



**FORM 51-102F1**  
**MANAGEMENT DISCUSSION AND ANALYSIS**  
**THREE MONTH PERIOD ENDED SEPTEMBER 30, 2004**

The following discussion and analysis, prepared as of October 30, 2004, should be read together with the unaudited consolidated financial statements for the nine month period ended September 30, 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 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**

Since the Company is moving aggressively to set up a strong marketing and sales base in North America, during the 3<sup>rd</sup> quarter sales increased to \$82,185. The net loss was increased to (\$731,363) due to the company's accelerated efforts to develop new products and commercialize its technologies.

However, with proceeds of \$2,691,773 from the exercises of the warrants in the 3<sup>rd</sup> quarter, the Company should be able to meet its planned cash flow.

|   | Warrants exercised during 3rd quarter | Exercise Price | Expiry Date           | Amount             |
|---|---------------------------------------|----------------|-----------------------|--------------------|
| Special Warrant warrants outstanding              | 898,969                               | \$0.35         | August 8, 2004        | \$314,639          |
| Warrants outstanding for IPO                      | 5,282,519                             | \$0.45         | September 19, 2004    | \$2,377,134        |
| <b>Total of Warrants exercised in 3rd Quarter</b> | <b>6,181,488</b>                      |                | <b>Total Proceeds</b> | <b>\$2,691,773</b> |

## PERFORMANCE SUMMARY (cont'd...)

Furthermore, during the 3rd quarter of 2004, the following events have taken place:

1. As of the end of the eligible period of September 19, 2004 – 4,870,252 of the 4,874,252 warrants issued and all 974,850 of the 974,850 Agent's Warrants issued in the Initial Public Offering ("IPO") were exercised. This resulted in the issuance of 5,845,102 common shares and total proceeds of \$2,630,296 to the company, with proceeds of \$2,377,134 received in the 3<sup>rd</sup> quarter.

Empower had issued 4,874,252 warrants and 974,850 Agent's Warrants, each warrant entitling the owner to purchase one common share at \$0.45, as part of its IPO in September of 2003.

2. As of the end of the eligible period of August 8th, 2004, all of the 1,200,317 warrants issued in previous private placements had been exercised, resulting in the issuance of 1,200,317 common shares and total proceeds of \$420,111 to the company, with \$314,639 received in the 3<sup>rd</sup> quarter.

Empower had issued 1,200,317 warrants, each warrant entitling the owner to purchase one Common Share at \$0.35, as part of a Private Placement in 2003, prior to going public.

3. Empower has re-opened its Shanghai office to accelerate its efforts to develop new products.
4. Empower has selected Toronto-based, Infinite Media to lead their brand marketing redevelopment campaign over the next 12 months. This brand reorganization initiative will also see changes to the Empower Technologies sub-brands, LinuxDA and PowerPlay Devices.
5. Empower US has signed a 16 month non-exclusive distributorship sales agreement with Spherex Inc. for its Spherex Xbox Surround Sound System. Under this sales distributorship agreement which covers North America, Empower is allowed to purchase and resell Spherex Inc.'s Xbox ® 5.1 Surround Sound System. The agreement is for sixteen months, renewable at both parties' discretion.
6. Empower US has signed a Memorandum of Understanding Agreement ("MOU") with ODM Technologies, Inc. Under the terms of the MOU, Empower US will authorize ODM Technologies to become an official developer of LinuxDA Embedded O/S ("LEOs") platform products for their Original Design Manufacturing ("ODM") customers.
7. Empower Canada has received the first purchase order from CompUSA of Dallas, Texas to supply the Xbox® 5.1 Surround Sound System. With CompUSA, Empower has added distribution channels of 227 stores which include 90 major metropolitan centres and made its first foray into the US. This is in addition to our Canadian distribution channel with Best Buy Canada, which has approximately 100 stores across Canada. Empower now has combined distribution channels of 300 plus stores and North America continent-wide coverage.
8. Empower US has announced it will introduce the embedded version of LinuxDA, LEOs, optimized for the Texas Instruments ("TI") OMAP5910 processor. LEOs for TI OMAP5910 development platform debuts in Empower's next generation of PowerPlay PDA and PDT (Personal Data Terminal) devices, featured at the fifth LinuxWorld Exposition in Frankfurt Germany from October 26 to 28, 2004.

