



Quarterly Report

FOR OUR SHAREHOLDERS

> QUARTER ENDING SEPTEMBER 30, 2002





CEO'S MESSAGE

Throughout the third quarter, Nstein has continued to focus its marketing and sales efforts towards its key target market, the e-publishing industry. It has pursued this marketplace aggressively, making every effort to realize successful sales with potential customers. Unfortunately, the results that Nstein achieved for the quarter have not met its expectations.

The e-publishing industry has been affected by the climate of economic uncertainty in the United States that continues to show signs of slowed infrastructure investment. This trend has significantly lengthened the sales cycle. Nstein remains confident that delays in purchase decision-making are not a reflection of its current strategy, since its competitors are showing slowed sales results as well. Nstein is continuing its progress with many potential customers despite slowed market conditions. Consequently, Nstein remains confident that it will achieve commercial success in its markets in the United States, Canada and Europe.

Nstein's confidence rests solidly on the quality of its technologically advanced automated indexing products, rated among the highest in the industry by analysts and customers. Further, Nstein continues to broaden and enhance its product line, integrating new applications in response to customers' specific needs. As a result, these efforts have stimulated the continuous expansion and creation of growth opportunities that are witnessed within the target market.

Nstein has initiated the development of a new series of products tailored towards companies managing high document volumes. Nstein's Nserver™ suite supports high-performance features that can be immediately applied to this new market segment to produce favourable opportunities in the short term.

During the next few months, Nstein's business strategy will focus on markets that will bring the most immediate opportunities for generating revenues. Its operational plan is committed to deploying resources towards achieving business objectives and maintaining financial autonomy. Within the last few weeks, Nstein has been reducing significantly its operating expenses, particularly by decreasing personnel and eliminating various external expenses.

Mario Girard
Chairman and Chief Executive Officer
Nstein Technologies Inc.

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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 SEPTEMBER 30, 2002



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



CONSOLIDATED FINANCIAL STATEMENTS

Operating Results

Nstein earned revenues of \$915,072 for the first nine months of 2002, similar to those recorded for the same period last year, \$907,782. During the third quarter of 2002, Nstein earned revenues of \$263,768, compared with \$360,464 for the same period in 2001. Losses for the company's third quarter increased to \$1,353,497 or \$0.013 per share, as compared with \$771,072, or \$0.009 per share for the same quarter last year. For the first three quarters of 2002, losses are recorded at \$4,242,263 or \$0.043 per share, as compared with \$3,578,257 or \$0.042 per share for the same period in 2001.

Income recorded in the third quarter is principally attributed to the integration of Japanese and Korean language modules to the Nserver™ suite sold last year to United Press International. Additional income was earned from support and maintenance services provided to existing customers, as well as from the delivery of product modules to Internet Securities Inc.

Operating, sales and administration expenses for the three-month period increased to \$1,102,150, as compared with \$641,954 for the third quarter of 2001, mainly due to the company's expanded business activity in the United States. Research and development costs totalled \$646,749 at the end of the third quarter, an increase from the same period last year, when the total was \$398,125.

Financial Situation

As of September 30, 2002, total short-term assets were \$5.4 million, compared to \$5.7 million as at December 31, 2001. Cash and cash equivalents reached \$3.6 million at the end of the third quarter of 2002, the same amount recorded, \$3.6 million, as at December 31, 2001. Term deposits at the end of the quarter totaled \$0.9 million, compared with \$1.0 million as at December 31, 2001.

Nstein's total interest-bearing debt stood at \$1.4 million on September 30, 2002, compared to \$2.5 million on December 31, 2001.

Cash Flow

Cash flow assigned to operating activities during the third quarter reached \$1.3 million, compared to \$445,890 for the corresponding quarter in 2001. This increase is mainly attributable to the growth in losses.

Cash flow related to financing activities reached \$489,554 for the third quarter of the current fiscal year. This compares to \$374,650 for the same quarter in 2001. This increase is mainly attributable to the payment of long-term debt.

Cash flow allocated to investment activities generated \$9,314 in the third quarter, resulting from a reduction in term deposits net of computer equipment purchases. During the same quarter last year, funds amounting to \$41,326 were assigned to investment activities.

NSTEIN TECHNOLOGIES INC. Consolidated Balance Sheets†

	As at Sept. 30, 2002 \$ (unaudited)	As at Dec.31, 2001 \$
Assets		
Current assets		
Cash and cash equivalents	3,554,751	3,559,847
Term deposits	872,600	1,048,977
Accounts receivable		
Trade, net amount	563,813	592,323
Commodity taxes recoverable and others	104,650	151,066
Tax credits recoverable	275,103	259,104
Prepaid expenses	57,736	69,022
	<u>5,428,653</u>	<u>5,680,339</u>
Property, plant and equipment	767,555	399,101
	<u>6,196,208</u>	<u>6,079,440</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities		
Corporate shareholders	-	19,448
Others	763,161	889,490
Deferred revenue	296,400	329,879
Current portion of long-term debt	1,195,810	1,440,109
	<u>2,255,371</u>	<u>2,678,926</u>
Long-term debt	178,079	1,023,560
	<u>2,433,450</u>	<u>3,702,486</u>
Shareholders' Equity		
Share capital	18,445,136	12,817,069
Deficit	(14,682,378)	(10,440,115)
	<u>3,762,758</u>	<u>2,376,954</u>
	<u>6,196,208</u>	<u>6,079,440</u>

