "Compensation Purchase Warrant") of the Company. This prospectus also qualifies for distribution 314,285 of the Compensation Options to be acquired upon the exercise of such Compensation Warrants. Each Compensation Purchase Warrant will entitle the Agent to subscribe for one Common Share at a price of \$1.00 per share at any time prior to 5:00 p.m. (Toronto time) on the date which is two years following the earlier of: (i) June 7, 2000; and (ii) the Clearance Date (as hereinafter defined). See "Plan of Distribution".

*This is a preliminary prospectus relating to these securities, a copy of which has been filed with the Ontario Securities Commission, but which has not yet become final for the purpose of a distribution to the public. Information contained herein is subject to completion or amendment. These securities are being issued to holders of Special Warrants of 01 Communique Laboratory Inc. in connection with the exercise of such Special Warrants and this prospectus does not constitute an offer to sell or a solicitation of an offer to buy any of these securities.*

- (3) Before deducting the expenses of the issue estimated at \$110,000, which will be paid by the Company out of its general funds.

Special Warrants may be exercised at any time prior to 5:00 p.m. (Toronto time) (the "Time of Expiry") on the date which is the earlier of: (i) the fifth business day after the date on which a final receipt is issued by the Ontario Securities Commission for this prospectus (the "Clearance Date"); and (ii) June 7, 2001. Any Special Warrants not exercised prior to the Time of Expiry will be deemed to be exercised immediately prior to such time.

Each Special Warrant entitles the holder to receive, upon exercise or deemed exercise and without additional payment, one Common Share and one-half of one Warrant for each Special Warrant exercised. Each Warrant entitles the holder to acquire one Common Share of the Company at a price of \$1.00 per share at any time prior to the date which is two years following the earlier of: (i) April 5, 2000; and (ii) the Clearance Date. In the event that the Clearance Date does not occur on or before April 5, 2000, then each Special Warrant exercised thereafter will entitle the holder thereof to acquire, without additional payment, 1.15 Common Shares and 0.575 Warrants in lieu of one Common Share and one-half of one Warrant. See "Plan of Distribution".

**An investment in the Common Shares and the Warrants is speculative and involves certain risks due to several factors. See "Risk Factors" for a discussion of certain matters which should be taken into consideration in connection with an investment in the Common Shares and Warrants.**

After giving effect to the exercise of the Special Warrants, the effective price paid for each Common Share issuable upon such exercise, being \$0.70, exceeds the net tangible book value per Common Share and Warrant as at October 31, 1999, after giving effect to this offering, by \$0.47, representing a dilution factor of 67%. See "Dilution".

The outstanding Common Shares are traded on the Canadian Dealing Network Inc. ("CDN"). On January 28, 2000, the closing price of the Common Shares on CDN was \$5.625. See "Price Range and Trading Volume". **There is no market through which the Special Warrants or Warrants may be sold and holders thereof may be unable to dispose of such securities.**

Definitive certificates representing the Common Shares and the Warrants will be available for delivery upon the exercise or deemed exercise of the Special Warrants in accordance with their terms.

Certain legal matters relating to the securities offered hereby will be passed upon by Goodman and Carr, on behalf of the Company, and by Cassels Brock & Blackwell LLP, on behalf of the Agent.

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## GLOSSARY OF TECHNICAL TERMS

**assembler language** - a type of computer programming language that is used mostly by hardware designers or system software designers that creates an interface with a computer hardware device.

**bandwidth** - the capacity for data transfer of an electronic communications system, or the amount of data that can be transmitted in a fixed amount of time. For digital devices, the bandwidth is usually expressed in bits per second (bps) or bytes per second. For analog devices, the bandwidth is expressed in cycles per second, or Hertz (Hz).

**browser** - in the context of the Internet, a browser is software that allows users to search for information and to use features available on the Internet.

**C++ language** - a type of computer programming language most widely used in the world of commercial software. C++ combines all the benefits inherited from its predecessor, the C language, with the ability to do object oriented programming.

**copy protect** - to render software unable to be duplicated under normal circumstances. This is the most commonly used practice for software publishers to protect against illegal software piracy.

**fulfilment house** - in the software publishing industry, a company sub-contracted to provide disk duplication, manual duplication, packaging, shrink wrap and shipping services.

**Intranet** - a network based on Internet protocols belonging to an organization, usually a corporation, accessible only by the organization's members, employees or others with authorization.

**ISP** - the acronym for Internet service provider.

**LAN** - the acronym for the term "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.

**"lite" software/product** - a version of software/product with fewer features than the standard full- featured version of such software/product.

**OEM** - the acronym for Original Equipment Manufacturer. In the context of the computer industry, OEMs typically purchase computer hardware in bulk, customize them for a particular application (often incorporating third party software into their product) and selling the customized product under their own name.

**PC** - the acronym for personal computer, which is a computer designed for an individual user.

**PCS** - the acronym for personal communications services, a new generation of digital, wireless communications services.

**POTS** - the acronym for plain old telephone service, which refers to the standard telephone service that most homes use, in contrast to telephone services based on high speed, digital communications lines.

**SOHO** - in the context of the computer industry, SOHO is an acronym for Small-Office-Home-Office, a target market or classification of computer users.

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## PROSPECTUS SUMMARY

*The following information is a summary only and is qualified, in its entirety, by the more detailed information and the financial statements appearing elsewhere in this prospectus. Capitalized terms appearing herein and not otherwise defined have the respective meanings ascribed thereto in the Glossary of Technical Terms or elsewhere in this prospectus. Certain of the information contained in this Summary and elsewhere in this prospectus under the headings "The Company", "Industry Overview" and "Business of the Company" has been obtained from publicly available information from third party sources. Neither the Company nor the Agent has verified the accuracy or completeness of any information contained in such publicly available information. In addition, neither the Company nor the Agent has determined if there has been any omission by any such third parties to disclose any facts, information or events which may have occurred prior to or subsequent to the date as of which any such information contained in such publicly available information has been furnished or which may affect the significance or accuracy of any information contained in any such information and summarized herein. Further, this prospectus contains certain forward looking statements and readers are cautioned not to place undue reliance on such statements contained in this prospectus. There can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company or any of the business or operations of the Company. See "Forward Looking Statements".*

### **The Company**

The Company develops and markets communication software that integrates, under a single user interface, a full range of communication capabilities, including e-mail, fax, voice, data, paging and Internet applications (e.g. Internet phone, fax and video), providing users with a single communication point of access or portal for their communications needs. This type of communications software is commonly referred to as "unified messaging/ communication software". Historically, the Company's products have been targeted towards the SOHO and home user, or consumer, markets. The Company's products are designed to integrate not only the different types of communications but also to integrate the different communications media available, including the Internet, POTS, corporate Intranets, cellular and wireless networks.

The Company was originally wholly-owned and funded solely by Mr. S.C. Cheung and Mr. Andrew Cheung, the Company's current President and Chief Executive Officer. From its inception through to the middle of 1995, the Company's business operations consisted primarily of product development. Throughout the remainder of 1995 and into 1996, the Company focused on the objective of securing channel partners to establish distribution of its products in order to be in a position to expand its market share. The Company's strategy has been to target both the conventional retail software channel and to "bundle" its products with modem manufacturers ("OEM licensing"). Throughout 1997 and 1998, the Company marketed its communication software products to establish a retail presence and create brand name awareness in the market for its *COMMUNICATE!* product line. Leveraging this brand name awareness, the Company was able to secure a number of OEM licensing arrangements in North America and Asia. In the spring of 1999, the Company's retail presence was expanded to Europe with the signing of a distribution agreement with a United Kingdom-based distributor.

Based on a report by Computer Retail Week, a CMP publication, in 1998 the Company's products were carried in nine out of the top ten retail chains in North America (as measured by gross revenues). In addition, the Company now has licencing agreements in place with, in aggregate, eight modem manufacturers in North America, Europe and Asia.

The Company's business and marketing strategy is to become a leading global provider of communications software for the consumer and SOHO market and to penetrate the corporate market to provide communications solutions. It is the Company's intention that a number of its new products under development will be designed to operate in a networked environment and, accordingly, will be available to be marketed to the corporate sector.

### **The Offering**

**Issue:** 6,285,714 common shares ("Common Shares") of the Company and 3,142,857 Common Share purchase warrants ("Warrants") of the Company issuable upon the exercise of 6,285,714 previously issued special warrants ("Special Warrants") of the Company.

**Price:** \$0.70 per Special Warrant. No additional price is payable on the exercise or deemed exercise of a Special Warrant.

**Special Warrants and Warrants:** On December 7, 1999, the Company issued 6,285,714 Special Warrants for consideration of \$0.70 per Special Warrant for aggregate gross proceeds of \$4,400,000. The Special Warrants were sold to investors on a private placement basis pursuant to an agency agreement (the "Agency Agreement") dated as of December 7, 1999 between the Company and Taurus Capital Markets Ltd. (the "Agent"). Each Special Warrant entitles the holder thereof to acquire, without payment of any additional consideration, a unit consisting of one Common Share and one-half of one Warrant. Each Warrant entitles the holder thereof to acquire one Common Share at a price of \$1.00 per share at any time prior to the date which is two years following the earlier of: (i) April 5, 2000; and (ii) the date (the "Clearance Date") on which a final receipt is issued by the Ontario Securities Commission for this prospectus. There are no voting rights attached to the Special Warrants or the Warrants.

In the event that the Clearance Date does not occur prior to 5:00 p.m. (Toronto time) on April 5, 2000, each Special Warrant exercised thereafter will entitle the holder thereof to receive, for no additional consideration, 1.15 Common Shares and 0.575 Warrants in lieu of one Common Share and one-half of one Warrant upon the exercise of each such Special Warrant.

The Special Warrants were issued pursuant to the terms of a special warrant indenture (the "Special Warrant Indenture") dated as of December 7, 1999 between the Company and Equity Transfer Services Inc. (the "Warrant Agent"), as special warrant agent. The Special Warrant Indenture provides that Special

Warrants may be exercised at any time prior to 5:00 p.m. (Toronto time) (the "Time of Expiry") on the date which is the earlier of: (i) the fifth business day after the date on which a final receipt is issued by the Ontario Securities Commission for this prospectus (the "Clearance Date"); and (ii) June 7, 2001. The Warrants were issued pursuant to the terms of a warrant indenture (the "Warrant Indenture") dated as of December 7, 1999, between the Company and the Warrant Agent, as warrant agent.

Any Special Warrants not exercised prior to the Time of Expiry will be deemed to be exercised immediately prior to such time. If the Special Warrants are exercised by a holder prior to the Clearance Date, such holder may be subject to applicable hold periods and may not be entitled to trade the Common Shares and Warrants received upon such exercise or deemed exercise, as well as the Common Shares issuable upon the exercise of the Warrants, except pursuant to a prospectus or an exemption from the prospectus requirements of applicable securities legislation.

See "Plan of Distribution".

**Use of Proceeds:**

The estimated net proceeds realized by the Company through the sale of the Special Warrants was \$3,960,000, after deducting the Agent's fee of \$330,000 and other offering expenses estimated at \$110,000. The Company will not receive any additional proceeds from the exercise or deemed exercise of the Special Warrants. It is anticipated that approximately \$1,500,000 of the net proceeds will be used for marketing and operating expenses such as trade shows, print advertising and channel promotions and other sales and marketing expenditures, including the launch of the Company's new product, *COMMUNICATE! i2000*. Of the balance of the net proceeds, approximately \$1,500,000 is intended to be used for general corporate purposes to finance the expansion of the Company's business in North America and Europe and approximately \$960,000 is intended to be used for research and development. The amount of the net proceeds dedicated to research and development is intended to be used to develop new products and to enhance existing products. See "Use of Proceeds".

Pursuant to an agreement dated as of December 7, 1999 among the Company, the Agent and Equity Transfer Services Inc., as escrow agent, \$1,100,000 of the aggregate gross proceeds raised from the offering of the Special Warrants are being held in escrow, which funds, together with any interest earned thereon, will be released to the Company on the earlier of the Clearance Date and June 5, 2000. See "Plan of Distribution".

**Dividend Policy:**

The Company intends to retain future earnings to finance the development of its business and, accordingly, does not anticipate paying dividends on its Common Shares in the foreseeable future. See "Dividend Policy".

**Risk Factors:**

An investment in the Common Shares and the Warrants is speculative and involves certain risk factors, including factors relating to the following: (i) the inherent nature of the computer and software industry generally makes the prospects and future profitability of the Company uncertain; (ii) the communications software industry is characterized by rapidly changing technology, evolving industry standards and frequent new product introductions, any of which could make the Company's products obsolete; (iii) the marketplace may not accept the Company's products; (iv) competition in the communications software industry is intense and growing rapidly and many of the Company's current and potential competitors have significantly greater financial and other resources than the Company; (v) the Company is unable to ensure the successful marketing of its products; (vi) the Company may have significant future capital requirements and it is uncertain if additional financing will be available and, if available, on acceptable terms; (vii) the Company's intellectual property rights, including copyright, trademarks and trade secrets, may be duplicated or challenged by third parties; (viii) there are risks associated with product liability and there is uncertainty as to the availability of insurance on commercially reasonable terms; (ix) the Company is highly dependent on certain key personnel; (x) the volatility of the price at which the Common Shares trade; (xi) the Company is dependent on a small number of distributors and OEM customers for sales of the majority of its products; (xii) the Company is unable to ensure it will manage its growth effectively; (xiii) there is a trend towards consolidation in the software industry; (xiv) potential fluctuations in quarterly financial results; (xv) fluctuations in the exchange rate between the Canadian dollar and other currencies; (xvi) the ability of the principal shareholders of the Company to continue to exercise significant influence over the Company; (xvii) uncertainty regarding possible Year 2000 problems; (xviii) the lack of a liquid public market for the Common Shares of the Company and no market for the Special Warrants or Warrants of the Company; and (xix) the Company does not anticipate paying any dividends on its Common Shares in the foreseeable future. See "Risk Factors".

## THE COMPANY

### Corporate Information

The Company was incorporated under the *Business Corporations Act* (Ontario) by Articles of Incorporation effective October 7, 1992. By Articles of Amendment dated July 27, 1995, the Common Shares of the Company were subdivided by changing each Common Share into 8.1818182 Common Shares. By Articles of Amendment dated September 22, 1995, the private company restrictions were deleted from the Articles of the Company.

The principal office of the Company is located at 1450 Meyerside Drive, Mississauga, Ontario L5T 2N5, approximately ten kilometres from the Toronto Pearson International Airport in leased premises of approximately 3,500 square feet. The Company also has a sales office in Colorado Springs, Colorado, U.S.A.

### Company Overview and Background

The Company develops and markets communication software that integrates, under a single user interface, a full range of communication capabilities, including e-mail, fax, voice, data, paging and Internet applications (*e.g.* Internet phone, fax and video), providing users with a single communication point of access or portal for their communications needs. This type of communications software is commonly referred to as "unified messaging/ communication software". Historically, the Company's products have been targeted towards the SOHO and home user, or consumer, markets. The Company's products are designed to integrate not only the different types of communications but also to integrate the different communications media available, including the Internet, POTS, corporate Intranets, cellular and wireless networks.

The Company was originally wholly-owned and funded solely by Mr. S.C. Cheung and Mr. Andrew Cheung, the Company's current President and Chief Executive Officer. From its inception through to the middle of 1995, the Company's business operations consisted primarily of product development. Throughout the remainder of 1995 and into 1996, the Company focussed on the objective of securing channel partners to establish distribution of its products in order to be in a position to expand its market share. The Company's strategy has been to target both the conventional retail software channel and to "bundle" its products with modem manufacturers ("OEM licensing"). Throughout 1997 and 1998, the Company marketed its communication software products to establish a retail presence and create brand name awareness in the market for its *COMMUNICATE!* product line. Leveraging this brand name awareness, the Company was able to secure a number of OEM licensing arrangements in North America and Asia. In the spring of 1999, the Company's retail presence was expanded to Europe with the signing of a distribution agreement with a United Kingdom-based distributor.

Based on a report by Computer Retail Week, a CMP publication, in 1998 the Company's products were carried in nine out of the top ten retail chains in North America (as measured by gross revenues). In addition, the Company now has licencing agreements in place with, in aggregate, eight modem manufacturers in North America, Europe and Asia.

