



FIRST QUARTER 2006

PsiNaptic Inc. is a technology company that develops and markets middleware software based on open standards to address the growing need to connect small, low-power wired or wireless devices without human intervention, configuration or set up. PsiNaptic solutions operate on multiple platforms, across various networks and in all environments. With PsiNaptic's technology, networks of intelligent objects – from servers to embedded processors and Bluetooth® chips – can exchange information and services where and when needed, independent of how the underlying hardware or software is configured and/or managed.

All start-up costs have been expensed and research and development costs have not been capitalized. The Company has no long-term debt. PsiNaptic's resources are now targeted at the marketing and sales of its products and consulting services. The Company is planning to take advantage of growth opportunities in the rapidly evolving mobile market and the emerging embedded market space.

To the shareholders

We are pleased to present the financial and operating results of PsiNaptic for the three months ended December 31, 2005 and 2004.

The first quarter of the 2006 operating year has seen an increase in marketing activities in spite of the customary slowdown in business activities at the end of the calendar year.

In the automotive industry PsiNaptic continued to build on its strong technical innovative reputation in North America and is now working with a number of leading OEMs and Tier1 companies in Europe to enable integration of mobile devices with cars. As well we have increased our activities in the area of micro commerce and we are now working with three of the world leading suppliers of electronic modules for micro commerce.

We continued to appear as speakers in conferences and workshops. In October we presented an update on our technology to the Jini community at a conference in Chicago, Ill. And in November we represented the company in the annual Automotive Navigation Conference in San Jose, Ca.

The Board of Directors appointed Stephen Eyre as a new member of the board. Stephen is a Principal Strategy Consultant with Microsoft Canada and brings with him extensive experience in marketing technology and strategic business planning. Stephen is an important addition to our board and I would like to take this opportunity of welcoming him to the board of directors.

At this time, we face a shortage of available working capital. We are reviewing steps to reduce our operating expenses and continue to seek additional sources of financing to support our operations.

Sincerely,

Aaron Dagan
President and Chief Executive Officer
February 2006

Management's Discussion and Analysis of Results of Operations And Financial Condition

As of January 26, 2006

This discussion and analysis should be read in conjunction with the audited financial statements of PsiNaptic Inc. ("PsiNaptic" or "the Company") for the year ended September 30, 2005 and the interim financial statements for the three months ended December 31, 2005. The interim financial statements for the three months ended December 31, 2005 were prepared in accordance with Canadian generally accepted accounting principles.

FORWARD –LOOKING STATEMENTS

This MD&A contains forward-looking statements, including the Corporation's expectations as to the success of its research and development programs related to JMatos® and CMatos, which involve known and unknown risks and uncertainties, and which could cause the Corporation's actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, among others, the availability of funds and resources to successfully commercialize JMatos® and CMatos and general changes to the economic environment. Investors are cautioned against placing undue reliance on forward-looking statements. The Corporation does not undertake to update these forward-looking statements.

Comparison of the quarters ended December 31, 2005 and 2004

Results of Operations

PsiNaptic incurred an operating loss of \$182,871 in the quarter ended December 31, 2005, which compares to an operating loss of \$168,022 in the quarter ended December 31, 2004. The net loss, after expense recoveries and interest, increased to \$181,455 in the current quarter from a net loss of \$145,589 in the comparative quarter of the prior year.

Operating Expenses

Total operating expenses increased to \$182,871 in the quarter ended December 31, 2005 from \$168,022 in the quarter ended December 31, 2004. Salaries, including consultants and benefits were \$125,293 in the current quarter compared to \$111,419 in the corresponding quarter of the prior year. This small increase reflects the resumption to salaries at market levels by some senior management in the third quarter of fiscal 2005. Other general and administrative costs increased to \$44,234 in the quarter ended December 31, 2005 from \$34,428 in the quarter ended December 31, 2004, reflecting increased costs of investor relations and legal expenses.

Marketing expenses decreased to \$10,313 in the quarter ended December 31, 2005 compared to \$15,155 in the quarter ended December 31, 2004, reflecting reduced web page and third party marketing expenses of \$10,681. However this was offset by increased travel and legal of \$5,839.

Recoveries and Other Income

PsiNaptic's licensing agreements did not generate any licensing revenue during the three months ended December 31, 2005 compared to \$15,791 of licensing revenue for the three months ended December 31, 2004, the first such revenue from licensing agreements executed in the third fiscal quarter of 2004.

