



{ annual report 04 }



Nstein Technologies (TSX-V: EIN) develops and markets leading-edge software solutions for analyzing vast amounts of unstructured data in virtually all languages. Nstein's linguistic-based platform collects, organizes, analyzes, cross examines, shares and translates data from any sources, in real time. Nstein's solutions transform reactive decision-making into a high-impact proactive and even predictive process, and solve mission-critical problems. Nstein has developed tailored solutions for clients in homeland security & intelligence and e-publishing markets, as well as for large enterprises and government organizations. The Company is headquartered in Montreal, Canada, with offices in the USA and Europe. More information is available at www.nstein.com

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This annual report includes forward-looking statements that are based on certain assumptions and reflect Nstein's current expectations. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. Additional factors are discussed in Nstein's materials filed with the securities regulatory authorities in Canada from time to time. Nstein disclaims any intention or obligation to update or revise any forward-looking statements.

Chairman and chief executive officer's message

We are now on the threshold of a promising market. Large corporations no longer question the need to manage the endless stream of heterogeneous and multilingual information flooding in. Though still in its infancy, unstructured information management has already sparked the interest of major information technology (IT) players. This is confirmed by prominent IT research firms like Forrester and Gartner, who attribute it to the escalating volume of information tackled by large corporations (expected 40%¹ annual growth by 2012). Moreover verticalization of companies offering solutions in this field is a further indicator of the growing maturity of our industry and the pronounced interest in all types of unstructured information. As explained below, Nstein is extremely well positioned to reap the full benefit from this expanding market.



Fiscal 2004 proved to be a milestone year for Nstein. With three acquisitions, the Company secured the tools and key resources to become one of the few companies able to offer comprehensive solutions for multilingual information management to large organizations, on an international scale. Nstein has already taken the initiative and positioned itself advantageously in relation to the competition, thanks to the consolidation sweeping the industry in North America and Europe alike. The acquisitions made this year strengthened Nstein's structure in terms of technology, products and services, by adding productive elements such as instant translation and information viewing in all major languages, integration services, broadening of the potential client base and contact network, and providing access to additional funds for further commercialization of the Company's solutions.

Nstein's revenues soared, increasing by more than 173% in 2004 to \$4.8 million, compared with \$1.8 million in 2003. Integration of acquisitions and ongoing commercialization required additional investments, resulting in a slight increase in loss before interest, income tax and depreciation for the fiscal year; loss went from \$2.2 million in 2003 to \$2.3 million in 2004. Net loss, reflecting amortization of intangible assets from acquisitions totaling \$463,632, went from \$2.4 million in 2003 to \$3.2 million in 2004. However, we expect the present momentum to continue in the current fiscal year, allowing us to reap the benefits of these initiatives and efforts begun over a year ago.

1. Analytics from 2003 to 2012, Alexander Linden, Gartner Group, December 4, 2002



2004: a decisive year

In November, Nstein enjoyed exceptional international exposure, with the official launching at the United Nations of a new version of the Global Public Health Intelligence Network (GPHIN) platform. Nstein software solutions are the engine for this public health alert Web platform for the Public Health Agency of Canada. Among others, these solutions automate the analysis of all multilingual information, alerting international authorities in real time to a potential public health threat, and supplying them with synthesized critical information to speed up their decision process. The same solutions may also be used in other sectors such as homeland security and intelligence services. The UN launch produced major spin-offs in terms of business opportunities, on which we are currently working. During the year, Nstein pursued its program for closer links with major technological partners. The goal is to forge strategic alliances for the selling of combined solutions, tapping into the full potential of commercial opportunities with these valuable partners.

In addition to its technological and financial contribution, the acquisition of Alis Technologies in September brought the Company two new important financial partners, I.U.GO Ventures of Montreal and Mercury Partners of Geneva. Both these companies have huge networks of contacts and since the acquisition of Alis, they have been actively opening doors for Nstein at large international organizations.

The expertise of our executive team continued to develop this year. By appointing Stuart Woodring as advisor to the CEO, Nstein laid the foundations for an advisory board. Mr. Woodring spent 12 successful years with Forrester, one of the world's foremost IT research groups, during which time he contributed to expanding their research activities and launched many innovative projects. While Mr. Woodring was with Forrester, the firm's workforce went from 10 employees to more than 750, and sales exceeded the billion-dollar mark. During the current fiscal year, we look forward to welcoming other distinguished names to the Nstein advisory board, which will be a source of strength to our expanding Company.



■ ■ ■ Growth prospects

Nstein is pursuing its growth strategy and continuing to concentrate on increasing revenues, profitability, and focusing its commercialization activities in promising vertical markets. We now possess the elements to augment our revenues substantially in the next few years.

E-publishing is our original sector and the one in which we have differentiated ourselves. In the past years, we have developed technology to respond to the needs of this industry. The results are plain to see: our solutions are being adopted by the leading companies in the industry and our reputation is flourishing. The success we have already accomplished with large organizations allows us to predict sustained revenue growth in this sector.

Last year, we began to capitalize on our achievements in e-publishing and broadened our services to other growth areas, including homeland security and intelligence services. The GPHIN II launch at the United Nations was fitting testimony to our skill in penetrating this fast growing market. The GPHIN II platform is the result of close technological collaboration between Nstein and the companies it acquired in the last fiscal year, namely KMtechnologies, Alis Technologies and Valsar Consulting Group; this combined effort has considerably enhanced the scope of our solutions. Today we regard ourselves as the only company able to offer such a comprehensive range of solutions for processing multilingual information in the homeland security and intelligence sectors. For over a year, we have been energetically seeking out new clients in this sector, worldwide. We expect it to become a significant source of revenue for Nstein, starting this year, despite the longer sales cycle due to the newness of the market and the important investments required for these solutions.

The fact that our technological platform is suited to many different uses is another major asset for Nstein. The Company's sales cycles range generally from six to twelve months in the e-publishing, homeland security and intelligence sectors, depending on the client and the scale of the solution. To offset the length of these cycles, we are currently evaluating other uses for our technological platform that would shorten sales cycles. These would involve online solutions based on recurring revenue models. The *Corporate Intelligence* sector – for example, bringing companies real time data on clients' opinions and information circulating about them and their competitors in the press, newsgroups, blogs, etc. – is the one we are focusing on now. This sector should grow dramatically in the next few years.

Fiscal 2005 heralds a year of growth and achievements for Nstein. We have the tools to grow our market share substantially in this fast evolving industry. And most important of all, we can rely on a dynamic team determined to make Nstein a resounding success.

On behalf of the Board of Directors, I extend sincere thanks to our clients, shareholders, employees and partners for their unwavering support.

Chairman and Chief Executive Officer,



Mario Girard



Management's discussion and analysis of financial position and results of operations

This analysis provides the reader with a summary of changes in the financial position of Nstein Technologies Inc. ("Nstein" or the "Company") during the fiscal year ended December 31, 2004. It also compares results of operations and cash flows for the 12-month period ended December 31, 2004 with those of the previous fiscal year.

The analysis should be read in conjunction with the audited consolidated financial statements as at December 31, 2004 and related notes presented in this annual report. The financial statements of Nstein were prepared in accordance with Canadian generally accepted accounting principles (GAAP). The Company publishes its results in Canadian dollars. Unless otherwise indicated, all amounts in this analysis are in Canadian dollars.

Some statements in this analysis are forward-looking statements and reflect the Company's present assumptions regarding future events. Forward-looking statements involve risks and uncertainties that could cause actual results to differ from current expectations.

Overview

Founded in 2000, Nstein Technologies develops and markets leading-edge software solutions for analyzing vast amounts of unstructured data in virtually all languages. Nstein's linguistic-based platform collects, organizes, analyzes, cross examines, shares and translates data from any sources, in real time. Nstein's solutions transform reactive decision-making into a high-impact proactive and even predictive process, and solve mission-critical problems. Nstein has developed tailored solutions for clients in homeland security & intelligence and e-publishing markets, as well as for large enterprises and government organizations.

The Company is headquartered in Montreal, Canada, with offices in the USA and Europe. Nstein is listed on the TSX Venture Stock Exchange under the symbol EIN.