## INDUSTRY OVERVIEW

### The PC Communications Industry

The PC communications industry has been evolving continuously since the 1980s. The original, or "first wave" of PC communications software products were basic products permitting data communications via a modem. The "second wave" of products, introduced in the early 1990's, consisted of basic PC facsimile software. The "third wave" of PC communications software products have only recently been introduced and integrate different types of communications software functions available, including fax, data, video, e-mail, paging and voice, under one user interface. This "third wave" or all-in-one class of products is also referred to as "unified messaging" or "unified communications".

During the early 1990's when PC communication software evolved from its "first wave" into its "second wave", the document preparation segment of the computer software industry evolved substantially. During this time, it became common for PCs to be loaded with word processing and spreadsheet programs. The Company believes that the PC communications segment of the computer software industry will eventually evolve along the same lines as the document preparation segment evolved, with the result that it will become common for PCs to be loaded with sophisticated yet easy to use communications software and hardware as communicating via PCs will also become increasingly common. The Company believes that "second wave" products will become less common place as "third wave" products integrating the different ways a person communicates, including fax, e-mail, voice-mail, Internet phone, Internet video conferencing, data and voice communications and the telephone, become widely available. As a result of the Company's belief that "third wave" communications software will be the next standard PC requirement, it is focussing its resources on the development and distribution of "third wave" products.

According to Davidson Consulting, an independent research firm based in Burbank, California, in the PC-based unified messaging/communications software market in 1999, there were 63.1 million units and 1.1 million units sold to the OEM and retail segments, respectively. In addition, Davidson Consulting estimates that sales to this market will grow from this approximately 64 million units in 1999 to 112 million units in 2002, with the OEM and retail segments growing in consistent proportions. Davidson Consulting also predicts that, by 2004, sales to the corporate market for unified messaging/communications software will outgrow those to the PC-based market.

The Company also believes, however, that in order for "third wave" software to be effective, both the communication type and media will need to be seamlessly integrated under one software solution or package. Such a solution should make using the PC and other interfaces (such as cellular phones and pagers) to communicate easier for the user than having to integrate and learn to use several different software applications.

The way in which a person communicates is commonly referred to as the messaging or communication "type". This may be a combination of one or more of the following: telephone conversation, fax, e-mail, data transfer, paging, voice mail, video phone or conferencing, video or audio mail. Communication "media", however, refers to the many ways the message or communication is sent. This could include POTS, the Internet, a corporation's Intranet, cellular network, cable network, wireless network or a paging system.

The following diagram illustrates the convergence of the different communication media with the communication type using a PC:



The Company believes the demand for software that is capable of allowing messaging and communications seamlessly over the various types of media is being influenced by the convergence of a number of trends, including the following:

***The growing number of households with PCs.*** PCs are becoming increasingly popular in today's household. It is estimated by Forrester Research Inc. ("Forrester"), a market research firm, that there are now approximately 50 million households in the United States with a PC. Over the past two years (1998 and 1999), the percentage of United States households with a PC is estimated by Forrester to have increased from 39% to 47%. The number of multiple PCs in United States households also appears to be growing as, according to IDC, by the end of 2000 almost 38% of all households in the United States with PCs will have two or more PCs. The Company believes that a number of these households may require products that allow for shared access to the Internet and information residing on other PCs in such households.

***The growing popularity and use of cellular phones.*** According to the Strategis Group, a market research firm, the United States cellular and PCS industry is predicted to grow by more than 57 million new subscribers over the next four years, bringing the total to approximately 124 million subscribers by the end of 2003. The Company believes that with this growing popularity and use of cellular phones comes the increasing demand for more cellular-based services. Using a cellular phone to access, be notified of, or send messages regardless of the communication type, and, to access other information from the user's data base, is one such solution that provides an additional cellular-based service. This reduces the need for an individual to carry more than one communication device. That is, only a cellular phone may be required on a remote basis to remain connected to a central communications centre, such as a PC.

***The growing popularity of the Internet.*** The Internet is becoming increasingly important to both consumers and businesses. According to IDC, the number of Internet users worldwide reached approximately

140 million by the end of 1998 and this number is forecast to grow to approximately 500 million by the end of 2003. Products that integrate the use of cellular phones and the Internet to provide a user with Internet applications, such as reading and replying to audio mail, Internet voice mail and remote e-mail, through regular analog or digital cellular phones should be of interest to many of those users connected to the Internet.

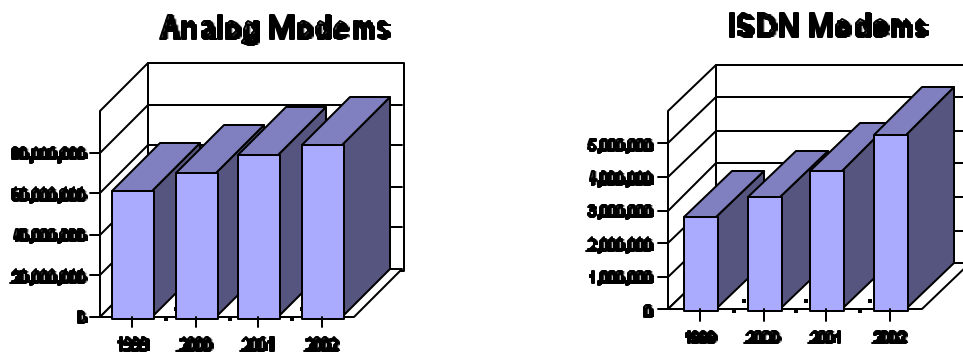
***The growing requirement for mobile access to corporate information.*** The Company believes that the increasing popularity of Local Area Networks and corporate Intranets over the past decade has been a factor in the increase in demand for the remote retrieval and use of information, which demand has also led to an increased need for software that would allow such users remote access to their corporate or personal database.

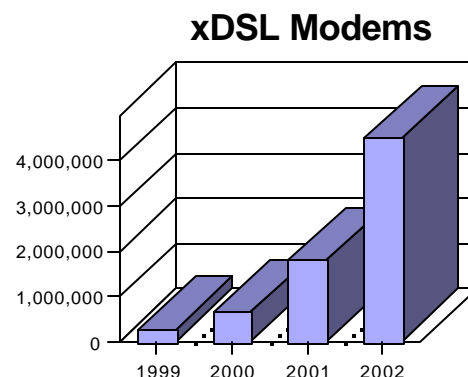
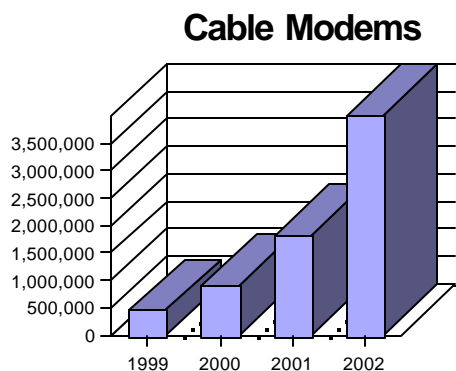
***The growing number of the workforce that is working out of their home.*** Entrepreneurs Home Office Magazine, a U.S. based business magazine, estimates that approximately 43 million people currently work out of their home in the United States. The Company believes that remote access to a central communications centre for retrieval of information and notification and sending of messages is often a requirement for many of these individuals.

***The growing acceptance of e-mail as a reliable means of communication.*** The Strategis Group estimates that there were more than 72 million e-mail users in the United States in 1998, which number is expected to grow to 98 million by 2001. E-mail has evolved beyond the basic sending and receiving of text-based electronic mail. It is becoming increasingly popular for users to send different types of mail, such as voice, video or audio mail, or a combination thereof, through the various communications media.

***The growing market for modems.*** In addition to the traditional analog modem, there are a number of other types of modems that the Company believes are becoming increasingly popular, such as cable modems, xDSL modems, cellular modems and ISDN modems. One factor in the popularity of these modems is consumer demand for increased bandwidth to handle their communications requirements. The following diagrams summarize and illustrate Davidson Consulting's forecast for world-wide modem shipments by modem type from 1999 to 2002:

**Modems - Forecasted Units Shipments by Year\***





\* The figures for 2001 and 2002 are based on a compound annual growth rate from 1997 to 2000 contained in the Davidson Consulting report.

Modems are used to integrate a PC into a communication media. PCs require a modem to be able to provide electronic communications and, in addition, require some form of communications software to be able to communicate. Accordingly, in addition to other factors, the Company believes that the market potential for communications software increases as the total number of modems shipped increases.

### **The 01 Communique Solution**

By developing software that integrates the different communication types and media under one single user interface, the Company believes that it provides a PC based software solution that turns the PC into a powerful communications centre that allows the user:

- seamless remote or local access to all their messages, including e-mail, voice messages or faxes;
- the ability to manage and retrieve information, whether local or remote, from their database;
- the ability to stay connected to their central communications centre as long as they have access to a communications device such as a cell phone or regular wire-based phone, or the Internet; and
- the ability to communicate over the Internet in a variety of ways, including: Internet phone, Internet video, and e-mail.

The Company believes that the wide breadth of functionality contained in the Company's products gives it a competitive edge. The Company is not aware of any product on the market today that provides the same level of functionality as the *COMMUNICATE!* line of products.

## BUSINESS OF THE COMPANY

### Product Overview

The first products developed by the Company were "second wave" personal communications software products, essentially PC fax software that enabled users to send and receive faxes directly from their workstations under a stand-alone or a network environment. These initial products were targeted towards the commercial and home user facsimile markets. Commercial shipments of these PC fax products commenced in 1995.

Emphasis is now placed on the Company's "third wave" software products. The Company's "third wave" product line is called *COMMUNICATE!*. Commercial shipments of the Company's first "third wave" product, *COMMUNICATE! v8.0*, began in August 1996. The second product release, *COMMUNICATE! PRO*, was first shipped in April 1998 and the third release, *COMMUNICATE! i2000*, was launched at the Comdex Las Vegas trade show in November 1999 and commenced shipping in January 2000. Each of these products incorporates the functionality of the previous product, while offering additional functionality.

### The Company's Products

The Company's products enable communication, by visual and verbal means, through a PC equipped with a modem. The Company offers a full range of unified messaging and communications software products for the SOHO and consumer markets. The software incorporated in the Company's products is object oriented and developed in C++ and assembler languages.

#### *COMMUNICATE! v8.0*

The first commercial shipments of *COMMUNICATE! v8.0* began in August 1996 and it is still actively marketed by the Company today. The product was first shipped as a 16 bit version and was later enhanced to a 32 bit version. The product supports Microsoft Windows 95 and 98, Windows NT and NT 4.0 platforms and was designed to resemble a telephone answering machine on screen, making it intuitive and easy to use. Voice, fax, data transfer, Internet e-mail and contact management applications are all combined under one common user interface, making it easier to use than integrating and learning a variety of different applications. *COMMUNICATE! v8.0* features include:

- sending and receiving faxes;
- voice mail and telephony;
- ability to record, save and forward voice telephone conversations;
- fax back, fax broadcast, and fax viewer;
- colour graphics editor;
- remote management capabilities;
- e-mail;
- data communications;
- log book and an integrated contact manager; and
- compatibility with Microsoft *Outlook* and Symantec *ACT*.

Today, *COMMUNICATE! v8.0* is the Company's "entry level" product for users.

## ***COMMUNICATE! PRO***

The first commercial shipments of *COMMUNICATE! PRO* began in April 1998. The product has all the functionality of *COMMUNICATE! v8.0* plus the following additional features:

- Internet phone;
- pager message dispatching;
- ability to launch a browser;
- contact history;
- data synchronization;
- multi-level voice-mail boxes and automatic selection of a voice menu greeting based on time and holiday;
- ability to activate different voice menus based on caller ID and distinctive ring received;
- more Internet-related fields in the contact manager; and
- multi-language capability.

*COMMUNICATE! PRO* supports eleven different languages, which are United Kingdom and American English, German, Dutch, French, Spanish, Italian, Portuguese, Japanese and both traditional and simplified Chinese. This multi-language capability is a major selling feature used by the Company to attract OEMs in Asia and Europe.

## ***COMMUNICATE! i2000***

The first commercial shipments of *COMMUNICATE! i2000* commenced in January 2000. With an easy to understand new user interface, this product has all the functionality of *COMMUNICATE! PRO* and numerous enhancements, including the following:

- additional remote management functionality including the ability to allow the user to listen remotely to e-mail messages (text-to-speech) and then instantly reply to the message attaching a voice response as an audio file;
- access the contact manager remotely to look up contact information such as phone numbers and be instantly connected (personal 411 service);
- Internet video monitoring, which allows the user to monitor their home or office with the built in motion detection software;
- video phone conferencing and video mail;
- Internet fax; and
- multi-line support allowing for simultaneous support of up to four modems. This allows the user to use one modem for telephony functions, a second modem for Internet connection, a third to send and receive faxes and have a fourth modem available for a second telephony line or other use.

## **Products Under Development**

The Company's goal is to continue to develop unified messaging/communications products for the SOHO and consumer market place or desktop PC, and to introduce new products suitable for the corporate market. To date, the Company's products have been designed with functionality primarily suited for the

desktop PC in a non-networked environment. The Company intends that a number of its new products under development will be designed to operate in a networked environment and, accordingly, will be available to be marketed to the corporate sector. No assurance can be given that any of the products described below will ultimately be developed by the Company.

### ***Short-Term Product Development***

During this fiscal year, the Company intends to develop the following products:

#### *Home Network*

The Company intends to continue to develop innovative communication software products with a wide breadth of functionality for the SOHO and consumer market. To address the demands of consumers having multiple PCs in their home and who wish to take advantage of a networked solution, the Company plans to develop a new product with this functionality. This product is planned to feature all the functionality of the *COMMUNICATE! i2000* and, in addition, allow multiple PC's in a home to share Internet access, contact management and other information, utilizing existing telephone wiring in the home. The Company believes that as the number of individuals working out of their homes increases and the number of households with multiple PCs increases, there will be an increase in demand for communications software that allows multiple PCs within a household to operate together sharing resources. By making use of existing wiring in the home, the Company believes that the installation of such a solution becomes easier and cost effective.

#### *Small Network*

The Company believes that the market for a complete unified messaging and communications centre is not limited to the SOHO or consumer market and that the benefits of this type of software may be equally as attractive to the world of small business. The Company intends to develop a product for the small business world which, like the home networking product, would contain all the functionality of the *COMMUNICATE! i2000*. In addition, it is proposed that it will operate in a workgroup solution allowing small groups of PCs to operate together sharing Internet access, contact management and other information. Development of such a product may expand the market potential for the Company to include the multitude of small businesses looking to increase their productivity. Like the *COMMUNICATE! i2000*, with the ability to support up to four lines, the user of this new product would be able to use one modem for telephony functions, a second modem for Internet connection, a third to send and receive faxes and have a fourth modem available for a second telephony line or other uses. The Company believes that functionality, such as the multi-line support, will be seen as a major selling feature for this product by small businesses.

### ***Long-Term Product Development***

After development of the new products described above, the Company plans to include the following in its product development:

## *Corporate Offering*

The Company plans to develop a totally integrated messaging and communications solution for the corporate market which would be server-based and would support Microsoft's Windows 2000, NT, and Linux platforms.

This product is planned to be an Internet telephony server product which would provide an opportunity for licensing to wide bandwidth service providers (for example, ISPs and cable companies). It is intended that this product allow the information technology department of a corporation to set up communications from its web site, allowing employees to access *COMMUNICATE!* functionally by way of a PC-based Internet browser.

It is also intended that this product would provide users, among other functionalities, with the ability to:

- access corporate databases and retrieve information on a remote basis, using any cellular or regular wired phone; and
- log on to the corporate network accessing the communications software remotely through the Internet. Functionality such as this gives the individual the ability to manage their communication requirements on a remote basis.

## *Linux Operating System*

With the increasing popularity and acceptance of the Linux operating system for the desktop, the Company plans to enhance its product offering for full Linux compatibility. The next generation of the Company's products are planned for the corporate market and are intended to be server-based and capable of operating in a client/server environment. Similar to *COMMUNICATE! i2000* in functionality, these products are intended to be fully compatible with both Linux and Windows 2000.

