

MANAGEMENT'S DISCUSSION & ANALYSIS

November 15, 2004

The following discussion of Matrikon's financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes for the year ended August 31, 2004, which have been prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP). All dollar amounts in this discussion are in Canadian dollars unless otherwise specified. Additional information about Matrikon, including the Annual Information Form is available on SEDAR at www.sedar.com.

All statements in this report that do not directly and exclusively relate to historical facts constitute forward-looking statements that involve risks, uncertainties and other factors, many beyond our control, which may cause actual results to differ materially. These forward-looking statements represent Matrikon's intentions, plans, expectations and beliefs and relate to, among other things, plans and timing for the introduction or enhancement to our services and products, expectations concerning future revenue and earnings, market opportunities and the sufficiency of capital to meet requirements.

These forward-looking statements are based on our experience, our perception and assessment of historical and future trends, and the application of key assumptions relating to future events and circumstances. The factors that could cause actual results to differ materially are described in the Risks Related to our Business section of the MD&A.

Readers should note that some assumptions, although considered to be reasonable at the date the forward-looking statement was made, might not materialize. Forward-looking statements are not guarantees of future performance.

This report includes references to and uses terms that are not specifically defined in the Canadian Institute of Chartered Accountants Handbook and do not have any standardized meaning prescribed by GAAP. These non-GAAP measures may not be comparable to similar measures presented by other companies. Matrikon refers to and uses the terms "gross margin", "utilization" and "factor report" throughout this analysis. The definition of factor report and utilization is provided when the term is first introduced.

COMPANY OVERVIEW

Matrikon is a growing international provider of industrial plant intelligence solutions that enable plants to produce their goods more efficiently. Solutions include data acquisition and storage, data analysis for plant optimization, decision support systems, data connectivity and web-delivered data presentation for improved collaboration. Matrikon is one of the largest industrial solution integrators in North America with a client base diversified across a number of industries, including oil and gas, energy and utilities, forestry, chemicals and refining, and mining. With our diversified client base, no single client accounts for more than 6% of our business.

Matrikon is listed on the Toronto Stock Exchange under the trading symbol "MTK". As at November 15, 2004 there were 29,474,364 common shares of the corporation issued and outstanding and 1,939,926 options outstanding.

At August 31, 2004, Matrikon had 465 employees, including 52 in administrative services, 64 in sales and marketing, 67 in product development and support and 282 in professional services (integration and consulting).

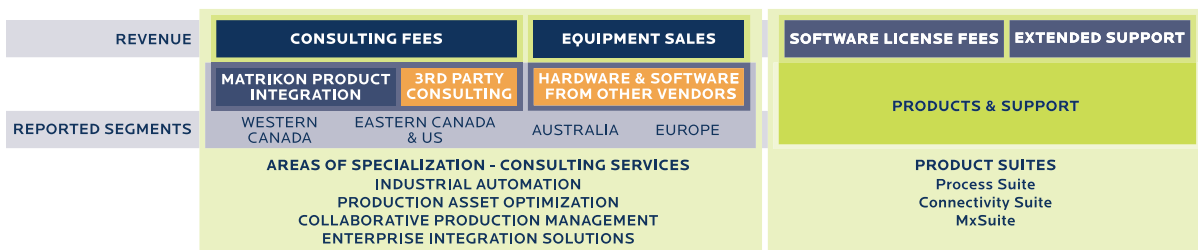
Revenue is derived from four different sources: Consulting fees (consisting of system integration related to third party products or Matrikon's proprietary products), Equipment sales (the reselling of third party software or hardware in the course of consulting engagements), Software license fees and the related Extended support. The diagram below shows the relationship of revenue sources and Matrikon's business segments discussed in this report.

Our integration and consulting services deliver value by ensuring that the plant infrastructure is in place to achieve optimal performance, providing applications to meet specific needs through custom programming and integrating various proprietary and third party products to create a customized solution. Our service expertise covers all aspects of plant information technology from plant design to asset management and audits of advanced control technologies.

Our products are arranged into three different suites:

Process Suite

Solutions in the Process Suite include alarm management, equipment monitoring, condition-based maintenance, advanced control technologies, downtime reporting, optimization and data visualization. Process Suite solutions are designed for process industry environments where goods



● IMPLEMENTATION ● CONSULTING ● PRODUCT RELATED

are produced continuously (oil and gas, chemicals and refining, utilities) and for batch industry environments where a large quantity of material is made and then individually packaged for consumer consumption (pharmaceuticals, food and beverage).

Connectivity Suite

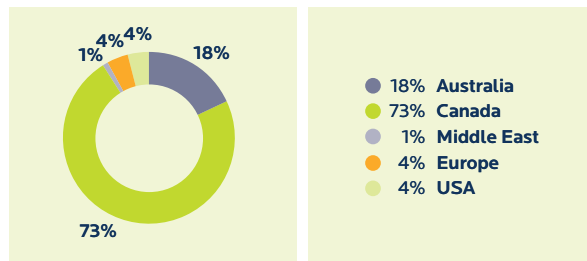
We are one of the world's largest suppliers of real-time industrial connectivity. Matrikon's Connectivity Suite includes a collection of over 500 drivers and related tools with a global install base of 100,000. Connectivity is vital to our other product suites as it enables communication between the myriad of plant data systems available on the market today.

MxSuite™

MxSuite solutions are designed for the discrete manufacturing environment where goods are made one at a time, usually on an assembly line (automotive, equipment and component manufacturing). Solutions in the MxSuite include planning and scheduling, assembly line sequencing, plant floor monitoring and data visualization.

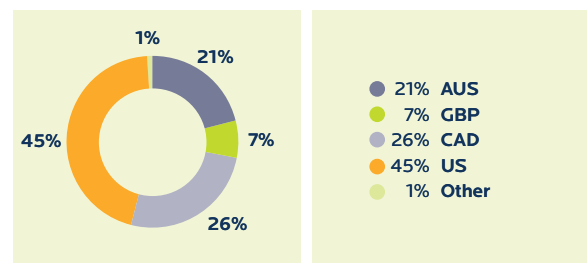
To support our global customer base, Matrikon has 16 offices around the world, with six in Canada (including our head office in Edmonton), five in Australia, three in the United States and one each in the Middle East and Europe.

EMPLOYEES BY REGION



We operate internationally, with a substantial portion of our business conducted in foreign currencies.

REVENUE BY CURRENCY



VISION AND STRATEGY

Matrikon's long-term strategy is to become the market leader in industrial plant intelligence solutions that solve the three primary issues faced by industrial facilities: performance, reliability and compliance – each of which has a direct impact on our customers' profitability.

Management believes that the company's innovative products and depth of expertise are well-suited to accomplishing this strategy. The size and scope of customer projects that use both Matrikon's proprietary products and professional services continue to grow. In 2004, the average value of projects over \$100,000 was \$384,000, a 34% increase over 2003. In addition, the number of projects over \$100,000 increased by 44% to 85 in the same period.

In addition, management believes that the company has made significant progress in the transition from a systems integrator to a solutions provider as evidenced by the commercial success and continued development of our proprietary products emphasizing solutions for the total enterprise. In 2004, thirteen clients signed corporate license agreements for specific Matrikon products or for entire product suites, compared to eight in 2003 and two in 2002.

