

2002  
*Annual Report*



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

## **PRESIDENT'S LETTER TO SHAREHOLDERS**

As we all know, it has been one of the most challenging years in recent memory for public companies, and in particular, telecommunication companies. Plaintiff however, continues to evolve in order to meet these challenges.

The Company took dramatic steps at the end of May 2002 to reduce its overall operating expenses in response to delays in expected orders. Our goal was to sharply reduce costs not directly related to sales and customer support. We continue to stand by our expectations for the market potential of Free Space Optics (FSO) and Plaintiff's potential in that particular market.

Plaintiff has been very fortunate to have the support of its major shareholder, Targa Group which has established a credit facility to allow us to continue to develop our customer base and assisting in weathering the time between now and when regular orders begin.

We believe our WAVEBRIDGE product is one of the most robust and reliable FSO systems on the market today. Customer response tells us that we have the solution to the problems of spectrum congestion and frequency licensing around the world. Plaintiff Systems takes pride in the support we have given our customers in the past. That support is there today and we expect it will continue long into the future.

I look forward to reporting on our progress in the future.

W. DAVID WATSON  
President and Chief Executive Officer  
July 26, 2002

## 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, 2002 and 2001 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, 2002 ("fiscal 2002"), management expected to experience an increase in sales from the WAVEBRIDGE series of optical wireless products to meet the demands of the FSO (Free Space Optics) market. The term Free Space Optics or FSO is interchangeable with optical wireless or OW.

This was a period of heavy investment into field trials for the cornerstone Plaintree product, the 500 series of the WAVEBRIDGE FSO links. Although the product worked well, many customers requested modifications to make the product more user-friendly and versatile. As Plaintree's customer base is world wide, these modifications resulted in an increase in expenditures related to travel, sales and customer support as well as engineering. It also meant that testing periods for product evaluations by our VARs (Value Added Resellers) and VAIs (Value Added Integrators) would be extended, thus increasing the sales cycle.

In the fourth quarter of fiscal 2002 Plaintree was advised by a number of potential customers that the WAVEBRIDGE 500 series of product had successfully completed product evaluations and that orders were expected shortly. However, the bulk of these potential orders have been delayed due to a variety of reasons, ranging from current events within our specific markets to recent funding difficulties with some customers. This resulted in lower than expected revenues for the year for the WAVEBRIDGE product line.

It is important to note that these potential customers have indicated that Plaintree remains their FSO product of choice and that the orders are still a priority for their networks.

As a result of the lower than expected revenues, management took measures to reduce costs at the beginning of the fourth quarter of fiscal 2002. These measures included a temporary 30 percent reduction in employees' hours. Following fiscal 2002, the Company experienced further delays in expected orders and management took further steps to cut operating costs through a temporary lay off of approximately 70 percent of its workforce in order to conserve cash until expected sales materialize.

During the year, the Company completed a private placement financing with Targa Group Inc. (Targa), the Company's largest shareholder, and raised net proceeds of \$1,294,030. The Company also established a credit facility with a company controlled by Targa for \$450,000 (see note 9 of the consolidated financial statements). Subsequent to fiscal 2002, this credit facility was increased from \$450,000 to \$600,000.

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.

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.

### **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 22 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)	
	<u>2002</u>	<u>2001</u>
	(thousands of Canadian dollars)	
Current Assets	\$ 3,112	\$ 7,383
Total Assets	\$ 3,711	\$ 9,337
Current Liabilities	\$ 1,153	\$ 828
Total Liabilities	\$ 1,153	\$ 828
Shareholders' Equity	\$ 2,558	\$ 8,509

#### *Statement of Operations Data:*

	Years Ended March 31 (audited)	
	<u>2002</u>	<u>2001</u>
	(thousands of Canadian dollars except loss per share amounts)	
<b>Statement of Operations:</b>		
Revenue	\$ 1,346	\$ 2,000
Gross margin	691	820
<b>Expenses:</b>		
Sales and marketing	2,794	2,482
Finance and administration	970	733
Research and development	2,095	1,240
Write-down of inventory	1,363	1,442
Write-down of intangible assets	743	-
Loss from operations	(7,274)	(5,077)
Interest income	65	410
Other (expense) income	(114)	160
<b>Net Loss</b>	<b>\$ (7,323)</b>	<b>\$ (4,507)</b>
<b>Loss per Share (Basic and Diluted)</b>	<b>\$ (0.08)</b>	<b>\$ (0.06)</b>

## **Results of Operations**

A meaningful analysis of the financial results for fiscal 2002 must take into account the strategic decision to wind down the switching business in the latter part of fiscal 2001 and focus primarily on the FSO optical wireless market. With this in mind, the following is a comparison of the Company's operations for the fiscal year ended March 31, 2002 ("fiscal 2002") to the fiscal year ended March 31, 2001 ("fiscal 2001").

