



**FORM 51-102F1**  
**MANAGEMENT DISCUSSION AND ANALYSIS**  
**THREE MONTH PERIOD ENDED MARCH 31, 2004**

The following discussion and analysis, prepared as of July 30, 2004, should be read together with the unaudited consolidated financial statements for the three month period ended March 31, 2004 and related notes attached thereto, which are prepared in accordance with Canadian generally accepted accounting principles. All amounts are stated in Canadian dollars unless otherwise indicated.

The reader should also refer to the annual audited financial statements for the year ended December 31, 2003, and the Management Discussion and Analysis for 2003.

Statements in this report that are not historical facts are forward-looking statements involving known and unknown risks and uncertainties, which could cause actual results to vary considerably from these statements. Readers are cautioned not to put undue reliance on forward-looking statements.

Additional information related to the Company is available for view on SEDAR at [www.sedar.com](http://www.sedar.com).

## **DESCRIPTION OF BUSINESS**

The company is a provider of Linux-based embedded system technologies and solutions for the consumer electronics industry and the intelligent appliance market. The Company was incorporated under the Company Act (British Columbia) on February 21, 2003. The Company operates through its wholly-owned Washington State subsidiary Empower Technologies, Inc. ("Empower US"), and indirectly; Empower Technologies (Canada) Inc. ("Empower Canada") and Linux DA (Shanghai) Inc. ("Empower Shanghai") The company trades on the TSX Venture Exchange under the symbol EPT.

## **PERFORMANCE SUMMARY**

The Company becomes a public issuer listed on the TSX Venture Exchange on September 19, 2003. This provides the company with another alternative to access capital, and the Company had raised \$749,000 through the Short Form Offering which completed on April 1, 2004.

Empower US continues to sell its products through its own product website with minimal promotional efforts. Empower US focused the majority of its marketing and sales efforts to solicit consumer electronics manufacturers to license its LinuxDA O/S product solutions and to solicit major retailers and developers to OEM, integrate or resale its PowerPlay PDA embedded with LinuxDA O/S.

During the three months to March 31, 2004, total sales were \$43,074 (2003 - \$399) as sales to retailers and on-line sales and the company incurred a loss of \$1,300,067 (2003 - \$176,798). This position reflects the amortization of deferred development costs to create commercially viable products over the past years, and the research and development costs expensed over this three months period.

The sales decreased over the previous quarter due to the fact that the company has planned to slowly phasing out PowerPlay Vs and plans to phase in the new model when it is available in later part of this year.

**SELECTED ANNUAL INFORMATION**

The following table provides a brief summary of the Company's financial operations. For more detailed information, refer to the Financial Statements.

	Year Ended December 31, 2003	Nine Month Period Ended December 31, 2002
Total revenues	\$ 134,728	\$ 7,352
Net loss before other items	(1,696,935)	(581,411)
Net loss	(1,697,600)	(581,411)
Basic and diluted loss per share	(0.11)	(0.04)
Total assets	2,299,123	1,672,523
Total liabilities	1,344,442	1,607,102
Cash dividends	-	-

Empower US sells its products either through its own product website or its exclusive Canadian retailer Best Buy Canada's two national chains – Future Shops and Best Buy Stores with minimal promotional efforts. The Company focused the majority of its marketing and sales efforts to solicit consumer electronics manufacturers to license its LinuxDA O/S product solutions and to solicit major retailers and developers to OEM (Original Equipment Manufacturer), integrate or resell its PowerPlay PDA embedded with LinuxDA O/S.

Effective January 1, 2004, the Company's accounting policy is to expense development costs (other than capital expenditures) relating to the development of Linux-based embedded system technologies as incurred unless they meet Canadian generally accepted accounting principles for deferral and amortization. Deferred development costs incurred prior to January 1, 2004 have been recorded at cost and are amortized upon commencement of commercial sales on a straight line basis over a period not exceeding three years. The Company reassesses whether it has met the relevant criteria for deferral and amortization and whether there is any impairment in value at each reporting date.