In 2005, Matrikon will focus on three strategic areas:

- Integrating our products into suites, both technically and in terms of the solutions they deliver and the issues they resolve.
- Leveraging our people expertise to deliver higher value solutions to our clients.
- Continuing our focus on improving efficiency and developing our greatest asset – our people.

Scorecard: stated targets to actual results

	Target	Actual	Note
Revenue Growth	20-40%	11%	Original target 20-40% growth (Q403 announcement) Revised target 0-10% growth (Q204 announcement) Organic revenue growth (excluding revenue of European acquisition) of 8%
Net Income	20-40%	2%	Original target 20-40% (0.11 – 0.13 EPS) growth (Q403) Revised target 0-10% (0.09 – 0.10 EPS) growth (Q204)
Software licenses and related support	25-30% of revenue	26%	2003 Annual Report
Increase average project value	-	34%	2003 Annual Report Average project value for projects over \$100k increased by 34% to \$384k compared to 2003
Increase service revenue from integrating MTK products	25-30% of revenue	29%	2003 Annual Report
4th Quarter gross margin	50-55%	55%	Q304 announcement

Matrikon's growth strategy focuses on four fundamentals: technological advancement and innovation; complementary professional services; geographic expansion; and vertical industry expansion. These growth strategies are achieved through both organic growth and strategic acquisitions. The following table outlines the progress made on objectives for 2004 set at the beginning of the year.

Growth Strategy	2004 Objectives	2004 Results
Geographic Expansion	<ul style="list-style-type: none"> Continue development of distributor program Expand into Europe Continue expansion in Australia 	<p>REVENUE BY REGION</p> <ul style="list-style-type: none"> Increased international revenue (outside North America) from 29% of revenue in 2003 to 37% of revenue in 2004 2 distributors (Korea & Germany) have licensed the Matrikon name and are exclusively selling Matrikon solutions Acquired PI Automation in Scotland in May, for our first European office. Australian operations expanded into 2 new regions and increased employee base by 10%
Technical Innovation	<ul style="list-style-type: none"> Ongoing product development based on industry feedback Establish additional research chairs with leading industrial computing universities 	<p><i>Matrikon's tree map technology makes it possible to instantly pick out key issues visually (based on block size and color) instead of sorting through 1000s of files to find important information. This functionality is a direct result of client requests for a method of sorting through information.</i></p> <ul style="list-style-type: none"> New versions of all products released, some with significant technological innovations. All new features and enhancements are the result of client input into our product direction. <p>ProcessDoctor Tai Ji automates the previously complex, manual process of retuning a plant's automation system. This results in a significant reduction in the time required to ensure a plant is running optimally, reducing it from approximately two months to about one week.</p> <p>Matrikon also introduced tree mapping technology, which enables users to visually see critical plant issues at a glance instead of looking through volumes of reports.</p> <ul style="list-style-type: none"> 3 new research chairs were established (2 at the University of Alberta, 1 at the University of Newcastle), all in partnership with a major client
Vertical Market Expansion	<ul style="list-style-type: none"> Continue focus on increasing presence in discrete manufacturing industries and on developing products that meet industry specific needs 	<p>REVENUE BY INDUSTRY</p> <ul style="list-style-type: none"> While progress has been made in the discrete industry, Matrikon's vertical market strategy has shifted to emphasize specific solutions for Matrikon's traditional process markets. The main industry focus areas are: oil & gas, refining & chemicals, power & utilities and mining.
People Expertise	<ul style="list-style-type: none"> Continue to develop service expertise in asset management disciplines, such as asset monitoring, expert analysis and automatic maintenance scheduling for condition-based maintenance consistent with our strategy to advance our service business 	<ul style="list-style-type: none"> Matrikon employs 17 Certified Enterprise Asset Management product consultants (9 in North America), an increase of 113% over 2003 Significant new asset management projects, including \$3.3 million Syncrude project

KEY PERFORMANCE DRIVERS & CAPABILITY TO DELIVER RESULTS

Several key performance drivers affect our ability to deliver value to our clients and therefore achieve our strategic vision and build long term value for our shareholders. These critical factors include our ability to attract and retain a highly skilled workforce, our ability to develop innovative products and continually increase their market share, our ability to operate efficiently and sustain growth, and our ability to attain the financial resources required to achieve our objectives.

An exceptional team

Our people are our finest asset. They drive our ability to be successful by developing innovative technology, delivering value to our clients through our integration and consulting services, supporting our customer base and developing long-term relationships with our clients. Matrikon recognizes that our ability to attract and retain quality people is fundamental to our success. Therefore, we emphasize the development of a sustainable corporate culture that values performance, leadership and innovation and provides exceptional opportunities for growth and career development.

Employee base growth and utilization are the primary performance measures used with respect to our workforce. Our team increased by 4% to 465 staff at August 31, 2004 from 448 on the same date in 2003. Utilization, which measures billable time against the total available time for each employee, also improved from 73% in September 2003 to 79% in August 2004. However, average utilization decreased to 72% in 2004 from 76% in 2003, primarily as a result of project delays in the second quarter and beginning of the third quarter.

We made a number of changes to our executive team over the past few months to ensure that we have the people in place to drive the initiatives needed to meet our growth objectives.

Shafin Kanji, former chief financial officer, was promoted to the new position of executive vice president of operations with the responsibility of ensuring our services business is growing, profitable and efficient.

Floyd Bjorgan returned to Edmonton as vice president of human resources after successfully completing the integration of our Australian subsidiary. His responsibility is to ensure that Matrikon is an exciting place to be, that our people assets are being trained effectively so that careers can grow as the company grows and to build the Matrikon culture.

Nimal Rodrigo has joined the Matrikon team to fill the chief financial officer position and ensure that Matrikon remains financially healthy as we continue to grow.

Sam Crisafulli has been promoted to managing director for Australian operations. Sam brings a wealth of experience to this position, having held senior positions within Hunter

Control as well as UNAC, both of which now form part of Matrikon's operations in Australia.

We believe that we have the human capital in place today to achieve our objective of growing to \$100 million in revenue. The critical factor for continued growth is our ability to develop tomorrow's leaders to enable international expansion while ensuring that our culture and values are maintained. To this end, Matrikon recently introduced two new employee programs to develop tomorrow's leaders. The focus of the first is the development of a formal technical career advancement plan to provide greater career opportunities and job satisfaction for those employees who prefer to fulfill technical roles. The second aspect is the formalization of our employee development strategy covering training in three critical areas: project management, technology and leadership.

Innovative technology

Our successful transition to a solutions company requires that we continue to develop innovative technology. Our commitment to innovation is achieved through continual research and development, award-winning collaboration with leading educational centers and collaboration with our clients to ensure that our products meet their current and future needs.

A primary method for efficiently developing new technology is through consulting engagements. When technology is developed during a project, we maintain intellectual property rights and in many cases are encouraged to commercialize the technology to ensure future development and support. Each product that we sell today was created as a result of a need that a client expressed or that we recognized through the course of consulting engagements.

Matrikon's product development is enhanced by our partnership with educational institutions. Through Matrikon sponsored research chairs, we collaborate with industrial clients and graduate students to commercialize leading edge technology. In fiscal 2004, Matrikon established three new research chairs, each in partnership with a significant client.