The Company believes that the Linux operating system has the potential to increase the market for consumer applications such as the *COMMUNICATE!* line of communication software. The Company plans to develop communication software solutions that will support Linux servers in the corporate office, embedded systems for the mobile user, and consumer versions for the desktop.

## **The Company's Target Market Segments**

The unified messaging/communications end-user software market comprises the following three groups of users:

- i) consumer or SOHO users utilizing their PCs with modems for personal and business communication, including telephone, fax, e-mail, voice-mail, fax-on-demand, data communication, paging, telephone notification and Internet applications;
- ii) small/medium LAN market or workgroup users (an office network environment of 25 to 30 or fewer users sharing software); and

- iii) the centralized communication server market for large LANs and enterprise-wide networks used by large corporations.

In the past, the Company targeted the SOHO and home-user, or consumer, market. The small/medium LAN market and the large LAN and enterprise-wide has not formed part of the Company's target market given that the Company's current product line is not compatible with a network environment. Rather, the Company's current product line operates in a single PC and requires a dedicated modem.

## **Business and Marketing Strategy**

The Company's business and marketing strategy is to become a leading global provider of communications software for the consumer and SOHO market and to provide communications solutions to the corporate market. The critical components of the Company's business and marketing strategy are set out below:

### ***Product Marketing***

With the introduction of the *COMMUNICATE! i2000* and other products under development, the Company will have a broader product offering that covers a broader market segment. Each product and market segment has its own unique requirements and expectations. The Company develops a specialized marketing strategy for each product launch, positioning each product released based on an analysis of market conditions. In general, however, each marketing campaign typically includes a combination of the tactics outlined below in respect of advertising and promotion in order to promote brand-name awareness and market acceptance of its products:

- joint channel promotions with the Company's retail channel partners;
- product reviews by major publications within the computer and communications industry;
- participation in trade shows;
- advertising in industry publications;
- creative packaging for the retail channel; and
- on-line information to promote the Company and its products.

### ***North American Retail Presence***

During the past two years, the Company has made efforts to develop a retail presence in North America. The results to date have met the Company's expectations as, according to a report by Computer Retail Week, the Company's products are currently carried by nine of the top ten retail chains in North America. This represents over 3,000 retail outlets carrying the Company's products in North America.

The Company takes a two-tier approach to retail distribution, using large distributors for their networking and logistical capabilities and retail chains for access to the end-user, or consumer, market. The retail chains purchase the Company's products from the distributor of their choice. The Company has distribution agreements with three large United States based distributors, being Ingram Micro Inc., Merisel Americas Inc. and Tech Data Corporation. The Company believes that the distribution agreements it has entered into with its distributors contain terms substantially similar to those generally accepted in the industry. The agreements are generally for a term of one year, are automatically renewable for a subsequent one-year

term, and provide for a short notice period of cancellation, generally 30 days written notice by either party. In addition, the distribution agreements provide for the return of product for full credit.

Among the larger retail chains and catalogue houses carrying the *COMMUNICATE!* products are: Best Buy, Computer City, Comp USA, Compusmart or Compucentre in Canada, Creative Computers, Electronics Boutique, Fry's, Future Shop, Global Direct, Hastings, J&R Computer World, Media Play, Micro Center, Micro Warehouse, Musicland, Multiple Zones, OfficeMax, Office Depot, CDW, PC Connection and Staples.

The Company believes that the presence it has created in the North American retail market is critical to the success of its products. Broad distribution through a variety of nationally recognized retail chains enhances market awareness of the Company and brand awareness of its products. This affects not only sales to the mass market individual users in the SOHO and mobile market but also to corporate and government users and OEM manufacturers of PCs and fax/data/voice modems. The Company believes that its penetration of the North American retail market to date provides it with a market presence which will enhance the Company's efforts in engaging additional international distributors and retail stores to market and sell the Company's family of products in international markets.

The Company plans to focus on sales and marketing efforts to increase its North American retail presence by adding additional retail chains to its distribution channel, where required, and increasing the revenue from each of the existing retail chains carrying the Company's products.

### ***European Retail Presence***

In July 1999 the Company expanded its retail presence into Europe using a two-tier distribution approach similar to the approach used by the Company in North America. The Company has one distribution agreement in place in Europe with Koch Media Ltd., located in the United Kingdom. The retail chain carrying the *COMMUNICATE!* products in Europe is Dixons Group PLC, making the products available in approximately 350 of its stores.

In fiscal 2000, the Company plans to expand the number of retail chains carrying its products in the United Kingdom as well as to expand its geographical coverage of Europe, with Germany being the first country intended to be targeted.

As indicated above under "The Company's Products", *COMMUNICATE! PRO* supports eleven different languages, including the major languages in Western Europe, being United Kingdom English, Dutch, German, Spanish, French, Portuguese and Italian, which the Company believes will be a major selling feature in the marketing of this product in Europe.

### ***OEM Channel with Modem and PC Manufacturers***

The Company sells both full-featured and "lite" versions of its products, under licensing agreements, through its direct sales force to modem and PC manufacturers. The OEM licencing agreements generally provide for payment to the Company of a specified amount per copy of the Company's software, with copies made by the OEM customer from master copies supplied by the Company. The agreements are generally

for a term of one year and are renewable on the anniversary date of such agreements with the consent of the parties.

The Company's strategy has been to develop a strong retail presence, then leverage this presence to attract large OEM partners. OEMs distribute the Company's products by bundling scaled-down versions of such products or, in some cases, customized full-featured versions, with their products and then distributing the bundled products through their sales channels. This method of distribution contributes to the creation of a substantial user base. The Company anticipates that sales to OEMs will lead to follow-up sales as those users with scaled-down versions of the Company's products upgrade to full-featured retail versions.

As part of its OEM strategy, the Company intends to continue to develop and sell to OEMs software products that are targeted to users who require more functionality and may wish to upgrade to either a full-featured product or a new enhanced product.

#### ***Expand OEM Partnerships to Include Service Providers and Cellular Phone Networks***

Recent studies suggest that the number of business people working outside of the office, either on the road or at home, is increasing. According to IDC, in 1998 approximately 27% of all households in the United States reported conducting some degree of work from home. In addition, IDC forecasts that the number of home offices in the United States with PCs and Internet capability will increase to over 30 million by 2002 from approximately 17 million in 1998, concluding that "there is potential business opportunities for communications service providers that offer services to the work-at-home and on-line consumer segments". The Company believes this trend of increased mobility by the workforce will create an increase in demand for unified messaging/communications capabilities that will deliver time sensitive messages and enhance communications.

The Company believes that its product offerings fit well into this market segment both in terms of functionality and price points. The Company intends to continue in its efforts to develop relationships and form strategic partnerships with service providers, such as cellular and telephone companies, in order to take advantage of this business opportunity.

#### ***Establish a Value Added Reseller (VAR) Channel***

As described above under the heading "Products Under Development", the Company plans to complete development of and launch additional communications software products designed to facilitate expansion into the small business and the corporate market. It is intended that the users of these products will be serviced by VARs.

The Company plans to develop a VAR channel to facilitate business into the small business and corporate world. The multi-line version of the *COMMUNICATE! i2000* which offers small business advanced communications features is viewed by the Company as a product that could be sold to small businesses by VARs.

Establishing a VAR channel should broaden the Company's distribution base and expand the potential market for the Company's products.

## ***E-commerce***

According to IDC, the number of worldwide Internet users was approximately 140 million in 1998, which users conducted almost \$100 billion in commerce. This is forecast to grow to 500 million users conducting close to \$1.3 trillion in commerce by 2003.

As it has with most segments of the retail market, the Internet is playing an increasingly important role in software distribution. The Company intends to implement additional programs that capitalize on e-commerce and distribution of software over the Internet. These programs will be designed to complement the Company's retail and OEM strategy.

Currently, the Company's homepage supports on-line ordering, by directing a customer to third party websites which carry the Company's products, and upgrade capabilities. A free thirty-day trial version of the Company's full-featured product, *COMMUNICATE! PRO*, is available on its website for downloading. There is a program in place whereby the trial version can easily be purchased with a lifetime activation key on-line or via toll-free customer service number.

## **Competition**

The computer software market is intensely competitive and is subject to rapid changes in technology. It is influenced by the strategic direction of major computer hardware manufacturers and operating system providers. The Company's competitiveness depends, among other things, on its ability to enhance existing products and to offer successful new products on a timely basis. The Company has limited resources and must ensure product development efforts are narrowly focussed.

Although there are many competitors with products that have some of the same features as the Company's products, the Company believes that none of its competitors offers a PC communication software product with all the integrated communications features of the *COMMUNICATE!* family of products. The Company's all-in-one software simplifies PC communications by eliminating the need for users to purchase, install, learn and manage multiple applications. Other products such as *TalkWorks* by Symantec and *HotFax MessageCenter* by Smith Micro Inc. have many of the same features as, but not all of the features of, the Company's *COMMUNICATE!* products. For example, *TalkWorks* and *HotFax MessageCenter* provide certain voice functions, but do not presently have Internet functionality such as e-mail, Internet phone, Internet fax or Internet video. In addition, the *COMMUNICATE!* product line has its own built-in contact manager, a feature which is currently lacking in the competition's products. As well as the ability to use its own contact manager, the *COMMUNICATE!* products are also compatible with some of the other leading contact managers on the market today, such as Microsoft *Outlook* and Symantec *Act*.

The Company considers the following companies to be the principal source of current and future competition for the Company's products:

### *Retail channel:*

<b><u>Company</u></b>	<b><u>Product</u></b>
Symantec Corporation	<i>TalkWorks</i>
Smith Micro Inc.	<i>HotFax MessageCenter</i>

*OEM channel:*

<b><u>Company</u></b>	<b><u>Product</u></b>
BVRP Software	<i>Phone Tool</i>
Cheyenne Software, Inc.	<i>BitWare</i>

In addition to the companies and their products listed above, it is possible that new competitors or alliances among competitors and vendors may emerge and rapidly acquire market share. As the Company broadens its products and markets to include remote communications and messaging for the retail consumer and business world, it anticipates that it will experience increased competition. The competitive environment for remote communications and messaging is evolving rapidly, with several companies already providing products with solutions for part of this market. For example, Research In Motion Limited, with its BlackBerry solution, provides an access device allowing users to access e-mail, and some personal information functions, over a wireless network. This solution requires the user to purchase a hand held device and subscribe to a monthly service for the data communication over a wireless network. As an alternative, the Company provides software that resides on a PC with a broad range of communications and messaging functionality, including the ability for the user to listen to and reply with a verbal response to their e-mail. While many consumers will opt for the use of a hand held device and a monthly service, it is anticipated there will be those consumers who prefer the flexibility and broader functionality allowed by the use of software such as that provided by the Company. Many of the Company's competitors have much greater brand name recognition, a larger customer base and greater financial and other resources than the Company. There can be no assurance that the Company will be able to compete effectively with such companies. See "Risk Factors - Competition".

### **Intellectual Property**

The Company regards its software as proprietary and attempts to protect it through a combination of copyrights, trade secret laws, contractual restrictions on disclosure and transferring title and other methods, rather than patents. Despite these precautions, it may be possible for unauthorized third parties to copy certain portions of the Company's products and obtain and use information the Company regards as proprietary. While the Company's competitive position may be affected by its ability to protect its proprietary information, the Company believes that copyright protections are less significant to the Company's success than other factors, such as trade secret protection, the knowledge, ability and experience of the Company's personnel, name recognition and ongoing product development and support.

The Company licenses its products primarily under licences included as part of the product packaging. These licences are not negotiated with or signed by individual licencees and purport to take effect upon the opening of the product package. Certain provisions of such licences, including provisions protecting against unauthorized use, copying, transfer and disclosure of the licensed program, may be unenforceable under the laws of certain jurisdictions. In addition, the laws of some foreign countries do not protect the Company's proprietary rights to the same extent as do the laws of Canada and the United States. The Company does not copy protect its software. Accordingly, it may be possible for unauthorized parties to copy or reverse engineer the Company's products or otherwise obtain and use information that the Company regards as proprietary. Further, there can be no assurance that the Company's competitors will not independently develop technologies that are substantially equivalent or superior to the Company's products, that the steps taken by the Company to protect its proprietary rights will be adequate or that third parties will not infringe or

misappropriate the Company's copyrights, trade marks, trade secrets or similar proprietary rights. In addition there can be no assurance that other parties will not assert infringement claims against the Company. Policing unauthorized use of the Company's products is difficult and, while the Company is unable to determine the extent of software piracy of its products, software piracy can be expected to be a persistent problem. See "Risk Factors - Proprietary Technology".

The Company has applied for trademark registration in Canada and the United States for the *COMMUNICATE!* product name.

## **Production**

The Company's products are shipped in both diskette and CD-ROM form. The Company produces its own master copy and ships to a "fulfilment house" to do the duplication and packaging. To date, the Company has not experienced any material difficulties or delays in the manufacture or assembly of its products or any material number of returns due to product defects.

## **Employees**

The Company has 30 full-time employees (consisting of 19 product support and development staff and 11 sales, marketing and administrative staff) and, in addition, makes use of contract software developers when required. The Company believes its success will depend, to a great extent, on its ability to retain highly qualified personnel and to attract new personnel where required. The Company is highly dependent on two principal members of its management team, Mr. Andrew Cheung, President and Chief Executive Officer, the loss of whose services might impede the achievement of development objectives, and Mr. Brian McElwain, Vice President, Sales and Marketing, the loss of whose services might impede the achievement of the Company's sales and marketing initiatives. The Company considers its relations with its employees to be good.

Competition in recruiting personnel in the software industry is intense. The Company believes that it must provide personnel with a competitive compensation package, which, among other things, necessitates the continued availability of stock options and shares to be issued under its employee stock option plan. See "Risk Factors - Dependence on Key Personnel".

## **Facilities**

The Company leases its head office, which houses its principal administrative, marketing and technical facilities. The head office is located at 1450 Meyerside Drive, Mississauga, and totals approximately 3,500 square feet.

The lease expires on September 30, 2000, and contains no renewal option. The Company expects to negotiate a new lease and stay in the same premises when the existing term expires. Approximately 3,000 square feet of additional space is available in the building. The additional space is sufficient to meet the Company's requirements for the foreseeable future. In the event the Company is unable to negotiate a new lease at its current leased premises on favourable terms or at all, the Company believes that suitable space and facilities will be available elsewhere on reasonably favourable terms to accommodate the Company's operations.

## SELECTED FINANCIAL INFORMATION

The following selected financial information for the fiscal years ended October 31, 1999, 1998 and 1997 has been derived from the Company's audited financial statements. The data should be read in conjunction with the Company's management discussion and analysis of financial condition and results of operations and the Company's consolidated financial statements and notes thereto included elsewhere in this prospectus.

### Statement of Operations Data

	Year Ended October 31,		
	1999	1998	1997
Revenue	\$ 7,031,568	\$ 4,003,313	\$ 1,765,282
Cost of goods sold	284,366	304,933	290,844
	<u>6,747,202</u>	<u>3,698,380</u>	<u>1,474,438</u>
<i>Expenses:</i>			
Selling, general and administrative	4,431,296	4,955,465	3,068,936
Research and development (net of ITCs)	819,331	609,284	375,789
Interest, net	41,483	-	90,000
Amortization of debenture discount	84,100	-	-
Depreciation and amortization	31,178	31,176	37,380
Total expenses	<u>5,407,388</u>	<u>5,595,925</u>	<u>3,572,105</u>
Net income (loss)	<u>1,339,814</u>	<u>(1,897,545)</u>	<u>2,097,667</u>
Net Income (loss) per share - basic	\$ 0.07	\$ (0.10)	\$ (0.15)
Net Income (loss) per share - fully diluted	\$ 0.06	\$ (0.10)	\$ (0.15)

### Balance Sheet Data

	As at October 31,		
	1999	1998	1997
<i>Assets:</i>			
Total current assets	\$ 3,556,272	\$ 2,063,755	\$ 2,894,729
Capital assets	82,847	113,731	134,171
Total assets	<u>\$ 3,639,119</u>	<u>\$ 2,177,486</u>	<u>\$ 3,028,900</u>
<i>Liabilities and shareholders' equity:</i>			
Total current liabilities	\$ 1,227,255	\$ 1,717,714	\$ 620,174
Long-term debt	393,800	-	28,321
Total shareholders' equity	<u>2,018,064</u>	<u>459,772</u>	<u>2,380,405</u>
Total liabilities and shareholders' equity	<u>\$ 3,639,119</u>	<u>\$ 2,177,486</u>	<u>\$ 3,028,900</u>

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

The following discussion and analysis provides information supplementary to the Company's results of operations and financial position and should be read in conjunction with the audited financial statements and notes thereto contained elsewhere in this prospectus.