Effective April 1, 2002, the Company adopted the new CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments", which recommends the use of a fair value-based methodology for measuring compensation costs. The policy has been applied to awards granted on or after the date of adoption. The new section also permits, and the Company adopted, the use of the intrinsic value-based method, which recognizes compensation cost for awards to employees only when the market price exceeds the exercise price at date of grant, but requires pro-forma disclosure of earnings and earnings per share as if the fair value method had been adopted. During the year ended December 31, 2003, the Company adopted, on a prospective basis, the fair-value method for accounting for all stock-based compensation.

The Company has not paid any dividends on its common shares. The Company has no present intention of paying dividends on its common shares, as it anticipates that all available funds will be invested to finance the growth of its business.

## RESULTS OF OPERATIONS

	Three month period ended March 31, 2004	Year Ended December 31, 2003	Three month period ended March 31, 2003
Sales			
Canada	\$ 33,588	\$ 127,276	\$ -
People's Republic of China	-	-	-
United States of America	9,486	7,452	399
Total Sales	43,074	134,728	399
Cost of Sales without amortization of deferred development costs	\$ 26,955	\$ 199,870	\$ 317
Total Expenses with Stock Based Compensation	\$ 1,158,073	\$ 1,473,449	\$ 176,880
Total Expenses without Stock Based Compensation	296,976	667,584	176,880
Loss for the period			
Canada	(1,158,956)	(1,388,358)	(73,406)
People's Republic of China	(22,711)	(35,351)	(3,270)
United States of America	(118,400)	(273,891)	(100,122)
	\$ (1,300,067)	\$ (1,697,600)	\$ (176,798)

### Revenue

Revenues generated for the three months ended March 31, 2004 were \$43,074 compared with the revenues for the three months period ended March 31, 2003 of \$399. This drastic increase was attributed to the continue sales of PowerPlay Vs to Best Buy Canada through Empower US's Canadian subsidiary, Empower Technologies (Canada) Inc. ("Empower Canada") in the period.

However the revenue decreased 67% from the previous quarter due to the fact that the company has planned to slowly phasing out PowerPlay Vs and plans to phase in the new model when it is available in later part of this year. This has been communicated with Best Buy Canada's Future Shop and Best Buy Store buyers and they have agreed with the new PowerPlay PDA model change scheme in their respective stores. The Company anticipated the revenue to be improved when the new PowerPlay PDA starts shipping. Consumer electronics usually slow down after Christmas and New Year and then ramp up again starting with back to school sales in late August.

### Costs of Goods Sold

The gross margin for the period has improved due to the elimination of some of the startup costs to meet Best Buy Canada's vendor requirements.

## General and Administrative

Effective April 1, 2002, the Company implemented the recommendations of CICA Handbook Section 3870, "Stock-Based Compensation and Other Stock-Based Payments". The significance of implementing this section was to add \$861,097 (2003 – \$NIL) to the General and Administrative expense. General and administrative expenses without the stock based compensation increase from \$176,880 in Q1 FY 2003 to \$296,976 in Q1 FY 2004. Of this increase, Research and development expenses increased due to the Company accelerated its effort to develop new products; Wages and benefits and office expense increased by \$22,977, reflecting staff additions within all areas of the Company; advertising and promotion increased by \$28,313 due to the costs of Short Form Offering. Management believes that future quarterly 2004 costs will be much higher than 2003 levels due to additions of staffs and the re-opening of Shanghai office.

## Research and Development

Research Development costs ("R&D Costs) relating to the development of Linux-based embedded system technologies are expensed as incurred unless they meet Canadian generally accepted accounting principles for deferral and amortization. R&D costs for three month period ended March 31, 2004 was \$116,402 (see below table for details).

Deferred development costs are recorded at cost and are amortized upon commencement of commercial sales on a straight line basis over a period not exceeding three years. The Company reassesses whether it has met the relevant criteria for deferral and amortization and whether there is any impairment in value at each reporting date. As at March 31, 2004, there is a balance of \$1,699,836.