Strategy

Since it was founded, Nstein has focused on commercializing its products in the e-publishing market. The Company has made major investments in research and development in order to multiply the applications for its GIIM platform in other sectors. In fiscal 2004, Nstein strengthened its technological platform by acquiring KMtechnologies, Alis Technologies and Valsar Consulting Group. Details of these acquisitions are found in the following section and in Note 3 to the audited consolidated financial statements of the Company for the fiscal year ended December 31, 2004.

These acquisitions also enabled the Company to expand its product offering to other promising sectors, particularly homeland security & intelligence and *Corporate Intelligence*.

In 2005, Nstein will focus on the following objectives:

- Consolidation and growth of market share in e-publishing.
- Penetration of promising markets, especially homeland security & intelligence.
- Development of solutions for the *Corporate Intelligence* sector, based on a recurring revenue model.

Thanks to the acquisitions realized in 2004 and the tireless development of the GIIM platform, the Company now regards itself as one of the only companies offering comprehensive solutions for the management of unstructured multilingual information to major organizations, worldwide. This in turn gives Nstein a major advantage over the competition.



Acquisitions

The Company made three acquisitions during the year.

On June 10, 2004, the Company acquired all outstanding shares in KMtechnologies Inc. ("KM"). KM is a Canadian software developer of Web-based collaboration solutions as well as document, knowledge and customer-relations management solutions. Under the terms of the agreement, Nstein issued 5,950,000 common shares, the majority of which were escrowed for a 9-month period, as well as warrants to acquire an additional 1,000,000 common shares at \$0.40 per share for a 12-month period following the transaction, and \$0.50 per share for an additional 12 months.

On September 1, 2004, Nstein acquired all outstanding shares in Alis Technologies Inc. ("Alis"), a company specializing in multilingual information management software solutions, helping large corporations and organizations to communicate more efficiently in a multilingual environment and on the Internet. Pursuant to the agreement, Nstein issued 35,185,185 common shares subject to escrow for a 24-month period.

On September 7, 2004, the Company acquired all outstanding shares in Valsar Consulting Group Inc. ("Valsar"), a company integrating information technology (IT) solutions for large companies and organizations. Under the terms of the agreement, Nstein issued 12,053,846 common shares subject to a 24-month escrow. The \$576,000 balance of the purchase price will be paid over a three-year period in instalments of \$192,000 per year, either in cash or in common shares priced at \$0.26 per share.

These three acquisitions were recorded using the purchase method of accounting. Based on this method, assets acquired and liabilities assumed were recorded at their estimated fair value as at the date of acquisition. The purchase price was reduced by an average discount of 35% (determined by a third party) in order to consider the impact of the escrow on the share values and the effect of having a large number of shares traded on the market at a precise moment in a limited market.

Key performance indicators

Nstein evaluates performance for the whole Company using key financial indicators, particularly revenues, EBITDA and loss. These items are described in the appropriate sections below. Management also monitors performance using certain indicators related to operations, in particular the acquisition of clients.

Selected annual information

In Canadian dollars	2004 (\$)	2003 (\$)	2002 (\$)
Revenues	4,848,140	1,775,322	1,352,164
EBITDA*	(2,349,974)	(2,183,044)	(4,342,296)
Loss	(3,195,477)	(2,395,744)	(4,678,136)
Basic and diluted loss per share	0.02	0.02	0.05
Total assets	15,716,206	5,425,449	5,277,522
Long-term liabilities	2,258,895	749,883	129,963

* Definition of EBITDA: Earnings (loss) before financial expenses, income tax, depreciation and amortization. EBITDA is presented as an additional measurement of earnings to help readers determine the Company's capacity to generate liquidity from its activities and defray its financial expenses. It is also an indicator widely used for evaluation purposes. Because this term has no standardized meaning under Canadian generally accepted accounting principles, it may not be comparable to similar measurements used by other companies.

During fiscal 2003, the increase in revenues was mainly attributable to the sale to a government-sector client of innovative new products stemming from the GILM platform. The Company also reduced its loss by implementing measures designed to lower operating costs. Higher revenues in 2004 were linked chiefly to increased commercialization, which generated additional sales, and to the acquisition of KMtechnologies, Alis Technologies and Valsar Consulting Group. The loss increased due to additional expenditures for commercialization and research and development, as well as additional expenditures associated with the acquisitions. These acquisitions also explain the increase in total assets and long-term liabilities.

Operating Results

Revenues

The Company recorded revenues of \$4,848,140 for the fiscal year ended December 31, 2004, an increase of 173% compared with revenues of \$1,775,322 in the previous fiscal year. The Company derives most of its revenues from the sale of software user licenses, post-sales technical support, and specialized services. The companies acquired during the year contributed favourably to revenue growth. Sales were mainly in the e-publishing, defense, health and homeland security sectors.

The Company expects its revenues to increase in 2005, based on the fourth quarter of fiscal 2004, during which the Alis Technologies and Valsar Consulting Group acquisitions were fully integrated into Nstein's operating activities.

Cost of revenues

The cost of revenues includes the cost of human resources assigned to the various projects (employees and external consultants), as well as the cost of third-party software. Cost of revenues rose substantially in 2004 to \$1,837,468, compared with \$69,939 in 2003. This increase was partly due to growth in revenues, but was chiefly accounted for by the higher proportion of revenues from the sale of services, for which direct costs are higher than for revenues from software sales.

Although a significant portion of revenues in 2004 came from the sale of services, Nstein expects revenues in fiscal 2005 to derive mainly from the sale of software user licenses; this will enable the Company to increase its profit margins.

Consolidated expenses

The Company recorded consolidated expenses of \$6,206,149 in 2004, compared with \$4,101,127 in 2003. This increase comes mainly from selling and administrative expenses, and research and development expenses.

Selling and administrative expenses

Selling and administrative expenses are mainly composed of salaries, commissions for sales personnel, travel expenses, costs related to office premises, professional fees, and the costs associated with administering a publicly held corporation. Selling and administrative expenses amounted to \$3,820,088 in 2004, compared to \$2,833,182 in 2003. The larger workforce and the additional costs associated with acquisitions were the principal reasons for this increase. A charge associated with stock options, in accordance with the new accounting standard, also had a significant impact on these expenses.

Research and development expenses

Research and development expenses are chiefly accounted for by the cost of human resources assigned to the different projects. The cost of research and development amounted to \$2,159,733 in 2004, compared to \$1,701,826 in 2003. This increase was mainly due to intensified development of the Nstein technological platform, and the enlarged workforce following the acquisitions made in 2004.

Investment in research and development is a priority at Nstein. In 2005, the Company plans to pursue the fine-tuning of its products for the e-publishing, homeland security and intelligence service markets. Nstein also intends to create new online products for the *Corporate Intelligence* sector.

Tax credits

As a result of its eligibility to the Cité Multimédia Montréal Program, the Company is entitled to a refundable tax credit of 40% on qualified salaries up to a maximum of \$15,000 per employee. The Company also benefits from tax credits for research and development. Tax credits were slightly lower than last year, amounting to \$637,423 in 2004, against \$650,214 in 2003.



Amortization of intangible assets

Amortization of intangible assets rose substantially, going from \$15,617 in 2003 to \$483,718 in 2004. This increase was due to the acquisitions realized during fiscal 2004 and includes amortization of intangible assets identified at the time of the transactions. These assets consist of technologies acquired, client relationships and backlog and a non-competitive agreement.

Financial expenses

Financial expenses amounted to \$223,079 in 2004, compared to \$45,550 in 2003. This increase was chiefly due to the \$85,457 increase in interest charges on long-term debt, under a banking agreement signed in November 2003, and debts of companies acquired during the fiscal year. A strong Canadian dollar in 2004 also resulted in an exchange loss of \$33,332, as opposed to the exchange gain of \$17,728 in 2003. Amortization of deferred financing expenses associated with the bank financing realized in November 2003 amounted to \$30,576 compared to \$2,339 in 2003.