The Company did not generate any consulting revenue this quarter compared to \$5,000 in consulting revenue for the three months ended December 31, 2004. While there are no commitments in place at the present time, the Company continues to solicit consulting revenue in the marketplace.

Net interest income of \$1,416 was earned in the quarter ended December 31, 2005 compared to \$1,642 in the quarter ended December 31, 2004.

Financial Condition and Liquidity

Funds used in operations were \$175,524 in the quarter ended December 31, 2005, compared to \$157,812 in the quarter ended December 31, 2004.

PsiNaptic did not generate any funds from financing activities during the quarter ended December 31, 2005 or the quarter ended December 31, 2004.

Investing activities during the quarters ended December 31, 2005 and December 31, 2004 consisted of the redemption of funds to support operations.

Cash Requirements Outlook

PsiNaptic had working capital of \$121,697 at December 31, 2005 compared to \$300,360 at September 30, 2005. Although the Company is again reviewing steps to reduce its operating expenses and contain its costs in an attempt to cover its operating requirements, the working capital on hand is not sufficient to support operations beyond 90 days. Funds are not expected to be generated from its existing licensing agreements in the current fiscal year. The Company continues to investigate both public and private sources of funds.

Management's Responsibility for Financial Statements

The accompanying unaudited interim financial statements and all of the information included in this first quarter report have been prepared by, and are the responsibility of, management and have been approved by the Audit Committee of the Board of Directors. The interim financial statements have been prepared in accordance with generally accepted accounting principles and reflect management's best estimates and judgements based on current information. The significant accounting policies which management believes are appropriate for the Company are described in Note 3 of the audited financial statements for September 30, 2005.

The Company has developed and maintains an appropriate system for internal controls in order to ensure, on a reasonable and cost-effective basis, that relevant and reliable financial information is produced.

The Audit Committee is appointed by the Board and consists of two independent Directors and the President.

Deloitte & Touche LLP, the Company's external auditors, who were recommended by the Directors for reappointment and appointed by the shareholders of the Company, have not been asked to perform a review of the following statements as the present level of operations does not warrant such a review.

Aaron Dagan
President and Chief Executive Officer
January 26, 2006

Morris Bleviss
Chief Financial Officer

Balance Sheets

	<i>unaudited</i> December 31, 2005	<i>audited</i> September 30, 2005
ASSETS		
Current Assets		
Cash	\$ 13,266	\$ 13,188
Short-term investments	132,002	310,587
Accounts receivable	6,382	4,426
Prepaid expenses	10,138	15,129
	161,788	343,330
Capital assets	31,411	30,814
Intellectual property	6,004	8,141
	199,203	382,285
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	40,091	42,971
SHAREHOLDER'S EQUITY		
Share capital	4,670,300	4,669,047
Deficit	(4,511,188)	(4,329,733)
	159,112	339,314
	199,203	382,285

Statements of Loss and Deficit

Three month period ending December 31,
(unaudited)

	2005	2004	Cumulative from Inception on Dec. 16 1999
EXPENSES			
Depreciation and amortization	\$ 4,523	\$ 6,168	\$ 257,463
General and administrative	81,565	62,219	1,747,530
Marketing	65,414	54,011	1,446,743
Research and engineering	31,369	45,624	2,063,117
	182,871	168,022	5,514,853
LOSS BEFORE OTHER INCOME	(182,871)	(168,022)	(5,514,853)
OTHER INCOME			
Licensing revenue	-	15,791	17,856
Consulting revenue	-	5,000	43,659
Interest income	1,416	1,642	110,801
IRAP expense recovery	-	-	211,197
SR&ED tax credits	-	-	620,152
	1,416	22,433	1,003,665
NET LOSS	(181,455)	(145,589)	(4,511,188)
DEFICIT , beginning of period	(4,329,733)	(3,593,095)	
DEFICIT , end of period	(4,511,188)	(3,738,684)	(4,511,188)
Loss per share	(0.0076)	(0.0077)	
Number of shares outstanding	23,786,812	18,906,812	

Statements of Cash Flows

Three Months Ending December 31,
(Unaudited)

