

**BRAINHUNTER INC.**

**Management Discussion and Analysis  
For the Period Ending June 30, 2005**

**August 15, 2005**

## **Sections of the MD&A**

1. Business Overview
2. Year to Date in Review
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## **BUSINESS OVERVIEW**

Brainhunter is a high value added technology company specializing in providing end-to-end recruiting and staffing solutions and services. The Company provides IT, Engineering, Industrial and Health Care professionals on a full time and contract basis along with web enabled software solutions handling all aspects of the recruiting and staffing relationship between customer, contractor and agency, including all back office functions. Technology and services are provided throughout Canada and the United States under the brand Brainhunter to a wide variety of corporate and government clients, and are divided into five core interrelated revenue streams as follows:

- 1. Contract Staffing (Core Business / High Growth / IT, Engineering, Industrial, Health Care)**
- 2. Permanent Staffing (Essential Service / Full Service, Virtual Agency)**
- 3. Specialized Job Boards (Core Business / High Growth / Job Postings, Database Access)**
- 4. Software Licenses (Essential Service / Applicant Tracking, Vendor Management, Back Office Systems)**
- 5. Professional Services / Solutions Delivery (Essential Service / Project Revenue, Technology Platform Support, Business Process Outsourcing (“BPO”))**

Brainhunter’s Technology Platform and Best practices are believed to deliver the most cost effective, flexible and customizable recruiting and staffing solutions and processes in the marketplace today. The Platform is deployed internally and is sold externally in a modular capacity or as a fully integrated end-to-end solution on an ASP Model to customers in conjunction with Brainhunter’s extensive Job Board Technology and Job Seeker Database capability (over 1 million resumes). The Platform provides the engine driving Brainhunter’s high-growth Recruiting and Staffing Solutions and Services strategy. It is supported by our solutions division which employs approximately 100 highly specialized, fully billable technical employees driving a highly profitable solutions business.

Brainhunter is a publicly traded company with a senior listing on the Toronto Stock Exchange. Brainhunter deploys over 700 Contractors / Consultants with an internal staff of approximately 150 personnel. The Company has offices in Toronto, Ottawa, Calgary, Vancouver, a correspondence relationship in China and has recently opened a Business Process Outsourcing (“BPO”) office in India.

# THE YEAR TO DATE IN REVIEW

## *Overview*

After making 13 acquisitions in 2 years, the Company has been focusing on:

- consolidating the businesses;
- phasing out those sections of the acquired businesses, which are deemed “non-core” to the major lines of business; and
- investing in and expanding the core businesses.

In the *Contract Staffing* sector, the focus has been on enhancing our preferred supplier arrangements with large users of IT or Engineering contract services. During the quarter, our preferred supplier arrangements increased to 52, expanding the Company’s coverage in Quebec and Alberta.

The company has successfully launched its Business Process Outsourcing (“BPO”) centre in India. The centre is now fully operational and has signed 12 new supplier agreements in the USA and 6 in India. In addition, the BPO operation has several Recruiting Process Outsourcing (“RPO”) proposals for major clients in the pipeline.

Brainhunter has launched a separate Permanent Staffing Group. The group has very good success in a short period of time, adding over 27 major Fortune 1,000 clients to the Company’s base of business.

Brainhunter has made a significant investment in its operational infrastructure through the development of a comprehensive and robust Back Office System. The Back Office System will dramatically improve internal efficiency and customer satisfaction. More importantly, the Back Office System provides Brainhunter with a major competitive advantage in positioning the Company as a Master Vendor on supply agreements.

Brainhunter has completed its marketing and branding realignment, brand rationalization and unified corporate identity program enterprise-wide across the 13 acquired entities. In addition, the Company will engage in a brand awareness advertising campaign planned for early fiscal 2006.

In the *Specialized Job Boards* sector, significant progress was made. Brainhunter now operates 95 specialized Job Boards, up from 65 at the beginning of the quarter. An arrangement was finalized with one of the largest Diversity groups in Canada, which will add significantly to Brainhunter’s Diversity Hiring initiatives. Progress was also made on sales and marketing initiatives with the launch of Passport, which allows customers to significantly improve access to the complete range of Brainhunter specialized job boards.

In the *Technology Sales* sector, Vision2Hire was acquired (see below), expanding Brainhunter's installed base of applicant tracking systems ("ATS") to over 100 customers on a national basis. Additionally, the development program for the ATS, Vendor Management Systems and Back Office Systems was substantially completed. The platform has been implemented internally and is now being marketed to the Brainhunter customer base.

In the *Professional Services / Solutions Delivery* sector, a small acquisition, Promethean Systems Consultants Inc. (see below) was completed, which will, in addition to other benefits, add senior sales skills to the sector and broaden Brainhunter's specialty practice area to include a very strong Microsoft practice.

### ***Acquisitions***

#### **Vision2Hire Solutions**

As of November 30, 2004, Vision2Hire Solutions Inc ("V2H") was acquired for cash and a zero-interest note payable of \$446,054 convertible for a term of 3 years to Brainhunter shares at an exercise price of \$2.00 per share. One senior technical sales executive joined Brainhunter as a result of the acquisition and all technology and sales support has been taken over by Brainhunter.