### **Revenues**

The Company began its transition from selling telecommunications switches to focusing almost entirely on optical wireless (LED) communications products in the latter part of fiscal 2001. As a result of this transition, much of the Company's efforts were devoted to developing the WAVEBRIDGE series of optical wireless products and the sales mix shifted to predominately the higher margin FSO product line for fiscal 2002.

Product and service revenue decreased by \$178,024 from \$1,249,620 in fiscal 2001 to \$1,071,596 in fiscal 2002. During the year the Company performed product modifications and experienced extended testing periods from product evaluations of the WAVEBRIDGE 500 series held by our VARs (Value Added Resellers) and VAIs (Value Added Integrators). This resulted in lower product revenues than expected for fiscal year 2002, as there was an increase in the sales cycle which is often subject to delays for approval of program sales with the VARs and VAIs.

Management service fees, consisting of payments for consulting provided to related companies of Targa Group Inc., Plaintiff's largest shareholder, have declined as the Targa Group of companies are relying mostly on their internal management teams that they have strengthened over the past year. Accordingly, management service revenue decreased by \$475,000 from \$750,000 in fiscal 2001 to \$275,000 in fiscal 2002. The Company expects these fees to discontinue in the ensuing fiscal year.

### **Gross Margin**

Gross margin from product and service revenue for fiscal 2002 was 46% compared to 24% in fiscal 2001. The increase was a result of the change in the Company's product mix as there was an increase in sales of the higher margin WAVEBRIDGE optical wireless product line.

The Company expects its current and future WAVEBRIDGE high speed optical wireless products to be less susceptible to pricing pressure than the switching products and that as these products represent a greater portion of the Company's revenues, gross margin will increase or remain at the levels attained for 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 which include commissions for sales representatives, advertising, travel, trade shows and other promotional activities. Sales and marketing expenses increased by \$312,401 from \$2,481,860 in fiscal 2001 to \$2,794,261 in fiscal 2002. The increase was due to sales and marketing initiatives and additional personnel costs associated with implementing these initiatives in order to increase market awareness of the Company as an optical wireless company.

### **Finance and Administration**

Finance and administration expenditures increased by \$237,660 from \$732,780 in fiscal 2001 to \$970,440 in fiscal 2002. The increase was primarily attributable to an increase in professional fees and allowance for doubtful accounts.

### **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 increased by \$865,962 from \$1,239,861 in fiscal 2001 to \$2,094,823 in fiscal 2002. This increase in expenses was predominately related to the Company's on-going development of its WAVEBRIDGE series of optical wireless product line. During the year, research and development personnel increased in number and material costs were incurred in the development and building of initial prototypes as well as addressing product modifications of the WAVEBRIDGE optical wireless product line. The markets for the Company's products are characterized by continuing technological change. As a result, the Company anticipates that research and development expenditures will be required in the foreseeable future.

### **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 in a \$1,362,840 charge against income. Accordingly, the WAVEBRIDGE product line represents 100% of the inventory as at March 31, 2002.

### **Write-down of intangible assets**

After reviewing the components of intangible assets, management determined that it should be written off, as the carry amount of this asset would not be recovered. This resulted in a charge against income of \$742,538.

### **Interest Income (Expense) and Other**

Other income (expense) and interest income decreased by \$619,481 from income of \$570,115 in fiscal 2001 to an expense of \$49,366 in fiscal 2002. The decrease is primarily due to a reduction in cash and short-term investment balances and an increase in the foreign exchange loss. A gain on settlement of claims and debts of the unsecured creditors of the Company pursuant to the BIA proposal was also recorded in fiscal 2001.

### **Net loss**

The net loss for fiscal 2002 was \$7,322,926 or \$0.08 per share compared to \$4,507,266 or \$0.06 per share for fiscal 2001.

### **Liquidity and Capital Resources**

The Company closed fiscal 2002 with no long-term debt and working capital of \$1,959,263, which includes inventories of \$2,062,918 cash, and short-term investments of \$60,159 (net of \$400,000 credit facility owing to a related party) and other items.

The Company steadily increased its inventories over the 2002 fiscal year primarily due to an increase in work in process and finished goods and an increase in raw materials for production to meet the forecasted demand related to the WAVEBRIDGE series of products.

Cash provided by financing activities was \$1,286,820 for fiscal 2002 compared to \$406,551 in fiscal 2001. In fiscal 2002, the Company completed a private placement financing and raised net proceeds of \$1,294,030 compared to net proceeds of \$415,385 resulting from the exercise of agent compensation warrants in fiscal 2001.