Loss

Nstein recorded a loss of \$3,195,477 or \$0.02 per share for the fiscal year ended December 31, 2004, compared to a loss of \$2,395,744 or \$0.02 per share for 2003. A number of factors account for this higher loss, among them the larger workforce following the acquisitions, and intensified commercialization and development of new solutions. Other factors, such as amortization of intangible assets, also had a major impact.

Selected quarterly financial information

In Canadian dollars	First quarter (\$)	Second quarter (\$)	Third quarter (\$)	Fourth quarter (\$)	Total (\$)
Fiscal year ended December 31, 2004					
Revenues	761,977	690,566	1,140,962	2,254,635	4,848,140
EBITDA*	(557,556)	(667,179)	(664,013)	(461,226)	(2,349,974)
Loss	(620,994)	(752,011)	(786,233)	(1,036,239)	(3,195,477)
Basic and diluted loss per share	(0.005)	(0.006)	(0.005)	(0.004)	(0.020)
Fiscal year ended December 31, 2003					
Revenues	307,106	407,265	307,155	753,796	1,775,322
EBITDA*	(800,523)	(552,091)	(396,213)	(434,217)	(2,183,044)
Loss	(858,195)	(592,465)	(445,350)	(499,734)	(2,395,744)
Basic and diluted loss per share	(0.008)	(0.006)	(0.004)	(0.004)	(0.022)

* Definition of EBITDA: Earnings (loss) before financial expenses, income tax, depreciation and amortization. EBITDA is presented as an additional measurement of earnings to help readers determine the Company's capacity to generate liquidity from its activities and defray its financial expenses. It is also an indicator widely used for evaluation purposes. Because this term has no standardized meaning under Canadian generally accepted accounting principles, it may not be comparable to similar measurements used by other companies.

During the first and second quarters of fiscal 2004, the increase in revenues was the result of sales to e-publishing clients, apart from the agreement signed with Health Canada for the Global Public Health Intelligence Network (GPHIN), a worldwide disease and virus early warning system. In the third and fourth quarters, the increase in revenues came mainly from e-publishing clients, and from the acquisitions made at the end of the third quarter, namely Alis Technologies and Valsar Consulting Group.

||| Liquidity and financial resources

Cash and cash equivalents

At December 31, 2004, cash and cash equivalents amounted to \$2,751,574, compared to \$3,107,684 at December 31, 2003.

Cash flow

Operating activities

Operating activities used \$2,808,235 in cash flow in 2004, compared to \$2,671,812 last year, despite a loss that was \$799,733 higher in 2004. Items not affecting cash and cash equivalents amounted to \$776,900 in 2004, compared to \$173,122 in 2003, explaining the slight variation in cash flows from operating activities. The principal item not affecting cash and cash equivalents in 2004 was amortization of intangible assets related to acquisitions, which amounted to \$463,632.

Financing activities

Financing activities used cash flow of \$345,555 in 2004, compared with generating cash flow of \$2,210,911 in 2003. Amounts from financing activities in 2004 were related to instalments on long-term debt, repayment of a bank loan, and fees for the issuance of common shares in November 2003. These items were partially offset by the obtaining of a \$300,000 portion of the long-term debt contracted with a chartered bank under the financing agreement signed in November 2003.

Investing activities

The Company received a total of \$2,797,680 from investing activities in 2004, compared to \$227,507 in 2003. Funds came mainly from the cash on hand at companies acquired during the year — less the fees paid in connection with these acquisitions — amounting to \$2,850,224.

Contractual obligations

Instalments payable, by period	Total (\$)	Less than 1 year (\$)	1 to 3 years (\$)	4 to 5 years (\$)	After 5 years (\$)
Long-term debt	2,911,811	652,916	1,826,070	133,478	299,347
Capital lease obligations	12,188	12,188	—	—	—
Use of offices	1,812,929	415,265	1,048,248	349,416	—
Research agreement	113,333	68,333	45,000	—	—

The Company's long-term debt increased substantially, going from \$1,129,963 in 2003 to \$2,923,999 in 2004. This increase was due to third-party debts at acquired companies Alis and KMtechnologies amounting to \$1,222,763 at year-end, as well as a balance of the sales price payable to Valsar shareholders of \$505,349.

Under a loan agreement concluded in November 2003 with a chartered bank, secured by La Financière du Québec up to 80%, Nstein received \$300,000 during the fiscal year, bringing to \$1,300,000 the amount disbursed in connection with this authorized loan of \$2,250,000. In order to receive the balance of the loan, \$950,000, the Company had to meet certain conditions regarding sales level and EBITDA during fiscal 2004. Because these conditions were only partially fulfilled, the parties are now negotiating future disbursements in connection with this loan.



Shareholders' equity

Authorized share capital is as follows:

Unlimited number of common shares, without par value, voting and participating

Unlimited number of preferred shares, without par value, non-voting and non-participating

Issued and fully paid	March 2, 2005 and December 31, 2004	December 31, 2003
186,402,292 common shares (132,838,594 in 2003)	29,532,130	19,954,649

Stock purchase warrants and stock options:

Each stock purchase warrant and each stock option allow the holder to acquire one common share in the share capital.

Number	March 2, 2005	December 31, 2004	December 31, 2003
Stock purchase warrants	4,530,782	4,530,782	3,324,715
Stock options	9,596,200	9,096,200	6,379,534

Further information about these items are found in Note 8 to the audited financial statements of the Company for the fiscal year ended December 31, 2004.

The Company is confident that its current financial resources, together with cash flows from operations, will be sufficient to allow it to attain its objectives and preserve its financial autonomy for the foreseeable future. The Company may nevertheless decide to seek additional financing before the end of the current fiscal year.



Significant accounting policies

Revenue recognition

The Company recognizes revenues from the sale of software and related post-contract customer support and other related services in accordance with Emerging Issues Committee Abstracts EIC-141 to 143 on revenue recognition. Fees from arrangements involving licenses, post-contract customer support and other related services are allocated to the various elements based on company-specific objective evidence of fair value of each of the elements. Revenues from software licenses are recognized when persuasive evidence of an arrangement exists, the software product has been delivered, there are no uncertainties surrounding product acceptance, the related fees are fixed or determinable, and collection is considered probable. Revenues from post-contract customer support elements are recognized ratably over the related support period. Revenues from other related services are recognized as the services are performed.

Goodwill

Goodwill represents the excess of the purchase price over the fair values of the net identifiable assets acquired. Goodwill is not amortized. However, an impairment test is performed annually, or more frequently if events or changes in circumstances indicate that it might be impaired. The accounting value of goodwill is compared to its fair value and an impairment loss is recognized when the carrying amount exceeds the fair value. The fair value is measured according to actualized cash flows. The Company is organized under a single operating segment.

New accounting policies

Stock-based compensation and other stock-based payments

The Company provides for a stock option plan, as described in Note 8. In accordance with new CICA standards outlined in Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments", the Company adopted on January 1, 2004 the recommendations retroactively, without restatement of prior years. A compensation charge must be included in the financial statements for all forms of stock-based compensation granted to directors, officers and employees, including stock options, based on the fair value method. Consequently, the deficit and other equity components were increased by \$198,624. For the year ended December 31, 2004, the company recognized stock-based compensation charges of \$87,653.

Risks and uncertainties

Nstein's sphere of activity is subject to a variety of risk factors and uncertainties. The Company's business, financial position and results of operations may suffer the adverse effects of the risk factors and uncertainties described below. The risk factors and uncertainties listed here are not the only ones that may affect the Company. Other risks and uncertainties currently unknown to the Company or regarded as negligible could also impact the conducting of its business.

Length of sales cycle

The Company's current sales cycle is long, and approval of contracts by clients is often delayed. This is beyond the control of Nstein.

Recent losses

The Company incurred losses during fiscal 2004 and recent fiscal years. As a result, the Company posted an accumulated deficit of \$20.9 million as at December 31, 2004. There is no assurance that the Company will be in a position to support or improve its profitability or cash position with its operating activities on a quarterly or annual basis in the future.



Potential fluctuations in quarterly results

The Company's quarterly operating results may fluctuate according to the time frame and size of certain orders; the number, date and importance of new product announcements made by the Company or its competitors; the Company's ability in developing, presenting and commercializing new versions of its products on a regular basis; the competitiveness of products and prices; and economic factors in general. These and other events such as delays in development or delivery of new products may affect quarterly results in the future.