#### **Promethean System Consultants Inc**

As of January 1, 2005, Promethean System Consultants Inc. ("Promethean") was acquired in exchange for the issue of 150,000 common shares of Brainhunter, the issue of 511,125 share purchase warrants exercisable at \$1.00 per share and a guarantee of certain bank debt in the amount of \$100,000. Promethean was acquired to expand the range of solutions services offered and to consolidate existing opportunities in the Contract Staffing sector.

### ***Normal-course Issuer Bid***

In October, 2004, Under the terms of a Normal-course Issuer Bid, the Company acquired 29,409 common shares of the Company in the public markets for a cost of \$26,615 including transaction costs for an average cost of \$0.91 per share. With the acquisition of these shares, this Normal-course Issuer Bid has been completed.

### ***Business Process Outsourcing***

In February, 2005 the company opened a Business Process Outsourcing ("BPO") office in Hyderabad, India. Its initial task is to provide recruiting services for the company's growing USA IT Contract Staffing initiative.

## **Review of Operations**

### **Revenues**

In the June quarter Fiscal 2005 revenues increased \$2,554,570 or 15% versus the June quarter Fiscal 2004 from \$17,462,824 to \$20,017,394, and on a March YTD basis increased by \$5,037,985 or 10% from \$52,316,977 to \$57,354,962.

Significant contributors to the net increase for the June YTD period are as follows. IT Staffing grew by \$5.6 million through organic growth as well as \$2.5 million as a result of acquisitions. Engineering Staffing declined by \$3.2 million including a strategic withdrawal from low margin industrial business of \$1.8 million.

### **Cost of Sales**

Cost of Sales increased in an amount commensurate with the increase in Revenues and as a % of Revenues, due to a shift in the mix of business from higher-margin Solutions revenue, to lower-margin annuity Contract Staffing and Consulting business. As a % of Revenues, Cost of Sales increased from 76% to 78% on a June YTD basis reflecting the evolution in the mix of the business. The growth took place in Contract Staffing and Consulting, which has industry Cost of Sales norms in the 80% range as opposed to Information Technology Solutions, which has higher Gross Margins.

### **Gross Margins**

As discussed above, due to the shift in the mix of business from higher margin solutions business to lower margin contract business, in the June quarter the Gross Margin declined as a % of Revenues, although it increased by \$100,838 in absolute terms. Gross Margin increased from \$4,058,881 in the quarter ending June 30, 2004 to \$4,159,719 in the quarter ending June 30, 2005, but declined by \$202,324 from \$12,556,627 in the 9 months ending June 30, 2004 to \$12,354,303 in the 9 months ending June 30, 2005.

### **Overhead expenses (“Other Staffing Costs” and “General, Selling and Administrative”)**

Overhead expenses showed an increase in the June quarter 2005 versus June quarter 2004 of \$413,225, from \$3,460,400 to \$3,873,625 and an 8% increase for the 9 months ending June 30 of \$740,399 from \$9,562,252 in Fiscal 2004 to \$10,302,651 in Fiscal 2005. As a % of Revenue, overhead expenses have remained relatively constant, decreasing from 20% of Revenue in the quarter ending June 30, 2004 to 19% of revenue in the quarter ending June 30, 2005, and staying at 18% of Revenue on a June YTD basis for Fiscal 2004 and June YTD Fiscal 2005.

Included in the Overhead costs for the June quarter are in excess of \$400,000 of expenditures related to:

- litigation arising from issues present in companies acquired prior to acquisition;
- one-time brand development costs;
- rationalizing excess real estate costs; and
- management, consulting and legal fees related to the previously-announced proposed Limited Partnership acquisition strategy.

Additionally, the Company recorded in excess of \$100,000 of reorganization expenses, including severance costs incurred where Brainhunter made certain management changes

that better positioned the Company to handle the growth from acquisitions. Further, Brainhunter expanded its sales management and recruiting team, adding an additional \$75,000 per quarter to the cost structure.

In total, excluding legal fees and brand development costs, Brainhunter has increased its annual fixed costs in excess of \$1,000,000. These costs have been added primarily to ensure the infrastructure is in place to better manage the growth from acquisitions. Upon achieving targeted revenue levels through acquisitions and organic growth, Brainhunter management's targeted level of Overhead costs is in the range of 12%-14% of Revenue.

### **Earnings before Interest, Taxes and Amortization (EBITDA)**

As a result of the above, EBITDA is reported as \$286,094 for the Fiscal 2005 June quarter versus \$598,481 for Fiscal 2004 June quarter. On a YTD basis EBITDA is \$2,051,652 for the 9 months ending June, 2005 versus \$2,994,375 for the 9 months ending June, 2004. Due to the above, EBITDA declined as a % of Revenue, from 6% in the YTD period ending June, 2004 to 4% in the quarter and YTD period ending June, 2005.

### **Interest**

Interest costs are increasing over time commensurate with the increase in Revenues, being the cost of financing the costs of contract staffing and solutions work until the receivables are collected. Interest has remained constant as less than 1% of revenue through Fiscal 2004 and Fiscal 2005 YTD.

The interest costs are predominantly related to the Company's current line of credit with the Royal Bank, but also include imputed interest on non-interest bearing vendor take-back debt on certain acquisitions. The imputed interest amount is approximately \$16,000 for the quarter ending March 31, 2005 and \$53,000 for the 9 months ending June 30, 2005 compared with \$18,000 for the quarter ending June 30, 2004 and \$82,000 for the 9 months ending March 31, 2004. Please see discussion of Imputed Interest expense elsewhere in this document.