To further ensure that our product development addresses the technology priorities of our clients, Matrikon established a product advisory board for each product suite in 2002. Each advisory board is comprised of clients who have embraced our technology. The advisory board meets bi-annually to review product direction and discuss priority features and functionality. The advisory boards serve to keep our product development cycle in touch with the evolving needs of our clients. By giving our clients a voice in our technology direction, we develop an even stronger partnership with them while ensuring that our technology is heading in the right direction.

The primary measure of our success in technological innovation is the number of new product introductions and upgrades to existing products over the course of the year. In 2004, Matrikon released new versions of all products in the Process Suite, including several releases with significant technology advancements. Our priority for product development in 2005 is to integrate our products more tightly to deliver a solution suite for industrial plant intelligence that provides real solutions to the real issues faced by industry.

Improving operating efficiency

In order to enhance shareholder value, we must operate efficiently and thus we continually seek out ways to improve our efficiency.

The two measures used to determine operating efficiency are gross margin and factor reports. In 2004, our gross margin declined to 50% from 52% in 2003 and was on the low end of our target range of 50% to 55%. Full year gross margin was negatively impacted in the second quarter due to increased personnel, delayed projects and cost overruns on three projects. Gross margin in the fourth quarter of 2004 was 55% as a result of strong products sales and growing support revenue, which have a higher margin than services business.

The factor report is an internal measure of operating efficiency and is calculated by subtracting project expenses from total billings and dividing the result by payroll. The overall factor at the end of 2004 was 2.26, a slight decrease from the factor of 2.27 at the end of 2003.

Sustained growth

Since 2000, Matrikon has enjoyed a compound annual growth rate of 30% for revenue and 43% for net income. Our ability to continue to grow at this rate is predicated upon several factors, the most significant current factor being the sales and marketing to support this growth target.

Over the past three years, we have made a considerable investment in sales and marketing infrastructure to drive Matrikon's transition to a solution integrator and to expand the use and adoption of our proprietary products. Sales and marketing expenditures increased by 55% in fiscal year 2004 over the comparable period of 2003. In addition, we have dramatically increased our sales team (from 35 at the end of 2002 to 64 at the end of 2004) to support our drive to increase product sales and win larger projects. This investment has been and is continuing to drive our growth and ability to capitalize on the significant potential that exists for our solutions.

The strategic account management focus of the sales organization has resulted in an increase in the number of large scale projects of 44% over 2003, while the average value of projects over \$100,000 increased by 34% in the same period. In addition, the number of new corporate license agreements increased from 8 in fiscal year 2003 to 13 in 2004.

The tactical focus of the marketing team is developing collateral to support sales personnel, generating leads, generating general awareness and developing tighter bonds within the Matrikon user community.

In May 2004, Matrikon held its first annual users group event, which was well attended by clients and partners from across North America, Europe, Australia, Asia, the Middle East and South America. The users group was successful in introducing existing clients to the full range of products and services Matrikon offers, identifying additional business opportunities that exist with these clients and in moving some opportunities to the corporate level.

Another marketing tactic is workshops, which we use to educate existing and potential clients about specific industry issues (for example: alarm management, connectivity and redundancy). This provides an opportunity for Matrikon to showcase its products while demonstrating proficiency in the resolution of these issues. In 2003 these workshops were provided free of charge. Due to the popularity of and demand for these workshops, we began charging attendees in 2004.

Financial resources

Matrikon's philosophy with respect to managing finances has always been to remain profitable and free of long-term debt. Our growth to date has been primarily funded by internal cash flow, supplemented by a line of credit and private equity placements.

In September 2003, Matrikon raised \$10 million through a private placement, allowing institutional investors to obtain a larger position in the company. This cash infusion improved our financial flexibility and enabled Matrikon to complete the \$7.68 million acquisition of PI Automation in May 2004.

Our financial condition is stable, with cash flow positive operations, no debt and an unused line of credit. We believe our financial position is adequate to carry out current growth strategies and do not anticipate the need to seek additional equity financing in 2005.

COMPETITIVE MARKET & EXTERNAL ENVIRONMENT

Matrikon is proud to be one of the Top 50 Control companies in North America (source: Control magazine). Matrikon was #50 on the list in 2002 and moved up to #42 in 2003 (based on 2002 revenue). Although we continue to move up in the rankings, our revenues account for just over 1% of the total potential market worldwide (\$3.1 billion US in 2004 with a compound annual growth rate of 10.88% through 2008 based on the research of ARC Advisory Group, an industry research and technology advisory company). We see a significant opportunity to continue to improve our standing on this list and increase our market share.

Matrikon is engaged in multiple business segments in various markets around the world, therefore competition varies for each business segment, product segment and geographic region.

Broadly, Matrikon's competition consists of:

- small system integrators or product companies that compete in one or two aspects of our business, generally in a defined geographic market
- a few mid-size companies (1,000+ employees, revenue in excess of US\$200 million) with competing products and service groups
- major global process control companies (10,000+ employees, revenue in excess of US\$1 billion, primarily hardware vendors with some products and services that compete with Matrikon)

The industry in which we operate has been characterized by numerous mergers and acquisitions over the past decade, leaving a very large gap between the small system integrators and the major global control companies. According to Control magazine, 40% of the companies named on the original Top 50 Control companies list in 1995 have disappeared via acquisition. This consolidation has left a void that Matrikon is well positioned to fill.

According to ARC Advisory Group, the key growth industries over the next few years include oil and gas, pharmaceutical, automotive and forestry. The fastest growing regions will be Europe, the Middle East and Africa.

ITEMS OF NOTE IN 2004

Fiscal year 2004 started off with a record quarter and much excitement about our potential. However, the second quarter of 2004 – the first quarter in which we recorded a net loss as a public company – was a huge disappointment, both to our shareholders and internally. It was also a significant opportunity to bring focus to our internal processes, improve efficiencies and ensure that our overall objectives are linked and aligned with individual responsibilities.

To this end, we made a number of changes to our executive team to ensure that we have the people in place to drive the initiatives needed to meet our growth objectives.

In addition, improved processes and infrastructure are now in place to better monitor large projects and keep them on time and on budget. Our services business continues to move up the value chain as we focus on delivering more strategic services that command higher rates for the specialized knowledge they require. Last year we focused on building expertise in enterprise asset management. As a result of this focus, we now have 17 certified enterprise asset management consultants world-wide and have begun to win some significant projects in this area.

As a result of our internal focus over the last half of the year, Matrikon is stronger and better prepared to achieve the next phase of growth.

Acquisitions

In May 2004, we acquired PI Automation Limited, a system integrator and Matrikon distributor based in Scotland. With the combination of Matrikon and PI Automation (now Matrikon Europe Limited) technology, resources, geography and domain expertise, management believes that the company is well-positioned to increase market penetration in Europe. Europe had been a targeted area for geographic expansion and growth at the outset of fiscal year 2004. The integration of Matrikon Europe is completed and we see solid potential for continued growth and strong results from the region.