Cash flow generated from investing activities totaled \$1,820,009 for fiscal 2002 including capital expenditures of \$132,465 and proceeds from the sale of short-term investments of \$1,925,888. Cash flow used in investing activities for fiscal 2001 totaled \$2,654,144 which included investments in capital assets, capitalized development costs and short-term investments of \$469,442, \$196,657 and \$1,953,216 respectively.

Throughout fiscal 2002, the Company experienced product modifications and extended testing periods for the WAVEBRIDGE products that are ongoing around the world. As a result of these longer than anticipated evaluation periods and lengthier sales cycle, effective May 31, 2002, the Company temporarily laid off approximately 70% of its work force in an effort to reduce expenses and preserve working capital until expected sales materialize.

During fiscal 2002, the Company established a credit facility for \$450,000 with a related company controlled by Targa Group Inc. (Targa), the Company's principal shareholder. As at March 31, 2002 the Company has utilized \$400,000 of this credit facility and on June 27, 2002, this credit facility was increased from \$450,000 to \$600,000.

In addition to the above facility, the Company will 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.

It is the intention of management to begin the process of making an application to the Securities Commissions across Canada for approval to refrain from the requirement to mail the Company's annual report and interim financial statements to its shareholders. Management believes that, given the Company's current financial resources, this action is necessary as the high costs associated with the printing and mailing of its annual and interim financial statements are greatly outweighed by the benefit to the Company of using these funds for the Company's continued operations. 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](http://www.plaintree.com) and at [www.sedar.com](http://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 wishes to note that the actions taken are only on a temporary basis and when the Company's financial situation improves, it intends to recommence the normal mailing of its statements to its shareholders.

*Consolidated Financial Statements of*

**PLAINTREE SYSTEMS INC.**

*March 31, 2002*

## **Independent Auditors' Report**

To the Board of Directors and the Shareholders of  
Plaintree Systems Inc.

We have audited the accompanying consolidated balance sheets of Plaintree Systems Inc. and subsidiary as at March 31, 2002 and 2001 and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years in the two-year period ended March 31, 2002. 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.

With respect to the consolidated financial statements for the years ended March 31, 2002 and 2001, we conducted our audits in accordance with Canadian generally accepted auditing standards and auditing standards generally accepted 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, 2002 and 2001 and the results of its operations and its cash flows for each of the years in the two-year period ended March 31, 2002, in accordance with Canadian generally accepted accounting principles, which also conform in all material respects with accounting principles generally accepted in the United States of America, except as disclosed in Note 22.



Chartered Accountants  
Ottawa, Canada

July 5, 2002

### **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 Canadian generally accepted auditing standards and auditing standards generally accepted in the United States of America, our report to the Board of Directors and the Shareholders dated July 5, 2002 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.

**PLAINTREE SYSTEMS INC.**  
**Financial Statements**  
March 31, 2002

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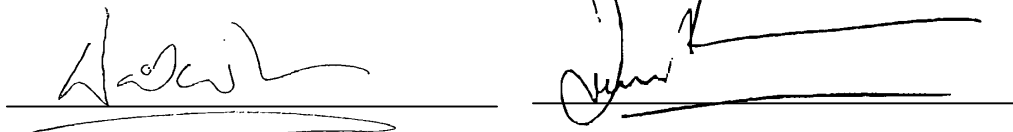
# PLAINTREE SYSTEMS INC.

## Consolidated Balance Sheets

as at March 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
CURRENT ASSETS		
Cash	\$ 432,831	\$ 1,771,973
Short-term investments	27,328	1,953,216
Trade accounts receivable	196,249	384,672
Investment tax credits receivable	246,000	90,000
Current portion of loans receivable (Note 6)	7,027	26,585
Due from related parties (Note 20)	36,878	441,119
Inventories (Note 4)	2,062,918	2,517,792
Prepaid expenses and advance contract payments	103,468	197,795
	<b>3,112,699</b>	7,383,152
LOANS RECEIVABLE (Note 6)	1,216	8,244
CAPITAL ASSETS (Note 5)	597,101	717,341
INTANGIBLE ASSETS (Note 8)	-	1,113,806
DEFERRED DEVELOPMENT COSTS (Note 7)	-	114,717
	<b>\$ 3,711,016</b>	<b>\$ 9,337,260</b>
CURRENT LIABILITIES		
Due to related party (Note 9)	\$ 400,000	\$ -
Accounts payable and accrued liabilities (Note 10)	711,030	754,485
Deferred revenue	42,406	66,089
Current portion of obligations under capital leases (Note 11)	-	7,710
	<b>1,153,436</b>	828,284
CONTINGENCIES AND COMMITMENTS (Note 19)		
SHAREHOLDERS' EQUITY		
Share capital (Note 12)		
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; 2001 - 86,059,869)	97,561,140	96,189,610
Deficit	(94,556,485)	(87,233,559)
Accumulated foreign currency translation adjustment	(447,075)	(447,075)
	<b>2,557,580</b>	8,508,976
	<b>\$ 3,711,016</b>	<b>\$ 9,337,260</b>

