



ANGOS

Second Quarter Interim Results 2005

Angoss Software Corporation

## Dear Shareholders

Enclosed are the financial statements of Angoss for the second quarter and first half of 2005.

As announced two weeks ago, we are pleased to report record second quarter revenues and improved profitability in our second quarter ending May 31, 2005. Revenues grew 21%, primarily from new software license sales and expanding predictive analytics solutions deployments among North American and European financial services and communications industry clients, resulting in significantly improved operating profitability and net income compared with prior year second quarter and half year results.

For the three months ended May 31, 2005 revenues of \$1,749,079 increased by 21% over 2004 results (\$1,443,690). Operating expenses were 2.6% lower than second quarter 2004 expenses. Operating profit was \$172,421 compared to an operating loss of \$208,628 in 2004. Net income was \$74,974 (\$0.00 per share) compared with a prior year net loss of \$395,374 (\$0.01 per share).

For the six months ended May 31, 2005 revenues of \$3,133,198 were up 14% over 2004 results (\$2,749,625). Operating expenses were 4.4% lower than first half 2004 expenses. Operating profit was \$117,065 compared with the six month 2004 operating loss of \$439,921. The Company's net income was \$22,985 (\$0.00 per share) for the six months ended May 31, 2005 compared with a 2004 six-month net loss of \$654,902 (\$0.02 per share).

As noted in our results release, we have continued to make good progress in growing client relationships and business opportunities. We continue to expand our business with more comprehensive, higher value, industry targeted predictive analytics systems offerings by combining our software and expert services capabilities. These systems are designed to help our customers use predictive analytics more effectively to solve significant business challenges in strategic marketing and revenue generation, credit risk management and loss mitigation, and claims management and abuse detection. They combine market proven Angoss predictive analytics software and industry specific templates, best practices and implementation services that help clients achieve business value benefits from predictive analytics faster, and at a lower cost.

### **Angoss Claims & Payments Analytics™ System Extends To Surveillance and Compliance**

Angoss has been selected by a leading North American financial services intermediary to provide a predictive surveillance solution. This solution, building on and extending Angoss capability already being delivered through the Claims & Payment Analytics solution at insurance industry providers, is helping surveillance and compliance professionals detect, assess and address high volume transactions.

### **Angoss FundGUARD™ Trial Generates \$56 Million in Incremental Sales In 3 Months.**

A major North American mutual fund industry client has realized \$56 million in incremental net asset sales during a 3-month trial of the Angoss FundGUARD™ solution. Specifically designed for the mutual fund and wealth management industry, FundGUARD uses advanced analytics to drive growth in assets under management while reducing redemption risk.

### **Angoss Telecom Marketing Analytics™ Deployment Expansion**

During the second quarter a second North American telecommunications client selected the Angoss Telecom Marketing Analytics system for deployment to support its consumer and small business marketing and sales analytics initiatives. Angoss has initiated further sales activities to expand deployments targeting wireless, broadband and voice-over-IP services providers that are offering their products and services in the personal, residential and small business market segments. Specifically designed for the communications industry, Angoss Telecom Marketing Analytics provides marketers with advanced analytics tools enabling strategic segmentation, product and service bundling and churn reduction.

Our record second quarter performance was driven primarily by direct expansion of our business in both North America and Europe. This trend is encouraging, reflecting our continued business transformation from analytics tools sales to higher value, end-to-end systems sales.

Direct sales results were partially offset, however, by lower year over year revenues from partner channels. While we continue to pursue marketing, business development and sales initiatives with partners on several fronts, our agreements with current partners are such that our revenues are linked to success of partners in selling new versions of their enterprise systems incorporating Angoss technology and their new license revenues. Our expectation is that partner revenue performance will improve, but partner revenues may make a smaller relative contribution to revenue growth this year than in fiscal 2004.

As longer term shareholders will know, the trading performance of Angoss common shares to date in fiscal 2005 has not mirrored the general improvements in the company's operations and outlook over the past several quarters. At our annual meeting earlier this year we identified capital markets initiatives as an area of focus for 2005.

The Company is currently valued at 50% less than it was 2 years ago, despite significant revenue growth, expansion in our product offerings and client base, and above industry average revenue growth performance in our market segment, all based on our demonstrated ability to deliver real business value to our customers. For much of the second quarter, the Company traded at well below 1 times revenues.

This divergence -- between business performance and share trading performance -- is a source of particular focus for both our board and management team. While revenue growth remains our primary focus, we also will be devoting additional time and effort to capital markets issues in coming months, with a view to address this value gap.

Regards,



Eric Apps

## Management's Discussion and Analysis of Operating Results and Financial Condition

Management's discussion and analysis of the interim unaudited consolidated financial position, operating results and cash flows of Angoss Software Corporation should be read in conjunction with the accompanying unaudited interim financial statements for the three and six months ended May 31, 2005 and the audited annual financial statements for the year ended November 30, 2004 which are both prepared by management in accordance with Canadian generally accepted accounting principles. All amounts are stated in Canadian dollars unless otherwise stated. This MD&A has been prepared with all information available up to and including June 28, 2005.

In accordance with the new CICA requirements, effective December 1, 2004, the Company has adopted, on a retroactive basis without restatement of prior periods and an adjustment to the opening deficit, the fair value of accounting for employee stock based compensation and other stock based payments. See note 3 to the accompanying unaudited interim financial statements for the three and six months ended May 31, 2005.

Some of the statements contained in this Interim Report including, without limitation, those relating to financial and business prospects and financial outlook of the Company, may be forward looking statements which reflect management's expectations regarding the Company's future growth, results from operations, performance and business prospects and opportunities. Wherever possible, words such as "anticipate", "believe", "expect", "intend" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including but not limited to, changes in the general economic and market conditions. Although forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, the Company cannot assure that actual results will be consistent with these forward looking statements. These forward-looking statements are made as of the date hereof and the Company assumes no obligation to update or revise them to reflect new events or circumstances until the effective date of the Company's future reports filed with the applicable securities regulatory authorities.

### Three Year Financial Information Comparison

Stated in \$ Canadian	For the twelve months ended November 30,		
	2004	2003	2002
Revenue	\$ 6,073,494	\$ 4,541,717	\$ 4,475,281
Loss from continuing operations before income taxes	(637,087)	(693,776)	(182,779)
Future income tax recovery (expense)	125,000	125,000	(125,000)
Discontinued operations – SmartWare business	-	-	574,127
Net (loss) income for the year	(512,087)	(568,776)	266,348
Basic and diluted (loss) earnings per share	(0.01)	(0.01)	0.01
Total assets	4,530,308	4,962,789	2,277,147
Total long term financial liabilities	1,650,021	2,315,560	250,000
Cash dividends declared per Preferred share	\$ 0.07	\$ 0.00	-

## Results of Operations

### Revenue

License revenues were derived primarily from the direct sale of licenses and earned license renewals. Professional service revenue represents time spent by professional service staff on customer defined analytic projects. Time spent by service staff on partner related projects is considered as partner revenue. Partner revenues consist of development and professional services associated with delivery of partner versions of Angoss products, licensing royalties payable on the sale of product licenses by partners, and fees for professional services provided directly to a partner or as part of a partner's solution for a customer. Interest income earned is generated on surplus cash.

	Three months ended May 31,			Six months ended May 31,		
	2005	2004	Increase (decrease)	2005	2004	Increase (decrease)
Licenses	\$ 1,308,969	\$ 964,229	35.8%	\$ 2,337,864	\$ 2,106,748	11.0%
Professional Services	423,052	165,765	155.2	734,105	254,872	188.0
Partners	-	304,839	(100.0)	33,720	365,705	(90.8)
Product Revenues	1,732,021	1,434,833	20.7	3,105,689	2,727,325	13.9
Interest	17,058	8,857	95.7	27,509	22,300	23.4
	<u>\$ 1,749,079</u>	<u>\$ 1,443,690</u>	<u>21.2%</u>	<u>\$ 3,133,198</u>	<u>\$2,749,625</u>	<u>14.0%</u>

During the three months ended May 31, 2005, license revenues, including earned license renewals, grew as a result of expanding the deployment of analytics software tools at current and new customer sites, and growth in services revenues associated with delivery of industry vertical predictive analytics solutions combining both software systems and related professional services.