The following tables segregate the consolidated statement of income and retained earnings and the consolidated balance sheet of Matrikon Inc. for the year ended and as at August 31, 2004 between what the results would have been had the acquisition of PI Automation not occurred and the impact of the acquisition on the consolidated results, including the impact of acquisition costs and the impact of the allocation of the purchase price, which were not limited to Matrikon's Europe segment:

12 Months ended August 31, 2004 (CAN \$000s)	Matrikon Inc. excluding acquisition		Effect of Europe acquisition		Consolidated	
		% of revenue		% of revenue		% of revenue
INCOME STATEMENT						
Total revenue	\$52,787	100	\$1,609	100	\$54,396	100
Cost of sales	26,304	50	881	55	27,185	50
Gross margin	26,483	50	728	45	27,211	50
Total expenses	22,978	44	547	34	23,525	43
Income before income taxes	3,863	7	425	26	4,288	8
Net Income	2,328	4	350	22	2,678	5

As at August 31, 2004 (CAN \$000s)	Matrikon Inc. excluding acquisition		Effect of Europe acquisition		Consolidated	
BALANCE SHEET						
Current assets	31,937		(3,851)		28,086	
Non current assets	9,102		5,856		14,958	
Total assets	41,039		2,005		43,044	
Current liabilities	8,918		1,528		10,446	
Non current liabilities	295		127		422	
Total liabilities	9,213		1,655		10,868	
Total shareholders' equity	31,826		350		32,176	

While we expect to achieve our fiscal year 2005 growth targets through organic growth, we continue to actively seek acquisition candidates to complement our growth strategy.

Lawsuit

Matrikon and OSIssoft, Inc. finalized a settlement agreement and have discontinued their respective lawsuits against each other. Matrikon does not expect the settlement to have a material impact on its business.

Canadian dollar appreciation

We operate internationally with approximately 74% of our business conducted in foreign currencies, predominantly US and Australian dollars and British pounds. Accordingly, our results are affected by the year-over-year exchange rate fluctuations of various currencies relative to the Canadian dollar. Matrikon recorded a foreign currency translation loss of \$0.18 million in 2004 compared to a foreign currency translation loss of \$1.01 million in 2003.

From time to time, Matrikon enters forward contracts to partially hedge exposure to currency fluctuations between the US and Canadian dollars. Approximately 45% of the company's revenues are received in US dollars while 75% of expenses are in Canadian dollars.

During the rapid decline of the US dollar relative to the Canadian dollar over the past two years, Matrikon reviewed its forward contracts policy and adjusted its pricing. Matrikon believes that its practices for mitigating the impact of currency fluctuations are sufficient, although the company recognizes that this risk cannot be fully mitigated when exchange rates fluctuate very rapidly or if all currencies move in the same direction in comparison to the Canadian dollar. When this occurs, there is likely to be an impact to net income. In general, it is Matrikon's policy not to exchange currency held unless required, thus minimizing the long term impact.

It is management's belief that Matrikon's continued global expansion functions as an offset to currency fluctuations by diversifying the currencies used and thereby lessening the company's dependency on any one currency. Revenue from international business increased to 37% in 2004 from 29% in 2003 and is expected to continue to increase as we progress with our geographic expansion strategy.

RESULTS OF OPERATIONS

Selected annual information

Software license fees and related support continue to drive revenue growth through 2004 and increased by 22% over fiscal year 2003.

12 Months ended August 31 (CAN \$000s)	2004		2003		2002		03 to 04 % Change
		%		%		%	
Total Revenue	\$54,396	100	\$48,880	100	\$37,339	100	11
Consulting fees	34,556	64	33,353	68	27,645	74	4
Equipment sales	5,508	10	3,816	8	3,294	9	44
Total services and related	40,064	74	37,169	76	30,939	83	8
Software license fees	9,804	18	8,753	18	4,163	11	12
Extended support	4,528	8	2,958	6	2,237	6	53
Total product and related	14,332	26	11,711	24	6,400	17	22
Net income	2,678	5	2,625	5	1,550	4	2
Earnings per share - basic	0.09		0.11		0.07		(18)
Earnings per share - diluted	0.09		0.11		0.07		(18)
Total assets	43,044		27,388		23,723		57
Total long term liabilities	422		-		-		
Weighted average shares outstanding	28,729		24,221		22,982		19

Software license fees and related support totaled 26% of revenue for the year. Management believes that the potential to grow software license revenue and extended support in 2005 and beyond is significant and will be the future cornerstone of company growth. Product momentum continues to build as next generation versions of each product are released. Industry feedback on new product innovations has been very positive. Management believes that specific products are gaining rapid acceptance in concept and have the potential to grow dramatically over the next few years. To date, license revenue has been unpredictable and has fluctuated period by period. This volatility is expected to continue.

Support revenue increased by 53% in fiscal year 2004 compared to 2003. The baseline of \$1.00 million per quarter in support revenue established at the beginning of 2004 continues to grow, following strong product sales. Management expects continued growth in support revenue as software licenses continue to grow.

Equipment sales, which include third party software and hardware, increased by 44% over fiscal year 2003. Equipment sales are ancillary to consulting engagements and will continue to fluctuate each period. In 2004, \$3.00 million of the equipment sales were related to projects in Australia.

Year-to-date consulting fees grew by 4% over fiscal year 2003. Management expects consulting to grow at approximately 20% in the future, driven by asset management projects, higher end consulting services and integration related to Matrikon's proprietary solutions.

Year-to-date revenue from product licensing, support and related training was 27% of revenue; revenue from the implementation of Matrikon products was 29%; and consulting revenue (related to third party products or general consulting) was 44%. Implementation and consulting percentages have been restated to more accurately reflect the respective percentage of each revenue source based on internal reporting. Matrikon's long-term goal is to achieve a balance of one-third revenue for each of these aspects of our business.

Segment revenues

Starting with the second quarter of 2004, management modified the company's business segments to align with current business management practices. Matrikon evaluates each business unit's performance and reports segmented information according to this structure. In the third quarter a new segment – Europe – was added to reflect our new European business unit following the acquisition of PI Automation. This segment includes Matrikon Europe's results from May 19, 2004 to August 31, 2004.

12 Months ended August 31, 2004 (CAN \$000s)	Eastern Canada / USA	Western Canada	Australia	Europe	Products	Total
Revenue	7,591	19,677	10,176	1,609	15,343	54,396
Cost of sales	4,499	12,494	7,001	881	2,310	27,185
Gross margin	3,092	7,183	3,175	728	13,033	27,211
Expenses	2,504	8,307	3,180	403	9,131	23,525
Other income (expenses) and foreign currency translation	277	71	11	243	-	602
Income before income taxes	865	(1,053)	6	568	3,902	4,288

12 Months ended August 31, 2003 (CAN \$000s)	Eastern Canada / USA	Western Canada	Australia	Europe	Products	Total
Revenue	6,819	20,392	7,334	-	14,335	48,880
Cost of sales	3,938	12,383	4,794	-	2,586	23,701
Gross margin	2,881	8,009	2,540	-	11,749	25,179
Expenses	2,656	8,769	2,139	-	7,048	20,612
Other income (expenses) and foreign currency translation	494	(1,048)	(25)	-	396	(183)
Income before income taxes	719	(1,808)	376	-	5,097	4,384

Eastern Canada/USA: The Eastern Canada/US region performed as expected throughout 2004 and delivered healthy profit margins. This group continues to make significant headway in the power industry and is expected to grow as initiatives to increase penetration in the power industry progress.