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



CONSOLIDATED FINANCIAL STATEMENTS

NSTEIN TECHNOLOGIES INC. Consolidated Statements of Earnings†

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2002	2001	2002	2001
	\$	\$	\$	\$
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues	263,768	360,464	915,072	907,782
Expenses				
Operating, selling and administrative	1,102,150	641,954	3,443,448	2,555,450
Research and development	646,749	398,125	1,843,328	1,407,419
Research and development tax credits	(230,241)	(70,000)	(420,241)	(179,000)
Amortization of property, plant and equipment	56,986	206,662	148,858	692,922
Net financial expenses	41,621	(45,205)	141,942	9,248
	1,617,265	1,131,536	5,157,335	4,486,039
Loss for the period	1,353,497	771,072	4,242,263	3,578,257
Basic and diluted loss per share	0.013	0.009	0.043	0.042
Basic and diluted weighted average number of shares outstanding	104,267,165	84,267,165	99,651,780	84,267,165

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

NSTEIN TECHNOLOGIES INC. Consolidated Statements of Deficit†

	Nine Months Ended Sept. 30,	
	2002	2001
	\$	\$
	(unaudited)	(unaudited)
Balance – Beginning of period	(10,440,115)	(6,018,878)
Loss for period	(4,242,263)	(3,578,257)
Balance – End of period	(14,682,378)	(9,597,135)

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



CONSOLIDATED FINANCIAL STATEMENTS

NSTEIN TECHNOLOGIES INC.

Consolidated Statements of Cash Flows†

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2002	2001	2002	2001
	\$	\$	\$	\$
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Cash flows from operating activities				
Loss for the period	(1,353,497)	(771,072)	(4,242,263)	(3,578,257)
Amortization of property, plant and equipment not affecting cash and cash equivalents	56,986	206,662	148,858	692,922
	<u>(1,296,511)</u>	<u>(564,410)</u>	<u>(4,093,405)</u>	<u>(2,885,335)</u>
Change in non-cash operating working capital items				
Accounts receivable				
Trade	(49,477)	(354,412)	28,510	(728,477)
Commodity taxes recoverable & other	131,268	28,940	46,416	134,885
Tax credits recoverable	174,001	410,894	(15,999)	301,894
Prepaid expenses	(26,779)	-	11,286	-
Accounts payable and accrued liabilities	(52,538)	(147,718)	(145,777)	194,482
Deferred revenues	(212,386)	180,816	(33,479)	180,816
	<u>(35,911)</u>	<u>118,520</u>	<u>(109,043)</u>	<u>83,600</u>
	<u>(1,332,422)</u>	<u>(445,890)</u>	<u>(4,202,448)</u>	<u>(2,801,735)</u>
Cash flows from financing activities				
Long-term debt contracted	-	-	-	485,690
Repayment of long-term debt	(342,600)	(374,650)	(1,089,780)	(1,081,121)
Variation in share capital, net of share issue expenses	(146,954)	-	5,628,067	-
	<u>(489,554)</u>	<u>(374,650)</u>	<u>4,538,287</u>	<u>(595,431)</u>
Cash flows from investing activities				
Increase in term deposits	19,734	(23,534)	176,377	(248,977)
Purchase of property, plant & equipment	(10,420)	(17,702)	(517,312)	(76,175)
	<u>9,314</u>	<u>(41,236)</u>	<u>(340,935)</u>	<u>(325,152)</u>
Net change in cash and cash equivalents	(1,812,662)	(861,776)	(5,096)	(3,722,318)
Cash and cash equivalents - Beginning of period	5,367,413	3,771,223	3,559,847	6,631,765
Cash and cash equivalents - End of period	3,554,751	2,909,447	3,554,751	2,909,447
Additional information				
Interest paid	41,943	79,652	110,917	254,262
Interest cashed	(39,763)	(66,267)	(66,315)	(200,769)

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



NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Interim Financial Information

The financial information as at September 30, 2002 and for the periods ended September 30, 2001 and 2002 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.

Stock-Based Compensation Plan and New Accounting Standard

The company maintains a stock-based compensation plan, which is described in note 9 to the audited annual consolidated financial statements. Under Canadian generally accepted accounting principles, no compensation cost is recognized for this plan when stock options are granted to plan participants. Any consideration received from plan participants upon the exercise of stock options is credited to share capital.

In November 2001, the Accounting Standards Board of the Canadian Institute of Chartered Accountants ("CICA") issued new standards for stock-based payments (Section 3870, Stock-Based Compensation and Other Stock-Based Payments), which are effective for fiscal years beginning on or after January 1, 2002. This section defines recognition, measurement and disclosure standards for stock-based compensation to non-employees and employees. Under these new standards, all stock-based payments made to non-employees must be systematically accounted for in the company's financial statements. These standards define a fair value-based method of accounting and encourage companies to adopt this method of accounting for their stock-based employee compensation plans. Under this method, compensation cost should be measured at the grant date based on the fair value of the award and should be recognized over the related service period. The companies that do not adopt the fair value method of accounting for their awards granted to employees are required to include in their financial statements pro-forma disclosures of net earnings and earnings per share as if the fair value method of accounting had been applied (note 3).

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 Sept. 30, 2002 \$ (unaudited)	2001 \$ (unaudited)
United States	254,018	350,964
Canada	9,750	9,500
	<u>263,768</u>	<u>360,464</u>

	Nine months ended Sept. 30, 2002 \$ (unaudited)	2001 \$ (unaudited)
United States	850,572	691,615
Canada	64,500	216,167
	<u>915,072</u>	<u>907,782</u>

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

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 September 30, 2002

Risk-free interest rate	5%
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 Sept. 30, 2002 \$ (unaudited)	Nine Months Ended Sept. 30, 2002 \$ (unaudited)
Pro-forma loss for the period	1,386,711	4,334,575
Pro-forma basic and diluted loss per share	0.013	0.044