

2003
Annual Report



P L A I N T R E E
S Y S T E M S

PRESIDENT'S LETTER TO SHAREHOLDERS

My address to my fellow shareholders over the last few years, have all begun with the same introductory warning about the challenging times facing the telecommunications industry.

This year the times are still challenging, however, there is a big difference.

Over the past few years we have faced a market that had little to no interest or capability to entertain any capital expansions or upgrades. This created a frustrating scenario for us wherein the industry continually advised us that our products were among the most reliable, complete and inexpensive available and yet there was negligible sales activity. Existing customers went quiet and potential new customers exhibited low interest levels.

The difference began in early Calendar 2003 when the phone began to ring and our website began receiving around 130,000 hits per month. In the past few months we have had seriously interested companies fly in from the UK, Japan, Australia, Korea and others specifically to view our products and be trained on our test range. All of these companies have signed VAR agreements which stipulate that we are the only FSO product line they will represent.

In summary, the interest level has improved dramatically and we are anticipating tangible sales to begin this fall.

Once again, thank-you for your support of Plaintree through this period.

DAVID WATSON
President and Chief Executive Officer
August 26, 2003

Consolidated Financial Statements of

PLAINTREE SYSTEMS INC.

March 31, 2003

Deloitte & Touche LLP
800-100 Queen Street
Ottawa, ON
K1P 5T8

Tel: (613)236-2442
Fax: (613)236-2195
www.deloitte.ca



Independent Auditors' Report

To the Board of Directors of
Plaintree Systems Inc.

We have audited the accompanying consolidated balance sheets of Plaintree Systems Inc. and subsidiary as at March 31, 2003 and 2002 and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three-year period ended March 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Canada and in the United States of America. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company and subsidiary as at March 31, 2003 and 2002 and the results of its operations and its cash flows for each of the years in the three-year period ended March 31, 2003, in accordance with Canadian generally accepted accounting principles.

A handwritten signature in cursive script that reads "Deloitte & Touche LLP".

Chartered Accountants
Ottawa, Canada

July 25, 2003, except for Note 22 which is as of July 31, 2003

Comments by Auditor on Canada-United States of America Reporting Difference

In the United States of America, reporting standards for auditors require the addition of an explanatory paragraph when the financial statements are affected by conditions and events that cast substantial doubt on the Company's ability to continue as a going concern, such as those described in Note 1 to the financial statements. Although we conducted our audits in accordance with both auditing standards generally accepted in Canada and in the United States of America, our report to the Board of Directors dated July 25, 2003 is expressed in accordance with Canadian reporting standards which do not permit a reference to such conditions and events in the auditors' report when these are adequately disclosed in the financial statements.

A handwritten signature in cursive script that reads "Deloitte & Touche LLP".

Chartered Accountants
Ottawa, Canada

July 25, 2003

PLAINTREE SYSTEMS INC.
Financial Statements
March 31, 2003

	<u>PAGE</u>
Consolidated Balance Sheets	1
Consolidated Statements of Operations	2
Consolidated Statements of Cash Flows	3
Consolidated Statements of Shareholders' Equity	4
Notes to the Consolidated Financial Statements	5 - 23

PLAINTREE SYSTEMS INC.

Consolidated Balance Sheets

as at March 31, 2003 and 2002

	<u>2003</u>	<u>2002</u>
CURRENT ASSETS		
Cash	\$ 42,148	\$ 432,831
Short-term investments	-	27,328
Trade accounts receivable (net of allowance for doubtful accounts of \$110,160; 2002 - \$137,827)	90,884	196,249
Investment tax credits receivable	-	246,000
Current portion of loans receivable (Note 6)	-	7,027
Due from related parties (Note 18)	-	36,878
Inventories - net (Note 4)	116,343	2,062,918
Prepaid expenses and advance contract payments	27,384	103,468
	276,759	3,112,699
LOANS RECEIVABLE (Note 6)	-	1,216
CAPITAL ASSETS (Notes 5 and 18)	263,655	597,101
	\$ 540,414	\$ 3,711,016
CURRENT LIABILITIES		
Due to related party (Note 8)	\$ 297,856	\$ 400,000
Due to related parties (Note 18)	377,808	94,644
Accounts payable and accrued liabilities (Note 9)	745,363	616,386
Warranty reserve	25,073	42,406
	1,446,100	1,153,436
GUARANTEES, CONTINGENCIES AND COMMITMENTS (Note 17)		
SHAREHOLDERS' (DEFICIENCY) EQUITY		
Share capital (Note 10)		
Series I, preferred shares (authorized - 7,000; NIL outstanding)	-	-
Series II, preferred shares (authorized - 9,000; NIL outstanding)	-	-
Common shares (unlimited number of shares authorized, 90,221,634 outstanding; 2002 - 90,221,634)	97,561,140	97,561,140
Deficit	(98,019,751)	(94,556,485)
Accumulated foreign currency translation adjustment	(447,075)	(447,075)
	(905,686)	2,557,580
	\$ 540,414	\$ 3,711,016

APPROVED BY THE BOARD:

See accompanying Notes to the Consolidated Financial Statements

PLAINTREE SYSTEMS INC.
Consolidated Statements of Operations
years ended March 31, 2003, 2002 and 2001

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Revenue			
Product and service revenue	\$ 1,304,068	\$ 1,071,596	\$ 1,249,620
Management service revenue (Note 18)	-	275,000	750,000
	1,304,068	1,346,596	1,999,620
Cost of revenue			
Product and service costs	199,370	578,109	947,297
Management service costs	-	77,145	232,710
	199,370	655,254	1,180,007
Gross margin	1,104,698	691,342	819,613
Operating expenses			
Sales and marketing	756,414	2,794,261	2,481,860
Finance and administration	583,303	970,440	732,780
Research and development	765,472	2,094,823	1,239,861
Restructuring (Note 11)	200,603	-	-
Write-down of inventory (Note 11)	2,081,792	1,362,840	1,442,493
Write-down of intangible assets (Note 7)	-	742,538	-
	4,387,584	7,964,902	5,896,994
Loss from operations	(3,282,886)	(7,273,560)	(5,077,381)
Interest (expense) income (Note 12)	(54,847)	65,317	410,216
Other income (loss) (Note 13)	(125,533)	(114,683)	159,899
NET LOSS	\$ (3,463,266)	\$ (7,322,926)	\$ (4,507,266)
Basic and diluted loss per common share (Note 15)	\$ (0.04)	\$ (0.08)	\$ (0.06)
Weighted average common shares outstanding	90,221,634	86,958,580	81,912,740

See accompanying Notes to the Consolidated Financial Statements

PLAINTREE SYSTEMS INC.
Consolidated Statements of Cash Flows
years ended March 31, 2003, 2002 and 2001

	<u>2003</u>	<u>2002</u>	<u>2001</u>
OPERATING			
Net loss	\$ (3,463,266)	\$ (7,322,926)	\$ (4,507,266)
Items not affecting cash			
Amortization	200,798	738,690	575,613
Shares issued for services	-	77,500	-
Write-down of intangible assets	-	742,538	-
Loss on disposal of capital assets	113,805	-	-
Changes in non-cash operating working capital items (Note 16)	2,703,566	1,318,727	(2,057,746)
	(445,097)	(4,445,471)	(5,989,399)
INVESTING			
Purchases of capital assets	-	(132,465)	(469,442)
Capitalized development costs	-	-	(196,657)
Decrease (increase) in loans receivable from related parties	8,243	26,586	(34,829)
Proceeds from disposition of short-term investments	27,328	1,925,888	(1,953,216)
	35,571	1,820,009	(2,654,144)
FINANCING			
Payments on capital leases	-	(7,710)	(8,834)
Proceeds from disposal of capital assets	18,843	-	-
Proceeds on issuance of share capital - net of issue costs	-	1,294,030	415,385
	18,843	1,286,320	406,551
Decrease in cash	(390,683)	(1,339,142)	(8,236,992)
Cash, beginning of year	432,831	1,771,973	10,008,965
Cash, end of year	\$ 42,148	\$ 432,831	\$ 1,771,973
Supplementary information:			
Interest paid	\$ 297	\$ 1,425	\$ 10,337