### **Results of Operations**

#### ***Fiscal 1999 Compared to Fiscal 1998***

##### *Overview*

Fiscal 1999 was the Company's first year of profitability, with a profit reported in each quarter. On revenues of \$7,031,568, net income for the year was \$1,339,814 or \$0.07 per Common Share as compared to a loss of \$1,897,545 or \$0.10 per Common Share on revenues of \$4,003,313 for fiscal 1998.

##### *Revenue*

Revenue increased by 76% for the year, from \$4,003,313 in fiscal 1998 to \$7,031,568 in fiscal 1999. Revenues from both the retail and OEM sectors increased during the year, with retail revenue increasing by 40% from \$2,095,000 in fiscal 1998 to \$2,933,000 in fiscal 1999, and OEM revenue increasing by 114% from \$1,908,000 in fiscal 1998 to \$4,098,000 in fiscal 1999. The Company believes that this growth reflects the success of the Company's strategy to develop a strong retail presence and subsequently leverage this presence to attract OEM partners.

The increase in revenue in the OEM sector during fiscal 1999 was achieved through the signing of new customers as well as increased revenue from accounts signed during fiscal 1998. The increased revenue in the retail sector during fiscal 1999 was a result of additional revenue gained by adding new retail chains, as well as increasing sales through the existing retail chains carrying the Company's products. In addition, the Company expanded its retail presence to include the United Kingdom, which effected an incremental revenue increase over fiscal 1998.

##### *Cost of Revenue/Sales*

Gross profit (revenue minus cost of revenue) was \$3,698,380 in fiscal 1998 compared to \$6,747,202 in fiscal 1999, representing an increase of 82%. Gross margin increased from 92% in fiscal 1998 to 96% in fiscal 1999 as a consequence of the relatively larger increase in revenues from the OEM sector and the relatively lower cost of goods sold for that sector, as compared to the retail sector.

### *Selling, General and Administrative Expenses*

Total expenses for selling, general and administration decreased by \$524,169 during the year, from \$4,955,465 in fiscal 1998 to \$4,431,296 in fiscal 1999, as more particularly described below:

*Selling and marketing expenses.* Selling and marketing expenses consist of the salaries, commissions and other expenses required to operate the Company's sales department and the marketing programs aimed at creating awareness of the Company and its products. Overall selling and marketing expenses decreased by \$589,466 from \$4,215,893 in fiscal 1998 to \$3,626,427 in fiscal 1999. Marketing expenses decreased as a result of a reduction in the number of trade shows attended and expenditures for advertising in large national trade publications, both of which are relatively expensive. Instead, emphasis was placed on joint channel promotions with retail chains. Salaries and related expenses were consistent from year to year, with the Company maintaining a consistent staff level from fiscal 1998 to fiscal 1999.

*General and administrative expenses.* General and administrative expenses consist of the personnel costs, professional fees, occupancy and other costs required to operate and manage the Company. These costs remained relatively consistent, with a modest increase of \$65,397 from \$739,572 in fiscal 1998 to \$804,969 in fiscal 1999.

### *Research & Development Expenses*

Research and development expenses consist of the personnel, subcontractor and equipment expenses required to develop the Company's new products. As a Canadian controlled private corporation ("CCPC"), the Company qualifies for investment tax credits ("ITCs") under the *Income Tax Act* (Canada). ITC's are fully refundable to a CCPC at a rate of 35% of eligible current research and development expenditures. The Company provided for ITCs, as a reduction of research and development expenses, in an amount of \$150,000 in fiscal 1999 compared to \$350,000 in fiscal 1998. Prior to giving effect to the reduction for the ITC, research and development expenses increased marginally by \$10,047 from \$959,284 in fiscal 1998 to \$969,331 in fiscal 1999.

Software development costs are expensed as incurred unless they satisfy the generally accepted accounting criteria for deferral and subsequent amortization. In the view of management of the Company, such criteria have been difficult to satisfy in the past and, as a result, development costs have been expensed as incurred.

### *Net Income*

During fiscal 1999, the Company's net income after taxes was \$1,339,814 or \$0.07 per Common Share as compared to a loss of \$1,897,545 or \$0.10 per Common Share in fiscal 1998. The Company's past research and development activities gave rise to income tax loss carry forwards and investment tax credits which reduced the Company's taxable income to nil for income tax purposes in fiscal 1999. See note 8 to the Company's financial statements contained elsewhere in this prospectus.

## ***Fiscal 1998 Compared to Fiscal 1997***

### *Overview*

Revenue for the year more than doubled increasing from \$1,765,282 in fiscal 1997 to \$4,003,313 in fiscal 1998. The increase in revenue was attributable to increased penetration of the North American retail channel, new contracts signed with OEM partners and the successful launch of *COMMUNICATE! PRO*. The net loss for the year was \$1,897,545 or \$0.10 per Common Share as compared to a loss of \$2,097,667 or \$0.15 per Common Share for fiscal 1997.

### *Revenue*

Revenue increased by 127% for the year, from \$1,765,282 in fiscal 1997 to \$4,003,313 in fiscal 1998. Retail revenue increased 19% during the year, from \$1,759,000 in fiscal 1997 to \$2,095,000 in 1998. This growth was less than expected due primarily to the limited availability of financial resources for sales and marketing activities, and the long lead times needed for these activities to achieve the desired results. These factors impacted upon revenue growth.

Revenue from the OEM sector increased from a negligible amount in fiscal 1997 to \$1,908,000 in fiscal 1998. Many of the OEM accounts were added late in fiscal 1998 and, as such, the full revenue potential from these accounts was not realized until fiscal 1999.

### *Cost of Revenue/Sales*

Gross profit was \$1,474,438 in fiscal 1997 compared to \$3,698,380 in fiscal 1998, representing an increase of 150%. Gross margin increased from 84% in fiscal 1997 to 92% in fiscal 1998. This increase was directly related to the relatively larger increase in revenues from the OEM sector in fiscal 1998 and the relatively lower cost of goods sold for that sector, compared to the retail sector.

### *Selling, General and Administrative Expenses*

Total expenses for selling, general and administration increased from \$3,068,936 in fiscal 1997 to \$4,955,465 in fiscal 1998. This increase of \$1,886,529 was due primarily to an increase in sales and marketing expenses of \$1,653,022. A total of \$4,215,893 was spent in fiscal 1998 primarily on national advertising and channel promotion with the objective of creating a strong retail presence for the Company's products. General and administrative expenses increased by 46% from \$506,065 in fiscal 1997 compared to \$739,572 in fiscal 1998.

### *Research & Development Expenses*

The Company provided for ITCs in an amount of \$350,000 in fiscal 1998 compared to \$162,500 in fiscal 1997. Prior to giving effect to the reduction for the ITC, research and development expenses increased from \$538,289 in fiscal 1997 to \$959,284 in fiscal 1998. The increase was a result of new product development initiatives, primarily for the development of *COMMUNICATE! PRO* and international language support. All research and development costs, net of ITCs, were expensed as incurred.

## **Liquidity and Capital Resources**

At the beginning of fiscal 1999, the Company had bank indebtedness of \$635,890. As at the date of this prospectus, the Company has no bank indebtedness. As reflected in the Company's statements of cash flows, there was an increase in cash, prior to repaying bank indebtedness, of \$1,590,502 for the year, resulting in net cash of \$954,612 at year end. In addition, the Company has a revolving operating line of credit in the amount of \$750,000 with a Canadian chartered bank.

Of the \$1,590,502 positive cash flow for the year, financing activities, prior to repaying bank indebtedness, contributed net cash of \$611,594, with most of the remaining \$978,908 cash flow having been generated by profitable operations. The financing activities consisted primarily of: (i) the issuance of Common Shares for net proceeds of \$218,478; (ii) the issuance of a debenture in the principal amount of \$215,900, which was repaid during the year at par value of \$300,000; and (iii) incurring long-term debt in the principal amount of \$500,000. Subsequent to the fiscal year ended October 31, 1999, the Company issued additional equity through the issuance of the Special Warrants, generating net proceeds of \$3,960,000 (after deducting the Agent's fee and expenses of the offering).

With the proceeds raised from the issuance of the Special Warrants combined with cash of \$954,613 and funds contributed by ongoing operations, the Company believes that its cash resources are sufficient to fund the Company's operations for fiscal 2000. In addition, there is the possibility of additional funds being generated through the exercise of the Warrants.

### **Year 2000 Issue**

#### *State of Readiness*

The "Year 2000" issue affects computer systems that have date-sensitive programs that may not properly recognize the year 2000. The problem arises because many computer systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the "00" as 1900 rather than 2000. The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000.

The Company instituted a company-wide review to address the Year 2000 issue, focussing on product compliance and applications used in operations. Management of the Company believes that all of its currently supported products are Year 2000 compliant and that the Company will not have to undertake additional Year 2000 research and development efforts. All major internal systems were reviewed and actions undertaken to resolve all Year 2000 issues by December 31, 1999. The Company continues to monitor Year 2000 issues, and, as at the date of this prospectus, no significant Year 2000 issues affecting the Company's operations have been discovered. In addition, should a supplier or other third party be unable to resolve, in a timely manner, a Year 2000 issue which has an adverse impact on the Company's operations, the Company will develop remedial action or contingency plans, as required.

#### *Costs*

The total cost of attaining Year 2000 compliance was not material to the Company. These costs were funded through the operating cash flow of the Company and are not expected to have material adverse effect on the Company's business, results of operations or financial condition.

## ***Risks***

The Company believes that it has identified and resolved all Year 2000 issues that could materially adversely affect its business, financial condition or results of operations. However, it may not be possible to determine with complete certainty that all Year 2000 problems affecting the Company have been identified or corrected. As a result, the Company could be at risk of experiencing a significant number of operational inconveniences and ineffectiveness that may divert management's time and attention from its ordinary business activities. The Company would also be at risk of experiencing a lesser number of serious systems failures that may require significant efforts by the Company to prevent or alleviate material business disruptions. In addition, in the event that the Company has not accurately identified or corrected all such Year 2000 problems, the costs of achieving Year 2000 compliance could be material to the Company. See "Risk Factors - Uncertainty Regarding Possible Year 2000 Problems".

## ***Contingency Plans***

The Company's contingency planning for the Year 2000 issue consisted of addressing various alternatives, including assessing a variety of "most reasonably likely worst case scenarios" to which the Company may be required to react. The Company's contingency plans are updated on an ongoing basis.

## **PLAN OF DISTRIBUTION**

On December 7, 1999, the Company issued 6,285,714 Special Warrants at a price of \$0.70 per Special Warrant for aggregate gross proceeds of \$4,400,000. The Special Warrants were sold by the Company to investors on a private placement basis pursuant to an agency agreement (the "Agency Agreement") dated as of December 7, 1999, made between the Company and Taurus Capital Markets Ltd. (the "Agent"). An aggregate fee of \$330,000 was paid to the Agent in connection with the offering of Special Warrants. In addition to such fee, the Company issued to the Agent non-assignable compensation warrants ("Compensation Warrants") of the Company entitling it to acquire, upon exercise thereof and without payment of any additional consideration, 628,571 compensation options ("Compensation Options") of the Company. Each Compensation Option will entitle the Agent to purchase a unit (a "Compensation Unit") at a price of \$0.70 per unit at any time prior to 5:00 p.m. (Toronto time) on December 7, 2001. Each Compensation Unit will consist of one Common Share (a "Compensation Share") and one-half of one Common Share purchase warrant (a "Compensation Purchase Warrant") of the Company. Each Compensation Purchase Warrant will entitle the Agent to subscribe for one Common Share at a price of \$1.00 per share at any time prior to 5:00 p.m. (Toronto time) on the date which is two years following the earlier of: (i) June 7, 2000; and (ii) the Clearance Date (as hereinafter defined). This prospectus also qualifies for distribution 314,285 of the Compensation Options to be issued upon the exercise of the Compensation Warrants. No additional proceeds will be received by the Company, nor will any additional fee be payable to the Agent, in connection with the Common Shares and Warrants issuable upon the exercise or deemed exercise of the Special Warrants.

The Special Warrants were issued pursuant to the terms of a special warrant indenture (the "Special Warrant Indenture") dated as of December 7, 1999 between the Company and Equity Transfer Services Inc. (the "Warrant Agent"), as special warrant agent. The Warrants will be issued pursuant to the terms of a warrant indenture (the "Warrant Indenture") dated as of December 7, 1999, between the Company and the Warrant Agent, as warrant agent. Each Special Warrant entitles the holder thereof to receive, upon exercise

or deemed exercise thereof and at no additional cost, one Common Share and one-half of one Warrant. Each Warrant entitles the holder to acquire one Common Share of the Company at a price of \$1.00 per share at any time prior to the date which is two years following the earlier of: (i) the date ("Clearance Date") on which a final receipt is issued by the Ontario Securities Commission for this prospectus; and (ii) April 5, 2000. The Special Warrants may be exercised at any time and from time to time prior to 5:00 p.m. (Toronto time) (the "Time of Expiry") on the date which is the earlier of: (i) the fifth business day following the Clearance Date; and (ii) June 7, 2001. Any Special Warrants not exercised prior to the Time of Expiry will be deemed to be exercised immediately prior to such time.

In the event that the Clearance Date does not occur on or before April 5, 2000, then each Special Warrant exercised thereafter will entitle the holder thereof to acquire, without additional payment, 1.15 Common Shares and 0.575 Warrants in lieu of one Common Share and one-half of one Warrant (the "Conversion Rate Increase").

If the Special Warrants are exercised by a holder prior to the Clearance Date, such holder may be subject to applicable hold periods and may not be entitled to trade the Common Shares and Warrants received upon such exercise or deemed exercise, as well as the Common Shares issuable upon the exercise of the Warrants, except pursuant to a prospectus or an exemption from the prospectus requirements of applicable securities legislation.

Each of the Special Warrant Indenture and the Warrant Indenture contain certain anti-dilution provisions providing for, among other things, adjustment to the number of Common Shares issuable upon the occurrence of certain events.

Pursuant to an agreement dated as of December 7, 1999 among the Company, the Agent and Equity Transfer Services Inc., as escrow agent, \$1,100,000 of the aggregate gross proceeds raised from the offering of the Special Warrants are being held in escrow, which funds, together with any interest earned thereon, will be released to the Company on the earlier of the Clearance Date and June 5, 2000.

## **CANADIAN FEDERAL INCOME TAX CONSIDERATIONS**

In the opinion of Goodman and Carr, counsel to the Company, the following is a fair and accurate summary of the principal Canadian federal income tax consequences generally applicable to investors who, for purposes of the *Income Tax Act* (Canada) (the "Act"), are individuals or corporations resident in Canada, hold such Special Warrants, Common Shares and Warrants acquired upon the exercise of Special Warrants as capital property and at all times deal at arm's length with the Company. A Special Warrant, Common Share or Warrant will generally be capital property to a holder unless it is held in the course of carrying on a business or has been acquired in a transaction or transactions considered to be an adventure in the nature of trade. This summary is not applicable to an investor that is a "financial institution" for purposes of the mark-to-market provisions of the Act.

This summary is based upon the current provisions of the Act, the regulations thereunder (the "Regulations"), counsel's understanding of the current administrative practices of the Canada Customs and Revenue Agency (the "CCRA") and all proposed amendments (the "Tax Proposals") to the Act and Regulations publicly announced by the Minister of Finance prior to the date hereof. This summary assumes

that the Tax Proposals will be enacted as proposed and does not take into account or anticipate any other changes in law whether by way of judicial, legislative or governmental decision or action, nor does it take into account provincial, territorial or foreign income tax legislation or considerations. No assurances can be given that such Tax Proposals will be enacted as proposed or that legislative, judicial or administrative changes will not modify or change the statements expressed herein.

