# Quarterly Report

FOR OUR SHAREHOLDERS

> QUARTER ENDING MARCH 31, 2003

## CEO'S MESSAGE

During the first quarter Nstein remained on course regarding its business strategy, particularly in sales to its key target market, the e-publishing industry. The company signed a contract valued at over $0.5 million CDN for the sale of its Nserver™ software suite and professional services to a global U.S. publishing company, and is confident to complete contract negotiations with numerous target pipeline customers.

Nstein also aggressively pursued the government and enterprise sectors in the first quarter. Within the government sector, Nstein signed a contract with Industry Canada to develop this federal government department's new taxonomy, as a key component of its overall information management strategy. Within the enterprise sector, Nstein continued the rollout of its multi-faceted Global Alliance Partner program - a program that will accelerate Nstein's market penetration strategy within the enterprise sector via licensing agreements with e-publishers, as well as reseller agreements with the integrator and content management community.

Nstein significantly advanced negotiations with a number of highly-reputed global information service giants such as BIOSIS and Dun & Bradstreet. The completion of new agreements is expected to occur in the following quarters. Nstein will benefit significantly from the knowledge of these e-publishers via pre-packaged software components that integrate seamlessly into enterprise-based content management software solutions. Nstein's product components will connect and add significant value to leading content and document management applications, and to well known search engines.

As part of its integrator/content management Reseller Program, Nstein announced its first Value Added Reseller agreement during the quarter with IXIASOFT, an industry leader in providing XML content management solutions, notably to the European market and in industries such as the press, publishing and aerospace. This agreement opens an immediate sales channel for Nstein's technology in Europe. Nstein is also currently negotiating similar agreements with several leading system integrators and content management software providers that will accelerate Nstein's diversified market expansion.

Nstein continues to be recognized as an industry leader and is proud of its achievement in March of having received the Best Content Management Software Award from Canada's prestigious E-Content Institute. It continues to receive overall excellence ratings from its customers and the industry.

**Mario Girard**
Chairman and Chief Executive Officer

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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 MARCH 31, 2003

## 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 ended March 31, 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 first quarter of 2003, Nstein recorded a loss of $858,195 or $0.008 per share, as compared with $1,325,465 or $0.015 per share for the same quarter last year, representing a 35% decrease.

The company earned revenues of $307,106 during the three-month period ended March 31, 2003, compared to $373,533 for the same period last year. Income recorded in 2003 is mainly attributable to Nserver™ user licence sales and to maintenance and support services provided to Nstein's current customers.

Operating, selling and administrative expenses amounted to $762,250 during the first quarter of 2003, a 32% decrease from the first quarter of 2002, were they stood at $1,126,277. Meanwhile, research and development expenses were $424,246, a reduction from last year when they totalled $584,940. These cost reductions result from a program initiated during the fourth quarter in 2002.

**Financial Situation and Cash flow**

As at March 31, 2003, current assets were $3.5 million compared to $4.6 million as at December 31, 2002. Current liabilities reached $1.6 million compared with $1.8 million as at December 31, 2002.

As at March 31, 2003, cash and cash equivalents stood at $2 million compared to $3.3 million as at December 31, 2002. Nstein's long-term debt was $96,359 compared to $129,963 as at December 31, 2002.

During the first quarter of 2003, cash flow assigned to operations reached $998,609, slightly more than for the same period in 2002 when the amount was $848,562. Last year, Nstein had considerably increased its accounts payable during the first quarter.

Cash flow allocated to debt repayment during the period ended March 31, 2003 totalled $358,283 compared to $391,253 for the same period last year. During the first quarter of 2002, the company received a share capital net investment of $5.8 million from the Fonds de solidarité des travailleurs du Québec (F.T.Q.). In 2002 Nstein also allocated $279,156 for the purchase of fixed assets towards its move to *Cité Multimédia*. During the first quarter of 2003, Nstein did not receive cash from financing nor acquire fixed assets.