See accompanying Notes to the Consolidated Financial Statements

PLAINTREE SYSTEMS INC.
Consolidated Statements of Shareholders' Equity
years ended March 31, 2003, 2002 and 2001

	Common Shares		Accumulated Foreign Currency Translation Adjustment	Retained Earnings (Deficit)	Shareholders' Equity (Deficiency)
	<u>Number</u>	<u>Amount</u>			
Balance March 31, 2001	86,059,869	\$ 96,189,610	\$ (447,075)	\$ (87,233,559)	\$ 8,508,976
Issuance of shares					
Private issue net of \$35,970 issue costs (Note 10)	3,911,765	1,294,030	-	-	1,294,030
Issued for services (Note 10)	250,000	77,500	-	-	77,500
Net loss	-	-	-	(7,322,926)	(7,322,926)
Balance March 31, 2002	90,221,634	97,561,140	(447,075)	(94,556,485)	2,557,580
Net loss	-	-	-	(3,463,266)	(3,463,266)
Balance March 31, 2003	90,221,634	\$ 97,561,140	\$ (447,075)	\$ (98,019,751)	\$ (905,686)

See accompanying Notes to the Consolidated Financial Statements

PLAINTREE SYSTEMS INC.

Notes to the Consolidated Financial Statements

1. GOING CONCERN

The financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. However, there is substantial doubt about the Company's ability to continue as a going concern because of the Company's losses during the past year of \$3,463,266 and an accumulated deficit of \$98,019,751 as at March 31, 2003. The Company's continued existence is dependent upon its ability to raise additional capital, to increase sales and ultimately become profitable.

The Company believes that future funding and certain sales-related efforts will provide sufficient cash flow for it to continue as a going concern in its present form. However, there can be no assurances that the Company will achieve such results and to date, the Company has not secured such funding either through an equity investment or strategic partnership. Accordingly, the consolidated financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts or the amount and classification of liabilities or any other adjustments that might be necessary should the Company be unable to continue as a going concern.

2. DESCRIPTION OF BUSINESS

The Company designs, develops, manufactures, markets and supports optical wireless links, network switches and telecommunications products that allow its customers to improve the performance and increase the manageability of their existing local area networks, while providing a migration path to emerging networking technologies.

3. ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. These principles conform in all material respects with accounting principles generally accepted in the United States of America except as disclosed in Note 20.

Basis of presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned inactive U.S. subsidiary, Plaintree Systems Corporation. All significant intercompany accounts and transactions have been eliminated.

Inventories

Finished goods are valued at the lower of cost (first-in, first-out) and net realizable value. Work in process and raw materials are valued at the lower of cost and replacement cost.

Provisions for excess and obsolete inventory are made in the period in which management determines the inventory to be excess or obsolete.

PLAINTREE SYSTEMS INC.

Notes to the Consolidated Financial Statements

3. ACCOUNTING POLICIES (Continued)

Capital assets

Capital assets are stated at cost. Amortization is provided using the following methods and rates:

Software	2 years straight-line
Computer and office equipment	3 years straight-line
Other equipment	2 years straight-line
Furniture and fixtures	20% declining-basis
Leasehold improvements	Straight-line over the lease term
Building	20 years straight-line

The Company's policy is to review all long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount as an asset may not be recoverable. If events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable, the Company will estimate the future cash flows expected to result from the use of the assets and their eventual disposition and record an impairment of the assets if required.

Research and development costs

Research costs are expensed as incurred. Development costs are deferred once technical feasibility has been established and all criteria for deferral under generally accepted accounting principles are met. Such costs are amortized, commencing when the product is released, over the lesser of the expected life of the related product and three years.

Revenue recognition and warranties

Revenue from product sales is recorded on shipment provided evidence of an arrangement exists and collection is probable. In addition, a provision for potential warranty claims is recorded at the time of sale, based on warranty terms and prior claims experience. Customer support and maintenance contracts are sold separately from the product. Service revenue is recognized when the service is performed, or, in the case of maintenance contracts, is recognized on a straight-line basis over the term of the contract. Deferred revenue arises when maintenance or services are paid in advance.

Management service revenue is recognized when the service is performed.

Foreign currency translation

The Company accounts for its foreign subsidiary using the temporal method resulting in foreign exchange gains and losses being included in the determination of net earnings.

Other monetary assets and liabilities, which are denominated in currencies foreign to the local currency of the operation, are translated to the local currency at fiscal year-end exchange rates, and transactions included in earnings are translated at rates prevailing during the fiscal year. Exchange gains and losses resulting from the translation of these amounts are included in net earnings.

PLAINTREE SYSTEMS INC.

Notes to the Consolidated Financial Statements

3. ACCOUNTING POLICIES (Continued)

Stock option plans

The Company has stock option plans as described in Note 10. Effective April 1, 2002, the Company adopted the new recommendations of section 3870 of the CICA Handbook ("CICA 3870") with respect to stock-based compensation. The Company records an expense only when the exercise price of the option is lower than the market price of the stock on the date of grant. To date, no option grants have met the criteria for expense recognition. The Company discloses in Note 10 the pro forma effect of the options on the net loss as if they were valued using a fair value method.

Use of accounting estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Actual results could differ from the estimates made by management.

Income taxes

The Company uses the asset and liability method to account for income taxes. Future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities for accounting purposes, and their respective tax bases. Future income tax assets and liabilities are measured using statutory tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in statutory tax rates is recognized in net income in the year of change. A valuation allowance is recorded for those future income tax assets whose recoverability is not sufficiently likely.

4. INVENTORIES

	<u>2003</u>	<u>2002</u>
Raw materials	\$ 81,328	\$ 1,088,068
Work in process	34,820	524,850
Finished goods	195	450,000
	<u>\$ 116,343</u>	<u>\$ 2,062,918</u>

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

5. CAPITAL ASSETS

	2003		
	Cost	Accumulated Amortization	Net Book Value
Software	\$ 57,538	\$ 54,810	\$ 2,728
Computer and office equipment	2,724,702	2,675,759	48,943
Other equipment	233,392	233,392	-
Furniture and fixtures	134,213	112,379	21,834
Leasehold improvements	-	-	-
Land and building	218,672	28,522	190,150
	\$ 3,368,517	\$ 3,104,862	\$ 263,655
	2002		
	Cost	Accumulated Amortization	Net Book Value
Software	\$ 57,538	\$ 33,282	\$ 24,256
Computer and office equipment	2,724,702	2,568,414	156,288
Other equipment	304,290	304,290	-
Furniture and fixtures	142,148	104,249	37,899
Leasehold improvements	255,657	76,656	179,001
Land and building	218,672	19,015	199,657
	\$ 3,703,007	\$ 3,105,906	\$ 597,101

6. LOANS RECEIVABLE

	2003	2002
Note receivable, bearing interest at 6.5%, principal and interest repayable in monthly instalments of \$613, maturing April 2003	\$ -	\$ 8,243
	-	8,243
Less current portion	-	7,027
Non-current portion	\$ -	\$ 1,216

The loans are unsecured and were made to senior officers of the Company.