APPROVED BY THE BOARD:



See accompanying Notes to the Consolidated Financial Statements

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

	<u>2002</u>	<u>2001</u>
Revenue		
Product and service revenue	\$ 1,071,596	\$ 1,249,620
Management service revenue (Note 20)	275,000	750,000
	<u>1,346,596</u>	<u>1,999,620</u>
Cost of revenue		
Product and service costs	578,109	947,297
Management service costs	77,145	232,710
	<u>655,254</u>	<u>1,180,007</u>
Gross margin	<u>691,342</u>	819,613
Operating expenses		
Sales and marketing	2,794,261	2,481,860
Finance and administration	970,440	732,780
Research and development	2,094,823	1,239,861
Write-down of inventory (Note 13)	1,362,840	1,442,493
Write-down of intangible assets (Note 8)	742,538	-
	<u>7,964,902</u>	<u>5,896,994</u>
Loss from operations	<u>(7,273,560)</u>	(5,077,381)
Interest income (Note 14)	65,317	410,216
Other (expense) income (Note 15)	<u>(114,683)</u>	159,899
NET LOSS	<u>\$ (7,322,926)</u>	<u>\$ (4,507,266)</u>
Basic and diluted loss per share (Note 17)	<u>\$ (0.08)</u>	<u>\$ (0.06)</u>
Weighted average common shares outstanding	<u>86,958,580</u>	<u>81,912,740</u>

See accompanying Notes to the Consolidated Financial Statements

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

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

See accompanying Notes to the Consolidated Financial Statements

# PLAINTREE SYSTEMS INC.

## Consolidated Statements of Shareholders' Equity

years ended March 31, 2002 and 2001

	Common Shares		Special Warrants		Accumulated	Retained	Shareholders' Equity
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Foreign Currency</u>	<u>Earnings (Deficit)</u>	
Balance March 31, 2000	73,216,732	\$ 87,839,496	10,000,000	\$ 7,934,728	\$ (447,075)	\$ (82,726,293)	\$ 12,600,856
Issuance of shares							
Conversion of special warrants net of \$1,044,460 issue costs	10,000,000	7,934,728	(10,000,000)	(7,934,728)	-	-	-
Business arrangement with Targa Group Inc. (Note 12)	2,443,137	1	-	-	-	-	1
Exercise and conversion of agent compensation warrants, net of \$20,615 issue costs (Note 10)	400,000	415,385	-	-	-	-	415,385
Net loss	-	-	-	-	-	(4,507,266)	(4,507,266)
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 12)	3,911,765	1,294,030	-	-	-	-	1,294,030
Issued for services (Note 12)	250,000	77,500	-	-	-	-	77,500
Net loss	-	-	-	-	-	(7,322,926)	(7,322,926)
<b>Balance March 31, 2002</b>	<b>90,221,634</b>	<b>\$ 97,561,140</b>	<b>-</b>	<b>\$ -</b>	<b>\$ (447,075)</b>	<b>\$ (94,556,485)</b>	<b>\$ 2,557,580</b>

See accompanying Notes to the Consolidated Financial Statements

# **PLAINTREE SYSTEMS INC.**

## **Notes to the Consolidated Financial Statements**

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### **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 \$7,322,926 and an accumulated deficit of \$94,556,485 as at March 31, 2002. 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 United States generally accepted accounting principles except as disclosed in Note 22.

#### *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.

# PLAINTREE SYSTEMS INC.

## Notes to the Consolidated Financial Statements

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### 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.

#### *Software licences*

Software licences are recorded at cost and amortized on a per unit basis over the expected life of the underlying products.

#### *Intangible assets*

Intangible assets, consisting of acquired technology assets and goodwill are being amortized on a straight-line basis over a four-year period. 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 and customer acceptance 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.

# PLAINTREE SYSTEMS INC.

## Notes to the Consolidated Financial Statements

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### 3. ACCOUNTING POLICIES (Continued)

#### *Foreign currency translation*

Prior to fiscal 2000, the current rate method was used to translate the financial statements of the Company's foreign subsidiary into Canadian dollars, as the subsidiary was considered to be self-sustaining. The resulting translation adjustment is deferred as a separate component of shareholders' equity until there is a realized reduction in the net investment in the subsidiary.

During fiscal 2000, the foreign subsidiary was considered to be integrated in that it was financially dependent on the Canadian parent company. As a result, commencing in fiscal 2000, the Company is accounting 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.