### **Amortization**

Amortization expense declined from \$654,606 in the June quarter Fiscal 2004 to \$542,559 in the June quarter Fiscal 2005 and from \$2,312,245 for the 9 months ending June 30, 2004 to \$1,625,871 for the 9 months ending June 30, 2005. The largest portion of Amortization expense is the amortization of Intangible Assets. Please see discussion of changes regarding Intangible Assets elsewhere in this document

### **Earnings before Income Tax**

Based on all of the above, the Company is reporting a loss before income taxes and non-controlling interest of \$384,730 for the quarter ending June 30, 2005 versus a loss of \$109,145 for the quarter ending June 30, 2004, and a profit before taxes and non-controlling interest of \$48,278 for the 9 months ending March 30, 2005 and \$426,655 for the 9 months ending June 30, 2004.

### **Income Tax Expense**

The company has sufficient tax losses acquired through acquisitions to ensure it will not have to pay income taxes for Fiscal 2005.

### **Non-controlling Interest**

The Company acquired 61% of InBusiness Solutions Inc. in April, 2003 and purchased the remaining shares in the period December, 2003 to April, 2004. In the 6 months ending March 31, 2004, the Non-controlling interest was calculated at \$31,222. As the Company acquired full control in the June quarter, of Fiscal 2004, the accumulated Non-controlling interest was reversed, thus showing a recovery of \$31,222 in the June quarter and a NIL balance for the 9 months ending June 30, 2004.

### **Net Earnings**

Based on all of the above, the Company is reporting a Net Loss of \$246,227 for the quarter ending June 30, 2005 versus a net loss of \$111,658 for the quarter ending June 30, 2004, and a net income of \$124,132 for the 9 months ending June 30, 2005 versus \$348,002 for the 9 months ending June 30, 2004.

## **Liquidity**

### **Cash and Bank Indebtedness**

At March 31, 2005, the Company reported Bank Indebtedness of \$9,009,062. This number consisted of the actual draw against the Company's line of credit of \$8,735,000 plus outstanding cheques of \$846,010, offset by Cash on hand of \$571,948.

The Company's line of credit as at September 30, 2004 was \$7,000,000 but was increased to \$10,000,000 on October 29, 2004. The Company's interest rate is Prime + 1.5%. In connection with an amendment to the credit facility, the Company has agreed to raise no less than \$3 million of new capital on or before December 31, 2005.

Cash from Operations for the quarter ending June 30, 2005, was \$(81,400), versus \$328,649 for the quarter ending June 30, 2004, and for the 9 months ending June 30, 2005 was \$(1,725,903) versus \$1,371,988 for the YTD June 30, 2004 period. This trend reflects the growth in accounts receivable and improved payroll terms for our contract-based personnel.

The net change in non-cash working capital was a decrease of \$271,321 over the June quarter and \$3,643,941 over the 9 month period ending June 30, 2005. The largest component was an increase in accounts receivable, due to growth in revenues and accommodations to certain clients in terms of payment terms.

### **Obligations by year (\$,000)**

			Operating Leases	Long Term Debt	Total
Year ending:	June	2006	\$977	\$1,055	\$2,032
	June	2007	\$722	\$316	\$1,038
	June	2008	\$667	\$206	\$873

	June	2009	\$667	\$0	\$667
	June	2010	\$667	\$0	\$667
	June	2011	\$667	\$0	\$667
	June	2012	\$667	\$0	\$667
	June	2013	\$667	\$0	\$667
	June	2014	\$667	\$0	\$667
	June	2015	\$496	\$0	\$496
	<b>Total</b>		<b>\$6,864</b>	<b>\$1,576</b>	<b>\$8,440</b>

### **Issue of Common Shares**

The Company raised \$59,432 during the quarter on the issue of common shares due to the exercise of options and warrants. This compares to the Fiscal 2004 June quarter when the Company expended \$943,750 to acquire shares under the terms of a Normal Course Issuer Bid (see below).

### **Purchase of common Shares**

Under the terms of a Normal-course Issuer Bid, the company acquired 29,409 shares at a total cost of \$26,615 in October, 2004, being reported as part of the March, 2005 YTD numbers. Of that amount, \$12,940 is recorded as a reduction in Share Capital and \$13,675 is recorded as a reduction in Retained Earnings.

### **Notes Due from Related Parties**

The company recorded a net increase of \$255,379 for Notes Due from Related Parties during the June quarter, the bulk being loans to newly-hired executives to purchase shares. For the 9 month period ending June 30, the company recorded a net repayment of \$81,061 of this item. The Notes Due from Related Parties are advances mostly to acquire shares in the Company where the loans are collateralized by the Company shares. The loans are part of employment contracts for new senior management personnel.

### **Repayment of Long-term Obligations**

The Company repaid \$75,000 of Long Term Debt during the quarter, being a scheduled repayment of debt arising from acquisitions, as well as a \$60,000 debt arising from an acquisition. The company in fact repays a further \$125,000 of Long Term Debt each quarter, but as the funds for this payment are made from a treasury bill which the company has set aside to pay the funds, and which is recorded as an offset to Long Term Debt, there is no net effect on cash in the period.