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

7. INTANGIBLE ASSETS

	<u>2003</u>	<u>2002</u>
Goodwill and acquired technology at cost	\$ -	\$ 1,485,075
Less accumulated amortization	-	(742,537)
Less write-down	-	(742,538)
	<u>\$ -</u>	<u>\$ -</u>

On March 29, 2000, the Company acquired all the business assets of A.T. Schindler Communications Inc. (ATS), a designer and manufacturer of the FiRLAN wireless networking products. The acquisition has been accounted for by the purchase method of accounting. The purchase consideration was comprised of \$346,655 cash and the issuance of 2,569,921 common shares. The difference between the purchase price valued at \$1,631,616 and the fair value of the acquired net tangible assets of \$146,541 amounted to \$1,485,075, which is attributable to acquired technology and goodwill (the "intangible assets"). The intangible assets were to be amortized over their expected useful lives of four years on a straight-line basis and reviewed periodically for impairment.

At March 31, 2002, it became evident that the carrying amount of the intangible assets would not be recoverable. As a result, the net book value of intangible assets remaining on the books of \$742,538 was written off.

8. CREDIT FACILITY DUE TO RELATED PARTY

The Company had in place an operating credit facility with a company controlled by Targa Group Inc., the largest shareholder of the Company. The credit facility was secured by a general security agreement covering all assets of the Company but expired on March 25, 2003. The Company is consequently in default on this facility and no further draws may be made. As at March 31, 2003, the facility which bears interest at the Company's bank's prime rate plus 2%, amounted to \$266,321 (2002 - \$400,000). This principal amount and interest arrears of \$31,535 (2002 - \$NIL) are due upon demand and are reflected as the due to related party amount shown as a current liability on the balance sheet.

A new agreement was signed subsequent to year-end authorizing a new credit facility with the same company controlled by the Targa Group as above. Under the terms of the new credit facility, the Company can draw to a maximum of \$225,000. This new facility is also secured by a general security agreement over the assets of the Company.

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities are comprised of:

	<u>2003</u>	<u>2002</u>
Accounts payable	\$ 424,670	\$ 251,116
Accrued liabilities	117,526	200,852
Restructuring	200,603	-
Salaries and benefits payable	-	145,134
Commissions payable	2,564	19,311
	<u>\$ 745,363</u>	<u>\$ 616,386</u>

PLAINTREE SYSTEMS INC.

Notes to the Consolidated Financial Statements

10. SHARE CAPITAL

Authorized

Unlimited number of preferred shares, issuable in series

Series I: 7% cumulative dividend payable in cash or, subject to applicable law and stock exchange approval, common shares; semi-annually on the 30th day of May and November of each year;
redeemable at the option of the Company and retractable at the option of the holder at \$1,000 per share after November 21, 2002 or on the occurrence of a merger event;
convertible at the option of the holder to 1,647,058 common shares at any time prior to November 22, 2002;
amounts due for redemption or retraction may be converted to common shares at the option of the Company;
non-voting.

Series II: 7% cumulative dividend payable in cash or, subject to applicable law and stock exchange approval, common shares; semi-annually on the 30th day of May and November of each year;
redeemable at the option of the Company and retractable at the option of the holder at \$1,000 per share after June 3, 2003 or on the occurrence of a merger event;
convertible at the option of the holder to 4,186,046 common shares at any time prior to June 4, 2003;
amounts due for redemption or retraction may be converted to common shares at the option of the Company;
voting.

Unlimited number of common shares

Pursuant to a subscription agreement dated, December 19, 2001, the Company completed a private placement financing with Targa Group Inc. (Targa), the Company's principal shareholder at the time, of 3,911,765 units of the Company at a subscription price of \$0.34 per unit for aggregate gross proceeds of \$1,330,000 less related issue costs of \$35,970. Each unit is comprised of one common share and one warrant. Each warrant entitles the holder to acquire one common share at an exercise price of \$0.51 per common share up to January 8, 2005. The financing was completed without the use of an agent and the Company has not undertaken to qualify any of the securities being offered pursuant to the financing.

Pursuant to the terms of an employment agreement entered into during the year 2000, the Company issued 250,000 common shares in 2002 to an employee for no cash consideration. All common shares issued resulted in compensation expense being recorded in 2002 in the amount of \$77,500 which was determined based on the market price of the shares at the time of issuance.

Warrants

As at March 31, 2003, 3,911,765 common share purchase warrants remain outstanding. Each warrant is exercisable into one common share of the Company at an exercise price of \$0.51 per common share, expiring January 8, 2005.

As at March 31, 2002, 5,000,000 common share purchase warrants and 400,000 agent compensation warrants remained outstanding. Each of the common share purchase warrants were exercisable at \$2 per common share of the Company, expiring June 30, 2001. Each compensation warrant were exercisable into one common share of the Company at an exercise price of \$1.09 per warrant, expiring March 30, 2002. None of these warrants were exercised during their exercise period.

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

10. SHARE CAPITAL (Continued)

Stock option plans

During fiscal 2002 the Company amended the 1994 Stock Option Plan to (i) change the name of the 1994 Stock Option Plan from "1994 Employee and Director Stock Option Plan" to "Stock Option Plan"; (ii) allow the Company to grant options to officers and service providers; and (iii) increase the maximum number of options which may be granted under the 1994 Stock Option Plan from 4,500,000 to up to 8,600,000.

The Company also has a 1993 stock option plan for key employees and directors. No further options are eligible for grant under the 1993 plan.

Options under the stock option plans may not expire later than 10 years from the date of grant and the exercise price may not be less than the latest closing price of the common shares on the last trading day preceding the date of grant. Eligibility is determined by the Company's Board of Directors and the aggregate number available for issuance to any one person may not exceed 5% of the issued and outstanding common shares.

Activity in the stock option plan is summarized as follows:

	Number of Options	Option Price	Weighted Average Option Price
Options outstanding March 31, 2001	1,712,000	\$0.72-\$7.00	\$2.03
Granted during fiscal 2002	2,207,000	\$0.29-\$0.51	\$0.35
Cancelled	(68,000)	\$0.72-\$5.35	\$2.27
Options outstanding March 31, 2002	3,851,000	\$0.29-\$7.00	\$1.06
Granted during fiscal 2003	-	-	-
Cancelled	(2,111,000)	\$0.29-\$4.80	\$0.79
Options outstanding March 31, 2003	1,740,000	\$0.29-\$7.00	\$1.40

Additional information regarding options outstanding as of March 31, 2003 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.29 - \$0.39	1,000,000	3.5	\$ 0.33	800,000	\$ 0.33
\$0.50 - \$0.72	165,000	2.4	0.67	128,750	0.68
\$0.95 - \$1.40	50,000	1.9	1.40	37,500	1.40
\$2.31 - \$2.35	375,000	3.9	2.32	375,000	2.32
\$7.00	150,000	0.2	7.00	150,000	7.00
\$0.29 - \$7.00	1,740,000	3.1	\$ 1.40	1,491,250	\$ 1.56

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

10. SHARE CAPITAL (Continued)

Stock option plans

Additional information regarding options outstanding as of March 31, 2002 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 0.29 - \$ 0.39	1,807,500	4.8	\$ 0.31	80,000	\$ 0.39
\$ 0.50 - \$ 0.72	845,500	3.9	0.62	216,500	0.70
\$ 0.95 - \$ 1.40	376,000	3.3	1.24	154,000	1.30
\$ 1.95 - \$ 2.35	662,000	4.0	2.18	387,750	2.32
\$ 4.80 - \$ 7.00	160,000	1.1	6.86	160,000	6.86
\$ 0.29 - \$ 7.00	3,851,000	4.2	\$ 1.06	998,250	\$ 2.39

CICA 3870 requires pro forma disclosures of the net loss and loss per share, as if a fair value based method of accounting had been applied. As there were no option grants in fiscal 2003, no pro forma disclosures are provided.

11. WRITE-DOWN OF INVENTORY AND RESTRUCTURING CHARGES

During 2003 and 2002, it became evident that the Company would not recover the cost of certain inventory reflected on the balance sheet. Accordingly, the Company has written down this inventory by \$2,081,792 (2002 - \$1,362,840; 2001 - \$1,442,493) to reflect estimated recoverable value.