Software license and professional service revenues are expected to continue to grow reflecting the Company's continuing expansion of analytics tools sales to large organizations and its introduction of industry vertical predictive analytics solutions.

Revenues generated through partners were lower in the second quarter of 2005 compared with prior year second quarter results. For the six months ended May 31, 2004, 75.4% (2005 – nil) of partner revenues were earned on the completion of initial development and services deliveries under partner licensing agreements. The remaining partner revenues were earned royalties generated on partner sales of partner products incorporating Angoss software. On a comparative basis, excluding revenues associated with development deliverables and related professional services, 2005 partner royalty revenues were 62.5% lower year over year. Partner revenues are not subject to the direct control of the Company, are based on sales of partner products incorporating Company program modules and associated product and implementation services revenues, and occur during time periods that may not coincide with fiscal quarter ends of the Company. Partner revenues will fluctuate based on the success of partners in selling their applications incorporating Angoss programs and the timing and value of associated revenue opportunities derived from these sales. Angoss continued to work with partners during the second quarter on several marketing and business development initiatives both internally with their sales organizations and in the context of their customer and channel sales initiatives the effect of which is expected to increase demand for, partner revenues associated with, and royalty amounts payable to Angoss for partner solutions incorporating Angoss products and expert services.

The Company currently operates primarily in two geographic markets: North America and Europe. During the three months ended May 31, 2005, 82.7% of revenue was generated in North American (including Australia) (1994 – 85.7%); 17.3% in Europe (1994 – 14.3%). During the six months ended May 31, 2005, 85.6% of revenue was generated in North America (including Australia) (1994 – 83.2%); 14.4% in Europe (1994 – 16.8%).

### Operating Expenses

Operating expenses consist of sales and marketing ("S&M"), general and administration ("G&A") and research and development ("R&D") expenses. During the three and six months ended May 31, 2005, operating expenses decreased by 3.2% and 4.7% respectively over the same periods in 2004.

	Three months ended May 31,		Six months ended May 31,	
	2005	2004	2005	2004
Operating expenses	<u>\$ 1,572,148</u>	<u>\$ 1,623,317</u>	<u>\$ 3,007,644</u>	<u>\$ 3,155,160</u>

Salary and benefit expenses ("compensation") are allocated to the respective operating expenses. During the three months ended May 31, 2005, compensation accounted for 69.5% (2004 – 69.1%) of operating expenses. During the six months ended May 31, 2005, compensation accounted for 70.8% (2004 – 69.7%) of operating expenses.

Compensation expenses for the three and six months ended May 31, 2005 were down 2.7% and 3.2% respectively over the same periods in 2004 primarily reflecting the effects of staffing re-alignments introduced in May 2004.

Decreases in non-compensation related operating expenses occurred primarily in the areas of sales and marketing, professional fees and certain non-recurring amounts more fully discussed below.

### **Sales and Marketing**

For the three months ended May 31, 2005, S&M expenses were \$844,310, an increase of 0.8% over the same period in 2004 - \$837,783. For the six months ended May 31, 2005, S&M expenses were \$1,616,614, an increase of 2.9% over the same period in 2004 - \$1,571,457.

	Three months ended May 31,				Six months ended May 31,			
	2005		2004		2005		2004	
Compensation								
North America	\$ 503,683	59.7%	\$ 500,622	59.8%	\$ 987,750	61.1%	\$ 951,462	60.6%
Europe	151,264	17.9%	144,242	17.2%	298,747	18.5%	240,013	15.3%
Consulting fees	-	0.0%	3,734	0.5%	-	0.0%	12,894	0.8%
	<u>654,947</u>	<u>77.6%</u>	<u>648,598</u>	<u>77.5%</u>	<u>1,286,497</u>	<u>79.6%</u>	<u>1,204,368</u>	<u>76.7%</u>
Increase (decrease)	<b>1.0%</b>				<b>6.8%</b>			
Other								
North America	174,705	20.7%	138,538	16.5%	291,226	18.0%	293,010	18.6%
Europe	14,658	1.7%	50,647	6.0%	38,891	2.4%	74,078	4.7%
	<u>189,363</u>	<u>22.4%</u>	<u>189,185</u>	<u>22.5%</u>	<u>330,117</u>	<u>20.4%</u>	<u>367,089</u>	<u>23.3%</u>
Increase (decrease)	<b>0.1%</b>				<b>(10.1%)</b>			
	<u>\$ 844,310</u>	<u>100.0%</u>	<u>\$ 837,783</u>	<u>100.0%</u>	<u>\$ 1,616,614</u>	<u>100.0%</u>	<u>\$ 1,571,457</u>	<u>100.0%</u>
Increase	<b>0.8%</b>				<b>2.9%</b>			
Total S&M expenditures as a % of revenue	<b>48.3%</b>		<b>58.0%</b>		<b>51.6%</b>		<b>57.2%</b>	

For the three and six months ended May 31, 2005, the 1.0% and 6.8% respective increases in S&M compensation reflect increased staff levels and commissions based on higher revenues. At the end of the second quarter of 2005, 16 full-time people were assigned to this department in North America (2004 – 17). At the end of the second quarter, two additional people in North America were paid based solely on sales performance. In Europe, 5 people (2004 – 4) were fully dedicated to this department and in 2004; the compensation associated with one additional person was allocated between G&A and S&M.

For the three months ended May 31, 2005, 1.1% (2004 – 31.8%) of other sales and marketing expense related to fees paid to a third party consultant who provided strategic sales and marketing services. For the six months ended May 31, 2005, 1.4% (2004 – 28.4%) of other sales and marketing expense related to fees paid to a third party consultant who provided strategic sales and marketing services. The decrease in such expenses in 2005 was offset by increased travel and on site customer visits associated with gathering client requirements and preparing analytical solutions proposals linked to those requirements. This trend is expected to continue for the balance of 2005.

### **General and Administration**

For the three months ended May 31, 2005, G&A expenses were \$417,808, a decrease of 0.8% over the same period in 2004 - \$421,025. For the six months ended May 31, 2005, G&A expenses were \$814,063, a decrease of 4.4% over the same period in 2004 - \$851,370.

	Three months ended May 31,				Six months ended May 31,			
	2005		2004		2005		2004	
Compensation								
North America	\$ 128,084	30.7%	\$ 109,958	26.1%	\$ 251,086	30.8%	\$ 266,540	31.3%
Europe	19	0.0%	18,289	4.3%	16,699	2.1%	35,997	4.2%
	<b>128,103</b>	<b>30.7%</b>	<b>128,247</b>	<b>30.4%</b>	<b>267,785</b>	<b>32.9%</b>	<b>302,537</b>	<b>35.3%</b>
Decrease	<b>(0.1)%</b>				<b>(11.5)%</b>			
Other								
North America and Australia	222,635	53.3%	256,303	60.9%	438,314	53.8%	479,111	56.3%
Europe	67,070	16.0%	36,475	8.7%	107,964	13.3%	69,722	8.2%
	<b>289,705</b>	<b>69.3%</b>	<b>292,778</b>	<b>69.6%</b>	<b>546,278</b>	<b>67.1%</b>	<b>548,833</b>	<b>64.5%</b>
Decrease	<b>(1.1)%</b>				<b>(0.5)%</b>			
	<b>\$ 417,808</b>	<b>100.0%</b>	<b>\$ 421,025</b>	<b>100.0%</b>	<b>\$ 814,063</b>	<b>100.0%</b>	<b>\$ 851,370</b>	<b>100.0%</b>
Decrease	<b>(0.8)%</b>				<b>(4.4)%</b>			
Total S&M expenditures as a % of revenue	<b>23.9%</b>		29.2%		<b>26.0%</b>		31.0%	

For the three months ended May 31, 2005, an increase in North American headcount and salary levels was offset by a reduction in European compensation that has been contracted to a third party on an as needed basis. In 2004, European compensation represented the cost of one additional person allocated between G&A and S&M. At the end of the second quarter of 2005, 3 full-time people were assigned to this department in North America (2004 – 2). For the six months ended May 31, 2005, compensation costs are 11.5 % below 2004 levels as a result of increased 2005 headcount and compensation levels offset by bonuses paid in Q1 2004 and not paid in 2005.