	March 31 2004	December 31 2003
Balance, beginning of period	\$1,741,778	\$1,550,779
Equipment and supplies	6,558	17,308
Rent	7,134	28,588
Salaries and benefits	47,750	179,947
Technical consulting fees	54,960	123,500
	116,402	349,343
Expensed R&D Costs	(116,402)	-
Amortization for the period	(158,344)	(158,344)
Balance, end of period	\$1,583,434	\$1,741,778

## SIGNIFICANT PROJECT

### New Model to replace PowerPlay Vs

The Company has developed an embedded LinuxDA O/S on personal handheld device ("PowerPlay Vs"), which is sold through Best Buy Canada. The Company has planned to phase out PowerPlay Vs and plans to phase in the new model when available later part of this year. Currently the Company is working on finishing the product development of the new model and the Company expects production to begin in 4<sup>th</sup> quarter.

This new model has been communicated with Best Buy Canada's Future Shop and Best Buy Store buyers and they have agreed with the new PowerPlay PDA model change scheme in their respective stores.

## USE OF PROCEEDS OF IPO FROM LAST FINANCING

On September 19, 2003, the company has successfully completed its initial public offering (“IPO”) for gross proceeds of \$1,705,988. The agent for the IPO was Canaccord Capital Corporation and its fees for the IPO included a cash commission of \$136,479, being 8% of the gross proceeds of the IPO.

As cited in the prospectus dated July 31, 2003, “the company intended to use these funds to pay the working capital deficiency of \$583,409 (as of June 30, 2003), product development of \$130,000, and sales and marketing expenses of between \$119,000 and \$149,000, with the balance to be applied towards working capital.”

The following is a comparison of the relevant estimated items with actual usage of funds to March 31, 2004.

DESCRIPTION OF USE OF PROCEEDS OF IPO	ESTIMATE at July 31, 2003	ACTUAL to March 31, 2004	VARIANCE INDEX
Working capital (deficiency)	\$583,409	\$583,409	100%
Product Development	\$130,000	\$144,796	111%
Marketing and Sales (12 months)	\$149,000	N/A	
Administration and operating expenses (12 months)	\$210,000	\$675,502	322%
Unallocated working capital	\$497,100	N/A	
<b>TOTAL</b>	<b>\$1,569,509</b>	<b>\$1,403,707</b>	

The actual product development costs of “development software for the wireless enabled embedded Linux DA O/S to handle communication protocol for Bluetooth, IEEE802.11 and 3G”; and “development software to complete the LinuxDA O/S for target platform” were 11% greater than estimated due to higher engineering costs.

The actual expenses for marketing and sales is \$NIL (budgeted - \$149,000) due to the management reached an agreement with Best Buy Canada, and there is no further sales force required at current stage.

To the date of March 31, 2004, the Company has spent \$675,505 for administration and operating expenses. The over budgeted amount (actual \$675,505 – budgeted \$210,000) is \$465,505. The followings are the material items pushed the actual over the budgeted amount:

- The Company incurred R&D costs of \$116,402 (budgeted - \$NIL). For the details of the R&D costs of \$116,402, please refer to the “Research and Development” under the “Results of the operation”. The Company did not budget any for the joint development of a new consumer audio appliance with Spherex Inc., a wholly owned subsidiary of Audio Products International Corporation (“API”). The Memorandum of Understanding with Spherex Inc. /API was signed after the Prospectus was filed.
- The legal fees over budget by (actual \$104,853 - budgeted \$6,000) \$98,853 to patent its technologies, to trademark its name and its brands, to advise and to work on legal, securities, TSX Venture Exchange, and British Columbia Security Commission matters. The Company only budgeted to have minimum legal advice and work;
- The foreign exchange fluctuation of \$86,163 (budgeted - \$NIL) due to the foreign exchange fluctuation. The Company did not budget any provision for gain or loss due to foreign exchange fluctuation;
- the interest expense of \$51,528 (budgeted - \$NIL), please refer to Note 3 in the financial statement, the Company did not budget the interest expense;

