



Quarterly Report

FOR OUR SHAREHOLDERS



> QUARTER ENDING JUNE 30, 2003





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This quarterly report contains forward-looking statements which are subject to a number of risks, uncertainties and assumptions. Actual results and events may vary significantly.

> QUARTER ENDING JUNE 30, 2003



CEO'S MESSAGE

The second quarter has yielded a sales increase of 47% compared to the same quarter in 2002 and an increase of 33% over the first quarter of this year. Combined with effective expenditure management, the results for the first six months of 2003 are a loss of \$1.5 million compared with \$2.9 million, significantly less than in 2002. These increases are a direct response to our continued commitment to the e-publishing market where our technological leadership position assures the retention of our customer base as well as offering interesting growth opportunities. These figures are significant and encouraging, demonstrating a positive momentum in our market.

According to information retrieval industry analyst Linda Burman, e-publishing is a US\$300M to US\$400M market opportunity today – and it is expected to grow to approximately US\$1.3B within 5 years. In her report, Ms. Burman states that "Nstein is reputed for high accuracy, for possessing a strong and respected technology, and having a clear understanding of its clients needs."

In this past second quarter of 2003, the company completed sales to new customers via a service agreement with one of Canada's largest consulting firms and via partnerships with US-based companies MEI and Context Media (founded by former Netscape executives). We solidified our offering with taxonomy management products and related services as well as the Arabic language module. Sales to Internet Securities, Inc. and United Press International are both a direct result of this extended product offering.

Nstein continues to be chosen as the best technology by both our prospects and customers as evidenced through our recent sales, our growing VAR & OEM partnerships, the award granted by the e-Content Institute as *Canada's Best Content Management software* and recently by industry analysts such as Infosphere. In their recent industry analysis, *Unstructured Information Management 2003 Report*, Infosphere states Nstein "displays a very advanced approach to extracting knowledge using combinations of the most promising technologies in this area."

Internally, resources continue to be managed effectively, with high levels of productivity. Responding to market demands, Nstein has released Nserver™ 3.0. We are encouraged by our accomplishments in growing and retaining a loyal e-publishing customer base, and by the conclusion of a sale to a new US-based client, Wiley InterScience, who is delivering over 300 renowned publications online. Finally, we are also motivated by the expansion of our value added reseller and OEM network.

Mario Girard
Chairman and Chief Executive Officer



**MANAGEMENT'S DISCUSSION AND
ANALYSIS OF FINANCIAL SITUATION
AND OPERATING RESULTS**

The following discussion and analysis should be read in conjunction with the non-audited consolidated financial statements for the three month period ending June 30, 2003, as well as the Management's Discussion and Analysis in the 2002 Annual Report, including the section Risks and Uncertainties.

Operating Results

During the second quarter of 2003, Nstein recorded a loss of \$592,465 or \$0.006 per share, as compared with a loss of \$1,563,301 or \$0.015 per share for the same quarter last year, representing an amelioration of 62%.

The company earned revenues of \$407,265 during the three-month period ending June 30, 2003, compared to \$277,771 for the same period last year, representing a 47% increase. Income recorded in the second quarter of 2003 is mainly attributable to additional product sales, and maintenance and support services provided to current customers. Revenues were also generated through agreements with partners that use Nstein's suite to process information to service their clients.

Operating, selling and administrative expenses amounted to \$672,947 during the second quarter of 2003, a 45% decrease from the second quarter of 2002, when they stood at \$1,215,021. Meanwhile, research and development expenses were \$421,998, a reduction from last year when they totalled \$611,639. These cost reductions result from a program initiated during the fourth quarter in 2002.

Financial Situation and Cash flow

As at June, 2003, current assets were \$2.5 million compared to \$4.6 million as at December 31, 2002. Current liabilities reached \$1.1 million compared with \$1.8 million as at December 31, 2002.

Also at the end of the quarter, cash and cash equivalents stood at \$1.3 million compared to \$3.3 million as at December 31, 2002. Nstein's long-term debt was \$94,137 compared to \$129,963 as at December 31, 2002.

During the second quarter of 2003, cash flow assigned to operations reached \$367,764, compared to \$2,021,464 for the same quarter in 2002. This improvement can be explained with the decrease of this year's loss combined with a faster receipt of recoverable tax credits.

