



Quarterly Report  
for our shareholders

1<sup>ST</sup> QUARTER ENDING MARCH 31, 2005





## Message from the Chairman and Chief Executive Officer

In the first quarter, Nstein pursued its growth plan by focusing efforts on marketing its solutions to its three promising markets: homeland security and intelligence, e-publishing and corporate intelligence.

The first quarter saw the signature of a contract with ProQuest Information and Learning, a major publisher of e-content for libraries and academic institutions around the world. ProQuest will be using Nstein's Global Intelligent Information Management (GIIM) platform to improve current services and further leverage its computer and information assets. In addition, Nstein concluded an agreement with Industry Canada in the context of a pilot project for the use of Nstein's technology solutions.

We also announced a strategic partnership with U.S. firm Visual Analytics Inc., a major supplier of pattern discovery, viewing tools, and information sharing solutions. With the partnership, we can provide homeland security and intelligence service organizations with advanced new dynamic data viewing functions that integrate seamlessly with our GIIM technology platform. We believe this agreement will help us speed up penetration of the homeland security and intelligence market both in the United States and abroad.

Revenues continued to grow in the first quarter ended March 31, 2005, more than tripling to \$2.4 million compared to \$761,977 a year ago. The growth is attributable to the effective integration of the personnel and technologies involved in the companies that were acquired in 2004. In addition, this has allowed us to become one of the few firms that can provide large organizations with complete solutions for managing unstructured multilingual information at the international level.

We recently launched our first solution designed for the corporate intelligence market. This corporate public image monitoring solution is now being tested by certain customers. It is primarily designed to keep firms abreast of what is being said about them and their competitors in the press, forums, blogs, etc. This information is collected from every possible external source, then analyzed and delivered in a synthesized form. Information overload is increasingly difficult to manage. This cutting-edge solution has been designed to help decision-makers forecast and plan, rather than just reacting. We will also be providing companies with a solution that can take their clients' pulse in real time (through email analysis, surveys, etc.).

Nstein's Web site ([www.nstein.com](http://www.nstein.com)) has finally been overhauled. Recently launched, the new site emphasizes Nstein's three main promising markets. With a new, thoroughly contemporary design and highly intuitive browsing, the site contains a number of other new features, including an interactive demonstration of the GIIM technology platform.

The Company has also adopted a code of ethics and disclosure policy for customers in the homeland security and intelligence market. In this sector in particular, it is important, even critical, to protect our customers' identities and not disclose what solutions they have acquired, nor their price. This is a necessary policy if we wish to continue to grow in this booming market.

In short, we believe our dynamic approach to penetrating the homeland security and intelligence and corporate intelligence markets will continue to bear fruit. We are also noting some urgency in the demand for new solutions in the homeland security and intelligence market, which could augur well for Nstein. We are determined to become a leader in the management of global unstructured multilingual information, and are always on the lookout for partnerships and strategic acquisitions that will speed our growth.



**Mario Girard**  
Chairman and Chief Executive Officer

## Management's Discussion and Analysis of Financial Condition and Results of Operations

This analysis provides the reader with a summary of changes in the financial condition of Nstein Technologies Inc. ("Nstein" or the "Company") during the three-month period ended March 31, 2005. It also compares results of operations and cash flows for the three-month period ended March 31, 2005 with those of the same period 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 the Company's annual report for the fiscal year ended December 31, 2004. 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 source, in real time. Nstein's solutions transform reactive decision-making into a proactive and even predictive process, and solve mission-critical problems facing corporations and organizations. Nstein has developed tailored solutions for clients in the homeland security & intelligence and e-publishing markets, as well as for large enterprises and government organizations.

The Company is headquartered in Montreal (Quebec, Canada), with offices in the United States and Europe. Nstein is listed on the TSX Venture Exchange under the symbol EIN.

### Key Financial Data

(In Canadian dollars)	Three months ended March 31,	
	2005	2004
	\$	\$
Revenues	2,403,603	761,977
EBITDA*	( 373,399)	( 557,556)
Loss	( 832,016)	( 620,994)
Basic and diluted loss per share	0.004	0.005
Total assets	14,591,654	4,784,592
Long-term liabilities	2,144,367	669,169

\* 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.

## Results of operations

### *Revenues*

The Company recorded revenues of \$2,403,603 for the first quarter ended March 31, 2005, an increase of 215% compared with revenues of \$761,977 for the same period 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 in 2004 contributed favourably to revenue growth. The largest sales were mainly in the e-publishing, defense, health and homeland security sectors.