## RESULTS OF OPERATIONS

|   | Nine Month<br>Period Ended<br>September 30,<br>2004 | Nine Month<br>Period Ended<br>September 30,<br>2003 | Three Month<br>Period Ended<br>September 30,<br>2004 | Three Month<br>Period Ended<br>September 30,<br>2003 |
|---|---|---|--|--|
| <b>Sales</b>  |   |   |  |  |
| Canada  | \$ 120,337  | \$ -  | \$ 81,921  | \$ -   |
| People's Republic of China  | -   | -   | -  | -  |
| United States of America  | 18,791  | 1,263   | 264  | 414  |
|   | <u>\$ 139,128</u>                                   | <u>\$ 1,263</u>                                     | <u>\$ 82,185</u>                                     | <u>\$ 414</u>  |
| Cost of Sales without Amortization<br>of deferred development costs | <u>104,454</u>                                      | <u>1,287</u>  | <u>60,273</u>  | <u>856</u>   |
| Total Expenses with stock-based<br>compensation                     | <u>(2,195,959)</u>                                  | <u>(289,034)</u>                                    | <u>(595,221)</u>                                     | <u>(28,946)</u>                                      |
| Total Expenses without stock-based<br>compensation                  | <u>(1,334,862)</u>                                  | <u>(289,034)</u>                                    | <u>(595,221)</u>                                     | <u>(28,946)</u>                                      |
| Total Expenses without stock-based<br>compensation and R&D Costs    | <u>(838,352)</u>                                    | <u>(289,034)</u>                                    | <u>(361,136)</u>                                     | <u>(28,946)</u>                                      |
| <b>Income (Loss) for the period</b>                                 |   |   |  |  |
| Canada  | (2,105,806)   | (267,361)   | (501,693)  | (58,121)   |
| People's Republic of China  | (170,779)   | (341)   | (108,679)  | (341)  |
| United States of America  | (355,702)   | (21,294)  | (120,991)  | 29,136   |
|   | <u>\$ (2,632,287)</u>                               | <u>\$ (288,996)</u>                                 | <u>\$ (731,363)</u>                                  | <u>\$ (29,326)</u>                                   |

### Revenue

Revenues generated for the nine months ended September 30, 2004 were \$139,128 compared with the revenues for the nine months ended September 30, 2003 of \$1,263. This drastic increase is attributed to the sales of PowerPlay Vs to Best Buy Canada and the sales of Spherex X-Box® 5.1 surround sound systems in the period.

Also, with the plan to phase in the new model when it is available in the later part of this year or early next year and the plan to move aggressively to set up a strong marketing and sales base in North America, the Company anticipates revenue to be improved when the new PowerPlay PDA starts shipping.

### Costs of Goods Sold

The gross margin for the 3rd quarter is higher than the 2nd quarter due to the lower quantity of products returned; the gross margin for the nine months ended September 30, 2004 is almost the same as 2003.

## General and Administrative

General and administrative expenses for the nine month period ended September 30, 2004 increased to \$2,195,959 (2003 - \$289,034). Research and development expenses increased due to the Company's accelerated efforts to develop new products, and the other General and Administrative expenses increased due to the re-opening of the Shanghai office. Wages and benefits and office expense increased to \$246,604 (2003 - \$108,103), reflecting staff additions within all areas of the Company, advertising and promotion increased to \$133,522 (2003 - \$8,346) and travelling expenses increased to \$55,600 (2003 - \$9,519) due to management's efforts to promote and market their products.

Management believes that future quarterly 2004 costs will be much higher than 2003 levels due to additions of staff and the re-opening of the Shanghai office.

