



quarterly report for our shareholders
2nd QUARTER ENDING JUNE 30, 2004

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Chairman and Chief Executive Officer's Message

Nstein made significant progress on many fronts during the second quarter of 2004. This progress is reflected in a substantial increase in second quarter revenues resulting from the growth strategy implemented at the outset of the year. Our growth strategy has two primary objectives: to increase e-publishing revenues and to penetrate the Business Intelligence market, using our GIIIM-based software solutions (Global Intelligent Information Management) for large corporations and organizations.

To attain these objectives, we focused on developing our sales force. Consequently, since the beginning of the year, our solutions have been put to the test at a growing number of potential clients' operations. Several pilot projects are also underway in large corporations.

The software sales and professional services contracts signed recently with Time Inc. are a good example of the success of the action plan implemented six months ago. While the selection process was long and rigorous, these agreements are a major opportunity for Nstein to demonstrate the advantages of its solutions to the world's largest magazine publisher. Another recent contract, this time with LaPresseAffaires.com, provides for the use of Nstein's software solutions for an initial three-year period, and further underscores our strength in the e-publishing market.

Targeted, strategic acquisitions remain part of Nstein's growth strategy. In the second quarter, we completed the acquisition of KMtechnologies, a Canadian developer of Web collaboration and document management solutions. This acquisition provides an important complement for our GIIIM platform as well as access to an established customer base and a considerable network of potential customers in Canada, the United States and Europe.

Meanwhile, the development of strategic relationships with key IT players remains a priority. As a fact, we are continuing to proceed with the development of joint solutions for large corporations and organizations based on our GIIIM platform. This is a long process, but the potential benefits could prove very profitable for the Company.

We are proud of the results generated by our efforts of the last six months and optimistic going forward. We believe that we will reach the revenue growth targets that we have set at the beginning of the year, and remain on the look-out for opportunities to extend our growth to the international level.



Mario Girard

Chairman of the Board and Chief Executive Officer

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Management's Discussion and Analysis of Financial Situation and Operating Results

This analysis should be read in conjunction with the Company's unaudited consolidated financial statements for the three- and six-month periods ended June 30, 2004, as well as Management's discussion and analysis of financial situation and operating results in the Company's 2003 annual report, including the section on risks and uncertainties.

Overview

Founded in 2000, Nstein Technologies Inc. (TSX-V: EIN) is an innovative software development company that provides a Global Intelligent Information Management (GIIM) platform for large corporations and organizations. This flexible platform assimilates, organizes, analyzes (text mining), shares and disseminates information arising from structured and unstructured multilingual data sources and essential to operational and decision-making processes. The GIIM platform is the basis for Nstein software that provides decision-makers with highly pertinent information and transforms reactive decision-making into a proactive and even predictive process. Nstein offers Business Intelligence (BI) solutions that create a new level of global knowledge, accessible at any time, particularly suited for the e-publishing, finance, legal and government and homeland security markets.

Results of Operations

Revenues for the second quarter ended June 30, 2004 totalled \$690,566, up 70% from \$407,265 for the same period last year. E-publishing customers were the primary source of these revenues. For the six months ended June 30, 2004, revenues rose 103% to \$1.45 million from \$714,371 for the same period last year.

Operating, selling and administrative expenses amounted to \$997,272 in the second quarter, compared to \$672,947 in the second quarter of 2003. The increase is primarily due to certain direct costs related to stronger sales, as well as investments for the development of strategic partnerships with key IT players. For the first six months of the year, operating, selling and administrative expenses were \$1.9 million compared to \$1.4 million for the same period in 2003.

Research and development is a priority for Nstein, allowing it to maintain and enhance the competitive advantages of its solutions. Consequently, net research and development expenses were \$360,473 in the second quarter, compared to \$286,409 for the same period last year. Net research and development expenses for the first six months of the year amounted to \$736,247 compared to \$628,155 for the same six-month period a year ago.

Nstein posted a net loss of \$752,011 or \$0.006 per share for the second quarter, compared to a loss of \$592,465 or \$0.006 per share a year ago. The net loss for the year to date was \$1.37 million or \$0.010 per share compared to \$1.45 million or \$0.014 per share for the same period last year.