**Bruno Martel**
Finance Director

## CONSOLIDATED FINANCIAL STATEMENTS

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

| | As at March 31 2003 $ (unaudited) | As at Dec. 31 2002 $ |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | 1,984,186 | 3,341,078 |
| Term deposits | 372,600 | 372,600 |
| Accounts receivable | | |
| Trade | 547,651 | 405,387 |
| Commodity taxes recoverable and others | 88,281 | 75,779 |
| Tax credits recoverable | 435,000 | 352,500 |
| Prepaid expenses | 55,003 | 38,021 |
| | 3,482,721 | 4,585,365 |
| **Property, plant and equipment** | 640,126 | 692,157 |
| | 4,122,847 | 5,277,522 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | 768,313 | 677,018 |
| Deferred revenue | 220,564 | 250,056 |
| Current portion of long-term debt | 568,921 | 893,600 |
| | 1,557,798 | 1,820,674 |
| **Long-term debt** | 96,359 | 129,963 |
| | 1,654,157 | 1,950,637 |
| **Shareholders' Equity** | | |
| **Share capital** | 18,445,136 | 18,445,136 |
| **Deficit** | (15,976,446) | (15,118,251) |
| | 2,468,690 | 3,326,885 |
| | 4,122,847 | 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

**NSTEIN TECHNOLOGIES INC.**
**Consolidated Statements of Deficit**†

| | Three Months Ended March 31 2003 $ (unaudited) | 2002 $ (unaudited) |
|---|---|---|
| **Balance – Beginning of period** | 15,118,251 | 10,440,115 |
| Loss for the period | 858,195 | 1,325,465 |
| **Balance – End of period** | 15,976,446 | 11,765,580 |

**NSTEIN TECHNOLOGIES INC.**
**Consolidated Statements of Earnings**†

| | Three Months Ended March 31 2003 $ (unaudited) | 2002 $ (unaudited) |
|---|---|---|
| **Revenues** | 307,106 | 373,533 |
| **Expenses** | | |
| Operating, selling and administrative | 762,250 | 1,126,277 |
| Research and development | 424,246 | 584,940 |
| Research and development tax credits | (82,500) | (90,000) |
| Depreciation of property, plant and equipment | 52,031 | 34,784 |
| Net financial expenses | 9,274 | 42,997 |
| | 1,165,301 | 1,698,998 |
| **Loss for the period** | 858,195 | 1,325,465 |
| **Basic and diluted loss per share** | 0.008 | 0.015 |
| **Basic and diluted weighted average number of shares outstanding** | 104,267,165 | 90,267,165 |

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



**NSTEIN TECHNOLOGIES INC.**
**Consolidated Statements of Cash Flows**†

| | Three Months Ended March 31 2003 $ (unaudited) | 2002 $ (unaudited) |
|---|---|---|
| **Cash flows from operating activities** | | |
| Loss for the period | (858,195) | (1,325,465) |
| Depreciation of property, plant and equipment not affecting cash and cash equivalents | 52,031 | 34,784 |
| | (806,164) | (1,290,681) |
| Change in non-cash operating working capital items | | |
| Accounts receivable | | |
| Trade | (142,264) | 135,039 |
| Commodity taxes recoverable & other | (12,502) | (84,597) |
| Tax credits recoverable | (82,500) | (90,000) |
| Prepaid expenses | (16,982) | (15,372) |
| Accounts payable and accrued liabilities | 91,295 | 336,476 |
| Deferred revenues | (29,492) | 160,573 |
| | (192,445) | 442,119 |
| | (998,609) | (848,562) |
| **Cash flows from financing activities** | | |
| Payments on long-term debt | (358,283) | (391,253) |
| Variation in share capital, net of share issue expenses | - | 5,775,021 |
| | (358,283) | 5,383,768 |
| **Cash flows from investing activities** | | |
| Additions to property, plant & equipment | - | (279,156) |
| | - | (279,156) |
| **Net change in cash and cash equivalents** | (1,356,892) | 4,256,050 |
| Cash and cash equivalents – | | |
| **Beginning of period** | 3,341,078 | 3,559,847 |
| **End of period** | 1,984,186 | 7,815,897 |
| **Additional information** | | |
| Interest paid | 23,842 | 58,139 |
| Interest cashed | (20,361) | (30,840) |

† 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 March 31, 2003 and for the periods ended March 31, 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 March 31 | |
|---|---|---|
| | 2003 | 2002 |
| | $ | $ |
| | (unaudited) | (unaudited) |
| United States | 267,106 | 373,533 |
| Canada | 40,000 | - |
| | 307,106 | 373,533 |

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 March 31, 2003**

| | |
|---|---|
| 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 March 31 | |
|---|---|---|
| | 2003 | 2002 |
| | $ | $ |
| | (unaudited) | (unaudited) |
| Pro-forma loss for the period | 875,408 | 1,335,455 |
| Pro-forma basic and diluted loss per share | 0.008 | 0.015 |

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