During 2003, the Company restructured its operations in order to reduce costs and streamline operations. Restructuring charges, primarily workforce reduction related, recorded during 2003 were \$200,603 and remain in accrued liabilities at March 31, 2003. In total, 26 employees were terminated of which 7 performed research and development, 10 were involved in manufacturing and 9 were involved in sales and administration activities.

12. INTEREST (EXPENSE) INCOME

Interest expense in fiscal 2003 is presented net of interest income in the amount of \$4,291. (In 2002, interest income on the financial statements was presented net of interest expense of \$1,425. In 2001 interest income on the financial statements was presented net of interest expense of \$10,337).

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

13. OTHER INCOME

Other income is comprised of the following items:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Foreign exchange (loss) gain	\$ (23,213)	\$ (129,709)	\$ 5,849
Gain on creditor proposal	-	-	130,827
Loss on disposal of capital assets	(113,805)	-	-
Miscellaneous	11,485	15,026	23,223
	<u>\$ (125,533)</u>	<u>\$ (114,683)</u>	<u>\$ 159,899</u>

14. INCOME TAXES

(a) Investment tax credits

At March 31, 2003, the Company has approximately \$4,774,000 (2002 - \$4,846,000) of investment tax credits, relating primarily to research and development, available to reduce future years Canadian federal income taxes. These potential benefits expire as follows:

2004	\$ 516,000
2005	799,000
2006	1,314,000
2007	1,561,000
2011	240,000
2012	344,000
	<u>\$ 4,774,000</u>

(b) Tax losses available to carry forward

The Company has losses available to reduce future years' Canadian federal and provincial taxable income totalling approximately \$42,859,000 and \$46,353,000 respectively. These potential benefits expire as follows:

	<u>Federal</u>	<u>Provincial</u>
2004	\$ 1,180,000	\$ 3,592,000
2005	13,872,000	13,872,000
2006	14,592,000	15,682,000
2007	880,000	872,000
2008	3,850,000	3,850,000
2009	5,032,000	5,032,000
2010	3,453,000	3,453,000
	<u>\$ 42,859,000</u>	<u>\$ 46,353,000</u>

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

14. INCOME TAXES (Continued)

(c) Research and development deductions

The Company has claimed less research and development expenses for income tax purposes than has been reflected in the financial statements. These unclaimed expenses total approximately \$20,593,000 (2002 - \$20,593,000; 2001 - \$19,350,000) for Canadian federal and provincial income tax purposes. These are available without expiry to reduce future years' taxable income.

The potential future benefits associated with investment tax credits, tax losses, and unclaimed research and development expenses have not been reflected in these financial statements.

Current federal and provincial tax law in Canada includes provisions limiting the annual use of net operating loss and credit carryforwards in the event of certain defined changes in stock ownership. Accordingly, the annual use of the Company's net operating loss and credit carryforwards could be limited according to these provisions in the event of certain changes in stock ownership.

The provision for income taxes reported differs from the amount computed by applying the Canadian statutory rate to the income (loss) before income taxes for the following reasons:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Statutory income tax rate (Canada)	<u>38.1%</u>	<u>40.9%</u>	<u>43.1%</u>
Expected recovery of income tax	\$(1,320,197)	\$ (2,993,612)	\$ (1,942,631)
Reversal of timing differences, the benefit of which are not recorded	(1,728)	929,491	294,604
Benefit of loss carryforward not recorded	1,318,799	2,057,214	1,644,895
Other	3,126	6,907	3,132
Reported income tax provision	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The source of accumulated timing differences and the related future income taxes as at March 31 are as follows:

	<u>2003</u>	<u>2002</u>
Accounting amortization in excess of tax	\$ 2,048,000	\$ 2,386,000
Research and development expenses not deducted for tax purposes	6,203,000	6,203,000
Losses available to offset future income taxes	13,190,000	12,078,000
Other	96,000	192,000
Future income tax assets before valuation allowance	21,537,000	20,859,000
Less valuation allowance	(21,537,000)	(20,859,000)
Future income taxes	<u>\$ -</u>	<u>\$ -</u>

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

15. LOSS PER COMMON SHARE

Loss per share has been calculated on the basis of net loss divided by the weighted average number of common shares outstanding during the year. Diluted loss per common share is calculated by dividing the applicable net loss by the sum of the weighted average number of common shares outstanding and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the period. The treasury stock method is used to compute the dilutive effect of options and warrants. For all years presented, diluted loss per share is the same as basic loss per share.

For all years presented, basic and diluted loss per share under United States generally accepted accounting principles are the same as the amounts presented under Canadian generally accepted accounting principles.

16. CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Trade accounts receivable	\$ 105,365	\$ 188,423	\$ 839,294
Investment tax credits receivable	246,000	(156,000)	(90,000)
Due to related parties	36,878	404,241	(345,447)
Inventories	1,946,575	454,874	(1,358,105)
Prepaid expenses and advance contract payments	76,084	94,327	(87,505)
Due to related party	181,020	400,000	-
Accounts payable and accrued liabilities	128,977	(43,455)	(1,082,072)
Warranty reserve	(17,333)	(23,683)	66,089
	<u>\$ 2,703,566</u>	<u>\$ 1,318,727</u>	<u>\$ (2,057,746)</u>

17. GUARANTEES, COMMITMENTS AND CONTINGENCIES

Commitments

The Company is committed under lease contracts for the rental of certain premises and certain equipment in the aggregate amount of approximately \$8,900.

Annual lease payments over the life of the leases are as follows:

2004	\$ 6,700
2005	<u>2,200</u>
	<u>\$ 8,900</u>

The Company was awarded a Microelectronics and System Development Program (MSDP) grant during 1991 for approximately \$1,800,000 to assist in the development and commercialization of certain of its products. This grant is repayable to the government in the form of a royalty of two percent of total sales attributable to those products and expired in February 2003. These products were not sold during 2003, 2002 or 2001. This royalty does not apply to the Company's WaveSwitch line of products.

PLAINTREE SYSTEMS INC.

Notes to the Consolidated Financial Statements

17. GUARANTEES, COMMITMENTS AND CONTINGENCIES (Continued)

Contingencies

The Company has signed a general security agreement over all corporate assets in favour of a company controlled by Targa Group Inc., the largest shareholder of the Company.

Guarantees

Plaintree has entered into agreements that contain features which meet the definition of a guarantee under Canadian Accounting Guideline (AG) 14 and U.S. FIN 45. The pronouncements define a guarantee to be a contract that contingently requires Plaintree to make payments (either in cash, financial instruments, other assets, common shares of the Company or through the provision of services) to a third party based on changes in an underlying economic characteristic (such as interest rates or market value) that is related to an asset, a liability or an equity security of the other party. Plaintree has the following major types of guarantees that are subject to the disclosure requirements of AG 14 and FIN 45:

Product warranties

As part of the normal sale of product, Plaintree provides its customers with product warranties. These warranties extend for periods generally ranging from one to two years from the date of sale. The following summarizes the accrual of product warranties that is recorded as part of accrued liabilities in the accompanying consolidated balance sheet as at March 31, 2003:

Balance at the beginning of the year	\$ 42,406
Payments made during the year	(42,406)
Warranties issued during the year	<u>25,073</u>
Balance at end of year	<u>\$ 25,073</u>

18. RELATED PARTY TRANSACTIONS

Until March 31, 2003, the Company leased facilities in Canada from a company controlled by Targa Group Inc., the largest shareholder of the Company. For the year, lease costs for these facilities amounted to \$116,335 (2002 - \$105,828; 2001 - \$105,878). Lease arrears including interest of \$21,412 (2002 - \$NIL) owing to this related party amounted to \$240,220. During the year, this related party entered into a forbearance agreement with Plaintree whereby Plaintree agreed to repay the amounts owing and the related party was provided with a security interest in the form of a mortgage on the property owned by the Company. As a result of the proposal to creditors, the forbearance agreement is now in default and the amounts owing are due and payable.