#### *Financial instruments and 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.

#### *Stock option plans*

The Company has stock option plans as described in Note 12. No compensation expense is recognized for these plans when stock options are issued to employees. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to share capital. If stock or stock options are repurchased from employees, the excess of consideration paid over the carrying amount of the stock or stock option cancelled is charged to retained earnings.

#### *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.

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

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**3. ACCOUNTING POLICIES (Continued)**

*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>2002</u>	<u>2001</u>
Raw materials	\$ 1,088,068	\$ 1,036,090
Work in process	524,850	388,219
Finished goods	450,000	1,093,483
	<u>\$ 2,062,918</u>	<u>\$ 2,517,792</u>

**5. CAPITAL ASSETS**

	<u>2002</u>			<u>2001</u>
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Software	\$ 57,538	\$ 33,282	\$ 24,256	\$ 26,159
Computer and office equipment	2,724,702	2,568,414	156,288	205,774
Other equipment	304,290	304,290	-	-
Furniture and fixtures	142,148	104,249	37,899	49,781
Leasehold improvements	255,657	76,656	179,001	226,462
Land and building	218,672	19,015	199,657	209,165
	<u>\$ 3,703,007</u>	<u>\$ 3,105,906</u>	<u>\$ 597,101</u>	<u>\$ 717,341</u>

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

**6. LOANS RECEIVABLE**

	<u>2002</u>	<u>2001</u>
Note receivable, bearing interest at 6.5%, principal and interest repayable in monthly instalments of \$613, maturing April 2003	\$ 8,243	\$ 14,829
Note receivable, bearing interest at 7.25%, principal and interest repayable in monthly instalments of \$1,700, maturing March 2002	-	20,000
	<b>8,243</b>	34,829
Less current portion	<b>7,027</b>	26,585
Non-current portion	<b>\$ 1,216</b>	<b>\$ 8,244</b>

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

**7. DEFERRED DEVELOPMENT COSTS**

Certain costs related to the development of the Wavebridge<sup>™</sup> optical wireless products were capitalized during fiscal 2001.

	<u>2002</u>	<u>2001</u>
Amount capitalized	\$ 196,657	\$ 196,657
Amortization	196,657	81,940
Balance, end of year	\$ -	\$ 114,717

**8. INTANGIBLE ASSETS**

	<u>2002</u>	<u>2001</u>
Goodwill and acquired technology at cost	\$ 1,485,075	\$ 1,485,075
Less accumulated amortization	742,537	371,269
Less write-down	742,538	-
	<b>\$ -</b>	<b>\$ 1,113,806</b>

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.

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

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**8. INTANGIBLE ASSETS (Continued)**

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.

**9. CREDIT FACILITY DUE TO RELATED PARTY**

The Company has in place an operating credit facility with a Company controlled by Targa Group Inc., the largest shareholder of the Company, under terms and conditions reflecting the prevailing market conditions at the time the credit facility was entered into. The credit facility is secured by a general security agreement covering all assets of the Company and expires on March 25, 2003. Under the terms of the credit facility, the Company can draw on this line of credit to a maximum of \$450,000. As at March 31, 2002, the facility which bears interest at the Company's bank's prime rate plus 2%, amounted to \$400,000.

**10. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

Accounts payable and accrued liabilities are comprised of:

	<u>2002</u>	<u>2001</u>
Accounts payable (Note 20)	\$ 345,760	\$ 156,969
Accrued liabilities	200,825	214,419
Obligations under BIA proposal	-	280,183
Salaries and benefits payable	145,134	93,738
Commissions payable	19,311	9,176
	<u>\$ 711,030</u>	<u>\$ 754,485</u>

**11. OBLIGATIONS UNDER CAPITAL LEASES**

	<u>2002</u>	<u>2001</u>
Various capital lease obligations, bearing interest at rate ranging up to 12.2%, payable in blended monthly instalments ranging from \$250 to \$618 and with expiry dates to December 2001, secured by underlying capital assets	\$ -	\$ 7,710
Less current portion	-	7,710
Non-current portion	<u>\$ -</u>	<u>\$ -</u>

Interest expense on bank loans and obligations under capital leases was \$NIL and \$1,260 for the years ended March 31, 2002 and 2001 respectively.

# PLAINTREE SYSTEMS INC.

## Notes to the Consolidated Financial Statements

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### 12. 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 30<sup>th</sup> 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 30<sup>th</sup> 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, 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 2000 fiscal year the Company issued in fiscal 2002 250,000 common shares to an employee for no cash consideration. All common shares issued resulted in compensation expense being recorded in fiscal 2002 in the amount of \$77,500 which was determined based on the market price of the shares at the time of issuance.