### *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. The cost of revenues rose substantially in the first quarter of 2005 to \$1,056,999, compared with \$85,536 in 2004. 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 license sales.

### *Consolidated expenses*

Consolidated expenses stood at \$2,178,620 in the first quarter of 2005, compared with \$1,297,435 in 2004. This increase comes mainly from selling and administrative expenses, as well as amortization.

### *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 \$1,342,690 in the first quarter of 2005, compared to \$839,241 in 2004. The larger workforce needed to sustain growth and investments to develop new markets were the principal reasons for this increase.

### *Research and development expenses*

Research and development expenses are chiefly accounted for the cost of human resources assigned to the different projects. The cost of research and development amounted to \$546,586 for the first quarter of 2005, compared to \$500,776 in 2004. This increase was mainly due to intensified development of the Nstein technological platform that led to such things as the honing of a beta version of a new product for the corporate intelligence market. Investment in research and development is a priority at Nstein. The Company plans to pursue the fine-tuning of its products during the current fiscal year.

### *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. In the first quarter of 2005, tax credits rose to \$165,989 from \$125,001 in 2004. The change results from the expansion of the workforce as well as an increase in the estimated income tax credits receivable from a subsidiary.

*Amortization of intangible assets*

Amortization of intangible assets rose substantially, going from \$3,065 in the first quarter of 2004 to \$335,168 in the first quarter of 2005. This increase is due to the acquisitions realized in the third quarter of 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 \$90,325 for the first quarter of 2005, compared to \$24,187 in 2004. This increase was mainly due to the \$30,541 increase in interest charges on long-term debt, resulting from higher debts with respect to the companies acquired during the previous fiscal year. A currency loss of \$29,740 was recorded in the first quarter, compared to a currency gain of \$525 for the same period in 2004.

*Loss*

Nstein recorded a loss of \$832,016 or \$0.004 per share for the quarter ended March 31, 2005, compared to a loss of \$620,994 or \$0.005 per share for the same quarter the previous fiscal year. A number of factors account for this higher loss, among them the larger workforce following the acquisitions realized in the third quarter of 2004, and intensified commercialization and development of new solutions. Other factors, such as amortization of intangible assets, also had a major impact.

**Selected quarterly financial data**

(In Canadian dollars)				
	Second Quarter	Third Quarter	Fourth Quarter	First Quarter
	\$	\$	\$	\$
Quarter ended	June 30, 2004	September 30, 2004	December 31, 2004	March 31, 2005
Revenues	690,566	1,140,962	2,254,635	2,403,603
EBITDA*	(667,179)	(664,013)	(461,226)	(373,399)
Loss	(752,011)	(786,233)	(1,036,239)	(832,016)
Basic and diluted loss per share	(0.006)	(0.005)	(0.004)	(0.004)
Quarter ended	June 30, 2003	September 30, 2003	December 31, 2003	March 31, 2004
Revenues	407,265	307,155	753,796	761,977
EBITDA*	(552,091)	(396,213)	(434,217)	(557,556)
Loss	(592,465)	(445,350)	(499,734)	(620,994)
Basic and diluted loss per share	(0.006)	(0.004)	(0.004)	(0.005)

\* 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.

## Liquidity and financial resources

### Cash and cash equivalents

At March 31, 2005, cash and cash equivalents amounted to \$1,916,549, compared to \$2,751,574 at December 31, 2004.

### Cash flow

#### Operating activities

Operating activities used \$720,139 in cash flow in the first quarter of 2005, compared to \$572,243 last year. The positive variation of \$236,917 in non-cash working capital items during the quarter was offset by a sale of \$536,012 for which a portion will only be collectible over the long term. The Company does not intend to make a general practice of financing accounts receivable beyond the operating cycle.

#### Financing activities

Instalments on long-term debt have increased from \$33,602 in 2004 to \$64,783 in 2005 due to payments on debt taken over with the acquisitions.

#### Investment activities

Cash flow allocated to investment activities amounted to \$52,105 in the first quarter of 2005, compared to \$18,124 last year. This increase primarily stems from business acquisition expenses incurred in 2004, of which an amount of \$50,000 was paid this quarter.

## Contractual obligation

<i>(in Canadian dollars)</i>	Total	Instalments payable, by period			
		Less than 1 year	1 to 3 years	4 to 5 years	Over 5 years
	\$	\$	\$	\$	\$
Long-term debt	2,822,804	678,437	1,319,134	464,515	360,718
Capital lease obligations	8,210	8,210	-	-	-
Use of offices	2,268,364	288,343	698,831	698,831	582,359
Research agreement	93,333	48,333	45,000	-	-

The Company's long-term debt decreased slightly in the first quarter of 2005 to \$2,144,367 from \$2,258,895 at December 31, 2004. The Company is still in negotiations with La Financière du Québec about receiving the \$950,000 balance of a \$2,250,000 loan authorized in November of 2003.

