



## **NETGRAPHE INC.**

**For the Quarters ended  
September 1, 2001 and August 31, 2000**

**First Quarter  
June 1, 2001 - September 1, 2001**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Review for the Three-month Period Ended September 1, 2001

The three-month period ended September 1, 2001 represents a milestone in Netgraphe's history as it is the first quarter of operation for the merged CANOE-Netgraphe group. Netgraphe acquired CANOE's network of sites and portals on May 31, 2001. In recent months, management has therefore focused on integrating the two networks' activities, refocusing operations on key properties of the new group and setting up a structure that will maximize the synergies from the merger. Our network of sites and portals is unequalled in the Canadian market, in terms of variety, quality and reputation.

Since the CANOE-Netgraphe merger transaction is accounted for under the continuity of interests method, a method that is similar to the pooling of interests method, the financial results of the two companies are consolidated retroactively. Accordingly, prior period comparative information in this financial review reflects the effect of the merger and consolidates the financial results of both groups.

The Company posted revenues of \$6,763,279 for the three-month period ended September 1, 2001, an 82% increase over revenues of \$3,723,191 for the same period in the previous year. The increase is attributable to greater revenues from advertising banners, despite a less favourable economic context, and to the proceeds from the diversification of our revenue sources.

Operating, selling and administrative expenses increased from \$9,619,884 for the corresponding three-month period ended in 2000 to \$11,033,440 for the quarter ended September 1, 2001. Excluding operating expenses of a company acquired subsequent to the quarter ended August 31, 2000, operating, selling and administrative expenses for the three-month period ended September 1, 2001 were \$9,153,572, down substantially compared to the corresponding period in the prior year, particularly since that period did not yet include operating expenses for our European activities. The reduction in operating expenses is attributable to the streamlining of operations in the past year, with the greatest impact arising from staff cut-backs.

Based on these results, Netgraphe's operating loss before financial charges, depreciation, unusual items, income taxes and amortization of goodwill amounted to \$4,270,161 for the three-month period ended September 1, 2001, a significant 28% improvement over the \$5,896,693 operating loss for the same quarter in 2000.

Depreciation of fixed assets was \$1,499,514 for the three-month period, compared with \$1,200,677 in the corresponding period in fiscal 2000. Following the merger transaction, Netgraphe harmonized all of its accounting policies for the depreciation of fixed assets with those used by CANOE.

Financial charges for the period totalled \$149,403, a significant decline compared to \$641,556 in the prior year's corresponding period. The reduction is attributable to the fact that, subsequent to the issue of Netgraphe common shares in connection with the merger transaction on May 31, 2001, CANOE's debt was not transferred and is therefore not shown on the Company's post-merger balance sheet. Prior to the transaction, CANOE was financed out of the bank credit facilities of its ultimate controlling shareholder, Quebecor Media Inc.

For the three-month period ended September 1, 2001, Netgraphe reported a net loss before unusual items, income taxes and amortization of goodwill of \$5,919,078, a major improvement compared to \$7,738,926 recorded for the same period in the previous year. Taking into account:

- amortization of goodwill of \$3,570,818, compared to \$3,091,976 for the previous year, and
- unusual items of \$2,175,556,

Netgraphe's net loss totalled \$11,665,452 or \$0.05 per share, for the three-month period ended September 1, 2001. The weighted average number of shares outstanding during this period was 222,601,382 shares and the total number of shares outstanding as at September 1, 2001 was 222,604,555 shares. For the corresponding period last year, the net loss was \$10,971,335 or \$0.10 per share.

Unusual items for the quarter result from measures taken by management in the past quarter to improve the Company's financial performance and move closer to an operating breakeven point. These expenses result primarily from measures announced by management on August 22, 2001 to optimize the Company's cost structure and shed operations which could no longer be justified on the basis of future earnings projections. The Canoe.fr site in France and six city sites (FYI Edmonton, FYI Winnipeg, FYI Toronto, FYI Ottawa, ICI Montréal and ICI Québec) were closed down and the Company's management structure was reorganized. Accordingly, non-recurring expenses were recorded for severance pay and the write-off of assets resulting from this decision. The amount also includes the write-off of assets relating to the recent transfer of ViaSite's operations to Jobboom.

### ***Liquidity and Capital Resources***

Operations generated negative cash flows of \$2,489,466 for the three-month period ended September 1, 2001. See the analysis of operating results for a discussion. This represents a significant improvement compared to the negative cash flows from operations of \$9,162,237 generated in the corresponding period in the prior year.

Investment activities resulted in negative cash flows of \$1,031,673 during the three-month period, primarily from the acquisition of fixed assets. For the corresponding prior year's period, negative cash flows were \$4,791,391. The amount of \$85,486 shown under business acquisitions refers to a deferred payment associated with a previous acquisition.