## Research and Development

Research and 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 the nine month period ended September 30, 2004 were \$496,510.

Deferred development costs were 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 September 30, 2004, there is a balance of \$1,266,746.

|                              | Three Months<br>Ended September<br>30, 2004 | Three Months<br>Ended June 30,<br>2004 | Three Months<br>Ended March<br>31, 2004 | Year Ended<br>December<br>31, 2003 |
|------------------------------|---|--|---|------------------------------------|
| Balance, beginning of period | \$1,425,090                                 | \$1,583,434                            | \$1,741,778                             | \$1,550,779                        |
| Equipment and supplies       | 42,517                                      | 21,251                                 | 6,558                                   | 17,308                             |
| Rent                         | 7,147                                       | 7,147                                  | 7,134                                   | 28,588                             |
| Salaries and benefits        | 112,800                                     | 68,891                                 | 47,750                                  | 179,947                            |
| Technical consulting fees    | 71,621                                      | 48,734                                 | 54,960                                  | 123,500                            |
|                              | 234,085                                     | 146,023                                | 116,402                                 | 349,343                            |
| Expensed R & D Costs         | (234,085)                                   | (146,023)                              | (116,402)                               | -                                  |
| Amortization for the period  | (158,344)                                   | (158,344)                              | (158,344)                               | (158,344)                          |
|                              | (392,429)                                   | (304,367)                              | (274,746)                               | (158,344)                          |
| Balance, end of period       | 1,266,746                                   | \$1,425,090                            | \$1,583,434                             | \$1,741,778                        |

## **SIGNIFICANT PROJECTS**

### New Model to replace PowerPlay Vs

The Company has developed an embedded LinuxDA O/S personal handheld device (“PowerPlay Vs”), which is sold through Best Buy Canada. The Company is phasing out PowerPlay Vs and plans to phase in the new model when it is available later this year or early next year.

This new model has been communicated to 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.

### Joint Development with Spherex Inc.

Empower US and Spherex Inc. are jointly working on a confidential development project. The confidential product is to have the licensed LinuxDA Embedded Operating System on board and to also contain the licensed Spherex Optimized Surround Sound technology.

### Introduction of LinuxDA Embedded O/S (LEOs)

Empower US will introduce the embedded version of LinuxDA, called LinuxDA Embedded O/S (“LEOs”), optimized for the Texas Instruments (“TI”) OMAP5910 processor. LEOs for the OMAP5910 development platform debuts in Empower’s next generation of PowerPlay PDA devices, featured at the fifth upcoming LinuxWorld Exposition in Frankfurt Germany from October 26 to 28, 2004.

## USE OF PROCEEDS OF IPO FROM LAST YEAR'S FINANCING

On September 19, 2003, the Company successfully completed an 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 July 31, 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 on July 31, 2004.

| USE OF PROCEEDS DESCRIPTION                       | ESTIMATE at<br>July 31, 2003 | ACTUAL to<br>July 31, 2004 | VARIANCE<br>INDEX |
|---|------------------------------|----------------------------|-------------------|
| Working capital (deficiency)                      | \$583,409                    | \$583,409                  | 100%              |
| Product Development                               | \$130,000                    | \$144,796                  | 111%              |
| Marketing and Sales (12 months)                   | \$149,000                    | NA                         |                   |
| Administration and operating expenses (12 months) | \$210,000                    | \$1,214,423                | 578%              |
| Unallocated working capital                       | \$497,100                    | NA                         |                   |
| <b>TOTAL</b>                                      | <b>\$1,569,509</b>           | <b>\$1,942,628</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 following discloses the use of proceeds from August 1, 2003 to July 31, 2004 (12 months). In the third quarter of 2004 the Company completed a SFO financing and exercising of warrants. Due to changes in the Company's business operating environment and requirements, the use of the proceeds has been changed. Although there were variances in individual items, overall the Company met the objectives and milestones in its estimation of the use of the proceeds of Initial Public Offering.