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Liquidity and Financial Resources

At June 30, 2004, current assets stood at \$4.4 million compared to \$4.8 million at December 31, 2003. Current liabilities were \$2.5 million at June 30, 2004 compared to \$1.9 million at December 31, 2003. The Company had cash and cash equivalents of \$1.9 million at June 30, 2004 compared to \$3.1 million at December 31, 2003. Long-term debt stood at \$1.6 million compared to \$749,883 at December 31, 2003. The increase of the debt is primarily due to the debt assumed within the scope of the KMtechnologies acquisition.

In the second quarter of 2004, operating activities used cash flow of \$925,954 compared to \$367,764 in the same quarter of 2003. The difference resulted from a variety of factors, including the higher loss (\$159,545), an increase in accounts receivable from contracts signed late in the quarter (\$192,039) and an increase in tax credits recoverable (\$287,272). These items were partially offset by higher accounts payable and accrued liabilities (\$144,749). For the year to date, operating activities used cash flow of \$1.42 million compared to \$1.37 million for the same period in 2003.

Financing activities generated cash flow of \$157,884 in the second quarter, having used \$308,355 in cash flow for the same period in 2003. This variance arose primarily from the receipt of \$300,000 in long-term debt borrowed from a chartered bank pursuant to a financing agreement signed at the end of fiscal 2003, and a decrease in payments on long-term debt (\$272,758). These items were offset by share issue expenses paid in relation to the financing completed in late fiscal 2003. For the first half of the year, financing activities provided cash flow of \$14,638 compared to a use of \$666,638 for the same period in 2003.

Cash flow from investing activities amounted to \$246,512 in the second quarter of 2004 compared to \$36,445 for the same period in 2003. The difference was mainly due to the cash and cash equivalents held by KMtechnologies when it was acquired by the Company. For the year to date, cash flow from investing activities totalled \$228,388 compared to \$36,445 for the same six-month period in 2003.

The Company considers that its current financial resources, combined with the cash flow from its activities, are sufficient to attain its objectives and remain financially independent for the foreseeable future. It may nonetheless decide to proceed with an additional financing before the end of the current financial year.

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Closing of KMtechnologies' Acquisition

On June 10, 2004, the Company announced that it had closed the acquisition of KMtechnologies Inc., a Canadian developer of Web collaboration and document management solutions. This acquisition provides Nstein with an important complement to its GIIIM platform for large corporations and organizations.

Pursuant to the acquisition agreement, Nstein issued 5,900,000 common shares at \$0.30 per share, most of which are voluntarily escrowed. Nstein also issued warrants for the purchase of one million additional common shares at \$0.40 per share for a 12-month period following the transaction, and at \$0.50 per share for the ensuing 12 months.



Bruno Martel
Finance Director

Quarterly Report for our shareholders

The attached consolidated financial statements have been prepared by the Management of Nstein Technologies Inc. and have not been reviewed by an auditor. This quarterly 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.

> QUARTER ENDING JUNE 30, 2004

Consolidated Financial Statements

NSTEIN TECHNOLOGIES INC.

Consolidated Balance Sheets[†]

	As at June 30, 2004 \$ (unaudited)	As at Dec. 31, 2003 \$
Assets		
Current assets		
Cash and cash equivalents	1,931,335	3,107,684
Term deposits	164,600	164,600
Accounts receivable		
Trade, net amount	1,273,147	1,048,640
Commodity taxes recoverable and others	136,258	78,460
Tax credits recoverable	819,753	380,000
Prepaid expenses	61,669	20,224
	<hr/> 4,386,762	<hr/> 4,799,608
Property, plant and equipment	445,645	479,782
Intangible assets	45,463	22,085
Deferred financing expenses	129,589	123,974
Goodwill (note 5)	2,514,209	–
	<hr/> 7,521,668	<hr/> 5,425,449
Liabilities		
Current liabilities		
Bank loan	172,011	172,011
Accounts payable and accrued liabilities	1,465,513	1,250,235
Deferred revenues	290,136	101,728
Current portion of long-term debt	608,959	380,080
	<hr/> 2,536,619	<hr/> 1,904,054
Long-term debt	1,594,910	749,883
	<hr/> 4,131,529	<hr/> 2,653,937
Shareholders' Equity		
Share capital	21,806,130	19,954,649
Other equity components (note 3)	669,632	330,858
Deficit	(19,085,623)	(17,513,995)
	<hr/> 3,390,139	<hr/> 2,771,512
	<hr/> 7,521,668	<hr/> 5,425,449