Cash position and access to financing sources

Nstein occasionally turns to the financial markets to finance its activities. The Company's future needs with respect to capital depend on a number of factors, especially expenses related to the research and development required to consolidate or improve the competitive advantage of its technology, and the expenditures required to pursue commercialization of its products and services. However, there is no guarantee that additional financing will be available or be available on acceptable terms. Any factor affecting the Company's capacity to access financial markets, such as sharply fluctuating interest rates, changes in the economic climate, or investor perception of the Company's financial position or growth prospects could adversely affect its financial position and results of operations.

Competition

Nstein's sphere of activity is relatively new and includes several competitors. New players, new partnerships and new technology solutions are constantly entering the market. Nstein will thus need to pursue the market diversification strategy it introduced in 2003, persevere with aggressive commercialization, and also continue to develop its technology in order to meet the needs of large organizations. In order to do so, the Company will keep on investing intensively in research and development, and will have to retain key personnel.

Nstein products are state-of-the-art and nothing can guarantee that they will be adopted rapidly by its customers. The Company has demonstrated that its products meet the needs of the e-publishing market, but does not have enough historical metrics to gauge the exact potential of its solutions for large organizations.

Proprietary technology

Nstein uses, and will continue to use, various measures such as copyrights, trademarks, trade secret laws, confidentiality agreements and other contractual clauses, to establish, patent, maintain and protect its intellectual property rights. Unauthorized parties may try to copy certain of the Company's products or parts of these products, or seek to obtain proprietary information. With more competitors emerging, there is an increased risk of other firms trying to produce new products or replacement technologies. Endeavouring to control unauthorized access to the Company's information and technologies is expensive, complex and time-consuming.

Possible product liability

In view of their complexity, Nstein products may contain undetected errors or give rise to compatibility issues, especially when they are first introduced or when new versions are launched. Nothing guarantees that errors will not be found in new products after commercial delivery has begun. The Company operates a stringent quality assurance program, with rigorous testing to minimize errors.

Nstein has general liability insurance covering professional errors and omissions.



Credit risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, term deposits and accounts receivable. Cash and cash equivalents as well as term deposits are held with first class financial institutions. Consequently, management considers the risk of nonfulfilment related to these instruments to be minimal.

There is no particular concentration of credit risk. The Company does not normally require collateral or other security from customers for trade accounts receivable; however, credit is only extended after evaluation of creditworthiness. In addition, the Company performs ongoing credit reviews of all its customers and establishes an allowance for doubtful accounts when balances are deemed to be uncollectible.

Currency risk

The Company is exposed to currency risks as a result of its sales to foreign countries and the related trade accounts receivable. Most of these sales are denominated in US dollars and euros. The risks are partially hedged by purchases and operating expenses denominated in US dollars and euros.

Possible negative tax consequences

Nstein derives major benefits from government programs supporting research and development in Canada, particularly tax credits for scientific research and experimental development, and government funding. If changes in legislation or government policies respecting these programs result in their being cancelled or adversely modified, or if the Company is no longer in a position to participate in them, its operating costs would increase substantially.

This analysis of Nstein's financial position and results of operations was prepared on March 2, 2005. More recent information about the Company is published on the SEDAR Web site at www.sedar.com.



Bruno Martel
Finance Director



Management's Report

Nstein's management is responsible for the preparation, integrity and objectivity of the consolidated financial statements and other financial information presented in this Annual Report.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include some amounts that are based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly in all material respects.

Nstein's policy is to maintain a system of internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, accurate and reliable, and that our assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that Management fulfills its financial reporting responsibilities and is ultimately responsible for reviewing and approving the financial statements. The Board carries out these responsibilities primarily through its Audit Committee.

The Audit Committee is appointed by the Board and is composed of outside directors. The Committee meets periodically with Management and external auditors to review accounting, auditing and internal control procedures.

These consolidated financial statements have been reviewed and approved by the Board of Directors on the recommendation of the Audit Committee.

The consolidated financial statements have been audited on behalf of shareholders by PricewaterhouseCoopers LLP, the external auditors, in accordance with generally accepted auditing standards. The external auditors have full and free access to the Audit Committee.



Mario Girard
Chairman and Chief Executive Officer



Bruno Martel
Finance Director

Montreal (Quebec) Canada, February 18, 2005



Auditors' Report

■ ■ ■ To the Shareholders of Nstein Technologies Inc.

We have audited the consolidated balance sheets of Nstein Technologies Inc. as at December 31, 2004 and 2003 and the consolidated statements of earnings and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP
Chartered Accountants

Quebec, Quebec, Canada
February 18, 2005



Assets	2004 (\$)	2003 (\$)
Current assets		
Cash and cash equivalents	2,751,574	3,107,684
Term deposits (note 7)	164,600	164,600
Accounts receivable (note 4)	2,575,990	1,127,100
Tax credits recoverable (note 7)	1,145,985	380,000
Prepaid expenses	189,341	20,224
	<u>6,827,490</u>	<u>4,799,608</u>
Property, plant and equipment (notes 5 and 7)	414,576	479,782
Deferred financing expenses (note 7)	113,047	123,974
Intangible assets (notes 6 and 7)	3,194,217	22,085
Goodwill (note 3)	5,166,876	—
	<u>15,716,206</u>	<u>5,425,449</u>
Liabilities		
Current liabilities		
Bank loan	—	172,011
Accounts payable and accrued liabilities	2,821,769	1,250,235
Deferred revenues	350,594	101,728
Current portion of long-term debt	665,104	380,080
	<u>3,837,467</u>	<u>1,904,054</u>
Long-term debt (note 7)	2,258,895	749,883
	<u>6,096,362</u>	<u>2,653,937</u>
Shareholders' Equity		
Share capital (note 8)	29,532,130	19,954,649
Other equity components (note 9)	995,810	330,858
Deficit	(20,908,096)	(17,513,995)
	<u>9,619,844</u>	<u>2,771,512</u>
	<u>15,716,206</u>	<u>5,425,449</u>
Commitments (note 10)		

The accompanying notes are an integral part of the consolidated financial statements.



	2004 (\$)	2003 (\$)
Revenues (note 14)	4,848,140	1,775,322
Cost of revenues	1,837,468	69,939
	<u>3,010,672</u>	<u>1,705,383</u>
Expenses		
Selling and administrative	3,820,088	2,833,182
Research and development	2,159,733	1,701,826
Research and development tax credits	(637,423)	(650,214)
Depreciation of property, plant and equipment	138,706	151,533
Amortization of intangible assets	483,718	15,617
Loss on disposal of property, plant and equipment and intangible assets	18,248	3,633
Financial expenses (note 11a)	223,079	45,550
	<u>6,206,149</u>	<u>4,101,127</u>
Loss for the year	<u>3,195,477</u>	<u>2,395,744</u>
Deficit - Beginning of year	17,513,995	15,118,251
Adjustment resulting from a change in accounting policy (note 2)	(198,624)	—
Restated deficit - Beginning of year	<u>17,712,619</u>	<u>15,118,251</u>
Deficit - End of year	<u>20,908,096</u>	<u>17,513,995</u>
Basic and diluted loss per share	<u>0.02</u>	<u>0.02</u>
Basic and diluted weighted average number of shares outstanding ..	<u>151,909,759</u>	<u>106,928,613</u>

The accompanying notes are an integral part of the consolidated financial statements.