Western Canada: This segment includes the bulk of Matrikon's corporate infrastructure, including non-revenue generating administrative personnel. For FY04, Western Canada expenses include \$1.59 million in corporate expenses.

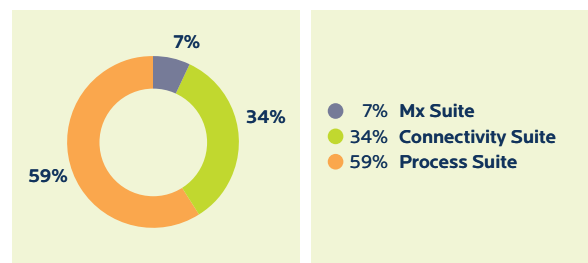
In addition, Western Canada is the segment that is hardest hit by currency fluctuations as the majority of expenses are in Canadian dollars while revenue is primarily in foreign currencies, thereby reducing the effective charge rate for services. Income before taxes includes foreign currency translation losses of \$0.98 million in the fourth quarter of 2004 and \$0.49 million for the year.

Australia: Australia underperformed in the second and third quarters of 2004 as a result of increasing staff for several large client projects that were subsequently delayed. These projects are now underway and Australia posted a profit of \$0.30 million in the fourth quarter. These projects should positively impact Australia's results for the next few quarters. In addition, Australia continued to be impacted by the large percentage of lower margin equipment sales in the fiscal year (\$3.00 million or 30% of revenue). Going forward, Australia is placing greater emphasis on higher margin projects which may result in a reduction of equipment sales and the subsequent negative impact on gross margin.

Europe: Europe delivered solid results with 36% margin on income before taxes in the fourth quarter as synergies from the acquisition continue to be realized.

Products: The product segment includes product development, training, sales and marketing and support. Fiscal year product revenue by suite was as follows:

REVENUE BY SUITE



Enhancements to existing products introduced in 2004 have been well received by clients and as the value and benefit of the products are recognized by clients, they are increasingly being selected as the corporate standard for multi-plant enterprises. Corporate licenses increased to 13 new agreements in 2004 compared to eight agreements in 2003.

The following table presents a summary of our unaudited consolidated operating results for the last eight quarters.

(CAN \$000s)	Reclassified							
	Q1 2003	Q2 2003	Q3 2003	Q4 2003	Q1 2004	Q2 2004	Q3 2004	Q4 2004
Revenue	11,800	12,480	12,284	12,316	14,302	10,152	13,372	16,570
Gross Profit	5,913	6,759	6,471	6,036	7,324	4,515	6,271	9,101
Gross Profit %	50	54	53	49	51	44	47	55
Net Income (Loss)	629	770	381	845	1,002	(230)	355	1,551
Net Income %	5	6	3	7	7	(2)	3	9
Shares Outstanding (000s)	24,210	24,209	24,215	24,224	27,274	28,877	29,270	29,321
EPS – basic	0.03	0.03	0.02	0.03	0.04	(0.01)	0.01	0.05
EPS – diluted	0.03	0.03	0.02	0.03	0.04	(0.01)	0.01	0.05
Headcount	423	434	444	448	476	485	486	465

Management has noted the following seasonal trends in sales over the past several years. The first quarter is typically strong, followed by a weaker second quarter due to a company-wide week-long shutdown in December and slower project startup in January. Sales typically begin to pick up in the third quarter due in part to the timing of Matrikon's annual sales conference (which is usually held in January, but was held in May in 2004), with this increase being offset by increased hiring activity. The fourth quarter is historically Matrikon's strongest quarter. In 2004, the second, third and fourth quarters reflect in part the delay of the sales conference to May and an increase in revenue following Matrikon's first annual users conference, also in May. The second quarter of 2003 included exceptionally strong product sales and therefore is not representative of the historic seasonality of Matrikon's business.

This seasonality has also been a result of the budget cycles of our clients, which typically start out in January with minimal buying in the first calendar quarter that gradually increases throughout the year. Management believes the seasonality we have observed in the past will be reduced as we continue to transition to a solutions provider, with larger projects spanning multiple years.

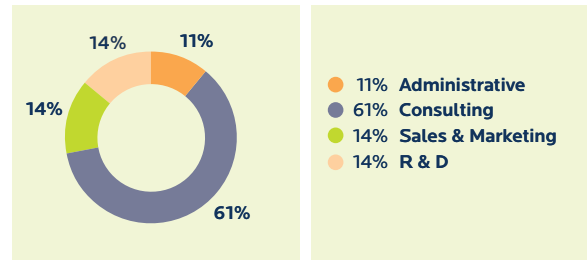
Gross margin

12 Months ended August 31 (CAN \$000s)	Reclassified		Reclassified		03 to 04 Change	03 to 04 % Change
	2004	2003	2002	2003		
Gross margin	\$27,211	\$25,179	\$18,336	\$2,032	8	
% of revenue	50	52	49	(2)		

Fourth quarter gross margin was 55% versus 49% in the comparable period of 2003. This improvement is primarily a result of strong product sales and growing support revenue in the fourth quarter. Gross margin for the full year was 50% compared to 52% in fiscal 2003. Full year gross margin was negatively impacted by the project delays that affected second and third quarter results.

As the cost of sales is relatively fixed (predominantly personnel related), gross margin will be driven by product sales and related support. Product sales continue to fluctuate quarter by quarter, therefore gross margin will also. Management expects the quarterly range to be 50% – 55%.

EMPLOYEES BY DEPARTMENT



Operating expenses

12 Months ended August 31 (CAN \$000s)	2004	2003	2002	03 to 04 Change	03 to 04 % Change
Consulting G & A	\$6,448	\$7,537	\$5,727	\$(1,089)	(14)
% of revenue	12	15	15	(3)	
Sales & marketing	\$7,428	\$4,800	\$4,032	\$2,628	55
% of revenue	14	10	11	4	
Research & Development	\$2,991	\$2,465	\$2,228	\$526	21
% of revenue	5	5	6	-	
General & administrative	\$5,160	\$4,442	\$3,135	\$718	16
% of revenue	9	9	8	-	

Combined operating expenses were \$23.53 million (43% of revenue) for fiscal 2004 compared to \$20.61 million (42% of revenue) in fiscal year 2003. Operating expenses remain in line with management's expectations.

Consulting general and administrative (consulting G&A) expense represents the non-billable portion of project expenses, including all related infrastructure costs. For the fiscal year, consulting G&A decreased to 12% of revenue from 15% in 2003. This decrease is a result of improved operating efficiency and some project management initiatives introduced subsequent to the second quarter, which have resulted in improved utilization.

Sales and marketing expenses were 14% in 2004 compared to 10% in the prior year, reflecting the increased investment required to hold the annual sales meeting with a growing and geographically dispersed sales force as well as Matrikon's first annual users conference. Sales and marketing has been a significant investment over the past few years, increasing by 55% to \$743 million in 2004 over \$4.80 million in 2003. Sales and marketing is critical to achieving our objective of accelerating customer adoption rates and revenue growth for Matrikon's proprietary solutions.