Other G&A expenses are made up of four main components – occupancy costs, professional fees, communication costs and ordinary course business expenses. For the three and six months ended May 31, 2005, both the mix and amount of expense in North America were consistent with the same period in 2004 except for a reduction in 2005 in the amount of provision against the Australia working capital loan [six months - 2005 - \$36,754; 2004 – \$61,583]. In Europe, the increase in G&A expense resulted from increased rent and recruiting fees.

## Research and Development

All research and development costs have been expensed as incurred.

Research and development comprises all engineering, quality assurance, support and related personnel resources associated with solution delivery. All research and development is conducted in North America. As at May 31, 2005, there were 16 staff in R&D (2004 – 19). Compensation costs in 2005 reflect the May 2004 restructuring of R&D operations and reduced staffing levels.

Other development costs include training costs, supplies, subscriptions, software and other costs associated with R&D. The amount fluctuates from year to year depending upon the development cycle and the number of changes in personnel. In 2004, the increase in other development expenses reflected the costs associated with increasing and supporting staff.

	Three months ended May 31,				Six months ended May 31,			
	2005		2004		2005		2004	
Compensation	309,178	99.7%	349,177	95.8%	575,240	99.7%	705,079	96.3%
Decrease	<b>(11.5)%</b>				<b>(18.4)%</b>			
All other	852	0.3%	15,333	4.2%	1,728	0.3%	27,225	3.7%
Decrease	<b>(94.4)%</b>				<b>(93.7)%</b>			
	<b>\$ 310,030</b>	<b>100.0%</b>	<b>\$ 364,509</b>	<b>100.0%</b>	<b>\$ 576,967</b>	<b>100.0%</b>	<b>\$ 732,333</b>	<b>100.0%</b>
Decrease	<b>(15.0)%</b>				<b>(21.2)%</b>			
Total R&D expenditures as a % of revenue	<b>17.7%</b>		25.3%		<b>18.4%</b>		26.6%	

During the second quarter of 2005, the Company's development activities were directed towards the expansion of its offerings to include higher value predictive analytics solutions. These initiatives included the following:

- Angoss Analytics Solutions - Development of extensions to the Angoss predictive analytics platform to support Credit Risk Reporting & Analytics, FundGUARD, Claims & Payments Analysis, Telecom Marketing Analytics and other planned predictive analytics solutions.
- KnowledgeSTUDIO® Enterprise - Migration of Angoss analytics tools, KnowledgeSEEKER®, KnowledgeSTUDIO®, KnowledgeSERVER®, and Mining Manager® to new client-server architectures based on Microsoft.Net client technologies and supporting client-server configurations for popular Windows and Unix server platforms. KnowledgeSEEKER® 5.0 was released in June 2005 and additional major releases are scheduled for 2005.

### **Amortization / Interest Accretion**

Amortization in 2005 comprised of amortization of capital assets and the amortization of financing fees associated with the issue of the Preferred shares in 2003.

### **Foreign Exchange**

The Company sells software and services in both United States dollars and other currencies while maintaining its primary base of business operations and source of operating expenses in Canada. These factors give rise to the risk that its earnings, cash flows and the value of assets held in United States Dollars may be adversely impacted by fluctuations in foreign exchange rates. The Company uses both its natural hedge to mitigate, to the extent possible, and will, from time to time, enter into foreign exchange forward contracts to manage foreign exchange risk on US cash held as term deposits and license renewal billings.

The Company enters into foreign exchange forward contracts to minimize its exposure to fluctuations in foreign currency exchange rates. These derivative contracts do not qualify for hedge accounting and therefore the contracts are recorded at fair value at the balance sheet dates and with the corresponding gain/loss recorded in the consolidated statements of loss. The Company does not enter into foreign exchange forward contracts for speculative purposes.

As at May 31, 2005, the Company had three outstanding foreign exchange forward contracts representing commitments to sell US\$1,500,000 in exchange for Canadian dollars with an average remaining term to maturity of 111 days. As at May 31, 2005, the effective rate of exchange on the contracts was 1.2473. As a May 31, 2005, a loss of \$5,500 was recorded on the contracts.

3 month average for the quarter ended	<b>May 31, 2005</b>	<b>May 31, 2004</b>	<b>Change</b>
1 U.S dollar equals Canadian dollars	1.2359	1.3431	(7.9)%
1 British pound equals Canadian dollars	2.3307	2.4378	(4.4)%
6 month average for the quarter ended	<b>May 31, 2005</b>	<b>May 31, 2004</b>	<b>Change</b>
1 U.S dollar equals Canadian dollars	1.2320	1.3278	(7.2)%
1 British pound equals Canadian dollars	2.3328	2.4156	(3.4)%
As at	<b>May 31, 2005</b>	<b>November 30, 2004</b>	<b>Change</b>
1 U.S dollar equals Canadian dollars	1.2510	1.1904	5.1%
1 British pound equals Canadian dollars	2.2808	2.2268	0.5%

### **Special Charges**

On May 31, 2004, the Company restructured its operations and terminated nine employees to re-align its on-going operating costs. As at May 31, 2004, a provision of \$113,489 was made for the termination and lay-off associated with these nine employees – seven in research and development, one in sales and one in administration. As at November 30, 2004, the Company had paid a total of \$108,413. As at May 31, 2005, all amounts had been paid.

## Summary of Quarterly Results

Unaudited	<u>2nd Quarter</u>		<u>1st Quarter</u>		<u>4th Quarter</u>		<u>3rd Quarter</u>	
	2005	2004	2005	2004	2004	2003	2004	2003
(000's)								
Revenues	\$1,749	\$1,444	\$1,384	\$1,306	\$1,661	\$822	\$1,662	\$1,065
Gross margin	1,744	1,415	1,380	1,301	1,654	817	1,654	1,061
Sales and Marketing, General and Administration and Research and Development expenses	1,572	1,624	1,435	1,532	1,505	1,205	1,411	1,124
Operating income (loss)	172	(209)	(55)	(231)	149	(388)	243	(63)
Foreign exchange gains (losses), Special charges, Financing expenses, Amortization and Other income	(97)	(186)	3	(29)	(219)	(78)	(155)	(37)
Income (loss) before income taxes	75	(395)	(52)	(260)	(70)	(466)	88	(100)
Recovery of future income taxes	-	-	-	-	125	125	-	-
Net Income (loss)	\$ 75	\$ (395)	\$ (52)	\$ (260)	\$ 55	\$ (341)	\$ 88	\$ (100)
Income (loss) per share	\$ 0.00	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ 0.00	\$ (0.01)	\$ 0.00	\$ (0.01)

Revenues in any quarter are dependent on orders received and licenses renewed in that quarter. In addition, the timing and amount of the Company's revenues are affected by a number of factors that make estimation of operating results before the end of a quarter uncertain.

Sales and Marketing, General and Administration and Research and Development expenses are planned based upon anticipated revenues. During the second quarter of 2005, the Company continued traveling to customer sites. In 2005, increased travel and on site customer visits with the expressed goal of better understanding our customer needs is expected to continue. In 2004, the Company engaged a third party consultant who had invested in the preferred share financing to provide strategic sales and marketing services. Including the value assigned to warrants, the third party consultant expenses in the three months ended May 31, 2005 were approximately \$2,058 (2004 - \$44,000). Including the value assigned to warrants, the third party consultant expenses in the six months ended May 31, 2005 were approximately \$4,495 (2004 - \$104,000). The Company continues to use various external consultants for strategic, advisory and operational purposes.