**This summary is of a general nature only, is not exhaustive of all Canadian federal income tax considerations and is not intended to be, nor should it be construed to be, legal or tax advice to any particular investor. Therefore, prospective investors should consult their own tax advisers with respect to their particular circumstances.**

### **Exercise of Special Warrants**

No gain or loss will be realized by a holder of Special Warrants on the exercise of Special Warrants.

### **Allocation of Purchase Price**

Upon the exercise of a Special Warrant, investors will be required to allocate the purchase price of the Special Warrant, on a reasonable basis, between the Common Share and the one-half of one Warrant received to determine the cost of each for tax purposes. The Company proposes to allocate \$0.655 as consideration for the issue of each Common Share and \$0.045 as the consideration for the issue of each one-half of one Warrant. If the Company is subject to the Conversion Rate Increase, the Company will allocate \$0.5696 for each Common Share issued and \$0.1304 for each one-half of one Warrant. Although the Company believes that these allocations are reasonable, such allocations are not binding on the CCRA.

### **Exercise or Expiry of Warrants**

The portion of the purchase price allocated to each Warrant will be the adjusted cost base to the holder of such Warrant. No gain or loss will be realized by a holder on the exercise of a Warrant. The cost of each Common Share acquired on the exercise of a Warrant will be equal to the aggregate of the holder's adjusted cost base of the Warrant immediately prior to the exercise thereof and the exercise price paid for the Common Shares. Such cost must be averaged with the adjusted cost base of any other Common Shares that are held by the holder.

Upon the expiry of an unexercised Warrant, the holder generally will realize a capital loss in an amount equal to the adjusted cost base of the Warrant to the holder immediately prior to the time of expiry.

### **Disposition of Common Shares or Warrants**

Upon a disposition or deemed disposition of a Common Share (other than to the Company) or Warrant (other than on the exercise thereof), a holder will generally realize a capital gain (or capital loss) equal to the amount by which the proceeds of disposition received by the holder, less costs of disposition, exceed (or are exceeded by) the adjusted cost base to the holder of the Common Share or Warrant, as the case may be. A holder that is a "Canadian-controlled private corporation " (as defined in the Act) may be liable to pay an additional 6 1/2% refundable tax on taxable capital gains.

Three-quarters of a capital gain (a "taxable capital gain") is included in computing income and three-quarters of a capital loss (an "allowable capital loss") is deductible from taxable capital gains. To the extent a holder has insufficient taxable capital gains in the current taxation year against which to apply allowable capital losses, the deficiency constitutes a net capital loss for the current taxation year which may generally be carried back to any of the three preceding taxation years or carried forward to any future taxation year and deducted against taxable capital gains in such preceding or subsequent taxation years.

In certain cases, the recognition of capital losses may be denied, including those involving transfers to "affiliated persons" (as defined in the Act). Furthermore, in the case of a corporation which realizes a capital loss on the disposition of a Common Share, the amount of the capital loss may, in certain circumstances, be reduced by the amount of any dividends received on such Common Share. Analogous rules apply where a corporation is a member of a partnership or a beneficiary of a trust that owns Common Shares.

### **Minimum Tax**

The Act requires that individuals (including certain trusts) compute an alternative minimum tax determined by reference to the amount by which the taxpayer's "adjusted taxable income" for the year exceeds his or her basic exemption which, in the case of an individual (other than certain trusts) is \$40,000. In computing adjusted taxable income, a taxpayer must include, among other things, all taxable dividends (without the application of the gross-up) and the full amount of net capital gains. A federal tax rate of 17% is applied to the amount subject to the minimum tax, from which the individual's "basic minimum tax credit for the year" is deducted. Included in the basic minimum tax credit are certain specified personal and other credits available to an individual under the Act as deductions from tax payable for the year. Generally, if the minimum tax so calculated exceeds the tax otherwise payable under the Act (without regard to any federal surtax), the minimum tax will be payable.

Any additional tax payable by an individual for the year resulting from the application of the alternative minimum tax will be deductible in any of the seven immediately following taxation years in computing the amount that would, but for the alternative minimum tax, be his or her tax otherwise payable.

**Investors are urged to consult their tax advisors to determine the impact of the alternative minimum tax.**

### **Dividends**

Dividends received on Common Shares will be subject to taxation as taxable dividends received from a Canadian corporation. In the case of an individual or trust, the gross-up and dividend tax credit rules will apply with respect to the dividends. In the case of a corporation, the dividends will generally be deductible in computing taxable income; however, certain corporations may be liable to pay a refundable tax under Part IV of the Act on such dividends.

### **Qualified Investments and Foreign Property**

The Common Shares and Warrants issuable upon exercise of the Special Warrants will, when listed on a prescribed stock exchange, be qualified investments under the Act for trusts governed by registered

retirement savings plans, deferred profit sharing plans, registered education savings plans and registered retirement income funds ("Deferred Plans").

The Common Shares and Warrants issuable upon exercise of the Special Warrants will not be foreign property under the Act for trusts governed by registered pension plans and Deferred Plans or for certain other tax-exempt persons.

## USE OF PROCEEDS

The estimated net proceeds realized by the Company through the sale of the Special Warrants was \$3,960,000 after deducting the Agent's commission of \$330,000 and other offering expenses estimated at \$110,000. The Company will not receive any additional proceeds from the exercise or deemed exercise of the Special Warrants.

It is anticipated that approximately \$1,500,000 of the net proceeds will be used for marketing and operating expenses such as trade shows, print advertising and channel promotions and other sales and marketing expenditures, including in respect of the launch of the Company's new product, *COMMUNICATE! i2000*. Of the balance of the net proceeds, approximately \$1,500,000 is intended to be used for general corporate purposes to finance the expansion of the Company's business in North America and Europe and approximately \$960,000 is intended to be used for research and development. The amount of the net proceeds dedicated to research and development is intended to be used to develop new products and to enhance existing products.

The Company anticipates that sales and marketing expenditures will consist of, among other things, promotional activities to increase brand name awareness and market acceptance of its products, including: joint channel promotions with the Company's retail channel partners, trade shows, advertising and creative packaging for the retail channel. Research and development expenditures will consist primarily of salaries and fees paid to software developers relating to the development of new products and enhancement of existing products.

Pursuant to an agreement dated as of December 7, 1999 among the Company, the Agent and Equity Transfer Services Inc., as escrow agent, \$1,100,000 of the aggregate gross proceeds raised from the offering of the Special Warrants are being held in escrow, which funds, together with any interest earned thereon, will be released to the Company on the earlier of the Clearance Date and June 5, 2000.

Management of the Company believes that its success and growth in the software industry will require the Company to maintain a strong cash position. Accordingly, it is the intention of the Company that any funds received by it from the exercise of the Warrants, Compensation Options and Compensation Purchase Warrants will also be utilized for the purposes described above.

## CAPITALIZATION

The following table and notes set forth the capitalization of the Company as at the dates indicated:

	<u>Outstanding as at October 31, 1999</u>	<u>Outstanding as at December 31, 1999, prior to giving effect to the offering</u>	<u>Outstanding as at December 31, 1999, after giving effect to the offering <sup>(1)</sup></u>
<b>Indebtedness</b>			
Bank indebtedness <sup>(2)</sup>	\$ —	\$ —	\$ —
Long-term debt <sup>(2)</sup>	500,000	482,500	482,500
<b>Total Indebtedness</b>	<u>500,000</u>	<u>482,500</u>	<u>482,500</u>
<b>Shareholders' Equity</b>			
Common Shares <sup>(3)</sup> (authorized: unlimited)	\$ 6,586,320 (19,687,094 shares)	\$ 6,645,070 (19,804,594 shares)	\$ 10,353,012 (26,090,308 shares)
Preference Shares (authorized: unlimited)	—	—	—
Special Warrants	—	\$ 3,960,000 (6,285,714 Special Warrants)	—
Warrants	—	—	\$ 252,058 (3,142,857 Warrants)
Deficit <sup>(4)</sup>	<u>(\$4,568,256)</u>	<u>(\$4,568,256)</u>	<u>(\$4,568,256)</u>
<b>Total Shareholders' Equity</b>	<u>2,018,064</u>	<u>6,036,814</u>	<u>6,036,814</u>
<b>Total Consolidated Capitalization</b>	<u>\$ 2,518,064</u>	<u>\$ 6,519,314</u>	<u>\$ 6,519,314</u>

(1) 6,285,714 Special Warrants were authorized and issued on December 7, 1999 for net proceeds, after the payment of the Agent's fee and estimated expenses of the offering, of \$3,960,000. This column reflects the issue of 6,285,714 Common Shares and 3,142,857 Warrants pursuant to the exercise of the Special Warrants. See "Plan of Distribution".

(2) See notes 4 and 5 to the financial statements of the Company for details concerning the security and terms of the Company's operating line of credit and long-term debt.

(3) As at the date hereof, 12,287,760 Common Shares have been allotted and reserved for issuance as follows: (i) 1,916,333 Common Shares issuable upon the exercise of options granted pursuant to the Company's Stock Option Plan; (ii) 6,285,714 Common Shares (subject to adjustment in certain circumstances) issuable upon the exercise of the Special Warrants; (iii) 3,142,857 Common Shares (subject to adjustment in certain circumstances) issuable upon exercise of the Warrants; (iv) 628,571 Common Shares issuable upon exercise of the Compensation Options and 314,285 Common Shares issuable upon exercise of the Compensation Purchase Warrants. See "Plan of Distribution" and "Options to Purchase Common Shares".

(4) The Company's deficit is, in each case, as at October 31, 1999.

- (5) See note 9 to the financial statements of the Company for details of various operating leases.

## **DESCRIPTION OF SHARE CAPITAL**

The Company is authorized to issue an unlimited number of Common Shares, without par value, and an unlimited number of preference shares, issuable in series. As at the date hereof, 19,906,594 Common Shares were issued and outstanding and 50,000 Series A preference shares were authorized but not issued.

### **Common Shares**

Each Common Share entitles the holder thereof to one vote at all meetings of shareholders, other than meetings of the holders of another class of shares, and to receive the property of the Company on liquidation, dissolution or winding-up after payment to the holders of the preference shares. The Common Shares carry no special rights or restrictions.

### **Preference Shares**

The Series A preference shares are entitled to a preference over the Common Shares of the Company in respect of the payment of dividends and return of capital in the event of liquidation, dissolution or winding up of the Company. The holder of each Series A preference share shall be entitled to receive, as and when declared by the directors out of the monies properly applicable to the payment of dividends, preferential non-cumulative cash dividends at the rate of eight percent per share per annum of the amount paid to the Company for such share and no more. The holder of each Series A preference share shall have the right to two votes for such Series A preference share at all meetings of shareholders, other than meetings of the holders of another class or series of shares. In the event of the liquidation, dissolution or winding up of the Company, the holder of each Series A preference share shall be entitled to receive the amount paid to the Company for such share, together with all unpaid dividends declared.

## **DIVIDEND POLICY**

The Company has no fixed dividend policy and no dividends have been paid on any shares of the Company during its five last completed financial years. The Company intends to retain future earnings to finance the development of its business and, accordingly, does not anticipate paying dividends on its common shares in the foreseeable future. Any future determination to pay dividends will be at the discretion of the Company's board of directors and will depend upon the results from operations, capital requirements and such other factors as the board of directors considers relevant.

## **PRICE RANGE AND TRADING VOLUME OF COMMON SHARES**

The Common Shares are traded on CDN under the symbol "OONE". The following table sets forth the reported high and low closing sales prices per share and the trading volume for the Common Shares on CDN for the periods indicated:

	<u>High</u>	<u>Low</u>	<u>Volume</u>
	(\$)	(\$)	(#)
<b><u>1998</u></b>			
March 13 to 31, 1998	0.95	0.80	315,250
Second Quarter	0.90	0.55	500,985
Third Quarter	0.60	0.34	481,537
Fourth Quarter	0.35	0.20	2,415,721
<b><u>1999</u></b>			
First Quarter	0.43	0.26	492,838
Second Quarter	0.75	0.28	827,400
July	0.75	0.50	478,045
August	0.74	0.60	247,850
September	0.73	0.50	1,634,365
October	0.84	0.53	1,284,925
November	1.33	0.70	3,675,727
December	3.10	1.10	5,640,658
<b><u>2000</u></b>			
January 4 to January 28, 2000	5.625	1.65	4,241,317

The above high and low closing sales prices reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not represent actual transactions. On December 7, 1999, the closing sales price of the Common Shares on CDN was \$1.60. On January 28, 2000, the closing sales price of the Common Shares on CDN was \$5.625.

### **OPTIONS TO PURCHASE COMMON SHARES**

The Company has a stock option plan (the "Stock Option Plan") for the grant of stock options to eligible directors, officers, employees and service providers to the Company. Pursuant to the Stock Option Plan, options to purchase Common Shares may be granted from time to time by the Board of Directors of the Company at an exercise price per share determined by the Board of Directors of the Company at the time such options are granted. The maximum number of Common Shares available for issuance to any one person under the Stock Option Plan is 5% of the Common Shares outstanding at the time of the grant. A maximum of 1,990,659 Common Shares may be reserved for options granted under the Stock Option Plan, of which options covering an aggregate of 1,906,333 Common Shares have been granted as at the date of this prospectus, as more fully described below.

The following table sets forth certain information with respect to options to purchase Common Shares which are currently outstanding:

<u>Name or Description and Number of Option Holders</u>	<u>Number of Common Shares Under Option</u>	<u>Exercise Price per Common Share</u>	<u>Market Price on Date of Grant</u>	<u>Expiry Date</u>
<i>(a) Options held by 5 executive officers of the Company</i>	100,000	\$1.70	\$1.75	January 6, 2001
	70,000	\$0.50	(1)	December 5, 2001
	50,000	\$0.50	\$0.38	February 22, 2004
	100,000	\$0.75	\$0.69	February 22, 2004
	50,000	\$0.50	\$0.50	June 29, 2004
	250,000	\$0.50	(1)	September 20, 2005
	100,000	\$0.75	\$0.69	September 20, 2005
	100,000	\$0.75	\$0.69	October 12, 2005
	190,000	\$0.50	(1)	October 23, 2005
	<u>10,000</u>	\$0.50	(1)	December 5, 2006
Sub-total	1,020,000			
<i>(b) Options held by 3 current directors and 2 former directors of the Company (each of whom are not also persons referred to in (a) above)</i>	180,000	\$0.50	(1)	December 5, 2001
	233,333	\$0.50	\$0.38	February 22, 2003
	35,000	\$0.50	\$0.50	June 29, 2004
	100,000	\$0.50	\$0.55	September 30, 2004
	<u>100,000</u>	\$0.50	(1)	September 20, 2005
Sub-total	648,333			
<i>(c) Options held by employees of and service providers to the Company</i>	50,000	\$0.75	\$1.10	November 29, 2003
	90,000	\$0.50	\$0.50	June 29, 2004
	40,000	\$0.70	\$0.72	October 13, 2004
	8,000	\$2.00	\$2.00	January 4, 2005
	<u>60,000</u>	\$0.50	(1)	December 5, 2006
Sub-total	248,000			
	Total	<u>1,906,333</u>		

(1) Stock options granted prior to the time the Company became a public company. Accordingly, there was no market for the Common Shares at the time such options were granted.

## PRIOR SALES OF COMMON SHARES

In the twelve months prior to the date hereof, the Company issued Common Shares as follows: (i) in February 1999, 300,000 Common Shares were issued pursuant to a private placement at a price of \$0.28 per share; (ii) in July 1999, the B.E.S.T. Discoveries Fund exercised 30,000 options at a price of \$0.23 per share pursuant to an option agreement entered into in February 1999. These options were issued to such fund in connection with a private placement of debentures of the Company which was completed in February 1999; (iii) between October 1999 and the date of this prospectus, the Company issued 387,500 Common Shares upon the exercise of options granted under the Stock Option Plan. The exercise price of all such options was \$0.50 per share; (iv) in January 2000, 42,000 Common Shares were issued to Goepel McDermid Inc. pursuant to the exercise of an option granted to it as partial consideration for its services in connection with a debt financing of the Company in July 1999; and (v) in the last twelve months, 67,000 Common Shares were issued to service providers to the Company for services rendered at an issue price of \$0.50 per share.