## Shareholders' equity

<i>(Issued and fully paid)</i>	May 9 and March 31, 2005	December 31, 2004
	\$	\$
186,422,292 common shares		
(186,402,292 as at December 31, 2004)	29,534,132	29,532,130

**Stock purchase warrants and stock options**

(Number)	May 9 and March 31, 2005	December 31, 2004
Stock purchase warrants	4,530,782	4,530,782
Stock options	9,421,200	9,096,200

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.

**Contingencies**

The Company, in conjunction with an institution, faces a lawsuit for an amount of \$885,000. Management believes that the lawsuit is not justified; accordingly no accrual has been recorded in this respect.

**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 listed below and described in greater detail in Management's discussion and analysis of financial position and results of operations for the fiscal year ended December 31, 2004.

- Length of sales cycle
- Recent losses
- Potential fluctuations in quarterly results
- Cash position and access to financing sources
- Competition
- Proprietary technology
- Possible product liability
- Credit risk
- Currency risk
- Possible negative tax consequences

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.

**Additional information and continuous disclosure**

This analysis of the Company's financial position and results of operations was prepared on May 9, 2005. Updated information on the Company can be found on the SEDAR Web site at [www.sedar.com](http://www.sedar.com).



**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.

> [www.nstein.com](http://www.nstein.com)



## Consolidated Financial Statements

NSTEIN TECHNOLOGIES INC.

Consolidated Statements of Earnings and Deficit <sup>†</sup>	Three months ended March 31,	
	2005 \$ (unaudited)	2004 \$ (unaudited)
<b>Revenues (note 6)</b>	<b>2,403,603</b>	<b>761,977</b>
<b>Cost of revenues</b>	<b>1,056,999</b>	<b>85,536</b>
	<b>1,346,604</b>	<b>676,441</b>
<b>Expenses</b>		
Selling and administrative	1,342,690	839,241
Research and development	546,586	500,776
Research and development tax credits	(165,989)	(125,001)
Depreciation of property, plant and equipment	33,124	36,186
Amortization of intangible assets	335,168	3,065
Loss (gain) on disposal of property, plant and equipment	(3,284)	18,981
Financial expenses (note 5)	90,325	24,187
	<b>2,178,620</b>	<b>1,297,435</b>
<b>Loss for the period</b>	<b>832,016</b>	<b>620,994</b>
<b>Deficit – Beginning of period</b>	<b>(20,908,096)</b>	<b>(17,513,995)</b>
Adjustment resulting from a change in accounting policy (note 2)	-	(198,624)
<b>Restated deficit – Beginning of period</b>	<b>(20,908,096)</b>	<b>(17,712,619)</b>
<b>Deficit – End of period</b>	<b>(21,740,112)</b>	<b>(18,333,613)</b>
<b>Basic and diluted loss per share</b>	<b>0.004</b>	<b>0.005</b>
<b>Basic and diluted weighted average number of shares outstanding</b>	<b>186,407,001</b>	<b>132,936,067</b>

<sup>†</sup> The accompanying notes are an integral part of these consolidated financial statements.

## Consolidated Financial Statements

NSTEIN TECHNOLOGIES INC.

### Consolidated Statements of Cash Flows<sup>†</sup>

Three months ended arch 31,

	2005 \$ (unaudited)	2004 \$ (unaudited)
<b>Cash flows from operating activities</b>		
Loss for the period	(832,016)	(620,994)
Items not affecting cash and cash equivalents		
Excess of long-term financed licence sales and interest thereon over cash receipts	(536,012)	-
Capitalized interests on long-term debt	(28,202)	-
Depreciation of property, plant and equipment	33,124	36,186
Amortization of intangible assets	335,168	3,065
Amortization of deferred financing expenses	8,271	7,017
Stock-based compensation	65,895	9,793
Loss (gain) on disposal of property, plant and equipment	(3,284)	18,981
	<b>(957,056)</b>	<b>(545,952)</b>
Change in non-cash operating working capital items		
Accounts receivable		
Trade	617,821	68,957
Commodity taxes recoverable and other	27,888	5,556
Refundable tax credits	(165,989)	(125,001)
Prepaid expenses	(25,355)	(10,571)
Accounts payable and accrued liabilities	(237,038)	(22,400)
Deferred revenues	19,590	57,168
	<b>236,917</b>	<b>(26,291)</b>
	<b>(720,139)</b>	<b>(572,243)</b>
<b>Cash flows from financing activities</b>		
Payments on long-term debt	(64,783)	(33,602)
Variation in share capital, net of share issue expenses	2,002	(30,822)
	<b>(62,781)</b>	<b>(64,424)</b>
<b>Cash flows from investing activities</b>		
Business acquisitions, net of cash and cash equivalents acquired	(50,000)	-
Additions to property, plant and equipment	(8,459)	(24,097)
Additions to intangible assets	(430)	-
Proceeds from the sale of property, plant and equipment	6,784	5,973
	<b>(52,105)</b>	<b>(18,124)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(835,025)</b>	<b>(654,791)</b>
<b>Cash and cash equivalents – Beginning of period</b>	<b>2,751,574</b>	<b>3,107,684</b>
<b>Cash and cash equivalents – End of period</b>	<b>1,916,549</b>	<b>2,452,893</b>
<b>Additional information (note 5)</b>		