Cash flow allocated to debt repayment during the period ending June 30, 2003 totalled \$308,355 compared to \$355,927 for the same period last year. Nstein did not acquire important fixed assets during the second quarter of 2003 while during the same quarter in 2002 the company allocated \$227,739 for the purchase of fixed assets mainly for its move to *Cité Multimédia*.

The company believes that its current financial resources, together with cash flow from operations, will be sufficient to preserve its financial autonomy for the foreseeable future. Nstein is considering new financing in order to maintain its growth and competitiveness. There is no guarantee that such financing will be available at acceptable conditions.

Bruno Martel
Finance Director



**CONSOLIDATED FINANCIAL
STATEMENTS**

**NSTEIN TECHNOLOGIES INC.
Consolidated Balance Sheets[†]**

	As at June 30 2003	As at Dec. 31 2002
	\$	\$
	(unaudited)	
Assets		
Current assets		
Cash and cash equivalents	1,344,512	3,341,078
Term deposits	372,600	372,600
Accounts receivable		
Trade	563,716	405,387
Commodity taxes recoverable and others	55,015	75,779
Tax credits recoverable	170,000	352,500
Prepaid expenses	23,093	38,021
	2,528,936	4,585,365
Property, plant and equipment	562,337	692,157
	3,091,273	5,277,522
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	693,686	677,018
Deferred revenues	164,437	250,056
Current portion of long-term debt	262,788	893,600
	1,120,911	1,820,674
Long-term debt	94,137	129,963
	1,215,048	1,950,637
Shareholders' Equity		
Share capital	18,445,136	18,445,136
Deficit	(16,568,911)	(15,118,251)
	1,876,225	3,326,885
	3,091,273	5,277,522

[†] The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Board of Directors,

Mario Girard
Director

Marc Dutil
Director



CONSOLIDATED FINANCIAL
STATEMENTS



CONSOLIDATED FINANCIAL
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NSTEIN TECHNOLOGIES INC.

Consolidated Statements of Earnings†

	Three Months Ended June 30		Six Months Ended June 30	
	2003	2002	2003	2002
	\$	\$	\$	\$
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues	407,265	277,771	714,371	651,304
Expenses				
Operating, selling and administrative	672,947	1,215,021	1,435,197	2,341,298
Research and development	421,998	611,639	846,244	1,196,579
Research and development tax credits	(135,589)	(100,000)	(218,089)	(190,000)
Depreciation of property, plant and equipment	41,344	57,088	93,375	91,872
Net financial expenses	(970)	57,324	8,304	100,321
	999,730	1,841,072	2,165,031	3,540,070
Loss for the period	592,465	1,563,301	1,450,660	2,888,766
Basic and diluted loss per share	0.006	0.015	0.014	0.030
Basic and diluted weighted average number of shares outstanding	104,267,165	104,267,165	104,267,165	97,305,839

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

NSTEIN TECHNOLOGIES INC.

Consolidated Statements of Deficit†

	Six Months Ended June 30	
	2003	2002
	\$	\$
	(unaudited)	(unaudited)
Balance – Beginning of period	(15,118,251)	(10,440,115)
Loss for period	(1,450,660)	(2,888,766)
Balance – End of period	(16,568,911)	(13,328,881)

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



CONSOLIDATED FINANCIAL
STATEMENTS



CONSOLIDATED FINANCIAL
STATEMENTS

NSTEIN TECHNOLOGIES INC.

Consolidated Statements of Cash Flows[†]