	2004 (\$)	2003 (\$)
Cash flows from operating activities		
Loss for the year	(3,195,477)	(2,395,744)
Items not affecting cash and cash equivalents		
Capitalized interests on long-term debt	26,079	—
Exchange gain	(8,080)	—
Depreciation and amortization	653,000	169,489
Stock-based compensation charge	87,653	—
Loss on disposal of property, plant and equipment	18,013	3,633
Loss on disposal of intangible assets	235	—
	<u>(2,418,577)</u>	<u>(2,222,622)</u>
Change in non-cash operating working capital items		
Accounts receivable	178,728	(645,934)
Tax credits recoverable	420,867	(27,500)
Prepaid expenses	52,875	17,797
Accounts payable and accrued liabilities (note 8)	(836,611)	354,775
Deferred revenues	(205,517)	(148,328)
	<u>(389,658)</u>	<u>(449,190)</u>
	<u>(2,808,235)</u>	<u>(2,671,812)</u>
Cash flows from financing activities		
Variation in bank loan	(172,011)	172,011
Long-term debt contracted	300,000	1,000,000
Payments on long-term debt	(324,061)	(893,600)
Variation in share capital, net of share issue expenses	(149,483)	1,932,500
	<u>(345,555)</u>	<u>2,210,911</u>
Cash flows from investing activities		
Term deposit maturity	—	208,000
Business acquisitions, net of cash and cash equivalents acquired	2,850,224	—
Additions to property, plant and equipment	(51,769)	(17,578)
Additions to intangible assets	(29,101)	(1,654)
Proceeds from the sale of property, plant and equipment	28,326	—
Tax credits related to property, plant and equipment	—	19,975
Tax credits related to intangible assets	—	18,764
	<u>2,797,680</u>	<u>227,507</u>
Decrease in cash and cash equivalents	(356,110)	(233,394)
Cash and cash equivalents — Beginning of year	3,107,684	3,341,078
Cash and cash equivalents — End of year	2,751,574	3,107,684
Additional information (note 11b and c)		

The accompanying notes are an integral part of the consolidated financial statements.

Approved by the Board of Directors,



Mario Girard
Director



Marc Dutil
Director



||| 1. Statutes and nature of activities

The company, incorporated in January 2000 under Part 1A of the Québec Companies Act, is an innovative software development company that provides advanced business intelligence solutions. The flexible platform developed by Nstein Technologies Inc. (Nstein) allows to use structured and unstructured multilingual data sources to disseminate information essential to operational and decision-making processes. Nstein's real-time business intelligence solutions allow its customers to transform reactive decision-making into a proactive and even predictive process.

||| 2. Summary of significant accounting policies

Consolidation and basis of presentation

These consolidated financial statements include the accounts of the company and those of its wholly-owned subsidiaries, Nstein R&D Inc., Nstein Technologies Corp., KMtechnologies Inc., Alis Technologies Inc. and Valsar Consulting Group Inc.

Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities reported in the financial statements. Those estimates and assumptions also affect the disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the years. Significant estimates include the allowance for doubtful accounts, refundable tax credits, the useful lives of property, plant and equipment and intangible assets, impairment of long-lived assets and certain accrued liabilities. Actual results could differ from those estimates.

Foreign currency

Foreign currency transactions

Transactions denominated in currencies other than Canadian dollars are translated into the functional currency as follows: monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenues and expenses are translated at the average rate for the year. Non-monetary assets and liabilities are translated at historical rates. Gains and losses arising from such translation are reflected in the statements of earnings.

Foreign subsidiaries

Foreign subsidiaries are considered to be integrated foreign operations. As a result, the foreign subsidiaries' accounts are remeasured into Canadian dollars using the temporal method. Under this method, monetary assets and liabilities are remeasured at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are remeasured at historical rates. Revenues and expenses are remeasured at the average rate for the year. Gains and losses resulting from remeasurement are reflected in the statements of earnings.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks as well as all highly liquid short-term investments having a term of less than three months at the acquisition date.

Property, plant and equipment

Property, plant and equipment are recorded at cost and are depreciated using the declining balance method at the rates mentioned in note 5, except for leasehold improvements which are depreciated using the straight-line method over a period of five years.

Intangible assets

Intangible assets are recorded at cost and are amortized using the declining balance or the straight-line methods at the rates mentioned in note 6.



Goodwill

Goodwill represents the excess of the purchase price over the fair values of the net identifiable assets acquired. Goodwill is not amortized. However, an impairment test is performed annually, or more frequently if events or changes in circumstances indicate that it might be impaired. The accounting value of goodwill is compared to its fair value and an impairment loss is recognized when the carrying amount exceeds the fair value. The fair value is measured according to actualized cash flows. The company is organized under a single operating segment.

Deferred financing expenses

Deferred financing expenses relate to the granting of warrants and are amortized over the term of the related financing (note 7).

Impairment of long-lived assets

Long-lived assets are reviewed for impairment when events or circumstances indicate that costs may not be recoverable. Impairment exists when the carrying value of the asset is greater than the undiscounted future cash flows expected to be provided by the asset. The amount of impairment loss, if any, is the excess of the carrying value over its fair value.

Income taxes

The company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities using enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse.

The company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

Tax credits

As a result of its eligibility to the Cité Multimédia Montréal Program, the company is entitled to a refundable tax credit of 40% on qualified salaries up to a maximum of \$15,000 per employee.

Research and development tax credits and other tax credits are accounted for using the cost reduction method. Under this method, tax credits related to qualified expenditures are accounted for as a reduction of the related expenditures in the year in which the expenditures are incurred, provided their realization is reasonably assured.

These tax credits could be subjected to a review and a possible adjustment by the Canadian federal and Quebec provincial tax authorities.

Revenue recognition

The company recognizes revenues from the sale of software and related post-contract customer support and other related services in accordance with Emerging Issues Committee Abstracts EIC-141 to 143 on revenue recognition. Fees from arrangements involving licenses, post-contract customer support and other related services are allocated to the various elements based on company-specific objective evidence of fair value of each of the elements. Revenues from software licenses are recognized when persuasive evidence of an arrangement exists, the software product has been delivered, there are no uncertainties surrounding product acceptance, the related fees are fixed or determinable, and collection is considered probable. Revenues from post-contract customer support elements are recognized ratably over the related support period. Revenues from other related services are recognized as the services are performed.



Research and development expenses

All expenses related to development activities, which do not meet generally accepted criteria for deferral, and research, are expensed as incurred, net of related tax credits and government grants. Development expenses which would meet generally accepted criteria for deferral would be capitalized, net of related tax credits and government grants, and would be amortized against earnings over the estimated period of benefit.

As at December 31, 2004 and 2003, the company had not deferred any development costs.

Basic and diluted earnings per share

Basic earnings per share are determined using the weighted average number of participating shares outstanding during the year.

Diluted earnings per share are determined using the weighted average number of participating shares outstanding during the year, plus the effects of dilutive potential participating shares outstanding during the year. The calculation of diluted earnings per share is made using the treasury stock method, as if all dilutive potential shares had been exercised at the later of the beginning of the year or the date of issuance, as the case may be, and that the funds obtained thereby be used to purchase participating shares of the company at the average market value of the participating shares during the year.

For the years ended December 31, 2004 and 2003, the diluted loss per share was the same as the basic loss per share since the dilutive effect of stock options and warrants was not included in the calculation; otherwise the effect would have been anti-dilutive. Accordingly, the diluted loss per share for those years was calculated using the basic weighted average number of shares outstanding.

Share issue expenses

Share issue expenses have been applied against the proceeds from the issuance of share capital.

Comparative figures

Certain comparative figures have been reclassified to conform with the current year presentation.

New accounting policies

Stock-based compensation and other stock-based payments

The company provides for a stock option plan, as described in note 8. In accordance with new CICA standards outlined in Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments", the company adopted on January 1, 2004 the recommendations retroactively, without restating prior years' result. A compensation charge must be included in the financial statements for all forms of stock-based compensation granted to directors, officers and employees, including stock options, based on the fair value method. Consequently, the deficit and other equity components were increased by \$198,624. For the year ended December 31, 2004, the company recognized stock-based compensation charges of \$87,653.



3. Business acquisitions

a) On June 10, 2004, the company acquired all of the outstanding capital shares of KMtechnologies Inc. ("KM"). KM is a Canadian company developing Web solutions to share and manage documents, knowledge and client relationship. Under the terms of the agreement, the company issued 5,950,000 common shares, as well as warrants for the purchase of 1,000,000 additional common shares at \$0.40 per share valid for a 12-month period following the transaction, and at \$0.50 for the next period of twelve months. The estimated fair value of those warrants is \$92,245 (note 8).