### **Business Acquisitions**

The Company reported a cost of \$64,755, net of cash acquired, to acquire Vision2Hire Solutions Inc. in the December quarter for a total of \$64,755 for the Fiscal 2005 June YTD. This compares to the \$11,148,059 recorded for Fiscal 2004 June YTD whereby the Company was completing the acquisitions of InBusiness Solutions Inc., Sirius Consulting and Prolink Consulting.

**Capital Expenditures**

The Company spent \$411,520 on Capital Expenditures during the June quarter, most of which was spent enhancing the Brainhunter software. The Company has intentions of spending \$300,000 to \$500,000 on capital expenditures in the last quarter of the fiscal year, primarily on developing the Brainhunter software. These expenditures will be paid out of working capital.

**Stock-based compensation plan**

Under the transitional provision of revised CICA Handbook Section 3870 *Stock-Based Compensation and other Stock-Based Payments*, the Company has adopted the fair value method of accounting for the stock options granted under its Share Option Plan in the year ended September 30, 2005. The retroactive adoption requires that the Company expense the fair value of stock options granted, modified, or settled during the fiscal year 2005 and subsequent. Prior periods are not restated and an adjustment is made to the opening balance of retained earnings of the current period to reflect the cumulative effect of the change on prior periods. The fair value was determined on a basis consistent with that used in the Company's disclosure under the former Section 3870 and reported by the Company annually since October 1, 2002. The fair value of stock options is determined using the Black-Scholes option pricing model. The charge for the nine-month period ended June 30, 2005 for stock options was \$97,155. The adjustment to the opening balance of retained earnings of the current period was \$757,648.

**EBITDA**

Management defines EBITDA as earnings before amortization, interest and taxes.. The Company's method of calculating EBITDA may not be comparable to similar measures presented by other companies.

## SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table provides summary financial data for our last eight quarters:

<i>(Expressed in thousands of dollars, except per share an</i>	Quarter ended			
	Jun 30 2005	Mar 31 2005	Dec 31 2004	Sep 30 2004
Revenue	\$ 20,017	\$ 19,548	\$ 17,789	\$ 16,576
Net income (loss)	\$ (246)	\$ 235	\$ 136	\$ (131)
Net income (loss) per share - Basic	\$ (0.005)	\$ 0.006	\$ 0.003	\$ (0.003)
- Diluted	\$ (0.005)	\$ 0.006	\$ 0.003	\$ (0.003)
	Jun 30 2004	Mar 31 2004	Dec 31 2003	Sep 30 2003
Revenue	\$ 17,463	\$ 18,549	\$ 16,305	\$ 10,767
Net income (loss)	\$ (80)	\$ 489	\$ (60)	\$ 145
Net income (loss) per share - Basic	\$ (0.002)	\$ 0.011	\$ (0.002)	\$ 0.005
- Diluted	\$ (0.002)	\$ 0.009	\$ (0.001)	\$ 0.005

## REVIEW OF ACCOUNTING POLICIES

### Background

Ernst & Young LLP (“Ernst & Young”) were appointed as auditors of Brainhunter for Fiscal 2005 on March 31, 2005 at the annual shareholders’ meeting. Ernst & Young’s first assignment under the terms of its engagement was to review the financial statements of Brainhunter for the period ending March 31, 2005, being the second quarter of Fiscal 2005. In the context of the review, Ernst & Young advised Brainhunter to review certain of its accounting policies, specifically:

- accounting for Goodwill, and consideration of the possibility that some of the Goodwill should have been allocated to Intangible Assets;
- accounting for the rent-free period of Brainhunter’s corporate head office lease; and
- recording of imputed interest costs on interest-free debt which Brainhunter issued in the form of Vendor Take-backs on the above mentioned acquisitions.

Brainhunter has completed its review of the above and determined that certain restatements are warranted.

### Accounting for Goodwill and Intangible Expenses

Brainhunter had made acquisitions which resulted in \$12.8 million in Goodwill on the Balance Sheet as at September 30, 2004, approximately \$10.1 million of which was recorded in Fiscal 2004.

For the Fiscal years ending September 2003 and 2004, the Company, in the context of its annual audit, reviewed the accounting for its acquisitions and determined at that time that the portion of the purchase price in excess of tangible assets was properly allocated to Goodwill and to Future Income Tax Assets, where the acquired companies had losses for Income Tax Purposes which could be utilized. No amounts were assigned to intangible assets such as customer contracts, customer lists, etc. and accordingly, the tax effect on any such allocations was not considered.

Brainhunter had not allocated a portion of the Goodwill to Intangible Assets as Brainhunter had determined that, in general, the tests were not met for inclusion in the suggested categories of Intangible Assets, namely Contracts and Customer Relationships. In general, it was felt that the contracts and customer relationships acquired were not firm enough to meet the criteria. Although they were ongoing relationships and the experience had been a high renewal rate, the contracts could be cancelled by the client without penalty with notice of between 10 to 30 days, depending on the client.

In the context of all major financial relationships, including banking relationships not giving any credit for goodwill and deducting it in their financial analyses of the Company, Brainhunter has allocated a portion of Goodwill to Intangible Assets.