Consulting fees and salary to a senior officer of the Company and majority shareholder of Targa Group Inc., amounted to \$151,679, plus interest charges of \$5,658 for a total payable of \$157,337. Sales and marketing expense includes \$151,679 for these fees paid and salary.

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

18. RELATED PARTY TRANSACTIONS (Continued)

In the past, the Company performed consulting and management services under an agreement between the Company and corporations controlled by Targa Group Inc.. The amount owed to the Company related to these services is \$19,749. The consulting and management fees billed under this agreement totalled \$275,000 in 2002 and \$750,000 in 2001. These fees are included in revenue and the related costs of \$77,145 in 2002 and \$232,710 in 2001 are included in cost of revenue.

The amounts arising from the related party transactions comprise the due to related parties amount, and are shown as a current liability on the balance sheet.

19. BUSINESS SEGMENT INFORMATION

The Company's chief decision maker, the Chief Executive Officer tracks the Company's operations as principally one business segment - the design, development, manufacture, marketing and support of computer networking products. The Company also provides management services primarily to related companies. The revenue and cost of sales related to these services are presented on the statement of operations. No other expenses or assets are attributable to this segment.

The Company determines the geographic location of revenues based on the location of its customers. All of the Company's assets are primarily located in Canada.

Revenue by geographic location

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Canada	\$ 81,610	\$ 519,559	\$ 1,066,752
United States	948,271	361,750	470,748
Europe	77,553	31,211	330,274
Other	196,633	434,076	131,846
	<u>\$ 1,304,067</u>	<u>\$ 1,346,596</u>	<u>\$ 1,999,620</u>

Product revenue in excess of 10 percent of the Company's total revenue was earned from two customers during the year ended March 31, 2003 who accounted for 45 and 14 percent of the total. In 2002, one customer accounted for 27 percent of total revenue and in 2001, two customers accounted for 35 percent of total revenue.

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

20. RECONCILIATION TO UNITED STATES GAAP

The financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). The following adjustments and/or additional disclosures would be required in order to present the financial statements in accordance with United States generally accepted accounting principles (GAAP):

Under US GAAP, the net loss and loss per common share figures for the years ended March 31, 2003, 2002 and 2001 and the shareholders' (deficiency) equity for the years ended March 31, 2003, 2002 and 2001 would be adjusted as follows:

	Net loss		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Canadian GAAP	\$(3,463,266)	\$(7,322,926)	\$(4,507,266)
Adjustment to development costs (a)	-	114,717	(114,717)
Adjustment to operating expenses relating to share issuances (b)	-	121,875	(121,875)
US GAAP	\$(3,463,266)	\$(7,086,334)	\$(4,743,858)
Basic and diluted loss per share based on US GAAP	\$ (0.04)	\$ (0.08)	\$ (0.06)

Under US GAAP, for all periods presented, net loss is equivalent to comprehensive loss.

	Shareholders' (deficiency) equity		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Canadian GAAP	\$ (905,686)	\$(2,557,580)	\$ 8,508,976
Adjustment to development costs (a)	-	-	(114,717)
Adjustment to operating expenses relating to share issuances (b)	-	-	(121,875)
US GAAP	\$ (905,686)	\$(2,557,580)	\$ 8,272,384

(a) *Accounting for development costs*

Under US GAAP, development costs would not be deferred. Accordingly under US GAAP, research and development expenses and net loss would have been adjusted by \$NIL (2002 - \$114,717; 2001 - (\$114,717)). Closing deficit and shareholders' equity would have been adjusted by \$NIL (2002 - \$NIL; 2001 - \$114,717). The basic and diluted loss per share would be (\$0.04) (2002 - (\$0.08); 2001 - (\$0.06)).

PLAINTREE SYSTEMS INC.
Notes to the Consolidated Financial Statements

21. RECONCILIATION TO UNITED STATES GAAP (Continued)

(b) *Accounting for stock options and share issuances*

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations, in accounting for its employee stock option plan. Accordingly, no compensation expense has been recognized for its stock-based compensation plan. Had compensation cost for the Company's employee stock option plan been determined based on the fair value at the grant date for awards under the plan, consistent with the methodology prescribed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," the Company's net loss would have decreased/increased to the pro forma amounts indicated below:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Net loss as reported for US GAAP purposes	\$(3,463,266)	\$(7,086,334)	\$(4,743,858)
Estimated stock based compensation (costs) reversal	255,199	(385,519)	(344,018)
Pro forma net loss	\$(3,208,067)	\$(7,471,853)	\$(5,087,876)
Pro forma basic net loss per share	\$ (0.04)	\$ (0.09)	\$ (0.06)

The weighted average fair value of all options granted during 2002 and 2001 was estimated as of the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Expected option life (years)	N/A	4.5	4.5
Volatility	N/A	130%	129%
Risk free interest rate	N/A	3.5%	5.6%
Dividend yield	N/A	NIL	NIL

The weighted average fair value of grant, for stock options granted during 2002 and 2001 were \$0.29 and \$1.12 per option, respectively.

The Black-Scholes model used by the Company to calculate option values, as well as other currently accepted option valuation models, were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated values. Accordingly, management believes that this model does not necessarily provide a reliable single measure of the fair value of the Company's stock option awards.

PLAINTREE SYSTEMS INC.

Notes to the Consolidated Financial Statements

20. RECONCILIATION TO UNITED STATES GAAP (Continued)

(b) *Accounting for stock options and share issuances (Continued)*

For the year ended March 31, 2001, compensation expense of \$121,875 would be recorded under US GAAP pursuant to FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and other Variable Stock Option or Award Plans" as a result of 250,000 shares issuable to an employee related to development of products. If the Company reported under US GAAP, this accrual would change at each reporting date until the final measurement date. Under Canadian GAAP, compensation expense is based upon the market price at the time of share issuance which resulted in compensation expense of \$77,500 for the year ended March 31, 2002. Under US GAAP, the date of share issuance becomes the measurement date and compensation expense is fixed at \$77,500, resulting in a reduction of the previous accrual under US GAAP of \$44,375 and a reversal of the Canadian accrual of \$77,500 for a total reduction of Canadian GAAP income of \$121,875 in fiscal 2002 to arrive at US GAAP income. Accordingly, under US GAAP, fiscal 2002 finance and administration expenses and net loss would have been reduced by \$121,875 (2001 - increased by \$121,875). The closing deficit and shareholders' equity would have been adjusted by \$NIL (2001 - reduced by 121,875). The basic and diluted loss per share would be \$(0.08) (2001 - \$(0.06)).

(c) *Accounting for investment tax credits*

Under US GAAP, the benefit of investment tax credit receivable would be recorded as an income tax recovery, rather than as a reduction of research and development expense under Canadian GAAP. Accordingly, under US GAAP, research and development expense and the loss from operations would increase by \$39,754 to \$805,226 and \$3,322,640 (2002 - \$156,000 to \$2,250,823 and \$7,429,560; 2001 - \$90,000 to \$1,329,861 and \$5,167,381) respectively. An income tax recovery of \$39,754 (2002 - \$156,000; 2001 - \$90,000) would be reflected resulting in no change to the net loss.

(d) *Accounting for write-down of inventory*

Under US GAAP, the write-down of inventory would be recorded in cost of sales, rather than operating expenses. Accordingly, under US GAAP, cost of sales would increase by and the gross margin and operating expenses would decrease by \$2,081,792 to \$2,281,162, (\$977,094), and \$2,305,792, (2002 - \$1,362,840 to \$2,018,094, (\$671,498) and \$6,602,062; 2001 - \$1,442,493 to \$2,622,500, (\$622,880) and \$4,454,501) respectively, resulting in no change to the net loss.