## DIRECTORS AND OFFICERS

The following sets forth the name, municipality of residence, positions held with the Company and principal occupation of each of the directors and officers of the Company.

<b><u>Name and Municipality of Residence</u></b>	<b><u>Position Held</u></b>	<b><u>Principal Occupation</u></b>
ANDREW CHEUNG Mississauga, Ontario	President, Chief Executive Officer and Director	President and Chief Executive Officer of the Company
HENRY S. PANKRATZ <sup>(2)</sup> Toronto, Ontario	Chairman of the Board of Directors	President of CanvanCore Capital, a personal investment and corporate advising firm
M. GRANT BROWN <sup>(1)(2)</sup> Oakville, Ontario	Director	Managing Partner and Director, Covington Capital Corporation, a Canadian venture capital firm
E. ALAN HUYCKE Toronto, Ontario	Director	President of Strategic Endeavours Capital Management Ltd., the managing company of the B.E.S.T Discoveries Fund.
GIGI LOO Mississauga, Ontario	Corporate Secretary, Controller and Director	Controller of the Company
JEFFREY F. OLIN Toronto, Ontario	Director	Director and Senior Vice-President at HSBC Securities (Canada) Inc., an investment banking firm

<b><u>Name and Municipality of Residence</u></b>	<b><u>Position Held</u></b>	<b><u>Principal Occupation</u></b>
WILLIAM A. TRAIN <sup>(2)</sup> Mississauga, Ontario	Director	Officer and director of Dynasty Components Inc., a distributor of high-technology equipment for semi-conductor component manufacturers.
BRIAN MCELWAIN Toronto, Ontario	Vice-President, Sales and Marketing	Vice-President, Sales and Marketing of the Company
STEVEN MYER, Ph.D. <sup>(3)</sup> Toronto, Ontario	Chief Technology Officer	Chief Technology Officer of the Company
BRIAN STRINGER Markham, Ontario	Chief Financial Officer	Chief Financial Officer of the Company

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- (1) Mr. Brown is a nominee of C.I. Covington Fund Inc. ("Covington"). Pursuant to an agreement dated as of December 7, 1999 among Andrew Cheung, Covington and the Company, Mr. Cheung and the Company have agreed that as long as Covington and/or any affiliate owns a specified minimum percentage of the issued and outstanding Common Shares, Covington will be entitled to include a nominee for election as a director of the Company and Mr. Cheung will vote his Common Shares in favour of such nominee.
- (2) Member of the Audit Committee.
- (3) Dr. Myer's services with the Company commence on February 1, 2000. Dr. Meyer has agreed to provide his services to the Company as Chief Technology Officer pursuant to an independent contractor agreement with the Company.

Each of the directors and officers of the Company has been engaged in his or her present occupation for the past five years except as otherwise described below:

*Henry Pankratz* - Mr. Pankratz recently retired from Ernst & Young in September 1999. He held various executive and senior management positions throughout his career at Ernst & Young which began in 1961 and upon retiring held the position of Deputy Chairman.

*Alan Huycke* - Mr. Huycke has been the President of Strategic Endeavours Capital Management Ltd. since September, 1996. From September 1995 until September 1996, he held a senior position with the Competitors, an organization focused on providing capital to new businesses. For 12 years prior to that time, Mr. Huycke was a commercial real estate broker with J.J. Barnicke Ltd.

*Jeffrey Olin* - Prior to joining HSBC Securities Canada (Inc.) in August 1997, Mr. Olin was Vice-President, Corporate Finance, of Canaccord Capital Corporation from April 1996 to August 1997. Prior to March 1996, Mr. Olin was Executive Vice-President and a Director of Merit Investment Corporation, a securities investment company.

*Brian McElwain* - Mr. McElwain served as Vice-President, Sales of Pure Data Ltd., a manufacturer of networking and communications products, for one year prior to joining the Company in October 1995. Prior to October 1995, Mr. McElwain served as the Vice-President of Sales of ATI Technologies Inc., a manufacturer of video interface boards, and prior thereto Mr. McElwain worked for 22 years for Honeywell

Bull Inc., an international technology company, in various positions, rising to the position of Vice-President of Sales.

*Steven Myer, Ph.D.* - Prior to agreeing to join the Company effective February 1, 2000, Dr. Meyer served as a software contractor for Dicomit Imaging Systems Corp., a software company that provides connectivity solutions for all medical modalities. From July 1992 to December 1998, Dr. Meyer held various senior product development positions with Delrina Corporation/Symantec Corporation, a company specializing in communications software products.

*Brian Stringer* - Mr. Stringer is a chartered accountant. Prior to June 1998, Mr. Stringer was a senior officer (including Chief Financial Officer) and, at times, a director of Pure Data Ltd., a manufacturer of networking and communications products, and its successor companies.

## EXECUTIVE COMPENSATION

### Summary Compensation Table

The following tables set forth all annual and long-term compensation for services in all capacities to the Company for the fiscal years ended October 31, 1999, 1998 and 1997 in respect of the Company's Chief Executive Officer and such other executive officers of the Company whose annual aggregate compensation exceeded \$100,000 during such periods (collectively, the "Named Executive Officers").

Name and Principal Position	Fiscal Year	Annual Compensation			Long-Term Compensation	
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)	Securities Options Granted (#)	All Other Compensation (#)
ANDREW CHEUNG, President and Chief Executive Officer	1999	\$127,720	--	--	--	--
	1998	\$72,000	--	--	--	--
	1997	\$72,000	--	--	40,000	--
BRIAN MCELWAIN, Vice-President, Sales and Marketing	1999	\$144,000	\$21,524	--	150,000	--
	1998	\$144,000	--	--	--	--
	1997	\$144,000	--	--	--	--

### Stock Option Grants Table

The following table sets forth information relating to the individual grants of stock options to purchase Common Shares of the Company during the fiscal year ended October 31, 1999 to each of the Named Executive Officers.

Name	Number of Common Shares Under Options Granted	% of Total Options Granted to Employees in Fiscal 1999	Exercise or Base Price	Market Value of Common Shares Underlying Options on the Date of Grant	Expiration Date
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Name	Number of Common Shares Under Options Granted	% of Total Options Granted to Employees in Fiscal 1999	Exercise or Base Price (\$/Share)	Market Value of Common Shares Underlying Options on the Date of Grant (\$/Share)	Expiration Date
ANDREW CHEUNG	–	–	–	–	--
BRIAN MCELWAIN	50,000	12.5%	\$0.50	\$0.38	Feb. 22, 2004
	100,000	25%	\$0.75	\$0.69	Oct. 12, 2004

### Options Exercised and Year-End Value Table

The following table sets out information with respect to individual exercises of stock options during the fiscal year ended October 31, 1999 by each of the Named Executive Officers and the fiscal year-end number and value of unexercised options held, on an aggregate basis:

Name	Common Shares Acquired on Exercise	Aggregate Value Realized <sup>(1)</sup>	Number of Unexercised Options as at October 31, 1999		Value of Unexercised in-the-money Options as at October 31, 1999 <sup>(2)</sup>	
			Exercisable	Unexercisable	Exercisable	Unexercisable
	(#)	(\$)	(#)	(#)	(\$)	(\$)
ANDREW CHEUNG	–	–	290,000	–	98,600	--
BRIAN MCELWAIN	–	–	340,000	–	90,600	–

(1) Calculated as the difference between the fair market value of the Company's Common Shares at the time of the option exercise and the exercise price.

(2) Market value expressed in Canadian dollars of underlying securities at exercise date or year-end, as the case may be, less the exercise price of options. As at October 31, 1999 the closing price for the Common Shares on the CDN was \$0.84 per share.

### Employment Agreements

Each of Andrew Cheung and Brian McElwain has entered into a non-competition and confidentiality agreement with the Company, each dated January 26, 1999, pursuant to which each of them have agreed, among other things, not to disclose, during and after the term of their employment with the Company, confidential information relating to the Company. Pursuant to his agreement with the Company, Mr. Cheung has also provided a non-competition covenant in favour of the Company for a period of six months following termination of his employment with the Company. Mr. McElwain has also provided such a covenant in favour of the Company but, in order to obtain the benefit of such covenant for the full six month period, the Company must continue to pay Mr. McElwain his salary for such period.

## Compensation of Directors

The Directors receive no compensation from the Company in their capacities as such, other than stock options. During the fiscal year ended October 31, 1999, an aggregate of 135,000 stock options were granted to directors. See "Options to Purchase Common Shares".

## INDEBTEDNESS OF DIRECTORS AND OFFICERS

No director, executive officer or senior officer, or any of their associates, has been indebted to the Company since the beginning of the last completed fiscal year of the Company.

## PRINCIPAL SHAREHOLDERS

To the knowledge of the directors and officers of the Company, the only persons that beneficially own, directly or indirectly, 10% or more of the issued and outstanding Common Shares of the Company as at the date hereof are:

Name and Municipality of Residence	Type of Ownership	Aggregate Number of Common Shares Prior to the offering	Percentage Prior to the offering	Number of Common Shares After Giving Effect to the offering	Percentage of Common Shares After Giving Effect to the offering <sup>(1)</sup>
ANDREW CHEUNG Mississauga, Ontario	Direct	4,425,000	22.4%	4,425,000	17.0%
SHU-CHAU CHEUNG Mississauga, Ontario	Direct	4,425,000	22.4%	4,425,000	17.0%
C.I. COVINGTON FUND INC. Toronto, Ontario	Direct	Nil	Nil	3,357,143	12.9% <sup>(2)</sup>

(1) After giving effect to the exercise of all Special Warrants resulting in 26,080,308 Common Shares outstanding, but without giving effect to the exercise of any Warrants.

(2) As at the date of this prospectus, C.I. Covington Fund holds 3,357,143 Special Warrants, which may be exercised to acquire an aggregate of 3,357,143 Common Shares and 1,678,572 Warrants.

As at the date hereof, the directors and senior officers of the Company, as a group, beneficially owned, directly or indirectly, approximately 6,362,111 Common Shares, representing approximately 32% of the issued and outstanding Common Shares of the Company, and 24.4% after giving effect to the exercise of the Special Warrants (but without giving effect to the exercise of any of the Warrants, the Compensation Options or the Compensation Purchase Warrants).

## **ESCROW ARRANGEMENTS**

In accordance with the policies of the Ontario Securities Commission, Andrew Cheung, the President and Chief Executive Officer of the Company, and Shu-Chau Cheung (collectively, the "Escrowed Shareholders") entered into an escrow agreement dated as of March 2, 1998 with the Company and Equity Transfer Services Inc. (the "Trustee") pursuant to which the Escrowed Shareholders placed on deposit with the Trustee an aggregate of 8,850,000 Common Shares beneficially held by them (the "Escrowed Shares"). The Escrowed Shares were scheduled to be automatically released by the Trustee to the Escrowed Shareholders as follows: 10% immediately after the date which is nine months after the date on which a final receipt for the Company's initial public offering prospectus was issued by the Ontario Securities Commission (the "Initial Release Date"), being December 13, 1998, 20% immediately after each of the first, second and third anniversaries of the Initial Release Date and 30% immediately after the fourth anniversary of the Initial Release Date. Accordingly, an aggregate of 2,655,000 Escrowed Shares have been released from escrow by the Trustee to date. In addition, all or any part of the Escrowed Shares may be released at any time with the prior written consent of, and at the discretion of, the Ontario Securities Commission.

## **PROMOTER**

Andrew Cheung may be considered the promoter of the Company, as that term is defined in the *Securities Act* (Ontario).

## **MATERIAL CONTRACTS**

Except for contracts entered into in the ordinary course of business, the only material contracts which have been entered into by the Company in the two years immediately prior to the date hereof and which can reasonably be regarded as presently material are the following:

1. the Special Warrant Indenture and the Warrant Indenture referred to under "Plan of Distribution";
2. the Agency Agreement referred to under "Plan of Distribution";
3. the Escrow Agreement referred to under "Plan of Distribution";
4. the subscription agreements and debentures entered into with investors in connection with the issuance of the debentures referred to under "Prior Sales of Common Shares"; and
5. the credit agreement pursuant to which the Company incurred long-term debt as referred to under "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources".

Copies of the above-noted contracts, or the relevant provisions thereof, may be examined at the office of the Company at 1450 Meyerside Drive, Mississauga, Ontario L5T 2N5 during normal business hours during the course of the distribution of the securities qualified hereunder and for a period of 30 days thereafter.

## **RISK FACTORS**

An investment in the Common Shares and Warrants is speculative and involves a high degree of risk, is subject to the following specific risks, among others, and should be undertaken only by investors whose financial resources are sufficient to enable them to assume such risks. The Common Shares and Warrants should not be purchased by persons who cannot afford the possibility of the loss of their entire investment. Prospective investors should review these risks as well as other matters disclosed elsewhere in this prospectus with their professional advisors.

### **No Assurance of Future Success or Profitability**

Prospects for companies in the computer and software industry generally may be regarded as uncertain given the inherent nature of the industry and, accordingly, investments in such companies should be regarded as speculative. The latest fiscal year which ended October 31, 1999 was the first year in which the Company recorded a profit. There can be no assurance that the Company will be able to maintain profitability in the future.

The Company has committed, and for the foreseeable future will continue to commit, significant financial resources to product development and research. There can be no assurance that the research and development conducted by the Company will result in commercially viable products or that the Company will be able to continue to develop or improve its products to keep up with technological developments in the Company's product markets. To achieve profitable operations the Company, alone or with others, must, among other things, successfully sustain development, introduction and marketing of competitive products. In addition, there can be no assurance that the Company has or will make adequate allowances, or will accurately assess, the costs and risks associated with the development, introduction or marketing of such products.

### **New Products and Technological Change**

The communications software industry is characterized by rapidly changing technology, evolving industry standards and frequent new product introductions, any of which could make the Company's products obsolete. There can be no assurance that the Company will be successful in enhancing existing products or introducing, manufacturing or marketing new products to meet changing end-user requirements and emerging industry standards and protocols. The Company must devote continued efforts and financial resources to develop and enhance existing products and conduct research to develop new products. The development of new, technologically advanced products is a complex and uncertain process requiring high levels of innovation, as well as the accurate anticipation of technological and market trends. The Company may not be able to identify, develop, manufacture, market or support new or enhanced products successfully or on a timely basis and may not be able to respond effectively to product announcements by competitors, technological changes or emerging industry standards which could, among other things, have a material adverse effect on the Company's business, operating results or financial condition. The Company may also announce new products or product enhancements, capabilities or technologies that have the potential to replace or shorten the life cycle of its existing product offerings and that may cause customers to defer purchasing its existing products.

## **Market Acceptance of Products**

The Company designs and develops products for the communications software industry. As with any new technology, there is a substantial risk that the marketplace may not accept the Company's products. Market acceptance of the Company's products depends, in large part, upon its ability to demonstrate its products' performance and cost-effectiveness over competing products and upon the success of its sales efforts as well as those of its customers. The Company may not be able to continue to market its products successfully and no assurance can be given that any of its current or future products will be accepted in the marketplace.

## **Competition**

Competition in the communications software industry is intense and growing rapidly. Accordingly, it is possible that new competitors or alliances among competitors and vendors may emerge and rapidly acquire market share. Many of the Company's current and potential competitors have significantly greater financial, technical, marketing, service, support and other resources than the Company, as well as longer operating histories, greater name recognition and larger customer bases. As a result, they may be able to secure resources on more favourable terms than the Corporation, and they may be able to respond more quickly to changes in customer preferences or to devote greater resources to the development, promotion and sale of their products than can the Company. Increased competition could result in significant price competition, reduced profit margins, fewer customer orders or loss of market share. The Company may not be able to compete successfully with existing or future competitors and can not assure that competitive pressures will not materially and adversely affect its business, operating results or financial condition.