As a result of conducting the review, and specifically the review and analysis of Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1581, Brainhunter has allocated \$5.4 million of \$12.8 million of Goodwill to Intangible Assets as follows:

- Customer Relationships                      \$4.1 million
- Contracts    1.1 million
- Non-compete agreements                      .2 million

The allocation of \$5.4 million of Goodwill to Intangible Assets above creates an offsetting tax effect whereby Goodwill is increased by an amount of \$2.1 million (the \$5.4 million allocated to Goodwill at the current tax rate of 38%) and a Future Income Tax Liability is created in the same amount. This Future Income Tax Liability will, in the normal course, be drawn down as an offset and at the same rate as the Intangible Assets are amortized. For clarification, the creation of the Future Income Tax Liability is for accounting purposes only, and being effectively a notional liability only, has no impact on actual taxes payable.

The net immediate effect is to reduce Goodwill from \$12.8 million to \$7.4 million and then immediately increase it to \$9.5 million.

As well, Brainhunter has recorded a charge for Amortization of the above-noted Intangible Assets for the year ended September 30, 2004 of \$2.1 million, which, together

with offsetting Income Tax adjustments of \$0.9 million has resulted in a net adjustment to Net Income of \$1.2 million for the year. This adjustment has no impact on EBITDA or cash flow but it does reduce reported Net Income after taxes.

Brainhunter has made this adjustment by restating its opening balance sheet for Fiscal 2005 and the comparative income statement and cash flow for the year ended September 30, 2004, including the impact on each quarter, as the quarterly financial statements are issued throughout Fiscal 2005.

### **Accounting for Lease Inducement (Free-Rent)**

Brainhunter executed a lease in February, 2004 for the period April 1, 2004 to December 31, 2014, i.e. 10 years and 9 months. The nine months April 1, 2004 to December 31, 2004 were free of all rent cost, including basic rent and additional rent (taxes, operating costs, etc.). Part of the nine months was to allow time for the construction of leasehold improvements, including extensive air-conditioning for the server room. Brainhunter personnel moved into the premises over the period from June to September, from four different locations.

The Company did not account for a rent expense in the new premises in the period April, 2004 to September, 2004 because:

- the space was free of cost
- although technically the lease was executed as of April 1, 2004, Brainhunter was not able to occupy the space until the leaseholds had been completed. The major leasehold improvement was the installation of a dedicated roof-top air conditioning unit for the server room. Brainhunter regarded a portion of the free rent period as the construction period which normally precedes the start of a lease, and could have structured the lease documents to delay the actual start date of the lease until the end of the construction period. This would have reduced the amount of the restated rent expense.
- Brainhunter personnel did not occupy the space from the beginning, moving in stages from June 1 to September 20
- Brainhunter was still paying rent on other premises that could not be sublet, and recording rent would result in abnormal overhead expenses.

As a result of conducting its review, and specifically of CICA EIC 21 “Accounting for Lease Inducements by the Lessee” Brainhunter has taken the total of the rent expected to be paid over the 10 years (i.e. 120 months) from January 1, 2005 to December 31, 2014 and divided that total over the 129 months from April 1, 2004 to December 31, 2014 and will expense it over that 129 month period. The result is a rent expense for the period April to September, 2004 of approximately \$240k for the 6 month period, with reductions in rent expense of approximately \$3k per month in later months of the lease term. This treatment that averages the rent expense applies only to the new leased premises and did not apply to the four other premises in Toronto.

This accounting treatment for rent expense has no impact on actual cash flow, but from an accounting perspective it reduces EBITDA and Net Income.

### **Imputed Interest on Interest-Free debt**

Brainhunter's standard consideration for each acquisition was a combination of cash, shares, options and (where appropriate) non interest-bearing notes (essentially Vendor take-backs). This last component was to ensure the Company had some opportunity for claw-back if the representations made by the Vendors turned out to be inaccurate or overstated. The first such debt instrument was issued March, 2003. Brainhunter had not recorded an expense for imputed interest as the amount owed was not viewed by management in the same light as funds borrowed but viewed simply as a portion of the purchase price of the acquisition that was delayed by agreement with the vendors. Additionally, the Vendor Take Back had convertible features.

As a result of conducting its review, and specifically of CICA Handbook Section 3855 "Financial Instruments—Recognition and Measurements", specifically Paragraph 55 "Initial Measurement of Financial Assets and Financial Liabilities", Brainhunter has discounted the non-interest bearing notes for accounting purposes and recorded an expense for the interest imputed on those notes. The cumulative imputed interest expense to the end of Fiscal 2004 is \$100k. The Imputed Interest calculation was made at an average current borrowing rate of 6% against those Vendor Take-Backs which had no interest component. Vendor Take-backs with interest terms averaging in the 2% to 4% range were not part of the calculation.

### **Reporting Changes to Shareholders**

Brainhunter is reporting the above changes to the shareholders by:

- issuing the March, 2005 quarter financial statements:
  - with the opening balance sheet (at September 30, 2004) restated for the changes referred to above;
  - with the 3 and 6 month comparable periods for the 2004 income statement and cash flows restated to include the changes for rent, amortization, and imputed interest expenses, along with offsetting tax adjustments;
  - including detailed notes to the financial statements fully describing the changes
- issuing a Management Discussion and Analysis ("MDA") which fully describes the changes including a full description of the background and nature of the changes, and the changes to the income statements and balance sheets and cash flows by quarter;
- including the press release and MDA on the Brainhunter website; and
- the Fiscal 2004 amounts will be restated as part of the audited Fiscal 2005 Financial Statements.