Except for the 150,000 issued shares, the shares are subject to a 9-month escrow from the closing date of June 10, 2004; 15% of the shares in escrow will be released monthly, three months after the closing date, and until all shares are released.

The escrow period of the 150,000 shares issued is fifteen months; 25% of the shares in escrow will be released monthly, twelve months after the closing date.

b) On September 1, 2004, the company acquired all of the outstanding capital shares of Alis Technologies Inc. ("Alis"), a company specialized in multilanguage information solutions, helping large companies and organizations to efficiently communicate in multi-language environment and on the Internet. Under the terms of the agreement, the company issued 35,185,185 common shares.

The shares are subject to a 24-month escrow from the closing date of September 1, 2004; 17% of the shares in escrow will be released every four months after the closing date, and until all shares are released.

c) On September 7, 2004, the company acquired all of the outstanding capital shares of Valsar Consulting Group Inc. ("Valsar"), a company specialized in information technology (IT) solutions for large companies and organizations. Under the terms of the agreement, the company issued 12,053,846 common shares. The balance of the purchase price of \$576,000 (note 7) will be paid in a three-year period with yearly instalments of \$192,000 in either cash or shares at an exercise price of \$0.26 per share, at the holder's option. The fair value of the debt at the acquisition date was \$492,095. The fair value of the stock option is estimated at \$266,779 (note 9).

The shares are subject to a 24-month escrow from the closing date of September 7, 2004. The shares in escrow will be released as follows:

A takeover of the company or the sale of Valsar will automatically release the shares.

	%
Closing date	7.3
4 months after closing date	10.9
6 months after closing date	13.7
12 months after closing date	22.7
18 months after closing date	22.7
24 months after closing date	22.7
	100.0



These acquisitions have been accounted for using the purchase method and the results were consolidated from the acquisition date. The following table summarizes the purchase price allocation, including acquisition costs based on the estimated fair value of the net assets acquired, as at the date of acquisition.

The purchase price was reduced by an average discount of 35% (determined by a third party) in order to consider the impact of the voluntary escrow on the share values and the effect of having a large number of shares traded on the market at a precise moment in a limited market.

	KM Technologies Inc. (\$)	Alis Technologies Inc. (\$)	Valsar Consulting Group Inc. (\$)	Total (\$)
Cash and cash equivalents	262,637	2,624,498	118,504	3,005,639
Other short-term assets	610,331	1,793,868	787,458	3,191,657
Property, plant and equipment	31,253	21,591	15,226	68,070
Intangible assets	651,984	2,257,000	718,000	3,626,984
Total assets acquired	1,556,205	6,696,957	1,639,188	9,892,350
Short-term liabilities	756,001	1,966,769	440,729	3,163,499
Long-term debt	696,170	464,893	—	1,161,063
Total assumed indebtedness	1,452,171	2,431,662	440,729	4,324,562
Net assets acquired	104,034	4,265,295	1,198,459	5,567,788
Goodwill	1,405,209	2,097,988	1,663,679	5,166,876
Purchase price	1,509,243	6,363,283	2,862,138	10,734,664
Paid as follows:				
Common shares issued	1,294,000	6,175,000	2,037,000	9,506,000
Warrants issued	92,245	—	—	92,245
Balance of purchase price (fair value)	—	—	492,095	492,095
Fair value of stock options	—	—	266,779	266,779
Business acquisition expenses	122,998	188,283	66,264	377,545
	1,509,243	6,363,283	2,862,138	10,734,664

Nstein Technologies Inc.

4. Accounts receivable

	2004 (\$)	2003 (\$)
Trade	2,420,004	1,056,224
Commodity taxes recoverable	155,986	70,876
	2,575,990	1,127,100



||| 5. Property, plant and equipment

	Depreciation rates and period	2004		2003	
		Cost (\$)	Accumulated depreciation (\$)	Cost (\$)	Accumulated depreciation (\$)
Office furniture and equipment	20%	240,046	112,486	218,183	79,202
Computer equipment	35%	682,105	517,720	645,950	480,207
Leasehold improvements	5 years	262,145	139,514	262,145	87,087
		1,184,296	769,720	1,126,278	646,496
Less:					
Accumulated depreciation		769,720		646,496	
Net amount		414,576		479,782	

During fiscal 2004, no tax credits have been applied against the cost of property, plant and equipment (\$19,975 in 2003).

||| 6. Intangible assets

	Amortization rates and periods	2004		2003	
		Cost (\$)	Accumulated amortization (\$)	Cost (\$)	Accumulated amortization (\$)
Software	50%	213,166	171,540	140,992	132,610
Nstein software	50%	1,040,000	1,031,777	1,040,000	1,026,297
Product technology	4 years	1,221,000	110,402	—	—
Backlog	1 year	566,000	187,633	—	—
Customer relationship	5 years	1,548,000	122,591	—	—
Non-competitive agreement	2 years	273,000	43,006	—	—
		4,861,166	1,666,949	1,180,992	1,158,907
Less:					
Accumulated amortization		1,666,949		1,158,907	
Net amount		3,194,217		22,085	

During fiscal 2004, no tax credits have been applied against the cost of intangible assets (\$18,764 in 2003).

||| 7. Long-term debt

	2004 (\$)	2003 (\$)
Term loans		
• Prime rate plus 2.95%, payable in monthly principal instalments of \$19,667 and \$6,250 plus interest, maturing respectively in May and December 2008. A second moveable hypothec of \$2,700,000 on Nstein technology's intellectual property and patent and the universality of the company's present and future properties has been given as security for this loan *	1,106,362	1,000,000
• Preferred rate of Caisse centrale Desjardins plus 2%, payable in monthly principal instalments of \$8,681 plus interest, guaranteed at 80% by Investissement Québec, maturing in November 2008. A moveable hypothec on the universality of a subsidiary's present and future properties as well as on specific personal properties including intellectual properties on all software developed by this subsidiary has been given as security for this loan	407,986	—
• 8%, with the National Research Council Canada ("NRC"), payable in four annual instalments of \$104,450, starting on January 1, 2007, maturing in January 2010	317,317	—
• 8%, payable in instalments of 20% of the positive cashflows generated by one subsidiary, since December 31, 2003, maturing on May 31, 2013	470,879	—
• 10%, for which a letter of credit in the amount of \$164,600 has been issued, payable in monthly instalments of \$1,538 including principal and interest, maturing in August 2011. A moveable hypothec on a deposit certificate in the amount of \$164,600 has been given as security for the letter of credit	89,525	98,529
• Preferred rate of Caisse centrale Desjardins plus 2.75%, payable in monthly principal instalments of \$833 plus interest and a final instalment of \$3,344 in June 2005. A first moveable hypothec on specific equipment and leasehold improvements of a subsidiary has been given as security for this loan	8,334	—
• Preferred rate of Caisse centrale Desjardins plus 2.75%, payable in monthly principal instalments of \$606 plus interest, maturing in October 2006. A first moveable hypothec on specific assets of a subsidiary has been given as security for this loan	6,059	—
• Balance on purchase price of a subsidiary (note 3c), 8%, payable in three annual instalments of \$192,000 including capital and interests, maturing in September 2007	505,349	—
• Obligations under capital leases, bearing interest at various rates between 11.16% and 20.52%, payable in monthly instalments between \$450 and \$522 including capital and interests, maturing in May and September 2005	12,188	—
Reimbursed during the year	—	31,434
	2,923,999	1,129,963
Less: Current portion	665,104	380,080
	2,258,895	749,883

* On November 27, 2003, the company accepted a financing offer from Bank of Montreal consisting of a term loan in the amount of \$2,250,000, secured by La Financière du Québec up to 80%. In consideration of the loan collateral, the company granted La Financière du Québec stock warrants entitling the latter to purchase 2,649,429 newly issued shares at a price of \$0.13 per share. These stock warrants vest over a five-year period. An amount of \$1,000,000 was paid upon the closing of the financing and an amount of \$300,000 was paid during the current year. The fair value of the stock warrants related to the financing disbursed has been estimated at \$145,964 (\$126,313 in 2003) using the Black-Scholes valuation model. The value of stock warrants has been accounted for as deferred financing expenses in the balance sheet and is amortized using the straight-line method over a 54-month period. As at December 31, 2004, the deferred financing expenses in the balance sheet represent \$113,047 (\$123,974 in 2003). The related credit is recorded as "Other equity components". Under this loan, the company is bound to meet certain financial conditions.