## Use of proceeds of IPO from last financing (cont'd ...)

- The advertising and promotion of \$45,970 (budgeted - \$NIL), the Company did not budget for the IPO printing and mailing in 4<sup>th</sup> Quarter of 2003 and the Short Form Offering printing and mailing in 1<sup>st</sup> Quarter of 2004;
- The traveling expenses of \$26,109 (budgeted - \$NIL). The Company did not budget for any roadshows or customer site visit;
- Auditing fees over budget by (actual \$37,359 - budgeted \$18,000) \$19,359, the Company under budgeted the amount required for auditing and accounting advice;
- The insurance costs of \$13,834 (budgeted - \$NIL) for the directors and officers, the Company did not budget any D&O (Director & Officer) insurance.

Although there are variances in individual items, overall the Company has been meeting the objectives in the estimation of the use of the proceeds of Initial Public Offering and the management will continue to make adjustment with the use of proceeds according to the changes in its business operating environment and requirement.

## SUMMARY OF QUARTERLY RESULTS

	Three Months Ended March 31, 2004	Three Months Ended December 31, 2003	Three Months Ended September 31, 2003
Total assets	\$ 2,821,999	\$ 2,299,123	\$ 2,801,870
Stock Based Compensation	861,097	805,865	-
Amortization of Deferred development costs	158,344	158,344	-
Working capital (deficiency)	694,898	279,828	688,658
Shareholders' equity	1,459,425	954,681	1,452,645
Revenues	43,074	133,465	414
Net Loss	(1,300,067)	(1,408,604)	(29,326)
Earnings (loss) per share	(0.06)	(0.09)	(0.01)

Significant changes in key financial data in 2003 can be attributed to the implementation of stock-based compensation, the amortization of deferred development costs, and revenues generated from sales of PDA to Best Buy.

## LIQUIDITY

The Company has financed its operations to date primarily through the issuance of common shares and exercise of stock options. The Company continues to seek capital through various means including the issuance of equity and/or debt.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business rather than through a process of forced liquidation.

The continuing operations of the Company are dependent upon its ability to continue to raise adequate financing and to commence profitable operations in the future.

**Liquidity** (cont'd ...)

	March 31, 2004	March 31, 2003
Deficit	(\$4,634,079)	(\$3,329,139)
Working capital (deficiency)	\$694,898	\$279,828

Net cash used on operating activities for the three month period ended March 31, 2004 was \$210,915 compared to net cash used of \$144,231 during the three month period ended March 31, 2003. The cash used in operating activities for period consists primarily of the operating loss and a change in non-cash working capital.

Net cash used for investing activities for the three month period ended March 31, 2004 was \$13,943 compared to net cash used by investing activities of \$70,747 during the three month period ended March 31, 2003. Cash used during the current period consists primarily of expenditures of \$13,943 for the purchase of property and equipment.

Financing activities provided cash of \$1,037,331 during the three month period ended March 31, 2004, compared to \$214,479 for the three month period ended March 31, 2003. Cash provided during the current period consisted of a loan from Scotia Bank, proceeds from the Short Form Offering and proceeds from the issuance of common shares.

As at March 31, 2003, the Company had \$1,010,080 in cash. The Company has been incurring operating losses at the average rate of \$98,992 per month over the last three months. With the expectation of new equity capital of \$3,315,308 raised from the warrants as listed below in the section "Capital Resources", the management believes the working capital should meet the planned cash flow and the strong cash position forecasted next quarter should enable the Company to accelerate its effort to develop new products and commercialization of its technologies.

## **CAPITAL RESOURCES**

The authorized capital of the Company consists of 100,000,000 common shares without par value. As at the date hereof, there are 23,571,068 common shares issued and outstanding. The Company has 658,543 Special Warrant warrants outstanding, 5,245,151 warrants from Initial Public Offering ("IPO") outstanding and 724,500 warrants from Short Form Offering ("SFO") outstanding.