### **Summary of Changes**

The changes made to Fiscal 2004 are to decrease EBITDA by \$238,000, and Net Earnings by \$1,500,000. The changes made to Fiscal 2005 Q1 are to decrease EBITDA by \$119,000 and to decrease Net Earnings by \$306,000; however, there is no impact on actual cash flow from any of the changes. Please see following pages for charts setting out the changes.

### Effects of Accounting Adjustments on Fiscal 2004 and Q1 Fiscal 2005 Balance Sheets (\$,000)

	Fiscal 2004												Q1 Fiscal 2005		
	As Reported				Adjustments				Restated				Reported	Adjust	Restated
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Cash	\$ -	\$ -	\$ 1,477	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,477	\$ -	\$ -	\$ -	\$ -
Accounts Receivable	12,344	13,378	13,314	12,957	-	-	-	-	12,344	13,378	13,314	12,957	13,950	-	13,950
Investment tax credits recoverable	491	694	693	1,246	(351)	(351)	(351)	(351)	140	344	342	895	1,416	(776)	640
Deposits and prepaid expenses	569	792	430	353	-	-	(200)	(200)	569	792	230	153	650	(200)	450
Future income tax asset	1,000	1,000	1,000	750	-	-	-	-	1,000	1,000	1,000	750	750	-	750
<b>Total current assets</b>	<b>14,403</b>	<b>15,865</b>	<b>16,914</b>	<b>15,305</b>	<b>(351)</b>	<b>(351)</b>	<b>(551)</b>	<b>(551)</b>	<b>14,052</b>	<b>15,514</b>	<b>16,363</b>	<b>14,755</b>	<b>16,765</b>	<b>(976)</b>	<b>15,789</b>
Capital assets	3,110	3,646	4,063	4,340	-	-	-	-	3,110	3,646	4,063	4,340	4,621	-	4,621
Investment tax credits recoverable	-	-	-	-	351	351	351	351	351	351	351	351	-	776	776
Deferred financing costs	-	-	-	-	-	-	200	200	-	-	200	200	-	200	200
Intangible assets	-	-	-	-	4,632	4,203	3,775	3,375	4,632	4,203	3,775	3,375	-	3,111	3,111
Goodwill	8,082	11,881	12,572	12,766	(2,274)	(2,274)	(2,567)	(2,567)	5,807	9,607	10,005	10,199	12,766	(2,567)	10,199
Due from related parties	443	443	443	1,278	-	-	-	-	443	443	443	1,278	1,016	-	1,016
Future income tax asset	3,391	3,391	3,391	3,341	(1,294)	(1,294)	(1,002)	(1,002)	2,097	2,097	2,389	2,339	4,065	(1,002)	3,063
<b>Total assets</b>	<b>\$29,429</b>	<b>\$35,226</b>	<b>\$37,382</b>	<b>\$37,029</b>	<b>\$1,063</b>	<b>\$ 635</b>	<b>\$ 207</b>	<b>\$ (193)</b>	<b>\$30,493</b>	<b>\$35,861</b>	<b>\$37,589</b>	<b>\$36,836</b>	<b>\$39,232</b>	<b>\$ (457)</b>	<b>\$38,775</b>
Bank indebtedness	\$ 4,675	\$ 611	\$ 4,290	\$ 5,921	\$ -	\$ -	\$ -	\$ -	\$ 4,675	\$ 611	\$ 4,290	\$ 5,921	\$ 6,322	\$ -	\$ 6,322
Accounts payable and accruals	6,619	7,638	7,098	6,136	-	-	-	232	6,619	7,638	7,098	6,368	6,414	-	6,414
Current portion of long term debt	2,023	963	935	435	-	-	-	-	2,023	963	935	435	435	-	435
Future income tax liabilities	-	-	-	-	305	305	305	305	305	305	305	305	-	305	305
Deferred revenue	75	209	160	105	-	-	-	-	75	209	160	105	362	-	362
<b>Total current liabilities</b>	<b>13,391</b>	<b>9,420</b>	<b>12,483</b>	<b>12,597</b>	<b>305</b>	<b>305</b>	<b>305</b>	<b>537</b>	<b>13,696</b>	<b>9,725</b>	<b>12,788</b>	<b>13,134</b>	<b>13,533</b>	<b>305</b>	<b>13,838</b>
Deferred lease inducement	-	-	-	-	-	-	119	238	-	-	119	238	-	357	357
Long term debt	1,634	1,374	1,174	849	(199)	(181)	(163)	(145)	1,435	1,193	1,011	704	1,220	(179)	1,041
Long term future income tax liability	-	-	-	-	1,463	1,280	1,097	914	1,463	1,280	1,097	914	-	819	819
<b>Total long term liabilities</b>	<b>1,634</b>	<b>1,374</b>	<b>1,174</b>	<b>849</b>	<b>1,264</b>	<b>1,099</b>	<b>1,053</b>	<b>1,007</b>	<b>2,898</b>	<b>2,473</b>	<b>2,227</b>	<b>1,856</b>	<b>1,220</b>	<b>997</b>	<b>2,216</b>
<b>Non-controlling interest</b>	<b>76</b>	<b>10</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>76</b>	<b>10</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Capital stock	11,335	20,678	19,678	20,646	-	-	-	(232)	11,335	20,678	19,678	20,415	21,114	811	21,925
Retained earnings	2,993	3,745	4,047	2,937	(506)	(769)	(1,152)	(1,506)	2,487	2,976	2,895	1,431	3,365	(2,569)	796
<b>Total equity</b>	<b>14,328</b>	<b>24,423</b>	<b>23,725</b>	<b>23,584</b>	<b>(506)</b>	<b>(769)</b>	<b>(1,152)</b>	<b>(1,738)</b>	<b>13,822</b>	<b>23,653</b>	<b>22,573</b>	<b>21,846</b>	<b>24,479</b>	<b>(1,759)</b>	<b>22,720</b>
<b>Total liabilities and equity</b>	<b>\$29,429</b>	<b>\$35,226</b>	<b>\$37,382</b>	<b>\$37,029</b>	<b>\$1,063</b>	<b>\$ 635</b>	<b>\$ 207</b>	<b>\$ (193)</b>	<b>\$30,493</b>	<b>\$35,861</b>	<b>\$37,589</b>	<b>\$36,836</b>	<b>\$39,232</b>	<b>\$ (457)</b>	<b>\$38,775</b>