With the exception of foreign exchange gains (losses) and special charges, financing expenses and amortization expense are consistent quarter to quarter. Foreign exchange gains (losses) are a continuing exposure for the Company. See separate discussion outlining the Company's foreign exchange strategy. Other income relates to Trifox and such income was received at the end of the second and is anticipated to be received in the fourth quarter (see note 13 to the audited 2004 consolidated financial statements). There is no guarantee that such income will be received.

## Liquidity and Capital Resources

Cash and cash equivalents as at May 31, 2005 were \$2,412,003 (November 30, 2004 - \$2,721,348). As at May 31, 2005, accounts receivable were \$1,441,606 (November 30, 2004 - \$1,497,344). The decrease in cash balances resulted from by the purchase of capital assets (2005 - \$126,618), payment of Preferred dividends (2005 - \$80,500), and a reduction in accounts payable and accrued liabilities.

Accounts payable and accrued liabilities as at May 31, 2005 were \$433,369 (November 30, 2004 - \$578,808). The decrease is primarily due to the payment of variable compensation linked to revenues and company performance accrued at the year-end and paid during the first quarter.

As at May 31, 2005, the Company's working capital was \$1,650,197 (November 30, 2004 - \$1,620,006). In November 2005, the Company will meet the first redemption of the Preferred shares (\$575,000). The Company currently intends to finance the repayment through operating cash flow.

As at May 31, 2005, deferred revenue, current and long-term totaled \$1,148,704 (November 30, 2004 - \$1,403,947). The decrease in deferred revenue resulted from the completion and delivery during the period of prepaid services delivered to customers and partners. While the amount of pre-billed services declined, the value of signed services contracts for future delivery and unbilled service contracts that are not reflected in either the balance sheet or income statement increased.

At May 31, 2005, the Company had share capital of \$13,998,719 (November 30, 2004 - \$13,805,813) and a deficit of \$13,710,468 (November 30, 2004 - 13,604,387). A portion of the increase in share capital is attributable to the exercise of stock options at various times throughout the first quarter. A portion of the decrease in the deficit is attributable to the net income in the first half of 2005. The balance of the increase in share capital and the deficit relates to the change in accounting policy as outlined in note 3 to the accompanying unaudited interim financial statements for the six months ended May 31, 2005.

## **Commitments and Obligations**

Commitments and contingencies outlined in the annual MD&A did not change during the second quarter of 2005.

## **Financial and Other Instruments**

Foreign exchange forward contracts are discussed under Results of Operations – Foreign Exchange.

Cash and cash equivalents include such items as bankers' acceptances carried at cost with maturities at acquisition of 90 days or less. The carrying values of accounts receivable, accounts payable and accrued liabilities and license fees payable approximate their fair values due to the relatively short periods to maturity of these financial instruments. The aggregate fair value of the Preferred shares, calculated at the current market rate of interest available to the Company for the same or similar financial instrument, approximates its current carrying value.

The Company manages its credit risk with respect to accounts receivable by dealing primarily with creditworthy customers and, where feasible, by billing in advance of rendering services. As at May 31, 2005, one customer represented 15.1% of the balance (November 30, 2004, one customer represented 10.8% of the balance).

## **Related Parties**

During the three and six months ended May 31, 2005 and 2004, related party transactions were similar to those outlined in the 2004 annual MD&A. The amount of such transactions was approximately equivalent to one quarter of such annual amounts.

## **Outlook**

During the rest of fiscal 2005, the Company expects to continue to fund the expansion of its sales and marketing capability and to pursue higher growth business opportunities. The Company's overall business strategy for 2005 is to continue to focus on revenue growth. However, the business climate and outlook for 2005 remain uncertain and broader economic factors may impact the Company's overall plans.

In the context of the Company's overall objectives, the Company intends to continue to manage its business to enable the hiring of additional personnel in several areas to support its growth objectives, provided that profitability and cash flow objectives are met. During 2005, staff increases are expected to focus primarily on the hiring of additional qualified personnel in sales, services and solution delivery. This expansion is expected to occur in North America and in Europe.

### ***Competition / Intellectual Property***

Competitive risks and risks associated with Intellectual Property outlined in the 2004 Annual MD&A did not change during the second quarter of 2005.

### ***Impacts of Fluctuations in Revenues***

The Company's quarterly operating results fluctuate due to several factors, including:

- The cyclical nature of customer purchases of enterprise software systems and tools which impact on quarterly results;
- Purchasing schedules, budgets and spending patterns of its customers;
- Changes in foreign currency exchange rates;
- The timing of solution implementations;
- Changes in mix of product and solutions revenues; and
- General economic conditions.

In addition, to the extent that the Company is successful in expanding its analytical solutions business, the changing relative proportion of software and services revenues involved in analytical solution sales, as well as schedules for solution delivery and associated recognition of software and services revenues, will impact on the timing of recording and reporting revenue on a quarterly basis.

The Company has historically operated with very little backlog because of its focus on sales of analytical tools that have generally been shipped as orders are received. As a result, revenues in any quarter are dependent on orders received and licenses renewed in that quarter. In addition, the timing and amount of the Company's revenues are affected by a number of factors that make estimation of operating results before the end of a quarter uncertain.

Although the Company endeavours to link operating expenses with revenue forecasts, many operating expenses are fixed and planned based on revenue expectations. If 2005 revenues fall below expectations, operating results may be adversely affected because the Company's expense levels are to a large extent based on these forecasts. Accordingly, the Company believes that quarter-to-quarter comparisons of its results of operations may not be meaningful and should not be relied upon as an indication of future performance. The Company cannot provide assurance that profitability will be achieved on a quarterly or annual basis in the future.

## Other Information

Other information related to the Company can be found on SEDAR at [www.SEDAR.com](http://www.SEDAR.com).

## Outstanding Share Data

Share capital consists of the following:	Authorized	Outstanding	Conversion rate
Common Shares	Unlimited	39,499,723	-
Preferred Shares	2,300,000	2,300,000	-
Warrants – 1 warrant is convertible to 1 Common share		3,450,000	\$0.30
Warrants – 1 warrant is convertible to 1 Common share		380,000	\$0.25
Options – 1 option is convertible to 1 Common share	5,700,000	3,919,547	At rates varying from \$0.12 to \$1.30 per option

Additional information about the Company's share capital is detailed in notes 6 and 7 to the unaudited May 31, 2005 consolidated financial statements.

## Notice to Shareholders

The attached consolidated financial statements have not been reviewed by the Company's external auditors.

# SECOND QUARTER INTERIM REPORT

## May 2005

### ANGOSS Software Corporation

#### Consolidated Balance Sheets

(Stated in Canadian dollars)

As at

	May 31, 2005 (unaudited)	November 30, 2004 (audited)
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents <i>[note 4]</i>	\$ 2,412,003	\$ 2,724,348
Accounts receivable <i>[note 4]</i>	1,441,606	1,497,344
Prepaid expenses	63,277	65,575
<b>Total current assets</b>	<b>3,916,886</b>	<b>4,287,267</b>
Deferred financing costs <i>[note 6]</i>	59,315	67,891
Capital assets, net <i>[note 5]</i>	251,106	175,150
	<b>\$ 4,227,307</b>	<b>\$ 4,530,308</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities <i>[notes 4]</i>	\$ 433,369	\$ 578,808
Dividends payable on Preferred shares <i>[note 6]</i>	26,686	26,576
Current redeemable portion of preferred shares <i>[note 6]</i>	575,000	575,000
Current portion of repayable contribution	94,530	94,530
Current portion of deferred revenue	1,137,104	1,392,347
<b>Total current liabilities</b>	<b>2,266,689</b>	<b>2,667,261</b>
Repayable contribution agreement	101,694	134,286
Deferred revenue	11,600	11,600
Preferred shares <i>[note 6]</i>	1,559,073	1,515,735
<b>Total liabilities</b>	<b>3,939,056</b>	<b>4,328,882</b>
Contingencies <i>[note 11]</i>		
<b>Shareholders' equity</b>		
Share capital <i>[notes 3, 6 &amp; 7]</i>	13,998,719	13,805,813
Deficit <i>[note 3]</i>	(13,710,468)	(13,604,387)
<b>Total shareholders' equity</b>	<b>288,251</b>	<b>201,426</b>
	<b>\$ 4,227,307</b>	<b>\$ 4,530,308</b>