(e) *Accounting for short-term investments*

Under US GAAP, the short-term investment would be classified as an available-for-sale security. The investment for the 2002 fiscal year is a guaranteed investment certificate that matures on April 5, 2002 and earns interest at a rate of 1.25% per annum.

PLAINTREE SYSTEMS INC.

Notes to the Consolidated Financial Statements

20. RECONCILIATION TO UNITED STATES GAAP (Continued)

(f) *Derivative instruments*

In June 1998, the Financial Accounting Standards Board issued the Statement of Financial Accounting Standards No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. Implementation of SFAS 133 was required for the Company effective April 1, 2001. The adoption of SFAS 133 did not have an effect on the Company's financial position or results of operations.

(g) *Recent United States Accounting Standards*

In January 2003, the FASB issued Interpretation No. 46 (FIN 46) "Consolidation of Variable Interest Entities". FIN 46 clarifies the application of Accounting Research Bulletin No. 51 "Consolidated Financial Statements" to those entities defined as "Variable Interest Entities" (more commonly referred to as special purpose entities) in which equity investors do not have the characteristics of a "controlling financial interest" or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 applies immediately to all Variable Interest Entities created after January 31, 2003, and by the beginning of the first interim or annual reporting period commencing after June 15, 2003 for Variable Interest Entities created prior to February 1, 2003.

Plaintree's operations as at March 31, 2003 would not be affected by this pronouncement. Plaintree has not yet determined the impact of the FIN 46 on the subsequent event described in Note 22.

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123" (SFAS 148) which amended the transitional provisions of SFAS 123 for entities choosing to recognize stock-based compensation under the fair value based method of SFAS 123, rather than electing to continue to follow the intrinsic value method of APB 25. Under SFAS 148, Plaintree may adopt the recommendations of SFAS 148 either in its fiscal year beginning April 1, 2002 using certain implementation procedures or in its fiscal year beginning April 1, 2003 using different implementation procedures. The Company has elected to defer implementation.

In November 2002, the FASB issued FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45), which requires elaborating on the disclosures that must be made by a guarantor in financial statements about its obligations under certain guarantees. It also requires that a guarantor recognize, at the inception of certain types of guarantees, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements of FIN 45 are effective for financial statements issued after December 15, 2002, and have been applied in the presentation of the accompanying consolidated financial statements. The recognition requirements of FIN 45 are applicable for guarantees issued or modified after December 31, 2002 and have not had an effect on the Company's financial position or results of operations.

PLAINTREE SYSTEMS INC.

Notes to the Consolidated Financial Statements

20. RECONCILIATION TO UNITED STATES GAAP (Continued)

(g) Recent United States Accounting Standards

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS 146), which is effective for exit or disposal activities initiated after December 31, 2002. SFAS 146 supersedes Emerging Issues Task Force ("EITF") Issue No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in Restructuring)" (EITF 94-3). SFAS 146 requires that costs associated with an exit or disposal activity be recognized when the liability is incurred, whereas EITF 94-3 required recognition of a liability when an entity committed to an exit plan. Therefore, the effect of SFAS 146 will be to change the timing of recognition of certain liabilities. Plans initiated before December 31, 2002 continue to be accounted for under EITF 94-3. Plaintiff does not expect the adoption of SFS 146 to have a material impact on its business, results of operations and financial condition.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS 143), which is effective for financial statements issued for fiscal years beginning after June 15, 2002. SFAS 143 addresses the recognition and measurement of obligations associated with the retirement of tangible long-lived assets. Plaintiff does not expect the adoption of SFAS 143 to have a material impact on its business, results of operations and financial condition.

In April 2003, FASB issued SFAS No. 149, "Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities" ("SFAS 149"). SFAS 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). In particular, it clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative, clarifies when a derivative contains a financing component, amends the definition of an underlying, and amends certain other existing pronouncements. SFAS 149 is generally effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The Company does not expect that the adoption of SFAS 149 will have a material impact on the results of operation or financial conditions.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS 150"). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Some of the provisions of this Statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, Elements of Financial Statements. The remaining provisions of this Statement are consistent with the proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own equity shares, depending on the nature of the relationship established between the holder and the issuer. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company does not expect the adoption of SFAS 150 to have a material impact on its results of operations results or financial condition.

PLAINTREE SYSTEMS INC.

Notes to the Consolidated Financial Statements

21. FINANCIAL INSTRUMENTS

Concentration of credit risk

Financial instruments which potentially subject the Company to a concentration of credit risk consist principally of cash investments and trade receivables. The Company invests its excess cash in high-quality financial instruments. The Company has credit evaluation, approval and monitoring processes intended to mitigate potential credit risks. Anticipated bad debt loss has been provided for in the allowance for doubtful accounts. The carrying amounts for cash, short-term investments, accounts receivable, investment tax credits receivable, loans receivable, amounts due to and from related parties, accounts payable and other current liabilities approximate fair market value due to the short maturity of these instruments.

Interest risk

The Company is financed through loans from related parties which bear interest at rates tied to the Canadian bank prime rate. Consequently, the Company is exposed to the risk of increases in the prime rate.

22. SUBSEQUENT EVENTS

On July 14, 2003 the Company made a capital contribution of \$20 million in order to acquire a 49% interest in a manufacturing partnership. In a related transaction, the Company obtained a non-recourse credit facility from a Canadian chartered bank in the amount of \$20.3 million to finance its capital contribution to the partnership, to cover related acquisition expenses, and to finance its payment obligations under the creditor proposal described below. The credit facility is secured by the partnership interest itself and will be repaid from cash distributions from the partnership.

As part of these transactions, the Company completed an internal restructuring of its operations, transferring primarily all of its business, its tangible assets (other than its intellectual property and its partnership interest) to a newly incorporated wholly owned subsidiary of the Company. This subsidiary has also assumed all of the liabilities of the Company, except for its credit facility with a related party and its liabilities under the credit facility described above. This subsidiary will continue to carry on the former business of the Company.

Pursuant to a proposal filed under the Bankruptcy and Insolvency Act (BIA) on December 18, 2002, and approved by the Courts on January 29, 2003, the Company will realize a gain of approximately \$375,000 on settlement of claims and debts. As of the date of these financial statements, the Certificate of Completion of the proposal had not been issued by the Courts and consequently the gain will be recorded in the financial statements for the subsequent year. The Certificate of Completion was issued on July 31, 2003.

23. COMPARATIVE FIGURES

Certain of the 2002 and 2001 comparative figures have been reclassified to conform to the current year financial statement presentation.



4th Quarter Report
March 31, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The section of "Management's Discussion and Analysis" contains, in accordance with applicable Canadian securities laws and policies, certain forward-looking information about the business and affairs of Plaintree Systems Inc. ("Plaintree" or the "Company"). Such forward-looking information is subject to significant risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward-looking statements. Readers should carefully review the risks concerning the business of the Company and the industries in which it operates generally described in the documents filed from time to time with SEC and Canadian securities regulatory authorities.

The following discussion of the financial condition, changes in financial condition and results of operations of the Company for the years ended March 31, 2003 and 2002 should be read in conjunction with the notes therein. Historical results of operations, percentage relationships and any trends that may be inferred therefrom are not necessarily indicative of the operating results of any future period. All amounts are in Canadian dollars unless otherwise stated.

Overview

At the beginning of the fiscal year ended March 31, 2003 ("fiscal 2003"), management watched the growing uncertainty in the telecommunications market and the effect of this on Plaintree's WAVEBRIDGE series of optical wireless products known as FSO (Free Space Optics). The term Free Space Optics or FSO is interchangeable with optical wireless or OW.