Financing activities resulted in negative cash flows of \$225,000 for the three-month period, due to a fluctuation in a subsidiary's bank line of credit. This amount compares to cash inflows of \$10,057,521 during the same period last year which resulted from the financing obtained by CANOE during that period from the authorized credit facilities of its ultimate controlling shareholder, Quebecor Media Inc.

As at May 31, 2001, the Company had cash resources amounting to \$1,836,782. The \$10,000,000 due by a company under common control resulting from the merger transaction should be received by December 31, 2001. These cash resources will be used to support the Company's operations, continue targeted development of Web sites, and implement e-commerce applications. Netgraphe has no financial debt coming due in the next twelve months, other than \$466,667 due by Progisia Informatique Inc. and which is payable in September 2001.

In view of Netgraphe's development stage and the current state of Internet-related advertising market, the Company expects to incur operating losses until the end of its fiscal year. These losses will be financed from current and receivable cash resources. Support from its principal shareholder could be an alternative to raising financing on financial markets.

### ***Consolidated Balance Sheet***

As at September 1, 2001, consolidated assets totalled \$129,010,335. Current assets were \$19,162,042, including \$1,836,782 in cash and cash equivalents. As a result of the merger transaction and as mentioned previously, an amount of \$10,000,000 is receivable from a company under common control. This amount is shown under accounts receivable. Fixed assets amounted to \$7,788,678, consisting primarily of computer hardware, software, investments in site creation and development, and office furniture and equipment.

Goodwill of \$102,059,615 was recorded on the September 1, 2001 balance sheet and results from business acquisitions over the years. Goodwill is entered on the balance sheet, net of depreciation during the period, calculated using the straight-line method over periods of seven to ten years.

Netgraphe's consolidated liabilities were \$17,062,437. Of this amount, current liabilities, consisting primarily of accounts payable and accrued liabilities, accounted for \$14,498,207. The amount of \$2,564,230, representing the liability component of the convertible debenture issued in December 2000, was recorded under long-term liabilities.

Shareholder's equity totalled \$111,947,898 as at September 1, 2001 and was the sum of:

- capital stock of \$201,344,578,
- the equity component of the convertible debenture issued in December 2000 in the amount of \$7,465,083,
- contributed surplus of \$3,790,666, and
- the deficit in the amount of \$100,652,429, representing the cumulative effect of the losses recorded to date.

### ***Dividend Policy and Financial Risk Management***

Netgraphe has not declared or paid dividends to date and does not expect to do so in the near future. The dividend policy is established by the Board of Directors.

In the normal course of business, Netgraphe and its subsidiaries are exposed to fluctuations in interest rates and exchange rates. These financial risks are not significant, however, in view of Netgraphe's low debt ratio and the fact that its balance sheet and operations are mostly stated in Canadian currency. Therefore, Netgraphe has not deemed it appropriate to date to use financial derivatives as a hedge against the financial risk associated with interest and exchange rate fluctuations.

### ***Forward Looking Statements***

Some statements made in this quarterly report, particularly with respect to Netgraphe's expectations, constitute forward-looking statements. Forward-looking statements are subject to known and unknown risks and uncertainties that may cause Netgraphe's actual results to differ materially from those anticipated. These risks include uncertainties related to the Internet business model, competition, financial markets, access to capital, and changes in the general and sectoral economic environment.

**Consolidated Earnings**

(unaudited)

	Three months ended	
	September 1 2001	August 31 2000
	\$	\$
<b>Revenue</b>	6 763 279	3 723 191
Operating, selling and administrative expenses	11 033 440	9 619 884
Operating loss before financial charges, depreciation and unusual items	(4 270 161)	(5 896 693)
Financial charges	149 403	641 556
Depreciation	1 499 514	1 200 677
Unusual items (note 3)	2 175 556	140 433
	3 824 473	1 982 666
Loss before income taxes and amortization of goodwill	(8 094 634)	(7 879 359)
Income taxes	-	-
Loss before amortization of goodwill	(8 094 634)	(7 879 359)
Amortization of goodwill	3 570 818	3 091 976
<b>Net loss</b>	(11 665 452)	(10 971 335)
Amounts per share		
Loss before amortization of goodwill	(0,04)	(0,07)
Net loss	(0,05)	(0,10)
Weighted average number of shares outstanding	222 601 382	109 356 920

**Consolidated Deficit**

(unaudited)

	Three months ended	Three months ended
	September 1 2001	August 31 2000
	\$	\$
Balance, beginning of period, as restated	88 846 358	26 925 566
Net loss	11 665 452	10 971 335
Increase in equity component of convertible debenture	140 619	-
	11 806 071	10 971 335
Balance, end of period	100 652 429	37 896 901

## Consolidated Cash Flows

(unaudited)