	Three Months Ended June 30		Six Months Ended June 30	
	2003	2002	2003	2002
	\$	\$	\$	\$
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Cash flows from operating activities				
Loss for the period	(592,465)	(1,563,301)	(1,450,660)	(2,888,766)
Depreciation of property, plant and equipment not affecting cash and cash equivalents	41,344	57,088	93,375	91,872
	<u>(551,121)</u>	<u>(1,506,213)</u>	<u>(1,357,285)</u>	<u>(2,796,894)</u>
Change in non-cash operating working capital items				
Accounts receivable				
Trade	(16,065)	(57,052)	(158,329)	77,987
Commodity taxes recoverable and other	33,266	(255)	20,764	(84,852)
Tax credits recoverable	265,000	(100,000)	182,500	(190,000)
Prepaid expenses	31,910	53,437	14,928	38,065
Accounts payable and accrued liabilities	(74,627)	(429,715)	16,668	(93,239)
Deferred revenues	(56,127)	18,334	(85,619)	178,907
	<u>183,357</u>	<u>(515,251)</u>	<u>(9,088)</u>	<u>(73,132)</u>
	<u>(367,764)</u>	<u>(2,021,464)</u>	<u>(1,366,373)</u>	<u>(2,870,026)</u>
Cash flows from financing activities				
Payments on long-term debt	(308,355)	(355,927)	(666,638)	(747,180)
Variation in share capital, net of share issue expenses	-	-	-	5,775,021
	<u>(308,355)</u>	<u>(355,927)</u>	<u>(666,638)</u>	<u>5,027,841</u>
Cash flows from investing activities				
Variation in term deposits	-	156,643	-	156,643
Additions to property, plant and equipment	(2,294)	(227,736)	(2,294)	(506,892)
Tax credits related to property, plant and equipment	38,739	-	38,739	-
	<u>36,445</u>	<u>(71,093)</u>	<u>36,445</u>	<u>(350,249)</u>
Net change in cash and cash equivalents	(639,674)	(2,448,484)	(1,996,566)	1,807,566
Cash and cash equivalents - Beginning of period	1,984,186	7,815,897	3,341,078	3,559,847
Cash and cash equivalents - End of period	1,344,512	5,367,413	1,344,512	5,367,413
Additional information				
Interest paid	14,818	50,423	38,660	108,382
Interest cashed	(9,776)	(30,879)	(30,137)	(61,719)

[†] The accompanying notes are an integral part of these consolidated financial statements.



NOTES TO FINANCIAL STATEMENTS

1. Summary of significant accounting policies

The financial information as at June 30, 2003 and for the periods ended June 30, 2002 and 2003 is unaudited; however, in the opinion of management, all adjustments necessary to present fairly the results of these periods have been included. The adjustments made were of a normal recurring nature. Interim results may not necessarily be indicative of results anticipated for the year.

These interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles and use the same accounting policies and methods used in the preparation of the company's most recent annual financial statements. However, all disclosures required for annual financial statements have not been included in these financial statements. These interim financial statements should be read in conjunction with the company's most recent annual financial statements.

2. Segment Information

The company is organized under a single operating segment, that being the sale of software and related post-contract customer support. Substantially all of the company's property, plant and equipment are located in Canada. The accounting policies used for these reportable segments are consistent with those described in the summary of significant accounting policies.

Revenues by geographic region are detailed as follows:

	Three Months Ended June 30	
	2003	2002
	\$	\$
	(unaudited)	(unaudited)
United States	348,632	228,021
Canada	58,633	49,750
	<u>407,265</u>	<u>277,771</u>
	Six Months Ended June 30	
	2003	2002
	\$	\$
	(unaudited)	(unaudited)
United States	610,738	596,554
Canada	103,633	54,750
	<u>714,371</u>	<u>651,304</u>

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



NOTES TO FINANCIAL STATEMENTS

3. Accounting for stock-based compensation

The company has elected not to use the fair value-based method to measure the compensation cost related to grants of stock options. In this instance, however, under section 3870, Stock-Based Compensation and Other Stock-Based Payments, the company is required to make pro-forma disclosures of loss and basic and diluted loss per share as if the fair value based method of accounting had been applied.



NOTES TO FINANCIAL STATEMENTS

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

Period Ended June 30, 2003

Risk-free interest rate	4%
Expected volatility	75%
Dividend yield	nil
Weighted average expected life	60 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. Because the company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

If the fair value based method had been used to account for stock-based compensation costs related to stock options issued to employees, directors and executive officers, the loss and related loss per share would be as follows:

	Three Months Ended June 30	
	2003	2002
	\$	\$
	(unaudited)	(unaudited)
Pro-forma loss for the period	612,711	1,612,519
Pro-forma basic and diluted loss per share	0.006	0.015

	Six Months Ended June 30	
	2003	2002
	\$	\$
	(unaudited)	(unaudited)
Pro-forma loss for the period	1,488,120	2,947,974
Pro-forma basic and diluted loss per share	0.014	0.030