The downturn in this industry was dramatic and it was management's opinion that the market would not recover in the fiscal 2003 year. Management then began a series of stringent moves to restructure the company into one that could survive the expected drought.

The first move was to reduce the work force by 70% and substantially reduce the operational expenses of the company. This reduction was done by closing all of the regional sales offices around the world and centralising all sales activities in the Canadian head office. The manufacturing team was cut back to levels that ensured that Plaintree was just able to meet the downwardly revised sales forecasts. Finance was reduced to a level that more accurately reflected the volume of corporate activity. In March of 2003 Plaintree ceased to have an official CFO and instead relied on spreading Finance's tasks among the remaining employees and relying professional advisors including our auditors, Deloitte & Touche LLP for guidance. The Engineering team was reduced to just the key talent required to support our existing technology and manufacturing.

In November as part of the restructuring, Plaintree filed a formal proposal to its creditors under the Bankruptcy and Insolvency Act (Canada) (BIA). This proposal was accepted by the creditors on January 8, 2003.

In short, Plaintree intended to go into a state of hibernation that would allow the company to support its customers and technology, but expend a minimum of cash until the demand for telecommunications returned.

However, after a very quiet summer and fall, Plaintree received a USD \$389,000 order for its legacy switching product from Northrop Grumman in the fall of 2002. Then in early fourth quarter, Plaintree began to get inquiries from around the globe about the WAVEBRIDGE product. This increase in Customer activity prompted a ground up review of the FSO line and a subsequent increase in R&D.

The product line was extensively redesigned. Plaintree was able to do this under tight budgeting due to the recent increase in available engineering talent at very reduced rates now found in the Ottawa area.

The WAVEBRIDGE line is now largely modular, allowing field upgradeability.

The new designs ensure greater commonality of components that assist in lower manufacturing costs.

A brand new line, the 400 series, was announced and launched to address the market's requests for lower priced, intermediate range products. List Priced at US \$8,570 for a 100 Mbps 500 Metre link, this is now one of the least expensive and robust units on the market.

Redesigned electronics have given the WAVEBRIDGE line performance increases of up to 50%.

These design improvements combined with an increase in customer inquiries enticed Plaintree's largest shareholder, Targa Group Inc. (Targa), to extend a further \$225,000 in financing in April 2003. This financing was extended under the condition that this amount and any previous amounts owing to Targa be converted to a convertible debenture. The conversion price is to be set at the time of each further advance. The TSX approval for this conversion right has been applied for. Targa has continued to advance the funds under the concurrence with the Board that this condition will be met.

In March of 2003, Plaintree was given a major concession by its landlord, a division of Targa, and was released from the terms of its lease on its Merivale location. Plaintree has now consolidated its operations at its Arnprior location.

Despite the above financing, the Company will require an infusion of additional capital in order to continue to operate in its present form and develop its business. In this regard, management continues to investigate other sources of financing.

Current Products and Market Overview

The WAVEBRIDGE series of optical wireless systems uses LED (light-emitting diode) technology to provide a local and wide area networking alternative to wire line, fiber, leased circuits, and radio wave (RF) data solutions. A WAVEBRIDGE link is transparent, replicating at the remote site the exact signal it receives from the network. The

WAVEBRIDGE series of products can be used as a bridge to extend, overbuild, or replace conventional cabling systems. The WAVEBRIDGE system can also be used to transport data, voice, and video information among computer workstations, file servers, PBX's, and printers either in the same office or between office buildings. Implementing the WAVEBRIDGE series technology offers various advantages including seamless replacement for cables or fiber, IEC (International Electrotechnical Commission) Class 1, eye safety under all reasonably foreseeable conditions, ease of installation and relocation, currently no regulatory licensing required and an estimated MTTF (Mean Time To Failure) in excess of 17 years.

Very few FSO companies specialise in LED systems, the vast majority have chosen Laser Systems. The Company has based its decision to go LED on the fact that only LED systems are 100% eye safe under any condition and they feel that this is going to become a major decision for customers of FSO. The Company feels that the other advantages of LED, such as ease of installation and low cost, offset the one disadvantage, that the fastest speeds you can drive an LED Diode is 155Mbps. It is the Companies opinion that the largest market for FSO is at speeds of 155Mbps or less and will be for a number of years to come.

After the recent period of retraction in the telecommunication markets, it is the Companies opinion that the demand for wireless access and bandwidth is about to increase. The popularity of Wi-Fi, internet high speed and increases in cell phone functions will drive this growth.

The risk the Company faces, along with most other telecommunication companies, is ensuring that cash flows are sufficient to allow the company to continue and remain competitive until the markets begin this expected growth phase. To this end, as described below, the company has lowered its operating costs dramatically and will strive to keep these costs low until the sales level warrants operating increases.

Selected Financial Information

The Company's consolidated financial statements are stated in Canadian dollars and are prepared in accordance with Canadian generally accepted accounting principles, which also conform in all material respects with accounting principles generally accepted in the United States, except as disclosed in note 20 of the consolidated financial statements. The following table sets forth-selected financial information of the Company extracted from the Company's respective audited consolidated financial statements.

Balance Sheet Data:

	As at March 31 (audited)	
	2003	2002
	(thousands of Canadian dollars)	
Current Assets	\$ 277	\$ 3,113
Total Assets	\$ 540	\$ 3,711
Current Liabilities	\$ 1,446	\$ 1,153
Total Liabilities	\$ 1,446	\$ 1,153
Shareholders' Equity	\$ (906)	\$ 2,558

Statement of Operations Data:

	Years Ended March 31 (audited)	
	2003	2002
	(thousands of Canadian dollars except earnings per share amounts)	
Statement of Operations:		
Revenue	\$ 1,304	\$ 1,347
Gross margin	1,105	691
Expenses:		
Sales and marketing	756	2,794
Finance and administration	583	
Restructuring	201	970
Research and development	766	2,095
Write-down of inventory	2,082	1,363
Write-down of intangible assets	-	743
Loss from operations	(3,283)	(7,274)
Interest (expense) income	(55)	65
Other (expense) income	(125)	(114)
Net Loss	\$ (3,463)	\$ (7,323)
Loss per Share (Basic and Diluted)	\$ (0.04)	\$ (0.08)

Results of Operations

A meaningful analysis of the financial results for fiscal 2003 must take into account the strategic decision to institute major cost reductions and consolidate operations. With this in mind, the following is a comparison of the Company's operations for the fiscal year ended March 31, 2003 ("fiscal 2003") to the fiscal year ended March 31, 2002 ("fiscal 2002").

Revenues

Plaintree had approximately 40 evaluations going on around the globe at the end of 2002. In early 2003 most of these evaluation customers, despite them advising that the performance of the WAVEBRIDGE product line met or exceeded their requirements, began to go quiet. However, it is important to note that the reason for the non-conclusion of these sales was not, to our best knowledge, due to the proposed sale going to any of our competitors. The main reason appears to have been a lack of demand and financing for these companies. The termination of all of Plaintree's regional sales offices also had an impact on revenue expectations.

Despite these setbacks, product revenue increased by \$232,472 from \$1,071,596 in fiscal 2002 to \$1,304,068 in fiscal 2003.

It is important to remember that \$583,638 of these revenues came from the sale of legacy switching product to one customer as mentioned above. It is not known if this customer will order again.

Gross Margin

Gross margin from product and service revenue for fiscal 2003 was 85% compared to 46% in fiscal 2002. The increase was largely due to the impact of the legacy switching product order described above that had a high gross margin due to the majority of the shipment being from written off inventory.

The Company expects its current and future WAVEBRIDGE high speed optical wireless products will represent a greater portion of the Company's revenues in the future and that the gross margin will return to a level closer to that attained in fiscal 2002.