## **No Assurance of Successful Marketing**

The Company does not have extensive experience in successfully marketing its products. Thus, there can be no assurance that future efforts to market its products will be successful. If the Company relies on third parties to market its products, the commercial success of such products may be outside of the Company's control. Inadequate marketing support could result in a high level of product returns by overstocked distributors with a corresponding detrimental impact on revenues and profits.

## **Liquidity and Capital Needs**

The Companies's future capital requirements will depend on many factors, including continued scientific progress in its product development programmes. In order to meet such capital requirements, the Company will consider additional public or private financings (including the issuance of additional equity securities) to fund all or part of its requirements. There can be no assurance that additional funding will be available or, if available, that it will be available on acceptable terms. If adequate funds are not available, the Company may have to substantially reduce or eliminate expenditures for marketing, research and development, testing, and production of its proposed products, or obtain funds through arrangements with partners that require the Company to relinquish rights to certain of its technologies or products. There can be no assurance that the Company will be able to raise additional capital if its capital resources are exhausted.

## **Proprietary Technology**

The Company's success will depend, in part, on its ability to maintain copyright and trademark protection, trade secret protection and operate without infringing the proprietary rights of third parties. There can be no assurance that the Company's intellectual property rights, copyright and/or trademarks will not be challenged by any third parties, or that the intellectual property rights of others will not have a material adverse effect on the ability of the Company to do business. Furthermore, there can be no assurance that others will not independently develop products similar to those developed by the Company or duplicate any of the Company's products. The Company may be required to obtain licences for proprietary rights of third parties. No assurance can be given that any licences required will be available on terms acceptable to the Company. If the Company does not obtain such licences, it could encounter delays in introducing one or more of its products to the market or could find that the development, manufacture or sale of products requiring such licences could be precluded. In addition, the Company could incur substantial time, effort and/or costs in policing unauthorized use of its intellectual property and/or in defending itself in suits brought against it or in suits in which the Company attempts to enforce its own intellectual property rights against other parties.

## **Product Liability and Insurance**

The sale and use of the Company's products or its products under development may entail risk of product liability. Although the Company considers that it currently has adequate insurance coverage for any product liability claim, as the Company expands and introduces new products there can be no assurance that it will be able to obtain appropriate levels of product liability insurance prior to any use of its products. An inability to obtain insurance on commercially reasonable terms or to otherwise protect against potential product liability claims could inhibit or prevent the commercialization of products developed by the Company or expose the Company to significant product liability risks. The obligation to pay any product liability claim or a recall of a product could have a material adverse effect on the business, financial condition, operating results or prospects of the Company.

## **Dependence on Key Personnel**

The Company's ability to develop, manufacture and market its products and compete with current and future competitors depends, to a great extent, on its ability to attract and retain highly qualified personnel (and attract new personnel where required). Competition for such personnel and relationships is intense and the Company must compete in this regard with companies that have substantially greater financial and other resources that it does. The Company is highly dependent on the principal members of its management and research and development staff ("Key Personnel") and, in particular, Mr. Andrew Cheung, its Chief Executive Officer. The loss of Mr. Cheung's services could have the effect of materially impeding the achievement of development objectives. Similarly, the loss of Mr. Brian McElwain's services as Vice President, Sales and Marketing, could have the effect of materially diminishing the Company's sales and marketing initiatives. Other than as described under the heading "Executive Compensation - Employment Agreements", none of the Company's employees is bound by any employment agreement.

The persons working with the Company are affected by a number of influences outside of the control of the Company. The failure to attract and retain qualified personnel or the loss of the services of one or more Key Personnel could have a material adverse effect on the Company's business, operating results or financial

condition. The Company currently has "key man" insurance in place in respect of Mr. Andrew Cheung and Mr. Brian McElwain in the amount of \$4 million and \$1 million, respectively.

### **Volatility of Share Price**

The Common Shares currently trade on CDN. Factors such as announcements of technological innovation or the introduction of new products by the Company or its competitors, actual or anticipated fluctuations in the Company's operating results, changes in estimates of the Company's future operating results by securities analysts or developments with respect to proprietary rights may have a significant impact on the market price of the Common Shares. In addition, the stock market has experienced volatility which has particularly affected the market prices of equity securities of many high technology companies and which often has been unrelated to the operating performance of such companies. These market fluctuations may materially adversely affect the market price of the Common Shares.

### **Distribution Agreements and Principal Distributor**

The Company's distribution and licensing agreements contain various provisions for termination and/or renewal, some of which provide for termination without cause and on short notice. Such provisions are not uncommon in the industry and the Company anticipates that it will continue to enter into such agreements. Some of the Company's distribution arrangements are also not embodied in written agreements. Many of the distribution and licensing agreements allow distributors to unilaterally return goods for full credit if the distributor deems it is overstocked.

Although the Company distributes products through a number of distributors, it has been, and may continue to be, dependent on a small number of customers with respect to sales of the majority of its products, both in terms of number of units sold and the aggregate dollar values of its sales. One of the Company's distributors accounted for approximately 31% of the dollar value of sales of the Company for the fiscal year ended October 31, 1999, and approximately 51% of the receivables of the Company at the fiscal year ended October 31, 1999, making the risk of non-payment more acute. The Company's exposure to credit risk associated with the non-performance of this distributor in fulfilling its contractual obligations could be directly impacted by, among other things, a decline in economic conditions which could impair its ability to satisfy its obligations to the Company. The distribution agreement with this distributor allows it to return the Company's products at any time for full refund and includes a provision permitting either party to terminate the agreement for any reason upon 30 days' prior written notice.

Although management of the Company does not believe the loss of this distributor as a customer would significantly impair the Company's revenue stream, as the retail chains which re-sell the Company's products to the end-user have the ability to purchase the Company's products from one of the Company's other distributors, there can be no assurance that the loss of this or any other significant distributor, or the reduction or postponement of current or expected purchases of the Company's products by such distributors, would not have a material adverse effect on the Company's business, financial condition or operating results. In addition, as over 50% of the Company's accounts receivable are from this distributor, the inability of such distributor to make payment could impair the Company's cash flow.

## **Principal OEM Customer**

There is no assurance that the Company's principal OEM customer will continue to bundle the Company's products. This customer is the Company's only OEM customer representing a significant portion of the Company's revenue. The loss of this customer could have a material adverse effect on the Company's business, operating results or financial condition. The risks described above in respect of the Company's principal distributor concerning non-performance of contractual obligations and the risk of non-payment apply equally to the Company's principal OEM customer.

## **Management of Growth**

The Company has experienced a period of significant growth which has, and may continue to, subject it to growth-related risks including capacity constraints and pressure on its internal systems and controls. The inability of the Company to deal effectively with this growth could have a material adverse impact on its business, operations and prospects. While management of the Company believes that it will have made the necessary investments in infrastructure to process anticipated volume increases over the upcoming 12 months, the Company may experience growth in the number of its employees and the scope of its operating and financial systems, resulting in increased responsibilities for the Company's existing personnel, the hiring of additional personnel and, in general, higher levels of operating expenses. In order to manage its current operations and any future growth effectively, the Company will also need to continue to implement and improve its operational, financial and management information systems and to hire, train, motivate, manage and retain its employees. There can be no assurance that the Company will be able to manage such growth effectively, that its management, personnel or systems will be adequate to support the Company's operations or that the Company will be able to achieve the increased levels of revenue commensurate with the increased levels of operating expenses associated with this growth.

## **The Trend Towards Industry Consolidation**

Consolidation in the software industry continues to occur, with competing companies merging or acquiring other companies in order to capture market share or expand product lines. As this consolidation occurs, the nature of the market may change as a result of fewer players dominating particular markets, potentially providing customers with fewer choices. Also, some of these companies offer a broader range of products than the Company, and the Company may not be able to compete effectively against these competitors. Any of these changes may have a significant adverse effect on the future revenues and operating results of the Company.

## **Potential Fluctuations in Quarterly Financial Results**

The Company's quarterly financial results could be impacted significantly by the timing of substantial orders and shipments as well as new releases of its products. The Company's operating expenses are based on anticipated revenue levels in the short term, are relatively fixed, and are incurred throughout the quarter. Additionally, the Company's products may be subject to long sales cycles. As a result, if expected revenues are not realized as anticipated, the Company's quarterly financial results could be materially adversely affected. Quarterly financial results in the future may be influenced by these or other factors, including possible delays in the shipment of new products and entering into or failing to enter into or renew a material contract or order. Accordingly, there may be significant variations in the Company's quarterly financial results

and such results may not meet the expectations of analysts or investors. If this occurs, the price of the Common Shares may decline. See also "Distribution Agreements and Principal Distributor", "Principal OEM Customer" and "Volatility of Share Price".

### **Currency Risk**

A substantial portion of the Company's revenues are now, and are expected to continue to be, realized in currencies other than Canadian dollars. The Company's operating expenses are primarily paid in Canadian dollars. Fluctuations in the exchange rate between the Canadian dollar and such other currencies may have a material adverse effect on the Company's results of operations. In particular, the Company may be adversely affected by a significant strengthening of the Canadian dollar against the United States dollar. Sales in fiscal 1999 to the United States represented the vast majority of the Company's total gross revenues.

### **Control of Shares by Principal Shareholders**

Following the issuance of the Common Shares issuable upon exercise of the Special Warrants, the two principal shareholders of the Company will maintain effective control of the Company through their ownership of, in the aggregate, approximately 34% of the outstanding Common Shares. As a result, these shareholders, acting together, will be able to continue to exercise significant influence over all matters requiring shareholder approval, including the ability to elect all of the directors and approve fundamental changes to the Company. Such concentration of ownership may have the effect of delaying or preventing a change in control of the Company, its board of directors or management. See "Principal Shareholders".

### **Uncertainty Regarding Possible Year 2000 Problems**

The Year 2000 issue affects computer systems and software products that have date sensitive programs that may not properly recognize the year 2000. The Company believes that it has identified and resolved all Year 2000 issues that could materially adversely affect its business, financial condition or results of operations. However, it may not be possible to determine with complete certainty that all Year 2000 problems have been identified or corrected. As a result, the Company could be at risk of experiencing a significant number of operational inconveniences and ineffectiveness that may divert management's time and attention from its ordinary business activities. The Company would also be at risk of experiencing a lesser number of serious systems failures that may require significant efforts by the Company to prevent or alleviate material business disruptions. In addition, in the event that the Company has not accurately identified or corrected all such Year 2000 problems, the costs of achieving year 2000 compliance could be material to the Company.

### **No Market for Securities**

There is currently no public market for the Special Warrants or the Warrants and no public market for the Special Warrants or the Warrants will develop or be sustained. Although the Common Shares issuable upon exercise of the Special Warrants and the Warrants will trade on CDN, there can be no assurance that an active trading market in such Common Shares will be sustained. The purchase price per Special Warrant was determined by negotiation between the Corporation and the Agent and may not be indicative of prices which will prevail in any trading market.

## **Payment of Dividends**

The Company has never paid cash dividends on its Common Shares and does not intend to pay any dividends for the foreseeable future. See "Dividend Policy".

## **FORWARD LOOKING STATEMENTS**

This prospectus contains certain forward-looking statements. Words such as "expects", "anticipates", "intends", "plans", "believes", "seeks", "proposes", variations of such words and similar expressions are intended to identify these forward looking statements. Specifically, and without limiting the generality of the foregoing, all statements included in this prospectus that address activities, events or developments that the Company expects or anticipates will or may occur in the future, including such things as future capital (including the amount and nature thereof), products under development, business strategies and measures to implement strategies, competitive strengths, goals, expansion and growth of the business and operations, plans and references to the future success of the Company are forward-looking statements, including, without limitation, those statements contained under the headings "Summary", "Business of the Company" and "Risk Factors", respectively, to this prospectus. Actual results could differ materially from those projected in the forward-looking statements as a result of certain factors, including those described in "Risk Factors"; general economic, market or business conditions; the opportunities (or lack thereof) that may be presented to and pursued by the Company; competitive actions by other companies or partnerships in which they have equity investments; competitive actions by other companies; changes in laws or regulations; and other factors, many of which are beyond the control of the Company.

Readers are cautioned not to place undue reliance on forward-looking statements contained in this prospectus, which reflect the analysis of the management of the Company, as appropriate, only as of the date of this prospectus. There can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company or any of the business or operations of the Company.

## **DILUTION**

The following table sets forth the of dilution per Common Share based on the Company's balance sheet as at October 31, 1999 after giving effect to the issuance of the 6,285,714 Common Shares issuable upon the exercise of the Special Warrants (but not the exercise of any Warrants, Compensation Options or Compensation Purchase Warrants). "Net tangible book value per share" represents the amount of total tangible assets of the Company reduced by the amount of the total liabilities, divided by the number of Common Shares of the Company outstanding.

Offering price per Special Warrant . . . . .	\$0.70
Net tangible book value before the offering of Special Warrants . . . . .	\$0.10
Increase in net tangible book value attributable to the offering of Special Warrants <sup>(1)</sup> . . . . .	\$0.13
Net tangible book value after this offering . . . . .	\$0.23
Dilution to Subscribers . . . . .	<u>\$0.47</u>
Percentage dilution in relation to the offering price . . . . .	<u>67 %</u>

(1) After deducting the Agent's fee and estimated expenses of the offering and assuming the Clearance Date occurs on or before April 5, 2000.

### **AUDITORS, TRANSFER AGENT AND REGISTRAR**

The auditors of the Company are KPMG LLP, Chartered Accountants, Yonge Corporate Centre, 4120 Yonge Street, Suite 500, North York, Ontario M2P 2B8. The registrar and transfer agent of the Common Shares of the Company is Equity Transfer Services Inc., 120 Adelaide St. W., Suite 420, Toronto, Ontario M5H 4C3.

### **LEGAL MATTERS**

Certain legal matters in connection with the securities qualified for distribution hereunder will be passed upon on behalf of the Company by Goodman and Carr and on behalf of the Agent by Cassels Brock & Blackwell LLP.

### **LEGAL PROCEEDINGS**

The Company is not currently involved in any litigation or proceedings which are material, either individually or in the aggregate, and to the Company's knowledge, no other legal proceedings of a material nature involving the Company are currently contemplated by any individuals, entities, or governmental authorities.

### **PURCHASERS' STATUTORY RIGHTS**

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

### **CONTRACTUAL RIGHTS OF ACTION FOR RESCISSION**

## **FOR HOLDERS OF SPECIAL WARRANTS**

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

## **AUDITORS' REPORT**

To the Board of Directors of 01 Communique Laboratory Inc.

We have audited the balance sheets of 01 Communique Laboratory Inc. as at October 31, 1999 and 1998 and the statements of income and deficit and cash flows for each of the years in the three-year period ended October 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 1999 and 1998 and the results of its operations and its cash flows for each of the years in the three-year period ended October 31, 1999 in accordance with generally accepted accounting principles.

Chartered Accountants

Toronto, Canada

December 10, 1999

# 01 COMMUNIQUE LABORATORY INC.

## Balance Sheets

October 31, 1999 and 1998

	1999	1998
<b>Assets</b>		
Current assets:		
Cash	\$ 954,612	\$ —
Amounts receivable (note 2)	2,446,260	1,969,092
Inventory	25,424	55,106
Prepaid expenses and deposits	129,976	39,557
	<u>3,556,272</u>	<u>2,063,755</u>
Capital assets (note 3)	82,847	113,731
	<u>\$ 3,639,119</u>	<u>\$ 2,177,486</u>

## Liabilities and Shareholders' Equity

Current liabilities:		
Bank indebtedness (note 4)	\$ —	\$ 635,890
Accounts payable and accrued liabilities	933,630	1,016,032
Deferred revenue	187,425	43,008
Current portion of capital lease obligations	—	22,784
Current portion of long-term debt (note 5)	106,200	—
	<u>1,227,255</u>	<u>1,717,714</u>
Long-term debt (note 5)	393,800	—
Shareholders' equity:		
Share capital (note 6)	6,586,320	6,367,842
Deficit	(4,568,256)	(5,908,070)
	<u>2,018,064</u>	<u>459,772</u>
Commitments (note 9)		
	<u>\$ 3,639,119</u>	<u>\$ 2,177,486</u>

See accompanying notes to financial statements.