These warrants represent an important source of new equity capital for the Company in the event that market conditions lead to their exercise.

Each Special Warrant warrant entitles the holder thereof to purchase an Empower Technologies common share at a price of \$0.35 at any time on or before August 8, 2004; each IPO warrant entitles the holder to purchase an Empower Technologies common share at a price of \$0.45 at any time on or before September 19, 2004; and each SFO warrant entitles the holder to purchase an Empower Technologies common share at a price of \$1.00 at any time on or before March 30, 2005.

As on July 26, 2004		Exercise Price	Expiry Day	Amount
Special Warrant warrants outstanding	658,543	\$0.35	August 8, 2004	\$ 230,490
Warrants outstanding for IPO	5,245,151	\$0.45	September 19, 2004	\$ 2,360,318
Warrants outstanding for SFO	724,500	\$1.00	March 30, 2005	\$ 724,500
	6,628,194			\$ 3,315,308

### **CAPITAL RESOURCES** (cont'd ...)

It is expected that the Special Warrant warrants, IPO warrants, and SFO warrants will be a significant source of new equity capital, and currently the Company is not committed to any material future capital expenditure.

### **OUTSTANDING SHARES**

As of the date hereof, the Company has shares, warrants and options outstanding as followings:

	Shares
Authorized	
100,000,000 common shares without par value	
Balance, December 31, 2003	21,163,949
Short Form Offering	1,000,000
Exercise of warrants during 2004	873,519
Agent shares in 2003	484,600
Agent shares issued pursuant to Short Form Offering	49,000
Options granted prior to December 31, 2003	2,480,000
Options granted after December 31, 2003	1,425,000
Special Warrant warrants outstanding	658,543
Warrants outstanding for IPO	5,245,151
Warrants outstanding for SFO	724,500
<b>Fully Diluted Shares</b>	<b>34,104,262</b>

### **RELATED PARTY TRANSACTIONS**

The Company entered into the following transactions with related parties:

- a) Paid or accrued management fees of \$4,500 (three month period ended March 31, 2003 - \$5,266) to a company with common directors.
- b) Paid or accrued wages and benefits of \$42,741 (three month period ended March 31, 2003 - \$30,785) to directors, officers and former officers of the Company.
- d) Accrued interest of \$24,062 (three month period ended March 31, 2003 - \$30,300) to a director of the Company.

- e) Recorded stock based compensation of \$861,097 (three month period ended March 31, 2003 - \$Nil) for services provided by directors, officers and employee of the Company.

Included in deferred developments are rent of \$Nil (March 31, 2003 - \$6,000) and technical consulting fees of \$30,000 (March 31, 2003 - \$30,000); and salaries and benefits of \$27,000 (March 31, 2003 - \$24,000) paid or accrued to directors and officers and to companies with directors and officers in common.

Empower USA, a wholly-owned subsidiary previously entered into service and research and development agreements with various companies related by virtue of a common director. The agreements will remain in effect until terminated by both parties.

### **Related Party Transactions** (cont'd ...)

These transactions were in the normal course of operations and were measured at the exchange amount, which was the amount of consideration established and agreed to by the related parties. In general, the Company conducts these transactions on terms similar to those that would be encountered were the transactions conducted with arm's length parties.

The amount due to related party, \$1,133,746, is payable to a director of the Company, bears interest at the rate of 9.5%, is secured by the assets of Empower US, and is payable in quarterly instalments of \$50,000 beginning on January 1, 2005.

Interest will accrue until January 1, 2005 when all accrued interest shall be paid and thereafter payable monthly commencing February 1, 2005.

Pursuant to a General Security Agreement dated October 10, 2003, security, in the form of the assets of the Company's Canadian subsidiary, Empower Canada, was granted by Empower Canada in favour of the Bank of Nova Scotia, for a Letter of Credit facility to finance inventory purchasing.