**Effects of Accounting Changes on Fiscal 2004 and Q1 Fiscal 2005 Income Statement (\$,000)**

	Fiscal 2004															Q1 Fiscal 2005		
	As Reported					Adjustments					Restated					Reported	Adjust	Restated
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year			
<b>Revenue</b>	<b>\$16,305</b>	<b>\$ 18,549</b>	<b>\$17,463</b>	<b>\$16,576</b>	<b>\$ 68,893</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$16,305</b>	<b>\$ 18,549</b>	<b>\$17,463</b>	<b>\$16,576</b>	<b>\$ 68,893</b>	<b>\$17,789</b>	<b>\$ -</b>	<b>\$17,789</b>
Cost of Sales	12,129	14,187	13,404	15,149	54,869	-	-	-	-	-	12,129	14,187	13,404	15,149	54,869	13,817	-	13,817
<b>Gross Margin</b>	<b>4,176</b>	<b>4,362</b>	<b>4,059</b>	<b>1,428</b>	<b>14,024</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>4,176</b>	<b>4,362</b>	<b>4,059</b>	<b>1,428</b>	<b>14,024</b>	<b>3,973</b>	<b>-</b>	<b>3,973</b>
Operating Costs	3,124	3,018	3,341	729	10,212	-	-	119	119	238	3,124	3,018	3,460	848	10,450	2,959	119	3,078
<b>EBITDA</b>	<b>1,052</b>	<b>1,344</b>	<b>717</b>	<b>699</b>	<b>3,813</b>	<b>-</b>	<b>-</b>	<b>(119)</b>	<b>(119)</b>	<b>(238)</b>	<b>1,052</b>	<b>1,344</b>	<b>598</b>	<b>580</b>	<b>3,575</b>	<b>1,013</b>	<b>(119)</b>	<b>894</b>
Amortization	206	224	226	765	1,421	800	428	428	400	2,056	1,006	652	655	1,165	3,478	287	264	551
Interest	91	47	35	154	328	46	18	18	18	100	137	65	53	172	428	93	18	111
<b>Inc before Tax</b>	<b>755</b>	<b>1,073</b>	<b>456</b>	<b>(221)</b>	<b>2,063</b>	<b>(846)</b>	<b>(446)</b>	<b>(565)</b>	<b>(537)</b>	<b>(2,395)</b>	<b>(91)</b>	<b>626</b>	<b>(109)</b>	<b>(758)</b>	<b>(331)</b>	<b>634</b>	<b>(401)</b>	<b>232</b>
Income Tax	295	304	185	(444)	340	(340)	(183)	(183)	(183)	(889)	(45)	121	3	(627)	(548)	192	(95)	97
Non-cont interest	15	16	(31)	-	-	-	-	-	-	-	15	16	(31)	-	-	-	-	-
<b>Net Income</b>	<b>\$ 446</b>	<b>\$ 752</b>	<b>\$ 302</b>	<b>\$ 223</b>	<b>\$ 1,723</b>	<b>\$ (506)</b>	<b>\$ (263)</b>	<b>\$ (382)</b>	<b>\$ (354)</b>	<b>\$ (1,506)</b>	<b>\$ (60)</b>	<b>\$ 489</b>	<b>\$ (80)</b>	<b>\$ (131)</b>	<b>\$ 217</b>	<b>\$ 442</b>	<b>\$ (306)</b>	<b>\$ 136</b>
Earnings per share																		
- Basic	0.012	0.017	0.006	0.005	0.040	(0.013)	(0.006)	(0.008)	(0.008)	(0.035)	(0.002)	0.011	(0.002)	(0.003)	0.005	0.010	(0.007)	0.003
- Diluted	0.010	0.015	0.005	0.005	0.035	(0.011)	(0.005)	(0.007)	(0.007)	(0.031)	(0.001)	0.009	(0.002)	(0.003)	0.004	0.008	(0.006)	0.003