Pursuant to the closing of a business agreement in fiscal year 2000 between Targa Group Inc. (Targa) and the Company the following changes were made to the issued share capital during the 2001 fiscal year:

# PLAINTREE SYSTEMS INC.

## Notes to the Consolidated Financial Statements

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### 12. SHARE CAPITAL (Continued)

1. The Company issued 1,246,000 common shares to Manaca Inc. (a company controlled by a former executive and director of the Company), as compensation for services provided to the Company in connection with the closing of the successful completion of the transactions in the agreement.
2. Following the issuance of the shares to Manaca Inc., the Company issued 1,197,137 common shares to Targa Group Inc. so as to maintain Targa's 49% interest of the outstanding common shares of the Company as contemplated by the agreement and no further common shares are issuable to Targa under the terms of the business agreement.
3. The issuance of the above noted common shares to Targa and Manaca was recorded at \$1 in total each, the estimated fair value of the shares at the time of the transaction, as determined by liquidation value.

Following the filing of a final prospectus on July 13, 2000, 10,000,000 special warrants were converted into common shares. During the 2001 fiscal year 400,000 agent compensation warrants were exercised and the Company issued 400,000 common shares for gross proceeds of \$436,000 less related issue costs of \$20,615.

#### *Warrants*

As at March 31, 2002, 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, 2001, 5,000,000 common share purchase warrants and 400,000 agent compensation warrants remain 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.

#### *Stock option plans*

During the year 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.

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

**12. SHARE CAPITAL (Continued)**

Activity in the stock option plan is summarized as follows:

	Number of Options	Option Price	Weighted Average Option Price
Options outstanding March 31, 2000	1,100,500	\$1.40-\$7.00	\$3.37
Granted during fiscal 2001	850,000	\$0.72-\$1.95	\$1.12
Cancelled	(238,500)	\$1.40-\$7.00	\$4.97
<b>Options outstanding March 31, 2001</b>	<b>1,712,000</b>	<b>\$0.72-\$7.00</b>	<b>\$2.03</b>
Granted during fiscal 2002	2,207,000	\$0.29-\$0.51	\$0.35
Cancelled	(68,000)	\$0.72-\$5.35	\$2.27
<b>Options outstanding March 31, 2002</b>	<b>3,851,000</b>	<b>\$0.29-\$7.00</b>	<b>\$1.06</b>

Of the 3,851,000 options outstanding, 400,000 relate to the 1993 plan.

In May 2000, the Company's Board of Directors approved a reduction to \$1.40 per share in the exercise price for 360,000 employee stock options granted through March 2000, the closing price of the Company's common shares on The Toronto Stock Exchange on the date of change. No options granted to corporate officers were included in the option price reduction.

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
<b>\$ 0.29 - \$ 7.00</b>	<b>3,851,000</b>	<b>4.2</b>	<b>\$ 1.06</b>	<b>998,250</b>	<b>\$ 2.39</b>

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

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**13. WRITE-DOWN OF INVENTORY**

During 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 \$1,362,840 (2001 - \$1,442,493) to reflect estimated recoverable value.

**14. INTEREST INCOME**

Interest income in fiscal 2002 is presented net of interest expense in the amount of \$1,425 (2001 - \$10,337).

**15. OTHER INCOME (EXPENSE)**

Other income (expense) is comprised of the following items:

	<u>2002</u>	<u>2001</u>
Foreign exchange (loss) gain	\$ (129,709)	\$ 5,849
Gain on settlement of debt pursuant to a BIA proposal	-	130,827
Miscellaneous	<u>15,026</u>	<u>23,223</u>
	<u>\$ (114,683)</u>	<u>\$ 159,899</u>

Pursuant to a proposal filed under the Bankruptcy and Insolvency Act (BIA) on September 1, 1999, the Company realized a gain in the amount of \$Nil (2001 - \$130,827) on settlement of claims and debts.

**16. INCOME TAXES**

(a) Investment tax credits

At March 31, 2002, the Company has approximately \$4,846,000 (2001 - \$4,502,000) 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:

2003	\$ 72,000
2004	516,000
2005	799,000
2006	1,314,000
2007	1,561,000
2011	240,000
2012	<u>344,000</u>
	<u>\$ 4,846,000</u>

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

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**16. INCOME TAXES (Continued)**

(b) Tax losses available to carry forward

The Company has losses available to reduce future years' Canadian federal and provincial taxable income totalling approximately \$43,736,000 and \$54,918,000 respectively. These potential benefits expire as follows:

	<u>Federal</u>	<u>Provincial</u>
2003	\$ 4,330,000	\$ 12,018,000
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
	<b>\$ 43,736,000</b>	<b>\$ 54,918,000</b>

The benefits of these losses have not been recorded in the financial statements.