Research and development remained constant at 5% of revenue (31% of software revenue) for the fiscal year. Matrikon controls R&D expenses through an efficient development process and partnership with leading research institutions (3 new research chairs were established in 2004). New versions of each product in the Process Suite were released in 2004 and product development is ongoing. The next stage of product development will be true suite integration, where all products in the Process Suite line interact seamlessly through ProcessNet to deliver increased performance, reliability and compliance to industrial clients.

The following table illustrates the impact of Scientific Research & Experimental Development (SR&ED) credits on R&D Expenses:

12 Months ended August 31 (CAN \$000s)	2004	% of revenue	2003	% of revenue
Research and development excluding SR&ED credit	3,591	7%	2,947	6%
SR&ED credit	(600)		(482)	
Research and development (under Canadian GAAP)	2,991	5%	2,465	5%

Matrikon's product advisory board continues to meet bi-annually. The product advisory board is comprised of major clients who provide input into Matrikon's product technology and future needs. The results of the product advisory meetings are funneled directly into product development to ensure that Matrikon's products are aligned with the current and future needs of our clients.

Net income

12 Months ended August 31 (CAN \$000s)	2004	2003	2002	03 to 04 Change	03 to 04 % Change
Net income	\$2,678	\$2,625	\$1,550	\$53	2
% of revenue	5	5	4	-	
Earnings per share	0.09	0.11	0.07	(0.02)	(18)

Net income as a percentage of revenue remained constant for the fiscal year at 5%. Management expects that profitability will improve as revenue from higher margin software licenses increases.

Adjusted net income

As a private company prior to the reverse takeover of TigrSoft in April 2001, Matrikon paid shareholder bonuses annually. This practice is common to private companies; however it makes it difficult to compare results with other publicly traded companies and does not provide for meaningful trend analysis. Therefore, management uses adjusted net income for the years prior to becoming a public company as a truer comparison of results to current presentation. Adjusted net income is net income plus shareholder bonuses net of related income taxes. Adjusted

net income is not a measure of performance under generally accepted accounting principles (GAAP) and therefore does not have a standardized meaning prescribed by GAAP and is not necessarily comparable to similar measures presented by other companies. The following table reconciles net income to adjusted net income.

12 Months ended August 31 (CAN \$000s)	2000	2001	2002	2003	2004
GAAP Net income (loss)	(449)	952	1,550	2,625	2,678
Shareholder bonus	1,805	700	-	-	-
Income tax effect of above	722	280	-	-	-
Adjusted Net Income	634	1,372	1,550	2,625	2,678

Liquidity & capital resources

At August 31, 2004, accounts receivable were \$19.20 million compared to \$13.90 million at August 31, 2003 and \$17.68 million at May 31, 2004. August 31, 2004 accounts receivable includes SR&ED tax credits of \$1.54 million and \$1.47 million in accounts receivable for the European operations following the acquisition of PI Automation late in the third quarter. The average collection period in the fourth quarter was 95 days compared to 90 days as at August 31, 2003 and 91 days at the end of the third quarter of 2004. Matrikon's client base consists primarily of Fortune 500 companies with strong credit ratings; hence bad debt expense has been minimal at less than 0.6% per annum.

(CAN \$000s)	31-Aug 2004	31-May 2004	31-Aug 2003	Q4-Q3 Change	Q4-Q3 % Change
Cash and equivalents	\$6,311	\$3,025	\$295	\$3,286	109
Trade receivables	16,771	15,439	13,083	1,332	9
Other receivables	2,432	2,238	814	194	9
Average collection period (trade receivables)	95 days	91 days	90 days	-	-
Contracts in progress	1,830	2,536	3,457	(706)	(28)
Current liabilities	10,446	8,424	8,512	2,022	24

Current liabilities increased from \$8.42 million at the end of the third quarter to \$10.45 million in the fourth quarter. The increase in current liabilities includes an increase of \$1.41 million in deferred revenue and \$0.43 million in income tax accruals due to record income in the fourth quarter.

The following table summarizes Matrikon's contractual obligations:

(CAN \$000s)	Payment Due				
	Total	Less than 1 year	2 - 3 years	4 - 5 years	After 5 years
Operating lease obligations	7,590	2,911	3,999	680	nil

Cash flow from operating activities was \$3.47 million for fiscal year 2004, an increase of 18% compared to \$2.94 million in fiscal year 2003.

Matrikon has a \$7.00 million operating line of credit at a variable interest rate of the bank's prime plus 25 basis points. At August 31, 2004, Matrikon had \$nil outstanding on the line of credit.

Matrikon had cash on hand of \$6.31 million at the end of the fourth quarter compared to \$3.03 million at May 31, 2004 and \$0.30 million at August 31, 2003.

Management believes that the financial resources of the company are adequate to carry out current growth strategies.

Off balance sheet arrangements

Matrikon is a lessee under several operating type leases for office space, office equipment and motor vehicles and is also a party to research funding arrangements with educational institutions in Canada and Australia. The future cash flow impacts of these agreements are disclosed in Note 13 to the financial statements. Matrikon is not party to any other undisclosed off Balance Sheet arrangements.

Related party transactions

Matrikon had leased approximately 2,000 square feet of office space in India from a person related to a former Vice President of the company. The lease expired in October 31, 2003, with \$8 thousand in lease payments in fiscal year 2004 compared to \$36 thousand in 2003. The lease was established based on prevailing market conditions when the lease commenced. Matrikon is not party to any other related party transactions.

Normal course issuer bid

Matrikon announced a normal course issuer bid which commenced June 9, 2003 and ended June 8, 2004. No shares were repurchased under the bid.

OUTLOOK & FISCAL YEAR 2005 TARGETS

Matrikon is committed to sustainable long-term growth and is well-positioned to capitalize on its market potential. Matrikon's solutions represent new technology in the industrial market and thus to date have been adopted primarily by technology innovators. With more wide-spread realization of the need for and benefits of Matrikon's solutions, management expects adoption rates of certain products to increase rapidly.

Based on the present economic environment, current contracts underway and assuming Matrikon's ability to win new business continues at the current pace, management expects the company to achieve the following in fiscal 2005:

- revenue growth of 14 – 23% (\$62-\$67 million)
- net income growth of 49 – 87% (\$4-\$5 million, or \$0.14-\$0.17 per share based on current shares outstanding)
- 28 – 32% revenue from software license fees and related support

This forecast is based on the following currency exchange rate assumptions in comparison to the Canadian dollar:

Currency	Exchange rate assumption in comparison to Canadian dollar	After tax impact of a one cent or pence appreciation of the currency
US Dollar	1.25	\$ 126,000
British Pound	2.25	\$ 18,000
Australian Dollar	0.90	\$ 90,000

The after tax impact of currency appreciation in the table above only applies to projects where no action has been taken to manage foreign currency risk (such as forward contracts).

CRITICAL ACCOUNTING ESTIMATES

Our discussion and analysis of Matrikon's financial condition and the results of operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in Canada. Our preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period presented. These estimates and judgments are evaluated on an on-going basis and are considered to be reasonable based upon our historical experience and assumptions. Actual results could differ from those estimates made by management.

Matrikon's critical accounting estimates are those it believes are the most important in determining our financial position or results or require significant judgment by management. The corresponding accounting policies are summarized in the notes to our consolidated financial statements.