On behalf of the Board:

(Signed) "William A. Train" \_\_\_\_\_ Director

(Signed) "Henry S. Pankratz" \_\_\_\_\_ Director

# 01 COMMUNIQUE LABORATORY INC.

## Statements of Income and Deficit

Years ended October 31, 1999, 1998 and 1997

	1999	1998	1997
Revenue	\$ 7,031,568	\$ 4,003,313	\$ 1,765,282
Cost of goods sold	284,366	304,933	290,844
	6,747,202	3,698,380	1,474,438
Expenses:			
Selling, general and administrative	4,431,296	4,955,465	3,068,936
Research and development, net investment tax credits of \$150,000 (1998 - \$350,000; 1997 - \$162,500)	819,331	609,284	375,789
Interest, net	41,483	—	90,000
Amortization of debenture discount (note 6(a))	84,100	—	—
Depreciation and amortization	31,178	31,176	37,380
	5,407,388	5,595,925	3,572,105
Net income (loss)	1,339,814	(1,897,545)	(2,097,667)
Deficit, beginning of year	(5,908,070)	(4,010,525)	(1,912,858)
Deficit, end of year	\$ (4,568,256)	\$ (5,908,070)	\$ (4,010,525)
Basic net income (loss) per common share	\$ 0.07	\$ (0.10)	\$ (0.15)
Fully diluted net income (loss) per common share	0.06	(0.10)	(0.15)

See accompanying notes to financial statements.

# 01 COMMUNIQUE LABORATORY INC.

## Statements of Cash Flows

Years ended October 31, 1999, 1998 and 1997

	1999	1998	1997
Cash provided by (used in):			
Operations:			
Net income (loss)	\$ 1,339,814	\$ (1,897,545)	\$ (2,097,667)
Items which do not involve cash:			
Depreciation and amortization	31,178	31,176	37,380
Amortization of debenture discount	84,100	—	—
Deferred lease inducement	—	(9,514)	(3,262)
Non-cash expenses	33,500	—	—
Change in non-cash working capital (note 7)	(475,890)	(378,304)	(306,118)
	1,012,702	(2,254,187)	(2,369,667)
Financing:			
Issue of common shares, net of issue costs	184,978	2,430	180,000
Issue of special warrants, net of issue costs	—	—	3,400,000
Share issue costs	—	(25,518)	—
Increase (decrease) in bank indebtedness	(635,890)	635,890	—
Payment of capital lease obligations	(22,784)	(34,801)	(21,631)
Issue of subordinated debenture (note 6(a))	215,900	—	—
Repayment of subordinated debenture (note 6(a))	(300,000)	—	—
Proceeds from long-term debt (note 5)	500,000	—	—
	(57,796)	578,001	3,558,369
Investments:			
Purchase of capital assets	(294)	(10,736)	(25,700)
Increase (decrease) in cash	954,612	(1,686,922)	1,163,002
Cash, beginning of year	—	1,686,922	523,920
Cash, end of year	\$ 954,612	\$ —	\$ 1,686,922
Supplemental cash flow information:			
Cash paid for interest	\$ 64,095	\$ 26,696	\$ 77,309
Cash received for interest	22,612	26,382	8,905

See accompanying notes to financial statements.

# 01 COMMUNIQUE LABORATORY INC.

Notes to Financial Statements

Years ended October 31, 1999, 1998 and 1997

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01 Communique Laboratory Inc. (the "Company") was incorporated on October 7, 1992 under the laws of Ontario. Its principal business activities are the development and marketing of communication software that integrates a full range of communication capabilities, including fax, voice, data and Internet applications, under an easy-to-use single graphical user interface. The Company's products are sold through the retail channel and the Original Equipment Manufacturer ("OEM") channel.

## 1. Significant accounting policies:

### (a) Revenue recognition:

Revenue from software sales is recognized upon shipment of product, net of discounts and provisions for marketing programs, returns and allowances, and customer price protection programs. Revenue from license fees is recognized at the later of delivery of the software master copy or, if applicable, fulfillment of all other significant obligations under terms of license agreements. Deferred revenues represent amounts invoiced in advance of revenue recognition.

### (b) Inventory:

Inventory consists of software products, packaging materials and documentation and is carried at the lower of cost and net realizable value.

### (c) Research and development:

All research costs are expensed as incurred. Software development costs are expensed as incurred unless they satisfy the generally accepted accounting criteria for deferral and subsequent amortization. The Company applies stringent criteria in its interpretation of development costs so that all such costs to date have been expensed in the periods incurred. Related refundable investment tax credits, net of valuation allowances, are recorded as a reduction of the related research and development expense or as a reduction of the related capital asset for items of a long-term nature when the Company has reasonable assurance that the credit will be realized.

### (d) Income taxes:

The Company records income tax expense on the tax allocation basis. Tax deferred as a result of claiming, for income tax purposes, amounts different from those recorded in the accounts are charged against current operations and recorded in the balance sheet as deferred income taxes.

# 01 COMMUNIQUE LABORATORY INC.

Notes to Financial Statements (continued)

Years ended October 31, 1999, 1998 and 1997

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## 1. Significant accounting policies (continued):

### (e) Capital assets:

Capital assets are recorded at cost. Depreciation and amortization are provided on a straight-line basis at the following annual rates:

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Computer systems	30%
Communications equipment	10% - 20%
Furniture and fixtures	20%

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Leasehold improvements are amortized on a straight-line basis over the term of the lease.

### (f) Deferred leasehold inducements:

Leasehold inducements are deferred and accounted for as a reduction of rent expense on a straight-line basis over the term of the lease.

### (g) Foreign currency translation:

The monetary assets and liabilities of the Company which are denominated in foreign currencies are translated at the period-end exchange rates. Revenues and expenses are translated at rates of exchange prevailing on the transaction dates. All of the exchange gains or losses resulting from these transactions are included in net income.

### (h) Measurement uncertainty:

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

The Company operates in a highly competitive market subject to fast-paced technological changes. The Company has estimated the rate of sales returns of its products based on historical patterns, communications with its distributors, industry trends and existing competitive pressures. Significant changes in technology or competitors' products could result in a material change in the rate of sales returns.

# 01 COMMUNIQUE LABORATORY INC.

Notes to Financial Statements (continued)

Years ended October 31, 1999, 1998 and 1997

## 1. Significant accounting policies (continued):

### (i) Income (loss) per share:

Net income (loss) per share has been calculated on the basis of net income (loss) divided by the weighted average number of common shares outstanding during each year. Fully diluted net income (loss) per share has been calculated using the weighted average number of common shares determined above, adjusted to reflect the exercise of stock options as if they were exercised at the later of the date of issuance and the beginning of the year.

## 2. Amounts receivables:

	1999	1998
Trade receivables	\$ 2,070,732	\$ 1,402,288
Refundable investment tax credits	375,528	566,804
	<u>\$ 2,446,260</u>	<u>\$ 1,969,092</u>

## 3. Capital assets:

	1999		1998	
	Cost	Accumulated depreciation and amortization	Net book value	Net book value
Computer systems	\$ 151,712	\$ 112,286	\$ 39,426	\$ 60,381
Communications equipment	25,053	6,454	18,599	19,853
Leasehold improvements, furniture and fixtures	81,622	56,800	24,822	33,497
	<u>\$ 258,387</u>	<u>\$ 175,540</u>	<u>\$ 82,847</u>	<u>\$ 113,731</u>

The cost and accumulated depreciation for assets under capital lease are \$111,172 (1998 - \$111,172) and \$73,799 (1998 - \$63,287), respectively.

Depreciation expense for assets under capital lease amounted to \$10,512 (1998 - \$14,658; 1997 - \$22,347).

# 01 COMMUNIQUE LABORATORY INC.

Notes to Financial Statements (continued)

Years ended October 31, 1999, 1998 and 1997

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## 4. Bank indebtedness:

The Company has a demand operating line to a maximum of \$750,000 with a bank. A general security agreement secures the facility and borrowings are at the rate of the bank's prime lending rate plus 2.5% per annum. Borrowings under the facility are subject to maximum amounts relative to accounts receivable and other covenant tests.

## 5. Long-term debt:

During 1999, the Company arranged long-term debt financing of \$500,000. The debt bears interest at 15% per annum, plus a royalty payment of 0.1179% of revenue.

Scheduled principal repayments are as follows:

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2000	\$ 106,200
2001	190,150
2002	203,650
	<hr/>
	\$ 500,000

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# 01 COMMUNIQUE LABORATORY INC.

Notes to Financial Statements (continued)

Years ended October 31, 1999, 1998 and 1997

## 6. Share capital:

Authorized:

50,000 Series A preference shares  
Unlimited preference shares, issuable in series  
Unlimited common shares

Issued:

	Number of common shares	Amount
Balance, October 31, 1996	13,576,854	\$ 2,800,430
Issued during 1997:		
For cash	250,000	180,000
Balance, October 31, 1997	13,826,854	2,980,430
Issued during 1998:		
On conversion of special warrants, net of issue costs	5,250,000	3,374,482
Expiry of share purchase warrants	—	10,500
For cash	3,240	2,430
Balance, October 31, 1998	19,080,094	6,367,842
Issued during 1999:		
For services rendered	67,000	33,500
Private placement, net of issue costs	330,000	79,978
Exercise of employee stock options	210,000	105,000
Balance, October 31, 1999	19,687,094	\$ 6,586,320

### (a) Private placement:

During 1999, the Company closed a private placement for cash proceeds of \$300,000. The private placement consisted of two equal units consisting in total of (i) a subordinated debenture at a purchase price of \$215,900 with a redemption value of \$300,000; (ii) 300,000 common shares with an ascribed value of \$0.28 per common share for a total consideration of \$84,000; and (iii) contingent options.

# 01 COMMUNIQUE LABORATORY INC.

Notes to Financial Statements (continued)

Years ended October 31, 1999, 1998 and 1997

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## 6. Share capital (continued):

The subordinated debenture bore interest at 12% per annum and matured on December 31, 1999. The debenture was repaid in full during the year. The difference between the issue amount of \$215,900 and the repayment amount of \$300,000, in the amount of \$84,100, has been recorded as amortization of debenture discount in the statements of income and deficit.

Under the terms of the agreement, 30,000 contingent options were exercised by the arm's-length holders at a price of \$0.23 per share for total proceeds of \$6,900.

One of the two units described above was purchased by a company owned by senior officers of the Company, one of which is also a director of the Company. The second unit was purchased by an arms-length party.

### (b) Stock options:

The Company has a stock option plan in place for directors, officers and employees under which options to purchase up to 10% of its issued and outstanding shares of the Company can be issued. During 1999, 210,000 options (1998 - nil) at a price of \$0.50 per share were exercised.

As at October 31, 1999, there were 1,922,500 options outstanding to purchase common shares at prices from \$0.50 to \$0.75 per share, expiring on various dates up to December 5, 2006.

In addition, the Company has issued 42,000 broker options to purchase common shares at a price of \$0.60 per share. These options expire on August 1, 2000.

## 7. Change in non-cash working capital:

	1999	1998
Amounts receivable	\$ (477,168)	\$ (945,992)
Inventory	29,682	41,388
Prepaid expenses and deposits	(90,419)	48,656
Accounts payable and accrued liabilities	(82,402)	479,144
Deferred revenue	144,417	(1,500)
	<u>\$ (475,890)</u>	<u>\$ (378,304)</u>

# 01 COMMUNIQUE LABORATORY INC.

Notes to Financial Statements (continued)

Years ended October 31, 1999, 1998 and 1997

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## 8. Income taxes:

As at October 31, 1999, the Company has the following non-capital losses available to reduce future years' income for income tax purposes, the tax effect of which has not been recorded in the accounts. These losses expire as follows:

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2004	\$ 1,748,000
2005	1,359,000

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In addition, the Company has an unclaimed pool of product development costs of approximately \$1,400,000, which can be carried forward indefinitely as a deduction against future taxable income, the tax benefit of which has not been recorded.

During the year, the Company utilized income tax losses of approximately \$1,340,000.

## 9. Lease commitments:

The Company has entered into operating lease agreements for premises and equipment. The minimum annual rental payments are:

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2000	\$ 179,478
2001	113,618
2002	29,812

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## 10. Financial instruments:

### (a) Fair values:

Fair value estimates are made at a specific time using available information about the financial instrument. These estimates are subjective in nature and often cannot be determined with precision.

The carrying values of cash, bank indebtedness, accounts receivable, accounts payable and accrued liabilities and current portion of capital lease obligations approximate their fair values due to the relatively short periods to maturity and terms of the instruments. The fair value of the long-term debt approximates the carrying value due to the interest rates and terms available to the Company for the same or similar debt instruments.

# 01 COMMUNIQUE LABORATORY INC.

Notes to Financial Statements (continued)

Years ended October 31, 1999, 1998 and 1997

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## 10. Financial instruments (continued):

### (b) Credit and foreign currency risk:

88% of accounts receivable as at October 31, 1999 are from three customers (1998 - 76% from two customers). The Company's exposure to credit risk associated with the non-performance of the customers in fulfilling their contractual obligations can be directly impacted by a decline in economic conditions which could impair the customers' ability to satisfy their obligations to the Company. The Company has minimal bad debt experiences in the past and monitors accounts receivable closely.

The Company operates in one business segment, the development and marketing of its computer telephone software. Substantially all of the Company's sales are in U.S. dollars. The Company uses the revenue stream in U.S. dollars as a hedge to cover expenses denominated in U.S. dollars. The Company does not hedge the risk related to the fluctuations in the exchange rate between the U.S. and Canadian dollar from the date of the sales transaction to the collection date due to the short-term nature of this exposure.

## 11. Uncertainty due to the Year 2000 Issue:

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

# 01 COMMUNIQUE LABORATORY INC.

Notes to Financial Statements (continued)

Years ended October 31, 1999, 1998 and 1997

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## 12. Subsequent event:

On December 7, 1999, the Company completed a special warrant private placement. In the financing, the Company sold 6,285,714 special warrants at a price of \$0.70 each, raising gross proceeds of \$4,400,000. Each special warrant allows the holder to acquire, for no additional consideration, units consisting of one common share and one-half of one common share purchase warrant of the Company. Each whole common share purchase warrant entitles the holder to purchase one common share of the Company at a price of \$1.00 per share at any time prior to the date which is two years from the earlier of (a) date a receipt is issued for a qualifying prospectus by the Ontario Securities Commission, and (b) April 5, 2000. If a receipt for the Company's qualifying prospectus has not been received by April 5, 2000 each special warrant will be exercisable for 1.15 common shares and 0.575 common share purchase warrants of the Company. \$1,100,000 of the proceeds of the financing are being held in escrow and will be released on the date a receipt for qualifying prospectus is received or June 5, 2000, whichever is earlier.

In connection with the offering, the Company paid the agent a fee of \$330,000 and granted the agent 628,571 compensation options of the Company. Each compensation option will entitle the agent to purchase a compensation unit at a price of \$0.70 per unit at any time prior to December 7, 2001. Each compensation unit will consist of one common share and one half of one common share purchase warrant of the Company. Each common share purchase warrant will entitle the agent to purchase one common share at a price of \$1.00 per share at any time prior to the date which is two years from the earlier of (a) June 7, 2000 and (b) the date a receipt is issued for a qualifying prospectus by the Ontario Securities Commission.

**CERTIFICATE OF THE COMPANY**

Dated: January 28, 2000

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.

"Andrew Cheung"

(Signed) ANDREW CHEUNG  
President and Chief  
Executive Officer

"Brian Stringer"

(Signed) BRIAN STRINGER  
Chief Financial Officer

On behalf of the Board of Directors

"Henry S. Pankratz"

(Signed) HENRY S. PANKRATZ  
Director

"William A. Train"

(Signed) WILLIAM A. TRAIN  
Director

**CERTIFICATE OF THE PROMOTER**

"Andrew Cheung"

(Signed) ANDREW CHEUNG

## **CERTIFICATE OF THE AGENT**

Dated: January 28, 2000

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

TAURUS CAPITAL MARKETS LTD.

"P. Gage Jull"

(Signed) P. GAGE JULL