See accompanying unaudited notes

On behalf of the Board:

<u>"John Gardner"</u> (Signed)	<u>"Eric Apps"</u> (Signed)
John Gardner Director	Eric Apps Director

# SECOND QUARTER INTERIM REPORT

## May 2005

### ANGOSS Software Corporation

#### Consolidated Statements of Income (Loss) and Deficit

(Unaudited, stated in Canadian dollars)

	Three Months ended		Six Months ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
Revenue <i>[notes 8 and 10]</i>	\$ 1,749,079	\$ 1,443,690	\$ 3,133,198	\$ 2,749,625
Cost of goods sold	4,510	29,001	8,489	34,386
<b>Gross margin</b>	<b>1,744,569</b>	<b>1,414,689</b>	<b>3,124,709</b>	<b>2,715,239</b>
<b>Operating expenses</b>				
Sales and marketing	844,310	837,783	1,616,614	1,571,457
General and administration	417,808	421,025	814,063	851,370
Research and development, net	310,030	364,509	576,967	732,333
	<b>1,572,148</b>	<b>1,623,317</b>	<b>3,007,644</b>	<b>3,155,160</b>
<b>Income (loss) before the following</b>	<b>172,421</b>	<b>(208,628)</b>	<b>117,065</b>	<b>(439,921)</b>
Other income <i>[note 12]</i>	30,648	24,066	30,648	24,066
Special charges <i>[note 13]</i>	-	(113,489)	-	(113,489)
Amortization of capital assets	(28,134)	(20,403)	(50,662)	(39,625)
Amortization of deferred financing costs <i>[note 6]</i>	(4,288)	(4,288)	(8,576)	(8,576)
Interest accretion on Preferred shares <i>[note 6]</i>	(22,661)	(20,176)	(43,338)	(58,014)
Dividend expense on Preferred shares <i>[note 6]</i>	(40,470)	(40,470)	(80,610)	(80,500)
Foreign exchange (loss) gain	(7,641)	(11,986)	93,020	61,157
Stock option expense <i>[note 7]</i>	(24,901)	-	(34,562)	-
<b>Net income (loss) for the period</b>	<b>74,974</b>	<b>(395,374)</b>	<b>22,985</b>	<b>(654,902)</b>
Deficit, beginning of period	(13,785,442)	(13,351,828)	(13,604,387)	(13,092,300)
Cummulative adjustment for stock-based compensation <i>[note 3]</i>	-	-	(129,066)	-
Deficit, restated at beginning of period	(13,785,442)	(13,351,828)	(13,733,453)	(13,092,300)
<b>Deficit, end of period</b>	<b>\$ (13,710,468)</b>	<b>\$ (13,747,202)</b>	<b>\$ (13,710,468)</b>	<b>\$ (13,747,202)</b>
<b>Basic and diluted loss per share <i>[note 7]</i></b>	<b>\$ 0.00</b>	<b>\$ (0.01)</b>	<b>\$ 0.00</b>	<b>\$ (0.02)</b>
Weighted average number of shares outstanding <i>[note 7]</i>				
Basic	39,499,723	39,226,311	39,448,274	39,164,722
Diluted	39,646,836	39,226,311	39,689,280	39,164,722

See accompanying unaudited notes

# SECOND QUARTER INTERIM REPORT

## May 2005

### ANGOSS Software Corporation

### Consolidated Statements of Cash Flows

(Unaudited, stated in Canadian dollars)

	Three Months ended		Six Months ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
<b>OPERATING ACTIVITIES</b>				
Net income (loss) for the period	\$ 74,974	\$ (395,374)	\$ 22,985	\$ (654,902)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities				
Interest accretion on Preferred shares	22,661	20,176	43,338	58,014
Amortization of capital assets	28,134	20,403	50,662	39,625
Amortization of deferred financing costs	4,288	4,288	8,576	8,576
Stock-based compensation and advisory services	26,959	11,319	39,057	89,054
	<b>157,016</b>	<b>(339,188)</b>	<b>164,618</b>	<b>(459,633)</b>
Changes in non-cash working capital balances				
(Increase) decrease in accounts receivable	(469,382)	285,655	55,738	169,740
(Increase) decrease in prepaid expenses	26,936	49,591	2,298	32,356
Increase (decrease) in accounts payable and accrued liabilities	72,951	11,336	(145,439)	167,315
Increase in dividends payable on Preferred shares	220	220	110	19,077
Increase (decrease) in deferred revenue	(87,208)	(359,649)	(255,243)	(309,256)
<b>Cash (used in) provided by operating activities</b>	<b>(299,467)</b>	<b>(352,035)</b>	<b>(177,918)</b>	<b>(380,401)</b>
<b>INVESTING ACTIVITIES</b>				
Purchase of capital assets	(69,873)	(17,319)	(126,618)	(101,951)
<b>Cash used in investing activities</b>	<b>(69,873)</b>	<b>(17,319)</b>	<b>(126,618)</b>	<b>(101,951)</b>
<b>FINANCING ACTIVITIES</b>				
Repayable contributions	(14,810)	-	(32,592)	-
Issuance of common shares on exercise of options	-	8,031	24,783	9,031
<b>Cash provided by financing activities</b>	<b>(14,810)</b>	<b>8,031</b>	<b>(7,809)</b>	<b>9,031</b>
<b>Net (decrease) increase in cash during the period</b>	<b>(384,150)</b>	<b>(361,323)</b>	<b>(312,345)</b>	<b>(473,321)</b>
Cash and cash equivalents, beginning of period	2,796,153	3,149,261	2,724,348	3,261,259
<b>Cash and cash equivalents, end of period</b>	<b>\$ 2,412,003</b>	<b>\$ 2,787,938</b>	<b>\$ 2,412,003</b>	<b>2,787,938</b>
<b>Supplemental cash flow information</b>				
Dividends and interest paid	\$ 40,250	\$ 40,250	\$ 80,500	\$ 61,423

See accompanying unaudited notes

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2005

[in Canadian dollars unless otherwise indicated]

### 1. DESCRIPTION OF BUSINESS

Angoss Software Corporation (“Angoss” or the “Company”) develops and licenses data mining and predictive analytics software solutions. Modellers and business analysts primarily in the banking, insurance, telecommunications, health care and pharmaceuticals, retail, manufacturing and technology industries use Angoss solutions.

Angoss solutions are based on a common suite of integrated technologies. They consist of (i) analyst tools, used for data analysis and modelling; (ii) a scoring and decisioning server used for deploying data mining models to operational systems; (iii) web based task automation, collaboration and model management tools used to develop template-based pre-packaged predictive analytics applications; and (iv) developer tools, used for automating data mining tasks, integrating data mining functionality with enterprise systems and creating intelligent analytic applications.

Angoss products are sold directly and by licensees as integrated and embedded components of their application suites. Angoss supports its software through a professional services organization that offers implementation services for Angoss offerings and complementary data mining and predictive analytics capability on a project and outsourcing basis.

### 2. BASIS OF PRESENTATION

These interim unaudited consolidated financial statements have been prepared by management in Canadian dollars in accordance with Canadian generally accepted accounting principles [“GAAP”] with respect to the preparation of interim financial information. Accordingly they do not include all information and notes as required in the preparation of annual consolidated financial statements.