As to the date of July 31, 2004, the Company had used up the proceeds of the IPO from last year's financing, and was using new funds from the Short Form Offering and the proceeds of warrants exercised to accelerate its efforts to develop new products and for commercialization of its technologies.

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

The Company has spent \$1,214,423 for administration and operating expenses since the completion of the IPO. The over budgeted amount (actual \$1,214,423 - budgeted \$210,000) is \$1,004,423. The following are the material items which accounted for the increase in the actual over the budgeted amount:

- The Company also incurred R&D costs of \$329,384 (budgeted - \$NIL). 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"); and did not budget any costs for the development of the new PDA and the confidential project with Spherex Inc. For a description of the new PDA project and the confidential project with Spherex Inc., please refer to "Significant Projects". The significant projects were anticipated after the Prospectus was filed.

## Use Of Proceeds Of IPO From Last Year's Financing (cont'd ...)

- The legal fees were over budget by \$137,822 (actual \$143,822 - budgeted \$6,000) 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 \$20,605 (budgeted - \$NIL) was due to the foreign exchange fluctuation. The Company did not budget any provision for gain or loss due to foreign exchange fluctuation;
- Interest expense of \$80,613 (budgeted - \$NIL), please refer to Note 3 and bank loan in the financial statement, the Company did not budget the interest expense;
- Advertising and promotion of \$94,212 (budgeted - \$NIL), the Company did not budget for the IPO printing and mailing in the 4<sup>th</sup> Quarter of 2003 and the Short Form Offering printing and mailing in the 1<sup>st</sup> Quarter of 2004;
- Auditing fees over budget by \$31,977 (actual \$49,977 - budgeted \$18,000), the Company under budgeted the amount required for auditing and accounting advice;
- Traveling expenses of \$57,900 (budgeted - \$NIL). The Company did not budget for any roadshows or customer site visit;
- The Directors' Fee of \$40,000 (budgeted - \$NIL) for the directors' services rendered, the Company did not budget any Directors' Fee.
- The insurance costs of \$22,751 (budgeted - \$NIL) for the directors and officers, the Company did not budget any D&O (Directors & Officers) insurance.

## SUMMARY OF QUARTERLY RESULTS

|  | Three<br>Months<br>Ended<br>September<br>30, 2004 | Three<br>Months<br>Ended<br>June<br>30, 2004 | Three<br>Months<br>Ended<br>March 31,<br>2004 | Three Months<br>Ended<br>December 31,<br>2003 | Three<br>Months<br>Ended<br>September<br>30, 2003 |
|--|---|--|---|---|---|
| Total assets                               | \$ 4,184,716                                      | \$2,359,470                                  | \$ 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                                      | 158,344                                       | 158,344                                       | -   |
| Working capital                            | 2,361,674   | 266,393                                      | 694,898                                       | 279,828                                       | 688,658   |
| Shareholders' equity                       | 2,881,332   | 920,923                                      | 1,459,425                                     | 954,681                                       | 1,452,645   |
| Revenues                                   | 82,185  | 13,869                                       | 43,074  | 133,465                                       | 414   |
| Net Loss                                   | \$ (731,363)                                      | \$ (600,857)                                 | \$(1,300,067)                                 | \$ (1,408,604)                                | \$ (29,326)                                       |
| Earnings (loss) per share                  | (0.03)  | (0.03)                                       | (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 the PDA to Best Buy Canada and the sales of Spherex X-Box® 5.1 Surround Sound System to CompUSA Inc.

## LIQUIDITY

The Company has financed its operations to date primarily through the issuance of common shares and the exercising of warrants. 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.

|                 | As at September 30<br>2004 | As at September 30<br>2003 |
|-----------------|----------------------------|----------------------------|
| Deficit         | (\$5,961,426)              | (\$1,920,535)              |
| Working capital | \$2,361,674                | \$688,658                  |

Net cash used in operating activities for the nine month period ended September 30, 2004 was \$1,167,030 compared to net cash used of \$693,276 during the nine month period ended September 30, 2003. The cash used in operating activities for the period consists primarily of the operating loss and a change in non-cash working capital.