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

Approved by the Board of Directors,



Mario Girard
Director



Marc Dutil
Director

Notes to Financial Statements

1. Summary of significant accounting policies

The financial information as at June 30, 2004 and for the periods ended June 30, 2003 and 2004 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. Changes in accounting policies and accounting of profit sharing plans

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 the results for 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 option plans, using the fair value method. Consequently, the deficit and other components of shareholders' equity at December 31, 2003 increased by \$198,624.

During the six months ended June 30, 2004, the Company granted its employees 1,800,000 stock options. The fair value of these stock options amounts to \$223,827. The compensation charge for the period ended June 30, 2004 amounts to \$28,256 and includes depreciation using the graded vesting method for grants made since January 1, 2002.

The fair value of options granted during the six-month period ended June 30, 2004 was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

Six months ended June 30, 2004	
Risk-free interest rate	3.52%
Expected volatility	75%
Dividend yield	nil
Weighted average expected life	48 months

Notes to Financial Statements

The Company is required to make pro-forma disclosures of loss, basic loss per share and diluted loss per share as if compensation charges had been included in the financial statements for options granted during fiscal 2003 based on the fair value method. However, no information is presented in the interim financial statements for the period ended June 30, 2003, as there was no material difference in the pro forma net loss and net loss per share.

3. Other equity components

This item consists of the value assigned to warrants issued to the Fonds de solidarité des travailleurs du Québec (F.T.Q.) in November 2003 pursuant to a private placement, as well as the value assigned to warrants issued to La Financière du Québec at the same time pursuant to a bank financing. The value assigned to such warrants using the Black-Scholes pricing model was \$350,507. The value assigned to warrants issued pursuant to the acquisition of KMtechnologies (see note 5), using the same pricing model, was also included under this item for an amount of \$92,245. The remaining \$226,880 included under this item represents the counterpart of the charge for stock options granted to directors, officers and employees shown in the Company's financial statements.

4. 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,		
	2004 \$ (unaudited)	2003 \$ (unaudited)
United States	508,122	348,632
Canada	182,444	58,633
Europe	—	—
	<u>690,566</u>	<u>407,265</u>

Six months ended June 30,		
	2004 \$ (unaudited)	2003 \$ (unaudited)
United States	950,634	610,738
Canada	434,147	103,633
Europe	67,762	—
	<u>1,452,543</u>	<u>714,371</u>

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

Notes to Financial Statements

5. Acquisition

On June 10, 2004, the Company acquired all the outstanding capital shares of KMtechnologies Inc. ("KM"). Starting at this date, KM's financial results have been taken into account in the consolidated financial statements. KM is a Canadian developer of Web collaboration and document management solutions. Pursuant to the acquisition agreement, Nstein issued 5,950,000 common shares at \$0.30 per share. Nstein also issued warrants for the purchase of one million additional common shares at \$0.40 per share for a 12-month period following the transaction, and at \$0.50 per share for the ensuing 12 months. The cost of acquisition has been established at \$1,985,243.

This acquisition was accounted for using the purchase method. Consequently, KM's operating results are included in the Company's consolidated results starting from the date of acquisition, June 10, 2004.

The following table shows a summary of the purchase price, including acquisition costs based on the estimated fair value of the net assets acquired, as at the date of acquisition. The purchase price allocations shown below are preliminary and are based on the Company's best estimate. The final purchase price allocations are expected to be completed during the course of 2004.

Short-term assets	\$ 872,968
Fixed assets	\$ 50,237
Total assets acquired	<u>\$ 923,205</u>
Short-term liabilities	\$ 756,001
Long-term debt	\$ 696,170
Total assumed indebtedness	<u>\$ 1,452,171</u>
Net assets acquired	\$ (528,966)
Goodwill	\$ 2,514,209
Purchase price	<u>\$ 1,985,243</u>
Minus:	
Common shares issued	\$ 1,785,000
Warrants issued	\$ 92,245
Other consideration – short-term liabilities	<u>\$ 107,998</u>