The annual principal instalments required on long-term debt over the next five years amount to \$665,104 in 2005, \$703,960 in 2006, \$717,820 in 2007, \$404,290 in 2008 and \$133,478 in 2009.

8. Share capital

Authorized

Unlimited number of common shares, without par value, voting and participating

Unlimited number of preferred shares, without par value, non-voting and non-participating

The following table presents the share capital activity of the company during the years ended December 31, 2004 and 2003:

	2004		2003	
	Number	Amount (\$)	Number	Amount (\$)
Balance – Beginning of year ...	132,838,594	19,954,649	104,267,165	18,445,136
Exercised stock options	374,667	71,481	—	—
Business acquisitions (note 3)	53,189,031	9,506,000	—	—
Private placement	—	—	28,571,429	1,509,513
Balance – End of year	<u>186,402,292</u>	<u>29,532,130</u>	<u>132,838,594</u>	<u>19,954,649</u>

Stock option plan

a) Under the plan

In June 2000, the company established a stock option plan for directors, employees and service suppliers of the company or its subsidiaries. All the options granted under the plan may be exercised within a maximum period of ten years following the date of grant. The Board of Directors will designate the recipients of options and will determine the number of common shares covered by each of these options, the date of vesting of each option, the exercise price of each option, the expiry date, the acquisition conditions and the restrictions related to the exercise of these options. The purchase price of these shares may not be lower than their closing price on the day preceding the date of grant. The maximum number of common shares that is issuable under the plan was fixed at 10,800,000 common shares and the maximum number that may be granted to a recipient shall not exceed 5% of all the outstanding common shares.

The company's directors have agreed that options might generally be exercised at a rate of 20% to 25% per annum from the first anniversary of the date of grant, except for options granted to directors and service suppliers, which are exercisable on the date of grant.

The following tables present the stock option activity since January 1, 2003 and summarize information about fixed stock options outstanding and exercisable as at December 31:

	2004		2003	
	Number	Weighted average exercise price (\$)	Number	Weighted average exercise price (\$)
Outstanding —				
Beginning of year	6,379,534	0.46	5,574,200	0.57
Granted	5,795,000	0.25	2,813,334	0.12
Exercised	(374,667)	0.19	—	—
Cancelled	(2,703,667)	0.32	(2,008,000)	0.70
Outstanding — End of year ..	<u>9,096,200</u>	<u>0.38</u>	<u>6,379,534</u>	<u>0.46</u>
Options exercisable —				
End of year	<u>2,938,149</u>	<u>0.69</u>	<u>2,287,662</u>	<u>0.77</u>

Exercise price	Options outstanding as at December 31, 2004		Options outstanding as at December 31, 2004	
	Number	Weighted average remaining contractual life	Number	Weighted average remaining contractual life
\$0.10	1,165,000	5.14	353,000	5.22
\$0.14	1,200,000	3.90	240,000	3.90
\$0.21	900,000	4.82	—	—
\$0.27	500,000	6.00	—	—
\$0.28	2,595,000	4.93	225,000	4.80
\$0.30	1,233,400	4.20	636,400	4.20
\$1.00	125,000	5.45	125,000	5.45
\$1.10	1,327,800	2.98	1,308,749	2.96
\$2.97	50,000	5.45	50,000	5.45
	<u>9,096,200</u>		<u>2,938,149</u>	

b) External to the plan

As at December 31, 2004 and 2003, the company had 64,000 common stock options outstanding that will expire in June 2005 at an exercise price of \$1.00.

Accounting for stock-based compensation plans

During the year ended December 31, 2004, the company granted its employees and services suppliers 5,795,000 stocks options. The fair value of these stock options amounts to \$828,032. The compensation charge for the year ended December 31, 2004 was \$87,653, including amortization based on the graded vesting method for grants since January 1, 2002. The compensation charges for the years 2002 and 2003 was \$78,721 and \$119,903 respectively, which represent an impact of \$0.0007 and \$0.0012 respectively on the basic and diluted loss per share (note 2).



The fair value of options granted in each fiscal year was estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

	2004	2003
Risk-free interest rate	3.46%	4.42%
Expected volatility	78%	75%
Dividend yield	nil	nil
Expected life	45 months	55 months

The Black-Scholes options valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions, and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility.

||| Warrants

a) The following table presents the warrants activity during the years ended December 2004 and 2003:

	2004		2003	
	Number	Weighted average exercise price (\$)	Number	Weighted average exercise price (\$)
Outstanding — Beginning of year	3,324,715	0.11	6,666,667	0.60
Granted	1,206,067	0.35	3,324,715	0.11
Cancelled	—	—	(6,666,667)	0.60
Outstanding — End of year	4,530,782	0.17	3,324,715	0.11

b) The following table presents the fair value of warrants using the Black-Scholes model:

	2004 (\$)	2003 (\$)
• 2,000,000 warrants at \$0.10, expiring on November 28, 2008 *	204,545	204,545
• 1,530,782 (1,324,715 in 2003) warrants at \$0.13, expiring on November 27, 2008 (note 7) *	145,964	126,313
• 1,000,000 (none in 2003) warrants at \$0.40 if exercised before June 10, 2005 and \$0.50 afterwards, expiring on June 10, 2006 (note 3a)	92,245	—
	442,754	330,858

* Stock warrants valued at \$204,545 issued to the Fonds de solidarité FTQ in November 2003 under a private placement as well as stock warrants valued at \$145,964 issued to La Financière du Québec under financing.

9. Other equity components

The following table presents the other equity components:

	2004 (\$)	2003 (\$)
Stock option related to business acquisitions (note 3c)	266,779	—
Stock-based compensation	286,277	—
Warrants (note 8)	442,754	330,858
	<u>995,810</u>	<u>330,858</u>

10. Commitments

Use of offices

The company's aggregate commitments under lease agreements for offices amount to \$1,812,929 and consist of annual payments of \$415,265 in 2005 and \$349,416 from 2006 to 2009.

Research agreement

The company's minimum aggregate commitments under a research agreement entered into in 2003 with the Université de Montréal amount to \$113,333. Minimum annual payments under this agreement amount to \$68,333 in 2005 and \$45,000 in 2006. Furthermore, the company put at the Université de Montréal's disposal, free of charge, two copies of its software, including customer support, and this, throughout the term of the agreement.

11. Additional information

Statement of earnings

a) Financial expenses

	2004 (\$)	2003 (\$)
Interest on long-term debt	138,950	53,493
Interest and bank charges	72,438	50,216
Interest income	(52,217)	(42,770)
Exchange loss (gain)	33,332	(17,728)
Amortization of deferred financing expenses	30,576	2,339
	<u>223,079</u>	<u>45,550</u>

Statement of cash flows

b) Additional information

	2004 (\$)	2003 (\$)
Interest paid	113,710	112,118
Interest cashed	(60,325)	(44,640)



c) Items not affecting cash and cash equivalents related to financing and investing activities

	2004 (\$)	2003 (\$)
Last year's share issue expenses paid in the current year	220,964	—
Business acquisition expenses payable	222,130	—
Common shares issued in consideration of business acquisitions (note 3)	9,506,000	—
Warrants issued (note 8)	111,896	126,313
Balance of purchase price of one subsidiary (note 3c)	492,095	—
Fair value of stock option (note 3c)	266,779	—

||| 12. Financial instruments

Fair value

Cash and cash equivalents, term deposit, accounts receivable, accounts payable and accrued liabilities and long-term debt are financial instruments whose fair value approximates their carrying value due to their short-term maturity or current market rates.

Credit risk

Financial instruments which potentially subject the company to concentrations of credit risk consist primarily of cash and cash equivalents, term deposit and accounts receivable. Cash and cash equivalents as well as term deposit are held with high-credit quality financial institutions. Consequently, management considers the concentration of credit risk related to these instruments to be minimal.