<sup>†</sup> 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, 2005 and for the periods ended March 31, 2004 and 2005 is unaudited. However, management considers that all the required adjustments have been made to present the results of that period fairly. Any such adjustments were of a normal recurring nature. Interim results are not necessarily indicative of the expected results for the year.

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

### 2. Accounting for stock-based compensation plans

In accordance with new CICA standards outlined in Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments", the Company adopted the recommendations retroactively on January 1, 2004, without restating prior years' results. 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 components of shareholders' equity at December 31, 2003 increased by \$198,624.

During the three-month period ended March 31, 2005, the Company granted its employees and service suppliers 500,000 stock options. The fair value of these stock options amounts to \$43,190. The compensation charge for the period ended March 31, 2005 was \$65,895, including amortization based on the graded vesting method for grants made since January 1, 2002.

The fair value of options granted during the three-month period ended March 31, 2005 was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	<b>Three months ended March 31, 2005</b>
Risk-free interest rate	2.98%
Expected volatility	80%
Dividend yield	nil
Weighted average expected life	19 months

### 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 \$350,509. The value assigned to warrants issued pursuant to the acquisition of KMtechnologies, using the same model, was also included under this item for an amount of \$92,245.

In regard of the Valsar Consulting Group Inc. acquisition, the Company gave the sellers the option of taking the \$576,000 representing the balance of the selling price payable over three years in cash or in shares priced at \$0.26 each. A value of \$266,779 was assigned to this option using the Black-Scholes pricing model, and was recorded under other equity components.

The remaining \$352,170 included under this item represents the counterpart of the charge for stock options granted to directors, officers, employees and service suppliers shown in the Company's financial statements.

### 4. Balances receivable on sales of software licences

The Company will be receiving an amount of \$556,416 in three equal payments of \$185,472 ending March 31, 2007. The long-term portion of \$165,068 is composed of an interest-free payment of \$185,472 capitalized at a rate of 6%.

The annual receipts in capital over the coming fiscal years are \$185,472 in 2005 and 2006, and \$165,068 in 2007.

### 5. Additional information

#### Statement of earnings

##### a) Financial expenses

	Three months ended March 31,	
	2005 \$ (unaudited)	2004 \$ (unaudited)
Amortization of deferred financing expenses	8,271	7,017
Interest on long-term debt	46,726	16,185
Interest and bank charges	18,294	16,373
Interest income	(12,706)	(14,862)
Foreign exchange loss (gain)	29,740	(525)
	90,325	24,187

**Statement of cash flows**

b) Additional information

	<b>Three months ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
	<b>\$</b>	<b>\$</b>
	(unaudited)	(unaudited)
Interest paid	32,937	23,202
Interest earned	(26,837)	(2,766)

**6. Segmented 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. 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 as follows:

	<b>Three months ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
	<b>\$</b>	<b>\$</b>
	(unaudited)	(unaudited)
United States	802,584	442,512
Canada	1,189,793	251,703
Europe	411,226	67,762
	2,403,603	761,977

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

**7. Contingencies**

The Company, in conjunction with an institution, faces a lawsuit for an amount of \$885,000. Management believes that the lawsuit is not justified; accordingly no accrual has been recorded in this respect.



Nstein Technologies Inc.  
75 Queen Street, Suite 4400  
Montreal (Quebec) H3C 2N6 Canada  
Tel.: (514) 908-5406  
Fax: (514) 908-5407  
Toll-free: 1 877 678-3461  
E-mail: [info@nstein.com](mailto:info@nstein.com)  
**[www.nstein.com](http://www.nstein.com)**