(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 (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:

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

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**16. INCOME TAXES (Continued)**

	<u>2002</u>	<u>2001</u>
Statutory income tax rate (Canada)	<b>40.88%</b>	43.1%
Expected recovery for income tax	<b>\$ (2,993,612)</b>	\$ (1,942,631)
Reversal of timing differences, the benefit of which are not recorded	<b>929,491</b>	294,604
Benefit of loss carryforward not recorded	<b>2,057,214</b>	1,644,895
Other	<b>6,907</b>	3,132
Reported income tax provision	<b>\$ -</b>	\$ -

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

	<u>2002</u>	<u>2001</u>
Accounting amortization in excess of tax	<b>\$ 2,386,000</b>	\$ 2,690,000
Research and development expenses not deducted for tax purposes	<b>6,203,000</b>	5,634,000
Losses available to offset future income taxes	<b>12,078,000</b>	17,255,000
Other	<b>192,000</b>	361,000
Deferred income tax assets before valuation allowance	<b>20,859,000</b>	25,940,000
Less valuation allowance	<b>(20,859,000)</b>	(25,940,000)
Deferred income taxes	<b>\$ -</b>	\$ -

**17. LOSS PER SHARE**

Loss per share have been calculated on the basis of net loss less dividend accrued on preferred shares divided by the weighted average number of common shares outstanding during the year. 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.

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

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**18. CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS**

	<u>2002</u>	<u>2001</u>
Trade accounts receivable	\$ 188,423	\$ 839,294
Investment tax credits receivable	(156,000)	(90,000)
Due from related parties	404,241	(345,447)
Inventories	454,874	(1,358,105)
Prepaid expenses and advance contract payments	94,327	(87,505)
Due to related party	400,000	-
Accounts payable and accrued liabilities	(43,455)	(1,082,072)
Deferred revenue	(23,683)	66,089
	<u>\$ 1,318,727</u>	<u>\$ (2,057,746)</u>

**19. COMMITMENTS AND CONTINGENCIES**

The Company is committed under lease contracts for the rental of certain premises and certain equipment in the aggregate amount of approximately \$414,000.

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

<b>2003</b>	<b>\$ 114,000</b>
<b>2004</b>	<b>113,000</b>
<b>2005</b>	<b>108,000</b>
<b>2006</b>	<b>79,000</b>
	<u><b>\$ 414,000</b></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 expires February 2003. These products were not sold during 2002 or 2001. This royalty does not apply to the Company's WaveSwitch line of products.

The Company is one of numerous defendants in a patent infringement claim. The Company believes that the patents involved are either invalid or do not cover its products, and in 1998 the Court entered a stipulated judgement that the Company and the other defendants did not infringe the asserted patents. The claim is currently before the U.S. Court of Appeals for the Federal Circuit and the Company intends to defend the claim vigorously. Because the outcome of the action is not certain at this time, no provision for any liability that may result from this appeal has been made in these consolidated financial statements.

The Company is involved in a claim with an employee concerning certain conditions of their employment contract. The Company believes these actions to be unfounded, lacking in merit and intends to defend the claim vigorously. As the outcome of this claim cannot be ascertained at this time, no provision for any liability that may result from this appeal has been made in these consolidated financial statements.

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.

# PLAINTREE SYSTEMS INC.

## Notes to the Consolidated Financial Statements

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### 20. RELATED PARTY TRANSACTIONS

The Company leases facilities in Canada from a company controlled by Targa Group Inc., the largest shareholder of the Company, under terms and conditions reflecting prevailing market conditions negotiated at the time the leases were entered into. The annual lease cost related to these facilities is \$105,828 and the leases expire on January 1, 2006. The total amount owing to this related party amounted to \$94,644 and is included in accounts payable as at March 31, 2002.

The Company performed consulting and management services under an agreement between the Company and corporations controlled by Targa Group Inc.. The consulting and management fees billed under the agreement which were based on negotiated amount, totalled \$275,000 (2001 - \$750,000). These fees are included in revenue, and the related costs of \$77,145 (2001 - \$232,710) are included in cost of revenue.

The amounts arising from the related party transactions are shown as current assets and current liabilities on the balance sheet.

### 21. 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>2002</u>	<u>2001</u>
Canada	\$ 519,559	\$ 1,066,752
United States	361,750	470,748
Europe	31,211	330,274
Other	434,076	131,846
	<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 one customer during the year ended March 31, 2002 who accounted for 27 percent of the total. In 2001, two customers accounted for 35 percent of total revenue. As disclosed in Note 20, all of the management service revenue came from related parties.