In the opinion of management, all adjustments considered necessary for the presentation of the Company’s financial position, results of operations and cash flows have been included. Operating results for the interim period are not necessarily indicative of the results to be expected for any subsequent quarter or for the full fiscal year ending November 30, 2005.

The accounting policies used in the preparation of these interim unaudited consolidated financial statements are consistent with those used in preparing the annual consolidated financial statements except for the change in the accounting policy noted below. These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended November 30, 2004, as set out in the 2004 Annual Report. Note disclosures have been presented for material updates to the information previously reported.

### 3. CHANGE IN ACCOUNTING POLICY

**Stock-Based Compensation** The Company adopted the CICA Handbook Section 3870 “*Stock-based Compensation and Other Stock-based payments*” which establishes standards for the recognition, measurement and disclosure of stock based compensation and other stock based payments. Section 3870 requires the fair value based method of accounting be applied to all stock-based payments to non-employees, and to employee awards that are direct awards of stock that call for settlement in cash or other assets. Until November 30, 2004, the Section permitted the Company to continue its policy of recording no compensation expense for the grant of stock options to employees with the addition of pro-forma information. In accordance with the new CICA requirements, effective December 1, 2004, the Company has adopted, on a retroactive basis without restatement of prior periods and an adjustment to the opening deficit, the fair value of accounting for employee stock based compensation and other stock based payments. The effect of the retroactive adoption of this accounting policy was to increase each of the deficit, contributed surplus and share capital as at December 1, 2004 by \$129,066 respectively.

### 4. FINANCIAL INSTRUMENTS

**Credit Risk** The Company manages its credit risk with respect to accounts receivable by dealing primarily with creditworthy customers and, where feasible, by billing in advance of rendering services. As at May 31, 2005, one customer represented 15.1% of the outstanding balance. As at November 30, 2004, one customer represented 10.8% of the balance.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2005

[in Canadian dollars unless otherwise indicated]

The Company has entered in an agreement with a customer, Angoss Software Australia Pty. Ltd. ("Australia"), wherein the Company is entitled to receive up to a 50% interest in the revenue generated by Australia. In exchange for its interest, the Company has granted Australia the exclusive right to represent and distribute the Company's software, services and related solutions. The Company's share of the revenue is recognized as earned by Australia and is re-invested in Australia as a non-interest bearing working capital loan. Subject to certain terms and conditions, the agreement otherwise expires on December 1, 2006.

**Currency Risk** The Company sells software and services in both Canadian and foreign currencies that give rise to the risk that its earnings and cash flows may be adversely impacted by fluctuations in foreign exchange. Certain purchases of services and equipment are also made in non-Canadian currencies. The Company uses its natural hedge to mitigate, to the extent possible, and will, from time to time, enter into foreign exchange forward contracts to manage foreign exchange risk on US cash held as term deposits and license renewal billings.

As at May 31, 2005, the Company had three (November 30, 2004 – 2) outstanding foreign exchange forward contracts representing commitments to sell US\$1,500,000 (November 30, 2004 - US\$1,000,000) in exchange for Canadian dollars at a weighted average rate of \$1.2473 (November 30, 2004 - \$1.2100) and a weighted average remaining contractual life of 111 days (November 30, 2004 – 303 days). The spot US dollar to Canadian dollars exchange rate as at May 31, 2005 was \$1.2510 (November 30, 2004 – 1.1904).

As at May 31, 2005 and November 30, 2004, two of the outstanding foreign exchange forward contracts represented commitments to sell US\$500,000 in exchange for Canadian dollars on each of June 30, 2005 and December 31, 2005. On delivery, the Company will receive the Canadian dollar equivalent determined at the spot rate in effect on the day of settlement subject to the following conditions:

- (a) if the spot rate on the settlement date is less than \$1.32, the amount will be determined by using the spot rate on the settlement date, such spot rate not to be less than \$1.21; and
- (b) if the spot rate on the settlement date is greater than \$1.32, the settlement will be made at \$1.21.

These contracts do not qualify for hedge accounting treatment and are recorded at their fair value at the close of each reporting period with the gain or loss being included in foreign exchange gain/(loss) on the consolidated statements of loss. For the three and six months ended May 31, 2005, a loss of \$5,500 on these contracts was recorded in the consolidated statements of loss.

As at May 31, 2005, 70.2% [November 30, 2004 – 66.8%] of cash and cash equivalents and 55.0% [November 30, 2004 – 64.8%] of accounts receivable are denominated in foreign currencies. As at May 31, 2005, 20.4% [November 30, 2004 – 21.9%] of accounts payable and accrued liabilities and license fees payable are denominated in foreign currencies.

**Fair Value** The carrying values of accounts receivable and accounts payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of these financial instruments. The aggregate fair value of the Preferred shares, calculated at the current market rate of interest available to the Company for the same or similar financial instrument, approximates its current carrying value.

### 5. CAPITAL ASSETS

Capital assets consist of the following:

	May 31, 2005		
	Cost	Accumulated Amortization	Net Book Value
Computer equipment	\$ 751,097	\$ 600,053	\$ 151,044
Duplication equipment	7,431	6,889	542
Equipment under capital lease	229,079	229,079	—
Office furniture and equipment	197,007	150,364	46,643
Computer software	322,691	269,814	52,877
Leasehold improvements	228,796	228,796	—
	<b>\$ 1,736,101</b>	<b>\$ 1,484,995</b>	<b>\$ 251,106</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2005

[in Canadian dollars unless otherwise indicated]

Capital assets consist of the following:

	November 30, 2004		
	Cost	Accumulated Amortization	Net Book Value
Computer equipment	\$ 687,323	\$ 572,038	\$ 115,285
Duplication equipment	7,431	6,794	637
Equipment under capital lease	229,079	229,079	—
Office furniture and equipment	169,842	145,011	24,831
Computer software	287,012	252,615	34,397
Leasehold improvements	228,796	228,796	—
	<b>\$ 1,609,483</b>	<b>\$ 1,434,333</b>	<b>\$ 175,150</b>

### 6. PREFERRED SHARES

Information about the Company's Preferred shares is included in Note 6 of the Company's November 30, 2004 annual audited financial statements. A summary of the Preferred shares outstanding as at May 31, 2005 and November 30, 2004 is as follows:

	May 31, 2005	November 30, 2004
<b>Authorized</b>		
Unlimited Class A Preferred shares, issuable in series		
<b>Issued</b>		
2,300,000 Class A Preferred shares, Series 1	<b>\$ 2,134,073</b>	\$ 2,090,735

The carrying value of the Series 1 is determined as follows:

	May 31, 2005	November 30, 2004
Stated value of Series 1 issued	<b>\$ 2,300,000</b>	\$ 2,300,000
Less amount allocated to warrants	<b>(310,500)</b>	(310,500)
Amount allocated to Series 1	<b>1,989,500</b>	1,989,500
Add cumulative interest accretion expense	<b>144,573</b>	101,235
Total liability	<b>2,134,073</b>	2,090,735
Less current portion to be redeemed	<b>(575,000)</b>	(575,000)
Long-term liability	<b>\$ 1,559,073</b>	\$ 1,515,735

For the six months ended May 31, 2005, the interest accretion on Series 1 was \$43,338 (2004 – \$58,014) and the dividend expense was \$80,610 (2004 – \$80,500). For the three months ended May 31, 2005, the interest accretion on Series 1 was \$22,661 (2004 – \$20,176) and the dividend expense was \$40,470 (2004 – \$40,470).

### 7. SHARE CAPITAL

Share capital consists of the following:

	May 31, 2005	November 30, 2004
<b>Authorized</b>		
Unlimited common shares		
Preferred shares [note 6]		
<b>Issued</b>		
Common shares	<b>\$ 13,471,845</b>	
May 31, 2005 – 39,499,723		
November 30, 2004 – 39,313,472		\$ 13,447,062

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2005

[in Canadian dollars unless otherwise indicated]

Warrants	3,450,000 warrants at \$0.30	<b>310,500</b>	310,500
	380,000 warrants at \$0.25	<b>49,146</b>	44,651
		<b>359,646</b>	355,151
Contributed surplus		<b>167,228</b>	3,600
		<b>\$ 13,998,719</b>	\$ 13,805,813

**Issued Common Shares** During the six months ended May 31, 2005, the Company issued 186,251 common shares on the exercise of stock options at prices ranging from \$0.12 to \$0.15 per common share, for a total of \$24,783. During the three months ended May 31, 2005, no common shares were issued.