### Effects of Accounting Changes on Fiscal 2004 and Fiscal 2005 Q1 Cash Flow Statement (\$,000)

	Fiscal 2004															Q1 Fiscal 2005		
	As Reported					Adjustments					Restated					Reported	Adjust	Restated
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year			
<b>Operating activities</b>																		
Net Income	\$ 446	\$ 752	\$ 302	\$ 223	\$ 1,723	\$ (506)	\$ (263)	\$ (382)	\$ (354)	\$ (1,506)	\$ (60)	\$ 489	\$ (80)	\$ (131)	\$ 217	\$ 442	\$ (306)	\$ 136
Adjust for non-cash items																		
Non-controlling interest	15	16	(31)	-	-	-	-	-	-	-	15	16	(31)	-	-	-	-	-
Future income tax recovery	-	-	-	-	-	(340)	(183)	(183)	(183)	(889)	(340)	(183)	(183)	(183)	(889)	-	(95)	(95)
Income tax expense	-	304	185	(189)	300	-	-	-	-	-	-	304	185	(189)	300	192	-	192
Non-cash interest expense	-	-	-	-	-	46	18	18	18	100	46	18	18	18	100	-	18	18
Defer leasehold inducement	-	-	-	-	-	-	-	119	119	238	-	-	119	119	238	-	119	119
Amortization	206	224	226	765	1,421	800	428	428	400	2,056	1,006	652	655	1,165	3,478	287	264	551
Total	667	1,296	682	799	3,445	-	-	-	-	-	667	1,296	682	799	3,445	921	-	921
Net change in non-cash working capital	(538)	(105)	(354)	(1,583)	(2,579)	-	-	-	232	232	(538)	(105)	(354)	(1,351)	(2,347)	(1,266)	(811)	(2,077)
<b>Total</b>	<b>129</b>	<b>1,191</b>	<b>329</b>	<b>(784)</b>	<b>866</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>232</b>	<b>232</b>	<b>129</b>	<b>1,191</b>	<b>329</b>	<b>(552)</b>	<b>1,097</b>	<b>(345)</b>	<b>(811)</b>	<b>(1,156)</b>
<b>Investing Activities</b>																		
Business acquisitions	(6,525)	(4,345)	(660)	411	(11,119)	-	-	-	-	-	(6,525)	(4,345)	(660)	411	(11,119)	(552)	-	(552)
Purchase of capital assets	(33)	(959)	(643)	(555)	(2,190)	-	-	-	-	-	(33)	(959)	(643)	(555)	(2,190)	(591)	-	(591)
Total	(6,557)	(5,304)	(1,303)	(145)	(13,310)	-	-	-	-	-	(6,557)	(5,304)	(1,303)	(145)	(13,310)	(1,143)	-	(1,143)
<b>Financing activities</b>																		
Shares issued	1,206	9,342	(56)	943	11,436	-	-	-	(232)	(232)	1,206	9,342	(56)	711	11,204	481	811	1,291
Purchase of shares	-	-	(944)	(1,308)	(2,252)	-	-	-	-	-	-	-	(944)	(1,308)	(2,252)	(27)	-	(27)
Advances to related parties	-	-	-	(835)	(835)	-	-	-	-	-	-	-	-	(835)	(835)	262	-	262
Proceeds long term obligations	1,059	-	-	(1,059)	-	-	-	-	-	-	1,059	-	-	(1,059)	-	446	-	446
Repay long term obligations	(401)	(1,165)	(228)	79	(1,715)	-	-	-	-	-	(401)	(1,165)	(228)	79	(1,715)	(75)	-	(75)
Total	1,864	8,177	(1,227)	(2,180)	6,634	-	-	-	(232)	(232)	1,864	8,177	(1,227)	(2,412)	6,402	1,087	811	1,897
<b>Increase (decrease) in cash</b>	<b>(4,564)</b>	<b>4,064</b>	<b>(2,202)</b>	<b>(3,108)</b>	<b>(5,810)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(4,564)</b>	<b>4,064</b>	<b>(2,202)</b>	<b>(3,108)</b>	<b>(5,810)</b>	<b>(402)</b>	<b>-</b>	<b>(402)</b>
Cash net of bank indebtedness																		
Beginning of period	(111)	(4,675)	(611)	(2,813)	(111)						(111)	(4,675)	(611)	(2,813)	(111)	(5,921)		(5,921)
<b>End of period</b>	<b>\$(4,675)</b>	<b>\$ (611)</b>	<b>\$ (2,813)</b>	<b>\$ (5,921)</b>	<b>\$ (5,921)</b>						<b>\$(4,675)</b>	<b>\$ (611)</b>	<b>\$ (2,813)</b>	<b>\$ (5,921)</b>	<b>\$ (5,921)</b>	<b>\$(6,322)</b>		<b>\$(6,322)</b>

## **OTHER**

### **Review of Quarterly Statements by Auditors**

The company's auditors have not reviewed the financial statements for the period ending June 30, 2005.

### **Transactions with Related Parties**

No transactions occurred with related parties during the quarter outside the normal course of business.

### **Legal Proceedings**

The company is involved in several pieces of litigation. Management believes the litigations are without merit and that the provisions, which have already been made by the Company, are sufficient to offset any uncertainties.

### **Additional Information**

Additional information about the Company may be obtained on SEDAR at [www.SEDAR.com](http://www.SEDAR.com).