Revenue Recognition and Contracts in Progress Valuation

Matrikon's revenue is earned from four primary sources: Software license fees received for the sale of proprietary software and drivers, Consulting fees related to developing solutions for our clients or installation services related to both Matrikon and third-party software, Equipment sales of third party products that are ancillary to consulting engagements, and Extended support contract fees relating to post implementation support services. Matrikon adheres to the Canadian Institute of Chartered Accountants' Emerging Issues Committee Abstract 142 (EIC-142) and Statement of Position (SOP) 97-2, Software Revenue Recognition as released by the American Institute of Certified Public Accountants (AICPA).

Under the terms of EIC-142 and SOP 97-2, management recognizes implementation and consulting revenues and the implement and consulting portions of multi element arrangements on the percentage-of-completion basis. The percentage completion of each project is estimated

by management based upon an analysis of actual versus budgeted hours, actual versus budgeted third party costs incurred, changes to the original scope of work and milestone achievement progress. The estimate is determined by the project manager, reviewed by the accounting department and senior services management, and is also used to ensure contracts in progress are recorded at the lower of cost and normal profit earned and their estimated realizable value. Any projected losses are accrued in the period when they become apparent. These estimates have a material impact on Matrikon's reported revenues, cost of sales or contracts in progress. A change in estimate could cause a material change to those account balances.

Scientific Research and Experimental Development (SR&ED) Tax Credits

Matrikon records tax credits offered for SR&ED activities using the cost reduction method whereby the tax savings are recorded as a reduction to R&D expenses. Management must estimate the costs incurred that will qualify for the tax credits, based upon management's experience in filing claims for the tax credits and the review of accounting data. Changes to the estimated quantity of tax credits receivable from prior periods are recorded as Other income or Other expenses. A change in the estimated amount of qualifying expenditures for SR&ED tax credits may have a material impact on research and development expenses for the period or Other income if the change in estimate occurs in a reporting period subsequent to when the expenditure was incurred.

Intangible Assets and Goodwill

Matrikon accounts for intangible assets and goodwill in accordance with CICA Handbook Sections 1581, Business Combinations and 3062, Goodwill and Other Intangible Assets. Intangible assets acquired both individually or with a group of other assets are initially recognized and measured at cost; Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on their fair values. Goodwill is allocated as of the date of the business combination to the Corporation's reporting units that are expected to benefit from the synergies of the business combination. At the date of the business combination, management must estimate the value of acquired Intangible assets that do not have a well-defined market value. Such Intangibles requiring valuation often include the value of customer lists and relationships, previously unrecorded intellectual property rights (e.g. internally developed software) and non-competition agreements. Valuing the assets involves estimates of the future net benefit to the organization as well as the useful life of such benefits and is based upon various internal and external factors. A change in those estimates could cause a material change to the value of the Intangible assets. Although Intangible assets are amortized over their useful life, if the estimated value of an Intangible asset has declined below its amortized book value, a write-down

would be recorded in the period event causing the decline in value occurred, which would increase Amortization expense and decrease the Intangible assets balance. At this time, Matrikon does not believe any of its Intangible assets have a book value in excess of its fair market value.

Matrikon tests its Goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. This process involves management estimates regarding the future cash flows that may be realized from the reporting segment that the goodwill had been allocated to at the date of the business combination. The cash flow estimates performed by management take into consideration both internal factors which include current profitability of the segment, historical trends in revenues and expenses, current contracts in progress, short and long term profitability projections, any known or contemplated changes in the operations of the segment and external factors such as economic fluctuations in the markets and locations that the segment operates in, regulatory changes and currency fluctuations. A change in the estimates giving rise to the valuation of the segment to which the goodwill is allocated may necessitate a write-down of goodwill and corresponding increase in Amortization expense. During 2004 Matrikon revised its segment disclosure to reflect the evolving change in how Matrikon managed its operations, which required a re-allocation of Goodwill to the new segments.

CHANGES IN ACCOUNTING POLICIES **Stock Based Compensation**

On September 1, 2002 Matrikon adopted the new Recommendations of the CICA with respect to accounting for stock based compensation and other stock based payments. The new Recommendations were applied prospectively to all stock based payments to non-employees and to employee awards that are direct awards of stock, call for settlement in cash and other assets, or are stock appreciation rights that call for settlement by the issuance of equity instruments, granted on or after September 1, 2002. Compensation expense for these stock based payments, including Matrikon's Employee Stock Ownership Program, is calculated using the fair value based method. Under the fair value based method, compensation cost attributable to employees that are direct awards of stock, or stock appreciation rights that call for settlement by the issuance of equity instruments, is measured at fair value at the grant date and recognized over the vesting period. For awards that vest at the end of the period, compensation cost is recognized on a straight-line basis.

Beginning September 1, 2004, compensation cost will also be recognized for all other stock based employee compensation awards, which are accounted for using the intrinsic value based method. Accordingly, when Matrikon awards stock options to employees, compensation cost will be recognized in the consolidated statement of income and retained earnings for common share options granted. The

options are valued at the grant date using the Black-Scholes pricing model based on the terms of the stock options and various economic assumptions and the expense is recognized over the vesting period of the options. Consideration paid by employees on the exercise of stock options is recorded as share capital. Matrikon will be retroactively restating prior periods to reflect the impact of prior years' compensation expense that was previously disclosed on a pro forma basis.

The impact of this change in accounting for stock based compensation on 2004 and 2003 results is summarized in the table below:

(CAN \$000s except per share amounts)	2004 (as reported)	2004 (pro forma)	2003 (as reported)	2003 (pro forma)
Compensation costs		641		572
Net earnings	2,633	1,992	2,625	2,053
Basic earnings per share	0.09	0.07	0.11	0.08
Diluted earnings per share	0.09	0.07	0.11	0.08

RISKS RELATED TO OUR BUSINESS

The following internal and external risks may affect Matrikon's operations. Management continually monitors and evaluates these risk factors and takes action to minimize them.

Market demand for products and services

There is no guarantee that our products will remain competitive, nor that they will respond to market demands, developments or new industry standards. If we are unable to identify a shift in market demand quickly enough, we may not be able to develop products to meet those new demands, or bring them to market in a timely manner.

This risk is mitigated through the ongoing commitment to research and development and to constantly improving the products based on industry feedback. Matrikon has established a product advisory board where clients from a variety of industries meet with the company to discuss industry needs in context of Matrikon's existing products and future demand.

In addition, Matrikon's service units continually provide insight into the business problems and trends occurring in a variety of industries. To date, Matrikon's products and enhancements have been developed through this insight and a continual feedback loop between industry, our services-based groups and product development teams.

State of the economy

Operating results may vary significantly based on the impact of changes in global economic conditions on customers.

Although the current economic environment is uncertain, Matrikon has observed minimal impact its ability to win new business in any region. While client needs change based on the economic climate, Matrikon's products and services are currently able to meet those needs. In a growing economy, Matrikon's clients' demand increased throughput and focus

on optimization technology. During a recession, the focus shifts to improving efficiencies, reducing costs and optimizing maintenance and operations. Matrikon's diversification in terms of geography, industrial sectors and its lack of dependence on any one customer also helps to mitigate this risk.

Exchange rates

Matrikon operates internationally; accordingly, all contracts outside of Canada are in various local currencies, the largest of which are the United States and Australian dollars and British Pounds.