During the six months ended May 31, 2004, 58,542 common shares were issued on the exercise of stock options at prices ranging from \$0.15 to \$0.20 per common share for a total of \$9,031. During the three months ended May 31, 2004, 53,542 common shares were issued on the exercise of stock options at \$0.15 per common share for a total of \$8,031.

Direct awards of stock to employees have been accounted for in accordance with the fair value method of accounting for stock-based compensation. During the six months ended May 31, 2004, the Company issued 100,000 common shares to an officer as part of an employment contract. The fair value of the common shares is based on the market price (\$0.20 per common share) on the date the contract was signed. Accordingly, the fair value of \$20,000 on the awarded common stock was charged to operations, with an offsetting credit to share capital.

**Warrants** During the six months ended May 31, 2004, the Company issued 380,000 warrants to purchase 380,000 common shares of the Company at \$0.25 per share in connection with a consulting services contract. The contract is cancellable on 30 days notice. As at May 31, 2005, 373,667 warrants have vested (2004 – 190,000). The warrants expire December 10, 2008. As at May 31, 2005, no warrants had been exercised. Principals of the consulting company were investors in the Series 1 financing [note 6] and have also provided consulting services [note 10]. The total fair value assigned to the warrants, \$49,400, will be expensed as the warrants vest. During the six months ended May 31, 2005, the value assigned to 95,000 warrants (2004 – 95,000) that vested, \$4,495 (2004 - \$33,604), was expensed. During the three months ended May 31, 2005, the value assigned to 47,500 warrants (2004 – 47,500) that vested, \$2,058 (2004 - \$11,319), was expensed. The value of the warrants was estimated at the date of their issue using the Black-Scholes option-pricing model. The assumptions used to value the warrants are outlined in note 7 to audited financial statements for the year ended November 30, 2004.

On November 14, 2003, the Company issued 3,450,000 warrants to purchase 3,450,000 common shares of the Company at \$0.30 per share in connection with the issue of Series 1 on that date [note 6]. The warrants expire November 13, 2008. As at November 30, 2004, no warrants had been exercised. The fair value of the warrants, \$310,500, was estimated at the date of their issue using the Black-Scholes option-pricing model. The assumptions used to value the warrants are outlined in note 7 to audited financial statements for the year ended November 30, 2004.

On February 25, 2002, the Company issued 100,000 warrants to purchase 100,000 common shares of the Company at US\$0.35 per share in connection with a licensing agreement signed on that date. The warrants are not exercisable until the software has been released and expires five years thereafter. As at February 28, 2005, the software was not released. No value has been assigned to the warrants.

**Stock-Based Compensation Plans** Information about the Company's two active stock-based compensation plans, Employee Share Purchase Plan ("ESSP") and Stock Option Plan, is included in Note 7 of the Company's November 30, 2004 annual audited financial statements.

As at May 31, 2005 and November 30, 2004, no shares had been acquired under the ESSP.

A summary of the Company's Stock Option Plan as at May 31, 2005 and November 30, 2004 and changes during the six and twelve months ended on those dates respectively is presented below:

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2005

[in Canadian dollars unless otherwise indicated]

	Six months ended May 31, 2005		Twelve months ended November 30, 2004	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of period	3,192,434	\$0.22	4,669,639	\$0.20
Granted	1,582,500	0.16	1,882,500	0.18
Exercised	(186,251)	0.13	(133,542)	0.15
Cancelled	(669,136)	0.22	(3,226,163)	0.18
<b>Outstanding, end of period</b>	<b>3,919,547</b>	<b>\$0.20</b>	<b>3,192,434</b>	<b>\$0.22</b>
<b>Options vested, at end of period</b>	<b>2,134,464</b>		<b>2,752,188</b>	

As at May 31, 2005 and November 30, 2004, non-executive directors of the Company have been granted a total of 312,500 options to acquire 312,500 common shares of the Company at prices ranging from \$0.13 to \$0.20 per share.

The following table summarizes information about the stock options outstanding as at May 31, 2005:

Exercise price	Options outstanding	Remaining Contractual life [months]	Options vested
\$0.12	60,000	33	60,000
0.13	959,747	49 to 52	693,497
0.15	302,000	25	292,334
0.16	1,452,500	56	—
0.19	257,500	36	230,833
0.20	316,800	20	316,800
0.28	30,000	44	30,000
0.32	100,000	44	70,000
0.33	185,000	13	185,000
0.35	66,000	11	66,000
0.50	150,000	9	150,000
1.30	40,000	3	40,000
	<b>3,919,547</b>		<b>2,134,464</b>

**Employees  
and  
Directors**

On December 1, 2004, the Company adopted the CICA's recommendations in Section 3870, "Stock-based Compensation and Other Stock-based payments" and has recorded the fair value of all options granted in the consolidated statement of loss. Upon adopting CICA Section 3870, the Company elected to retroactively

adjust the deficit without restatement. On December 1, 2004, the Company increased the deficit by \$129,066 and increased contributed surplus by the same amount. Employee stock based compensation expense for the six months ended May 31, 2005 was \$34,562 (three months ended May 31, 2005 – \$24,901).

The value of each option is estimated on the date of the grant using the Black-Scholes option-pricing model and recorded as an expense ratably over the vesting period of the option. During the six months months ended May 31, 2005, the Company granted 1,582,500 options to acquire 1,582,500 common shares of the Company at \$0.16 per share (three months ended May 31, 2005 – nil options). The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2005

[in Canadian dollars unless otherwise indicated]

Weighted average risk-free interest rate	3.52%
Dividend yield	0.0%
Weighted average volatility factors of the expected market price of the Company's common shares	59.8%
Weighted average expected life of the options (in years)	2.5

**Non-Employees** Stock and stock option awards granted to non-employees have been accounted for in accordance with the fair value method of accounting for stock-based compensation. Accordingly, the fair value of the options at the date of grant is accrued and charged to operations, with an offsetting credit to contributed surplus, on a straight-line basis over the vesting period. During the six and three months ended May 31, 2005, no such options were granted. During the six months ended May 31, 2004, the value assigned to 30,000 options granted to non-employees was \$3,600 (three months ended May 31, 2004 – nil). The fair value of these options was estimated at the date of grant using the Black-Scholes option-pricing model. The assumptions used to value the options are outlined in note 7 to audited financial statements for the year ended November 30, 2004.

**Stated Capital** The legal stated value of the Company's common shares differs from the carrying value reflected in these consolidated financial statements. As at May 31, 2005, the legal stated capital of the common shares is \$19,302,449 [November 30, 2004 - \$19,277,666].

The legal stated value of the Company's warrants differs from the carrying value reflected in these consolidated financial statements. The legal stated capital of the warrants is \$0.02.