Pursuant to a General Security Agreement dated March 31, 2002, security, in the form Empower US's assets, was granted by Empower US in favour of a director of the Company, for all funds loaned pursuant to a Loan Agreement between Empower US and the director.

The Company entered into a Communications & Investor Relations Agreement with Renmark Financial Communications Inc. ("Renmark") for a twelve-month term commencing December 1, 2003. Investor relation services provided by Renmark during the period was the communication of the message of the Company to the investment communities and the planning of road shows. There were payments of \$3,896 made to Renmark for the three months period end March 31, 2004.

These transactions are in the normal course of operations and are measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

## **FINANCIAL INSTRUMENTS**

The Company's financial instruments consist of cash, receivables, accounts payable and accrued liabilities, obligations under capital lease and due to related party. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximates their carrying value, unless otherwise noted.

The Company is exposed to financial risk arising from fluctuations in foreign exchange rates and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

Certain operations of the Company are conducted in the People's Republic of China ("PRC"). As a result, the Company's business, financial condition and results of operations may be influenced by the political,

economic and legal environments in the PRC, and by the general state of the PRC economy. The operations in the PRC are subject to different considerations and other risks not typically associated with companies in North America and Western Europe. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company's results may be adversely affected by changes in the political and social conditions in the PRC, and by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

## **OFF-BALANCE SHEET ARRANGEMENT**

The Company has no off-balance sheet arrangements

## **SUBSEQUENT EVENTS**

Subsequent to March 31, 2004:

- a) The Company issued 20,000 common shares pursuant to the exercise of warrants with an exercise price of \$0.35 per common share for gross proceeds of \$7,000.
- b) The Company issued 80,622 common shares pursuant to the exercise of warrants with an exercise price of \$0.45 per common share for gross proceeds of \$36,280.

## **CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT ESTIMATES**

### Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Significant inter-company balances and transactions have been eliminated upon consolidation.

### Use of estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the period. Actual results could differ from these estimates.

### Inventories

Finished goods are stated at the lower of average cost and net realizable value. Cost is determined on a first in, first out basis.

Deferred development costs

Development costs (other than capital expenditures) relating to the development of Linux-based embedded system technologies are expensed as incurred unless they meet Canadian generally accepted accounting principles for deferral and amortization. Deferred development costs are recorded at cost and are amortized upon commencement of commercial sales on a straight line basis over a period not exceeding three years. The Company reassesses whether it has met the relevant criteria for deferral and amortization and whether there is any impairment in value at each reporting date.

Property and equipment

Property and equipment are recorded at cost less accumulated amortization. Amortization is calculated using the declining balance method at the following annual rates:

Computer equipment	30%
Furniture and equipment	20%
Leasehold improvements	25%

Revenue recognition

The Company records revenue when services have been completed, a sales invoice has been rendered, transfer of title has occurred and collection of the amount is reasonably assured.

Income taxes

Future income taxes are recorded using the asset and liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or enactment occurs. To the extent that the Company does not consider it to be more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

Foreign currency translation

The Company's activities denominated in currencies other than Canadian dollars are translated as integrated operations using the temporal method. Under this method, monetary items are translated into Canadian dollar equivalents at the exchange rate in effect at the balance sheet date, non-monetary items are translated at historical rates, and revenue and expense items are translated at exchange rates prevailing when such items are recognized in the statement of operations. Exchange gains or losses arising on translation of foreign currency items are included in operating results.

Stock-based compensation

Effective April 1, 2002, the Company adopted the new CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments", which recommends the use of a fair value-based methodology for measuring compensation costs. The policy has been applied to awards granted on or after the date of adoption. The new section also permits, and the Company adopted, the use of the intrinsic value-based method, which recognizes compensation cost for awards to employees only when the market price exceeds the exercise price at date of grant, but requires pro-forma disclosure of earnings and earnings per share as if the fair value method had been adopted.

During the year, the Company adopted, on a prospective basis, the fair-value method of accounting for all stock-based compensation.