Net cash used for investing activities for the nine month period ended September 30, 2004 was \$89,538 compared to net cash used by investing activities of \$235,374 during the nine month period ended September 30, 2003. The cash used during the current period consists primarily of expenditures of \$89,538 for the purchase of property and equipment.

Net cash provided by financing activities for the nine month period ended September 30, 2004 was \$3,549,790 compared to net cash provided by financing activities of \$1,793,627 during the nine month period ended September 30, 2003. The cash provided during the current period consists primarily of proceeds from the exercising of the warrants.

As at September 30, 2004, the Company had \$2,490,829 in cash. The Company has been incurring operating losses at the average rate of \$292,476 per month over the last nine months. With the cash on hand, the management believes the working capital should meet the planned cash flow and should enable the Company to accelerate its efforts to develop new products and for commercialization of its technologies.

## CAPITAL RESOURCES

The authorized capital of the Company consists of 100,000,000 common shares without par value. As at September 30, there are 28,983,654 common shares issued and outstanding. The Company has 724,500 warrants from the Short Form Offering (“SFO”) outstanding.

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.

These warrants represent a source of new equity capital for the Company in the event that market conditions lead to their being exercised.

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| As at September 30, 2004     | Shares  | Exercise Price | Expiry Date    | Amount     |
|------------------------------|---------|----------------|----------------|------------|
| Warrants outstanding for SFO | 724,500 | \$1.00         | March 30, 2005 | \$ 724,500 |
|                              | 724,500 |                |                | \$ 724,500 |

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

## OUTSTANDING SHARES

As at September 30, 2004, the Company has shares outstanding as follows:

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|   | Shares     |
|---|------------|
| Authorized<br>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                          | 6,770,705  |
| Agent shares issued pursuant to Short Form Offering       | 49,000     |
| Balance, September 30, 2004                               | 28,983,654 |

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## **RELATED PARTY TRANSACTIONS**

The Company entered into the following transactions with related parties:

- a) Paid or accrued management fees of \$9,000 (nine month period ended September 30, 2003 - \$13,500) to a company with common directors.
- b) Paid or accrued wages and benefits of \$107,100 (nine month period ended September 30, 2003 - \$79,000) to directors and officers of the Company.
- c) Paid or accrued interest of \$75,010 (nine month period ended September 30, 2003 - \$89,308) to a director of the Company.
- d) Paid or accrued directors' fees of \$60,000 (nine month period ended September 30, 2003 - \$Nil) for services provided by directors of the Company.
- e) Recorded stock-based compensation of \$861,097 (nine month period ended September 30, 2003 - \$NIL) for options granted to directors, officers and employees of the Company.

Included in development costs are wages and benefits of \$54,094 (September 30, 2003 - \$54,000) and technical consulting fees of \$90,000 (September 30, 2003 - \$90,000) paid or accrued to directors and officers and to companies with directors and officers in common.

Empower US, 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.

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 \$882,644, 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 of 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.

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.

## **OFF-BALANCE SHEET ARRANGEMENT**

The Company has no off-balance sheet arrangements.

## **FINANCIAL INSTRUMENTS**

The Company's financial instruments consist of cash, receivables, accounts payable and accrued liabilities, loan payable 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.

## **SUBSEQUENT EVENT**

Subsequent to September 30, 2004:

1. The Company issued 16,000 common shares pursuant to the exercise of warrants with an exercise price of \$1.00 per common share for gross proceeds of \$16,000.

## **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.

## **Critical Accounting Policies And Significant Estimates** (cont'd ...)

### 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.

## **Critical Accounting Policies And Significant Estimates** (cont'd ...)

### 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 2004 fiscal year, the Company adopted, on a prospective basis, the fair-value method of accounting for all stock-based compensation.