There is no particular concentration of credit risk. Generally, the company does not require collateral or other security from customers for trade accounts receivable; however credit is extended following an evaluation of creditworthiness. In addition, the company performs ongoing credit reviews of all its customers and establishes an allowance for doubtful accounts receivable when accounts are determined to be uncollectible.

Interest rate risk

As at December 31, 2004, the company's exposure to interest rate risk is summarized as follows:

Cash and cash equivalents	Fixed and variable interest rate
Term deposit	1.75%
Accounts receivable	Non-interest bearing
Accounts payable and accrued liabilities	Non-interest bearing
Long-term debt	As described in note 7

Currency risk

The company is exposed to currency risks as a result of its export sales and the related trade accounts receivable. Substantially all of these sales are denominated in US dollars. These risks are partially hedged by purchases and operating expenses denominated in that foreign currency.



||| 13. Future income taxes

As at December 31, 2004, for Canada federal, Quebec provincial, United States and France income tax purposes, the company and its subsidiaries have accumulated non-capital losses of approximately \$38,040,000 (\$7,460,000 in 2003), \$38,200,000 (\$7,980,000 in 2003), \$4,760,000 (\$3,720,000 in 2003) and \$1,700,000 (\$0 in 2003), respectively, which can be carried forward against future years' taxable income and which will expire as follows:

	Canada		United States	France
	Federal (\$)	Provincial (\$)	(\$)	(\$)
2005	7,860,000	7,860,000	—	—
2006	3,090,000	3,190,000	—	—
2007	6,830,000	8,530,000	—	—
2008	9,180,000	7,590,000	—	—
2009	5,650,000	5,530,000	—	—
2010	3,380,000	3,400,000	—	—
2011	2,050,000	2,100,000	—	—
2021	—	—	440,000	—
2022	—	—	2,460,000	—
2023	—	—	810,000	—
2024	—	—	1,050,000	—
Indefinite	—	—	—	1,700,000

Certain research and development expenses incurred by the company can be carried forward against future years' taxable income. These unclaimed deductions, which can be carried forward indefinitely, amount to approximately \$11,730,000 (\$4,000,000 in 2003) for Canada federal income tax purposes and \$23,570,000 (\$5,020,000 in 2003) for Quebec provincial income tax purposes. Furthermore, for Canada federal income tax purposes, investment tax credits in the amount of \$2,568,000 will be deductible against the income tax payable of future years ending between 2005 and 2014.

Loss carryforwards and research and development expenses could be subjected to a review and a possible adjustment by tax authorities.

Share issue expenses in the amount of \$477,501 (\$868,000 in 2003) will be deductible for income tax purposes over a four-year period expiring at the latest in 2008.

Furthermore, the net tax value of property, plant and equipment and intangible assets exceeds their net carrying value by approximately \$1,517,000 (\$4,120,000 in 2003) for federal income tax purposes and by approximately \$1,707,000 (\$4,300,000 in 2003) for provincial income tax purposes.

The income tax expense differs from the amount that would have been calculated using the combined Canadian federal and provincial statutory income tax rate of 31.02% (33.02% in 2003) as no tax benefit in connection with those items has been accounted for in the financial statements since the company considers that it is not more likely than not that this future income tax asset will be realized.



||| 14. Segment information

The company is organized under a single operating segment, namely the sale of software solutions and related post-contract customer support. Substantially all of the company's property, plant and equipment are located in Canada.

Revenues by geographic region are detailed as follows:

	2004 (\$)	2003 (\$)
United States	1,355,509	1,258,511
Canada	2,915,153	462,721
Europe	577,478	54,090
	<u>4,848,140</u>	<u>1,775,322</u>

Revenues are allocated to geographic regions based on the country of residence of the related customers.

Two customers represent 22% (four customers represented 67% in 2003) of the company's total sales. As at December 31, 2004, these customers represent 31% of the company's accounts receivable (the four customers represented 66% in 2003).



Officers

Mario Girard

Chairman and Chief Executive Officer

Denis Lavallée

Vice President, Sales & Business Development

Gaston Thibault

Vice President, Technology Solutions

Bruno Martel

Finance Director

Laurent Proulx

Senior Vice President and Chief Technology Officer

Michel Guilbot

General Manager, Europe

Jean-François Desaulniers

President, Valsar

Stéphanie Benoit

Corporate Secretary

Management

Yves Ferland

Senior Product Development Director

Arman Tajarobi

Linguistic Engineering Director

Manon Bélanger

Human Resources, Director

Rina Marchand

Office Manager

Board of directors

Yves Bellemare

Yves Bellemare is a Portfolio Director – IT and Telecommunications sectors with the Fonds de solidarité FTQ (a Venture Capital Fund of \$5.5B CA). At the Fonds for the past six years, Yves has over 17 years of experience in the field of IT and telecommunications. As a manager at the Bell Innovation Centre, he helped launch and market a number of products and services. He subsequently moved to MetroNet (now Allstream) where his work as marketing director of the Eastern Canada sales team earned him the title of best employee in Eastern Canada. He is a member of the Board for the following corporations: Versatel Networks, Provance Technologies Inc. and Above Security Inc.

Pierre Ducros

President of P. Ducros & Associates Inc., Pierre Ducros co-founded DMR Group (information technology services) in 1973. He was Chairman of the Board and Chief Executive Officer of that company from 1973 to 1996. He was a member of the Policy Committee of the Canadian Council on National Issues, Director of the Conference Board of Canada and Chairman of the Board of the Information Technology Association of Canada. He is a member of the board of the following corporations: Emergis Inc. (ecommerce), ManuLife Financial (financial services), Cognos Incorporated (software) and eGENUITY Technologies Inc. (software). Pierre Ducros is also a Member of the Order of Canada and an Officer of the Ordre de la Couronne of Belgium.

Marc Dutil

Marc Dutil joined Canam Group Inc. (construction) in 1989. He held various positions at the head office of Canam Steel Works, Inc. before being named General Manager of Steel Plus Network®. In 2002, Mr. Dutil was named Executive Vice President of Canam Group Inc. In 2003, he was appointed President and Chief Operating Officer. He is also a member of the Board of Directors of Canam Group Inc.

Richard Drouin

Richard Drouin is Chairman of the Board of Abitibi Consolidated (pulp and paper) and Stelco (metallurgy). He is also Chairman of the Board of North American Electric Reliability Council (NERC) (energy). He is a former Chairman and Chief Executive Officer of Hydro-Québec (energy) (1988 to 1995). Richard Drouin is also a director of American Superconductor Corporation (Boston) (energy). He is a Fellow of the Royal Canadian Geographical Society and Chairman of the Board of Trustees of Université Laval. Mr. Drouin is an Officer of the Order of Canada and Honorary Consul of Great Britain in Quebec.

Mario Girard

Mario Girard, Chairman and Chief Executive Officer of Nstein Technologies Inc., was previously the Chairman and Chief Executive Officer of Gespro Technologie Inc. (information technology services), which he founded in 1985. Mario Girard played a major role in raising public and private investments worth over \$20 million. He oversaw several corporate acquisitions and managed their successful integration. Gespro became one of the most important technology companies in Quebec and was then sold to Telus Corporation in 2000. Mario Girard is a member of the Young Presidents' Organization and received the 1996 Arista-Sun Life Young Quebec Entrepreneur award. He is Vice President of La Fondation Toujours Ensemble and a member of the Board of Directors of Amadeus International Inc. (technology).



Shareholder and investor information

Stock Exchange Listing

TSX Venture Exchange (TSX-V), under the "EIN" symbol

Auditors

PricewaterhouseCoopers LLP

Legal Counsel

Ogilvy Renault

Transfer Agents and Registrars

CIBC Mellon Trust Company

Investor Relations

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Finance Director
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Annual Meeting

The annual meeting for Nstein Technologies Inc. shareholders will be held on May 9th 2005 at 10:30 A.M. (EST) at the hotel Omni Mont-Royal, Suite Été, 1050 Sherbrooke Street West, Montreal (Quebec) Canada, H3A 2R6.



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