	Three months ended	Three months ended
	September 1 2001	August 31 2000
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net loss	(11 665 452)	(10 971 335)
Non-cash items		
Depreciation	1 499 514	1 200 677
Write-off of fixed assets	955 556	-
Gain on disposal of fixed assets	(1 522)	(1 610)
Amortization of goodwill	3 570 818	3 091 976
Other items	-	298 148
Interest payments on convertible debenture	(56 250)	-
Cash flows from current operations	(5 697 336)	(6 382 144)
Changes in non-cash working capital items		
Accounts receivable	540 318	470 720
Work in progress and prepaid expenses	395 339	54 544
Accounts payable and accrued liabilities	2 159 207	(3 240 843)
Deferred revenues	113 006	(64 514)
Cash flows from operating activities	(2 489 466)	(9 162 237)
<b>INVESTING ACTIVITIES</b>		
Acquisition of fixed assets	(949 405)	(3 798 823)
Business acquisitions	(85 486)	-
Disposal of fixed assets	3 218	7 432
Short-term investment	-	(1 000 000)
Cash flows from investing activities	(1 031 673)	(4 791 391)
<b>FINANCING ACTIVITIES</b>		
Bank loan	(225 000)	-
Due to companies under common control	-	9 835 631
Issuance of capital stock	-	221 890
Cash flows from financing activities	(225 000)	10 057 521
<b>Net decrease in cash and cash equivalents</b>	<b>(3 746 139)</b>	<b>(3 896 107)</b>
Cash and cash equivalents, beginning of period	5 582 921	7 297 978
Cash and cash equivalents, end of period	1 836 782	3 401 871

## Consolidated Balance Sheets

	(unaudited)	(audited)
	September 1 2001	May 31 2001
	\$	\$
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	1 836 782	5 582 921
Short-term investment	1 000 000	1 000 000
Accounts receivable	16 101 548	16 641 866
Work in progress and prepaid expenses	223 712	619 051
	<u>19 162 042</u>	<u>23 843 838</u>
Fixed assets	7 788 678	9 163 363
Goodwill (note 4)	102 059 615	105 447 571
	<u>129 010 335</u>	<u>138 454 772</u>
<b>LIABILITIES</b>		
Current liabilities		
Bank Loan	270 000	495 000
Accounts payable and accrued liabilities	12 933 322	10 641 439
Deferred revenues	1 040 327	927 321
Instalments on equity component of convertible debenture	254 558	242 436
	<u>14 498 207</u>	<u>12 306 196</u>
Liability component of convertible debenture	2 564 230	2 632 602
<b>SHAREHOLDERS' EQUITY</b>		
Equity component of convertible debenture	7 465 083	7 324 464
Capital stock	201 344 578	201 247 202
Contributed surplus	3 790 666	3 790 666
Deficit	<u>(100 652 429)</u>	<u>(88 846 358)</u>
	<u>111 947 898</u>	<u>123 515 974</u>
	<u>129 010 335</u>	<u>138 454 772</u>

## Notes to Financial Statements

### 1 - GOVERNING STATUTES AND NATURE OF OPERATIONS

Netgraphe Inc. (Netgraphe or the Company) is an integrated company offering e-commerce, information, communication and information technology consulting services. Netgraphe owns the CANOE network which offers services to over 3.6 million on-line users each month (source: MédiaMétrix) and includes the Canoe.ca, Canoe.qc.ca, InfiniT.com, La Toile du Québec, Webfin.com, Multimediam.com, and Megagiciel.com sites, local FYI urban sites and, internationally, the Micanoa.com site (Spain). Netgraphe also offers on-line e-commerce services in the area of employment, with Jobboom.com, automobile, with Autonet.ca, meetings, with ReseauContact.com, on-line buying, with Shop.canoe.ca and classified ads, with ClasseesExtra.ca. Through its subsidiary, Progisia Informatique inc., Netgraphe also offers information technology consulting services in e-commerce, outsourcing, integration and computer security. Netgraphe is listed on the Toronto Stock Exchange under the symbol www.

### 2- ACCOUNTING POLICIES

#### Change in accounting policy

In the first quarter of 2001, the Company has adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) concerning earnings per share. These new recommendations, described in the new version of section 3500 of the CICA Handbook harmonize the Canadian standard with the United States standard, particularly as to the determination of the diluted earnings per share. All earnings per share amounts disclosed for comparison purposes need to be restated. This restatement does not have an impact since the company is in a loss position.

### 3- UNUSUAL ITEMS

	\$
Severance pay and other expenses related to the Company's decision to discontinue its operations in France, close certain FYI and ICI sites and reorganize its management structure	1 620 000
Write-off of assets following the transfer of the ViaSite operations to Jobboom	555 556
	<u>2 175 556</u>

### 4- GOODWILL

	\$
98,360 subordinate voting shares issued as final payment pertaining to the price adjustment clause, based on future revenues, of a previously acquired company	97 376
Deferred cash payment concerning a previous acquisition made by a subsidiary	85 486
	<u>182 862</u>