Sales and Marketing

Sales and marketing expenses consist primarily of personnel and related costs associated with the Company's sales and marketing departments that include commissions for sales representatives, advertising, travel, trade shows and other promotional activities. Sales and marketing expenses decreased by \$2,037,847 from \$2,794,261 in fiscal 2002 to \$756,414 in fiscal 2003. The decrease was due to major cutbacks on the international sales force and marketing initiatives.

Finance and Administration

Finance and administration expenditures decreased by \$387,137 from \$970,440 in fiscal 2002 to \$583,303 in fiscal 2003. The decrease was primarily attributable to a reduction in personnel.

Research and Development

Research and development expenditures consist primarily of software and hardware engineering personnel expenses, subcontracted research and development costs and costs associated with equipment and facilities. Research and development expenditures decreased by \$1,329,351 from \$2,094,823 in fiscal 2002 to \$765,472 in fiscal 2003. This decrease in expenses was predominately related to the Company's employee cutbacks and much reduced engineering consulting rates now available.

Write-down of inventory

After reviewing the remaining switching and certain WAVEBRIDGE product inventory, management determined it should be written down to reflect its estimated recoverable values resulting from the extensive redesign of the product line. This review resulted in a \$2,081,792 charge against income. Accordingly, the revised WAVEBRIDGE product line represents 100% of the inventory as at March 31, 2003.

Interest (Expense) Income and Other

Other loss and interest (expense) income increased by \$131,014 from \$49,366 in fiscal 2002 to an expense of \$180,380 in fiscal 2003. The increase is primarily due to a reduction in cash and short-term investment balances and an increase in interest expense incurred on lease arrears and credit facilities. A gain on settlement of claims and debts of the unsecured creditors of the Company pursuant to the BIA proposal undertaken in the year is expected to be recognized in 2004.

Net loss

The net loss for fiscal 2003 was \$3,463,266 or \$0.04 per share compared to \$7,322,926 or \$0.08 per share for fiscal 2002.

If the inventory write-down is removed, the actual operational loss for the 2003 year was \$1,381,474.

Liquidity and Capital Resources

The Company closed fiscal 2003 with no long-term debt.

In fiscal 2003, the Company was advanced \$200,000 and repaid \$333,679 to Targa and related parties.

Cash provided by financing activities was \$18,843 for fiscal 2003 compared to \$1,286,320 in fiscal 2002. In early 2004 Targa extended a further \$225,000 loan.

Cash flow generated from investing activities totaled \$35,571 for fiscal 2003 including proceeds from the sale of short-term investments of \$27,328

In addition to the above noted Targa facility, the Company may require an infusion of additional capital in order to continue to operate in its present form and develop its business. Management continues to investigate other sources of financing. However, the source, timing and costs of such infusion are uncertain, and there is no certainty that the Company will be successful in raising additional working capital, either through the sale of debt or equity securities, or through commercial banking lines of credit. The Company currently has no banking lines of credit.

If the Company is not successful in obtaining the necessary funding and/or if the Company does not meet its existing forecast, continuation of the existing business may not be viable. There can be no assurance that the Company will be able to raise additional capital.

Subsequent Events

* In May and June of 2003, the company had parties fly in from Japan, England and South Korea. Each of these groups made the trip specifically to view the Plaintree product and operations and compare us to our competition. All three are viewed by management as being credible options for our sales network. All three recently advised Plaintree that they view our product and pricing to be superior to our competitors and all three have signed Value Added Reseller (VAR) agreements. All three have since ordered demonstration units that they have paid for.

In addition to these visitors, Plaintree has signed up another 5 VARs and 2 distributors over the past five months.

*On July 15, 2004, the Company announced the acquisition of a 49% interest in a Manufacturing partnership. In a related transaction, Plaintree obtained a non-recourse credit facility of \$20,300,000 from a Canadian Chartered Bank to fund its required capital contribution of \$20,000,000 to the partnership.

As part of these transactions, The Company completed an internal restructuring of its operations transferring primarily all of its business, its tangible assets and liabilities (other than its intellectual property, Partnership Interest and the Targa debt) to a newly incorporated wholly-owned subsidiary of Plaintree, 4178611 Canada Inc (Newco). Newco will continue to carry on the former business of Plaintree.

The net result of this transaction for the Company was an immediate cash injection of \$300,000 into Plaintree which was used to settle off the amount owing to the creditors agreed to at the creditors meeting of January 8, 2003 and to pay any commissions and

other fees connected with the Partnership transaction. In addition to this, the Partnership may provide up to \$1,100,000 in cash to the Company over the next four years or less.

*As described above, The company has received its certificate of full performance from its Proposal Trustee confirming that the Company has paid in full its commitment to the Creditors as agreed to under the formal Proposal to Creditors and the Company is now released from the protection of the BIA.

* In a related issue, the TSX announced on July 9, 2003 that they were reviewing the TSX listing of Plaintree for the following reasons:

- 1) Insolvency or bankruptcy proceedings (S.708)
- 2) Financial condition and/ or operating results (S.709,710(a)(ii))
- 3) Payment of fees (S.715)

On July 24, David Watson and fellow Director, Jerry Vickers attended a meeting with the Listing Committee of the TSX. Items 1 and 3 had been addressed with the emergence Plaintree out of the BIA proposal. The representatives of the Company then presented cash flows, sales forecasts and preliminary financial statements for the fiscal year 2003.

After this presentation, the review committee agreed to defer the review until November 28, 2003, at which point the performance of the company would be again reviewed. A request by the Company for a summary of what financial issues concerned the committee has been submitted to the TSX review committee.

*On April 8, 2003, Jay Richardson and Scott Sinclair, both senior management members of Merchant Capital Group Incorporated, resigned.

*At the AGM held on May 6, 2003, one of these Board positions was filled when Jerry Vickers was elected.

*In June the company announced that the last Board opening had been filled when John Buchanan, Senator and former Premier of New Brunswick, joined the Company as a Director.

* In response to increased market interest in the Companies legacy switching lines, the Company has begun to research new markets for this product line.

Management continues to explore alternative methods of reporting to its shareholders due to the high cost in continuing to mail information, such as annual reports and general meeting material by traditional means. The Company wishes to make it clear that it will continue to prepare the financial statements required by it pursuant to relevant securities laws. As the annual report and interim financial statements of the Company are filed, these documents will continue to be available to shareholders and any other interested parties on the Company's website at www.plaintree.com and at www.sedar.com. In addition, upon specific request, the Company will provide such person with a hard copy of the statements by mail or a soft copy by way of e-mail. The Company will be making every effort to ensure that its shareholders are advised of how to obtain the information in question by means such as press releases.

Plaintree Systems Inc.

Board of Directors

W. David Watson II
President & Chief Executive Officer

William D. Watson
Chairman of the Board

Girvan L. Patterson
CEO, Motepoint Inc.

Jerry Vickers
Financial Advisor

Robert E. Shea
Chairman, Shea Financial Group

John Buchanan
Senator

Executives and Officers

W. David Watson II
President & Chief Executive Officer

Lynn E. Saunders
Vice President, Operations

Jason Lee
Vice President, Business Development

Principal Office

110 Decosta Street
Arnprior, Ontario, Canada K7S 2X1
Telephone: (613) 623-3434
Fax: (613) 623-4647

Website: <http://www.plaintree.com>

Auditors

Deloitte & Touche, Ottawa, Ontario, Canada

Transfer Agent

Computershare
100 University Ave., 8th Floor
Toronto, Ontario, Canada M5J 2Y1

Corporate Secretary

Gary O. Jessop
Partner
Blake, Cassels & Graydon, LLP
Ottawa, Ontario, Canada

Legal Counsel

Blake, Cassels & Graydon, LLP, Ottawa, Ontario, Canada

Stock Exchange Listings

Toronto Stock Exchange: LAN
NASDAQ OTC BB: LANPF