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

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**22. 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, 2002 and 2001 and the shareholders' equity for the years ended March 31, 2002 and 2001 would be adjusted as follows:

	Net loss	
	<u>2002</u>	<u>2001</u>
Canadian GAAP	<b>\$ (7,322,926)</b>	\$ (4,507,266)
Adjustment to development costs (a)	<b>114,717</b>	(114,717)
Adjustment to operating expenses relating to share issuances (b)	<b>121,875</b>	(121,875)
US GAAP	<b>\$ (7,086,334)</b>	\$ (4,743,858)
Basic and diluted loss per share based on US GAAP	<b>\$ (0.08)</b>	\$ (0.06)
	Shareholders' equity	
	<u>2002</u>	<u>2001</u>
Canadian GAAP	<b>\$ 2,557,580</b>	\$ 8,508,976
Adjustment to development costs (a)	-	(114,717)
Adjustment to operating expenses relating to share issuances (b)	-	(121,875)
US GAAP	<b>\$ 2,557,580</b>	\$ 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 \$114,717 (2001 - (\$114,717)). Closing deficit and shareholders' equity would have been adjusted by \$Nil (2001 - \$114,717). The basic and diluted loss per share would be (\$0.08) (2001 - (\$0.06)).

**PLAINTREE SYSTEMS INC.**  
**Notes to the Consolidated Financial Statements**

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**22. 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>2002</u>	<u>2001</u>
Net loss as reported for US GAAP purposes	<b>\$ (7,086,334)</b>	\$ (4,743,858)
Estimated stock based compensation costs	<b>(385,519)</b>	(344,018)
Pro forma net loss	<b>\$ (7,471,853)</b>	\$ (5,087,876)
Pro forma basic net loss per share	<b>\$ (0.09)</b>	\$ (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>2002</u>	<u>2001</u>
Expected option life (years)	<b>4.5</b>	4.5
Volatility	<b>130%</b>	129%
Risk free interest rate	<b>3.5%</b>	5.6%
Dividend yield	<b>NIL</b>	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

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#### 22. 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 \$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 \$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 \$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. The investment for the 2001 fiscal year is a bankers acceptance that matured on November 30, 2001 and earns interest at a rate of 5.87% per annum.

##### (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.

# PLAINTREE SYSTEMS INC.

## Notes to the Consolidated Financial Statements

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### 22. RECONCILIATION TO UNITED STATES GAAP (Continued)

#### (g) *Recent United States Accounting Standards*

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements". SAB 101 provides guidance on applying generally accepted accounting principles to revenue recognition issues in financial statements. The Company was required to adopt SAB 101 during fiscal 2001. The adoption of SAB 101 did not have a material effect on its financial position or results of operations.

In March 2000, the FASB issued Interpretation No. 44 ("FIN 44") "Accounting for Certain Transactions Involving Stock Compensation", which addresses certain accounting issues which arose under the previously established accounting principles relating to stock-based compensation. The adoption of this interpretation did not have a material effect on the Company's financial position or results of operations.

In July 2001, the FASB issued SFAS No. 141, "Business Combinations" ("SFAS 141"), effective for business combinations initiated after June 30, 2001, and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142") effective for fiscal years beginning after December 15, 2001. SFAS 141 transitional rules require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. The adoption of SFAS 141 and SFAS 142 did not have an impact on the business, results of operations, and financial condition of Plaintiff Systems Inc..

### 23. SUBSEQUENT EVENTS

On May 31, 2002, the Company temporarily laid off approximately seventy percent of its workforce. Because the expected return of the temporarily laid off employees is not certain at this time, the cost of severance and benefits, if any, associated with the temporarily laid off employees will be recorded when determinable. The potential liability, if any, that may result from these laid off employees is estimated to be approximately \$260,000.

On June 27, 2002, the Company increased its credit facility as described in Note 9 from \$450,000 to \$600,000. Also, the landlord for its Ottawa premises, a subsidiary of Targa Group Inc., has agreed to defer rental amounts owing and to allow such lease arrears to grow until the earlier of January 2003 and when regular monthly payments resume. In exchange for this agreement, the Company has agreed to grant a collateral mortgage over its land and building property in Arnprior to the landlord as security for the lease arrears.

# Plaintree Systems Inc.

## *Board of Directors*

W. David Watson II  
President & Chief Executive Officer

William D. Watson  
Chairman of the Board

Girvan L. Patterson  
CFO, Northland Systems Training Inc.

James A. Richardson  
Chairman and CEO, Manaca Inc.

Robert E. Shea  
Chairman, Shea Financial Group

Matthew Scott Sinclair  
Chairman, Merchant Capital Group

## *Executives and Officers*

W. David Watson II  
President & Chief Executive Officer

Dino B. Chiumera  
Chief Financial Officer

Lynn E. Saunders  
Vice President, Operations

Jason Lee  
Vice President, Business Development

## *Principal Offices*

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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., 8<sup>th</sup> 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