From time to time, Matrikon enters forward contracts to partially hedge exposure to currency fluctuations between the United States (US) and Canadian dollars. Approximately 45% of the company's revenues are received in US dollars while 75% of expenses are in Canadian dollars.

During the rapid decline of the US dollar relative to the Canadian dollar over the past two years, Matrikon reviewed its forward contracts policy and adjusted its pricing. Matrikon believes that its practices for mitigating the impact of currency fluctuations are sufficient, although the company recognizes that this risk cannot be fully mitigated when exchange rates fluctuate very rapidly.

As Matrikon expands internationally, the growing diversity of the revenue currencies offsets currency fluctuations. Revenue from international business increased to 37% in 2004 from 29% in 2003 and are expected to continue to grow. The addition of Europe in 2004 will further diversify the currency of receivables.

Ability to retain and attract qualified employees and contain payroll expenses

Executive management, senior technical personnel and other key personnel are essential to the business. The loss of the services of any of these persons could have a material adverse effect on the business. As a growing company, our ability to develop, market and support our products and deliver services could be harmed if Matrikon is not able to recruit and retain qualified personnel. In addition, due to the service nature of the company, payroll is a significant component of costs.

To mitigate these risks, Matrikon offers competitive compensation packages, unique and challenging career opportunities and maintains close ties with academic institutions that train specialists in the fields in which it operates. The corporate culture supports diversity, creativity and equality and values integrity and innovation. In addition to providing a challenging and rewarding work environment, Matrikon's social activities and corporate culture foster creativity and teamwork. Matrikon was named one of the Top 100 Employers in Canada in 2002 and 2003.

There has been no turnover at the senior management level since the inception of the company and very little within the next level of management.

Availability of credit line and future financing

The company may require additional funds through public or private financing, strategic relationships or other arrangements to meet future growth objectives. There can be no assurance that it will be able to obtain additional funding on favorable terms, if at all. If Matrikon cannot raise funds on acceptable terms, if and when needed, we may not be able to develop or enhance products and services, expand the business, acquire complementary businesses or technologies, respond to competitive pressures or unanticipated requirements, or take advantage of future opportunities, which could have a material adverse effect on our business.

Matrikon completed a \$10 million private placement in September 2003 which, coupled with our existing line of credit of \$7 million, we believe is adequate to meet our current growth strategies. \$7.68 million of the private placement was used to take advantage of the strategic acquisition of PI Automation.

Research and development

If Matrikon does not respond effectively and on a timely basis to rapid technological change, its products and services may become obsolete and customer loss could result.

The markets for Matrikon's products are characterized by:

- rapid and significant technological change;
- frequent new product introductions and enhancements;
- changing customer demands; and
- evolving industry standards.

To mitigate this risk, Matrikon is committed to research and development to ensure our continued technological leadership position. In addition to internal research and development, Matrikon sponsors three Industrial Research Chairs at the University of Alberta and one Australian Research Council Center of Excellence at the University of Newcastle.

Other strategies for minimizing this risk include Matrikon's industry and product advisory boards, which serve to alert the company to changes in our clients' technological direction, and membership and active involvement with industry standards organizations, which enables the company to ensure that our products comply with industry standards and helps to identify new trends.

Lengthy sales cycle

The lengthy sales cycle required to close larger projects makes it difficult to predict quarterly revenue levels and operating results. The sales process for larger projects and solutions can be lengthy and can exceed one year. Moreover, to the extent that Matrikon succeeds in shifting customer purchases toward corporate license agreements and larger solutions, the sales cycle may lengthen, which could increase the likelihood of delays and cause the effect of a delay to become more pronounced. The company has limited experience in forecasting the timing of sales of our i

ntegrated software and services solutions. Delays in sales could cause shortfalls in our revenues and operating results for any particular period.

Matrikon has been focused on building the sales and marketing infrastructure to support the transition to a products company. This includes sales success workshops and hiring senior sales personnel. Biweekly sales meetings also serve as a platform for sharing experiences amongst sales staff and providing an opportunity to learn from each individual's successes and failures.

With Sales Logix now fully utilized by all sales staff and collecting sales forecast information, we will have improved benchmark information going forward to better predict sales timing and probability based on historic data.

Legal claims

Intellectual property claims and other claims against the company could be time consuming and costly to defend. If we are unsuccessful, our ability to use intellectual property in the future could be limited or we may have to pay damages.

Matrikon has established policies that require all staff to comply with intellectual property laws. License agreements are obtained and staff is periodically reminded of their duty to observe these licenses.

Our license agreements with clients typically contain provisions designed to limit exposure to potential liability claims. In our agreements for the provision of services, we also try to negotiate limitations on liability. Despite this, it is possible that such provisions may not be effective as a result of existing or future laws or unfavorable judicial decisions. We have not received to date any product liability claims nor claims regarding services. A successful liability claim could result in significant monetary liability and could seriously disrupt our business.

We seek to minimize the risk of liability claims through a thorough quality assurance process, continual development of our products and staff training. Further, we continually monitor changes to laws and the results of court cases, and strive to keep our agreements up to date to mitigate any claims.

Failure to integrate operations

If Matrikon fails to integrate the operations of the companies it acquires, it may not realize the anticipated benefits and operating costs could increase. Matrikon continues to pursue strategic acquisitions that will provide complementary products, services and technologies. The identification and pursuit of these acquisition opportunities and the integration of acquired personnel, products, technologies and businesses require a significant amount of management time and skill. There can be no assurance that:

- suitable acquisition candidates can be identified
- any acquisition will be consummated on acceptable terms
- Matrikon will be able to successfully integrate any acquired business into its operations.

Acquisitions also expose Matrikon to potential risks, including diversion of management's attention, failure to retain key acquired personnel, assumption of legal or other liabilities and contingencies and the amortization of acquired intangible assets. Moreover, customer dissatisfaction with, or problems caused by, the performance of any acquired products or technologies could hurt Matrikon's reputation.

These risks are mitigated through a thorough due diligence process, which includes measuring a potential acquisition against Matrikon's growth strategy, interviewing key personnel and reviewing the cultural fit, reviewing the financial, legal and market aspects, talking to a sample of clients from the customer base and, in some cases, conducting character investigations for the company principals.

Failure to address challenges of international operations

Business may suffer if there is a failure to address the challenges associated with international operations. Approximately 70% of total revenues were from customers outside of Canada in the past fiscal year. It is expected that revenues from customers outside Canada will continue to account for a significant portion of total revenues for the foreseeable future. Operations outside Canada are subject to additional risks, including:

- unexpected changes in regulatory requirements, exchange rates, tariffs and other barriers
- political and economic instability
- difficulties in staffing and managing foreign subsidiary operation
- difficulties and delays in translating products and product documentation into foreign languages
- difficulties and delays in negotiating software licenses compliant with Canadian accounting revenue recognition requirements
- potentially adverse tax consequences

To mitigate these risks, Matrikon fully researches the business and economic environment of a country before beginning business in the country. In countries with which Matrikon is unfamiliar, an agent familiar with the region will act on behalf of Matrikon through the tender and negotiation process.

In addition, Matrikon's culturally diverse employee base has enabled it to offer product training to clients in numerous languages.