**Loss per Share** In accordance with the CICA's Section 3500, "Earnings Per Share", earnings (loss) per share are computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the year. Loss per share, for the periods presented, were calculated using the weighted average number of common shares outstanding during each period as follows:

	Six months ended	
	<u>May 31, 2005</u>	<u>May 31, 2004</u>
<b>Basic earnings (loss) per share</b>		
Net income (loss)	\$ 22,985	\$ (654,902)
Weighted average number of common shares outstanding	39,448,274	39,164,722
<b>Basic earnings (loss) per share</b>	<b>\$ 0.00</b>	<b>\$(0.02)</b>
<b>Diluted earnings (loss) per share</b>		
Net income (loss)	\$ 22,985	\$ (654,902)
Weighted average number of common shares outstanding	39,448,274	39,164,722
Dilutive effect of stock options and warrants	241,006	—
Weighted average number of common shares outstanding	39,689,280	39,164,722
<b>Diluted earnings (loss) per share</b>	<b>\$ 0.00</b>	<b>\$(0.02)</b>
	Three months ended	
	<u>May 31, 2005</u>	<u>May 31, 2004</u>
<b>Basic earnings (loss) per share</b>		
Net income (loss)	\$ 74,974	\$ (395,374)
Weighted average number of common shares outstanding	39,449,723	39,226,311
<b>Basic earnings (loss) per share</b>	<b>\$ 0.00</b>	<b>\$(0.01)</b>
<b>Diluted earnings (loss) per share</b>		
Net income (loss)	\$ 74,974	\$ (395,374)
Weighted average number of common shares outstanding	39,449,723	39,226,311
Dilutive effect of stock options and warrants	147,113	—
Weighted average number of common shares outstanding	39,646,836	39,226,311
<b>Diluted earnings (loss) per share</b>	<b>\$ 0.00</b>	<b>\$(0.01)</b>

For the three and six months ended May 31, 2004, all warrants and stock options were excluded from the calculation of diluted loss per share because the effect would have been anti-dilutive.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2005

[in Canadian dollars unless otherwise indicated]

### 8. MAJOR CUSTOMERS

For the six months ended May 31, 2005 and May 31, 2004, no single customer accounted for more than 10% of revenue. For the three months ended May 31, 2005, one customer accounted for 11.1% of revenue. For the three months ended May 31, 2004, no single customer accounted for more than 10% of revenue.

### 9. RELATED PARTY TRANSACTIONS

As at May 31, 2005, annual and meeting fees payable to directors acting in their capacity as directors was \$16,252 [November 30, 2004 - \$13,750]. For the six months ended May 31, 2005, directors' fee expense was \$25,002 [2004 - \$22,500]. For the three months ended May 31, 2005, directors' fee expense was \$12,501 [2004 - \$11,250].

During the six months ended May 31, 2004, the remaining employee notes totalling \$31,850 were forgiven (three months ended May 31, 2004 – nil).

In December 2003, the Company entered into a contract with a consulting company whose principals were investors in the Series 1 offering. On signing the contract the consulting company received warrants [note 7]. During the six months ended May 31, 2005 the Company expensed consulting fees totalling nil (2004 - \$70,813). During the three months ended May 31, 2005 the Company expensed consulting fees totalling nil (2004 - \$33,000).

As at May 31, 2005 and November 30, 2004, officers, directors and employees of the Company hold 10.9% of each of the outstanding Series 1 offering and warrants and received their pro-rata share of dividends.

### 10. INFORMATION BY GEOGRAPHIC AREA

The Company operates within one dominant industry segment, the development and sale of computer software products.

	<b>Six months ended May 31, 2005</b>			
	<b>North America and Australia</b>	<b>Europe</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Revenue</b>				
Customers	\$ 2,655,241	\$ 450,448	\$ —	\$ 3,105,689
Interest income	27,127	382	—	27,509
Intercompany	28,350	—	(28,350)	—
	<b>\$ 2,710,718</b>	<b>\$ 450,830</b>	<b>\$ (28,350)</b>	<b>\$ 3,133,198</b>
Income (loss) before income taxes	<b>\$ 40,645</b>	<b>\$ (17,660)</b>	<b>\$ —</b>	<b>\$ 22,985</b>
	<b>Six months end May 31, 2004</b>			
	<b>North America and Australia</b>	<b>Europe</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Revenue</b>				
Customers	\$ 2,265,636	\$ 461,688	\$ —	\$ 2,727,324
Interest income	22,275	26	—	22,301
Intercompany	36,468	—	(36,468)	—
	<b>\$ 2,324,379</b>	<b>\$ 461,714</b>	<b>\$ (36,468)</b>	<b>\$2,749,625</b>
Loss before income taxes	<b>\$ (632,954)</b>	<b>\$ (21,948)</b>	<b>\$ —</b>	<b>\$ (654,902)</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2005

[in Canadian dollars unless otherwise indicated]

Three months end May 31, 2005				
	North America and Australia	Europe	Eliminations	Consolidated
<b>Revenue</b>				
Customers	\$ 1,429,331	\$ 302,690	\$ —	\$ 1,732,021
Interest income	16,951	107	—	17,058
Intercompany	21,714	—	(21,714)	—
	<b>\$ 1,467,996</b>	<b>\$ 302,797</b>	<b>\$ (21,714)</b>	<b>\$1,749,079</b>
Income (loss) before income taxes	\$ 8,277	\$ 66,697	\$ —	\$74,974

Three months end May 31, 2004				
	North America and Australia	Europe	Eliminations	Consolidated
<b>Revenue</b>				
Customers	\$ 1,228,463	\$ 206,369	\$ —	\$ 1,434,832
Interest income	8,856	2	—	8,858
Intercompany	14,993	—	(14,993)	—
	<b>\$ 1,252,312</b>	<b>\$ 206,371</b>	<b>\$ (14,993)</b>	<b>\$1,443,690</b>
Loss before income taxes	\$ (300,399)	\$ (94,975)	\$ —	\$ (395,374)

	North America	Europe	Eliminations	Consolidated
<b>Capital assets</b>				
May 31, 2005	\$ 212,547	\$ 38,558	\$ —	\$ 251,106
November 30, 2004	\$ 147,726	\$ 27,424	\$ —	175,150

**11. CONTINGENCIES**

In the ordinary course of its business activities, the Company may be contingently liable with respect to litigation and other claims made by or on behalf of current or former employees, agents, customers, suppliers, partners, contractors or other persons, as well as federal, state, local and municipal taxation and other governmental and regulatory authorities. Management believes that adequate provision has been recorded in the accounts where required with respect to such claims, based on such considerations as the nature and scope of its business operations, the basis of such claims and remedies available to the Company with respect to them, the reasonableness and likelihood of such claims, exposure estimates for such claims, the Company's past experience with respect to such claims, and similar factors. It is reasonably possible that management estimates of such claims may differ materially from the amounts recorded in the consolidated financial statements.

**12. OTHER INCOME**

In May 2000, the Company settled an outstanding proceeding with TRIFOX, Inc. ["TRIFOX"]. The settlement provided for an initial cash payment of US\$250,000 [all of which was received] and ongoing semi-annual payments totalling US\$520,000 of which US\$199,079 [2003 - \$263,785] remains outstanding. These remaining payments are linked to the revenue of TRIFOX and are collateralized by way of a US\$995,394 Secured Promissory Note to be drawn down pro-rata based on the payments received. The Company is also entitled to receive additional cash consideration in certain circumstances and to participate, at its option, in certain future financing transactions involving TRIFOX. TRIFOX's payment obligations can be prepaid on an agreed net present value basis, and are collateralized by a first ranking General Security Agreement, Stock Pledge Agreement, Copyright Security Agreement, Limited Recourse Guaranty Agreement and a Source Code Escrow Agreement. In connection with the settlement, both companies have also entered into Mutual Final Releases of claims on all matters relating to litigation between the parties.

The balance of the amount receivable, after deducting collection expenses (21.37% of amounts received), will be recorded in Company income when the amount is otherwise due. To date, all amounts from TRIFOX have been received in accordance

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

May 31, 2005

[in Canadian dollars unless otherwise indicated]

with the settlement agreement.

### **13. SPECIAL CHARGES**

On May 31, 2004, the Company restructured its operations and terminated nine employees to re-align its on-going operating costs. As at May 31, 2004, a provision of \$125,646 was made for the termination and lay-off associated with these nine employees – seven in research and development, one in sales and one in administration. As at November 30, 2004, the Company had paid a total of \$108,413. As at May 31, 2005, all amounts had been paid.

### **14. COMPARATIVE FINANCIAL STATEMENTS**

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the current year consolidated financial statements.



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