	2005	2004	Cumulative from Inception on Dec. 16, 1999
OPERATING ACTIVITIES			
Net loss	\$ (181,455)	\$ (145,589)	\$ (4,511,188)
Adjustments for:			
Depreciation and amortization	4,523	6,168	257,463
Non-cash marketing expense	-	-	100,000
Stock-based compensation	1,253	186	3,137
	(175,679)	(139,235)	(4,150,588)
Changes in non-cash working capital:			
Accounts receivable	(1,956)	(15,974)	(6,382)
Prepaid expenses	4,991	3,775	(10,138)
Accounts payable and accrued liabilities	(2,880)	(6,378)	40,091
	(175,524)	(157,812)	(4,127,017)
INVESTING ACTIVITIES			
Redemption (Purchase) of short-term investments	178,585	158,358	(132,002)
Purchase of capital assets	(2,983)	-	(240,257)
Purchase of intellectual property	-	-	(73,139)
SR&ED recovery on capital assets	-	-	18,518
	175,602	158,358	(426,880)
FINANCING ACTIVITIES			
Issuance of shares (net of expenses)	-	-	2,554,333
Issuance of warrants (net of expenses)	-	-	2,012,830
	-	-	4,567,163
CASH, PERIOD CHANGE	78	546	13,266
CASH, beginning of period	13,188	22,208	-
CASH, end of period	13,266	22,754	13,266

Notes to the Financial Statements

For the Three Months ended December 31, 2005

1. Basis of presentation

These unaudited interim financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles for interim financial information. Accordingly, these interim financial statements do not include all the information and notes required by Canadian generally accepted accounting principles for complete financial statements. In the opinion of management, the interim financial statements contain all adjustments of a normal and recurring nature necessary to present fairly the financial position as at December 31, 2005 and the results of operations and the cash flows for the three months ended December 31, 2005 and 2004.

These interim financial statements have been prepared using the same accounting policies as the September 30, 2005 financial statements. The interim financial statements included herein should be read in conjunction with the Company's Annual Report for the year ended September 30, 2005.

2. Share Capital	Number of Shares	Amount
Issued		
<i>Common shares</i>		
Balance, September 30, 2004	18,906,812	\$ 3,963,835
Private placement at \$0.10 per share	2,110,000	211,000
Private placement at \$0.15 per unit	2,770,000	415,500
Less financing costs	-	(11,921)
Balance September 30 and December 31, 2005	23,786,812	4,578,414
<i>Contributed surplus</i>		
Balance, September 30, 2004	-	89,109
Stock based compensation	-	1,524
Balance September 30, 2005	-	90,633
Stock based compensation	-	1,253
Balance December 31, 2005	-	91,886
Total, September 30, 2005	23,786,812	4,669,047
Total, December 31, 2005	23,786,812	4,670,300

Private placement units

There are 1,385,000 common shares reserved for the exercise of private placement warrants issued in May 2005. Each whole private placement warrant is convertible into one common share at an exercise price of \$0.25 per share for a period of two years from the date of issuance. The last closing under the private placement was May 26, 2005.

Stock options

No options were issued, exercised or forfeited during the quarter ended December 31, 2005. Details of options outstanding under the stock option plan adopted September 22, 2003 are as follows:

2005				
Expiry	Number of Options	Exercise Price	Weighted Average Contractual Life (Years)	Number Exercisable
March 31, 2007	261,000	\$0.75	1.25	261,000
September 15, 2008	1,054,500	\$0.25	2.70	1,054,500
November 21, 2008	40,000	\$0.25	2.90	40,000
January 5, 2009	10,000	\$0.37	3.02	6,666
June 14, 2010	88,000	\$0.15	4.46	88,000
September 20, 2010	160,000	\$0.10	4.73	80,000
	<u>1,613,500</u>			<u>1,530,166</u>

The Company has estimated the value of the options granted using the Black-Scholes option pricing model. Based on the assumptions described in the annual report for the year ended September 30, 2005, the Company recorded \$1,253 on account of stock-based incentive expense for the quarter.

Agent's Option

On January 21, 2004, the Company closed on its initial public offering of 5 million Class "A" common shares.

The broker acting as agent for the offering received a commission of 7% of the gross proceeds and also received a non-transferable agent's option to purchase up to 500,000 common shares at \$0.25 per common share. The agent's option will expire on January 21, 2006.

Additional Information

Additional information relating to PsiNaptic can be located on SEDAR at www.sedar.com.

Corporate Information

BOARD OF DIRECTORS

Aaron Dagan*
President & CEO
PsiNaptic Inc.

Dr. Michel Fattouche*
Chief Technical Officer
Cell-Loc Location Technologies
Inc.

Stuart M. Olley*
Partner,
Stikeman Elliott LLP

Andrew L. Oppenheim
Partner,
Gowling Lafleur Henderson LLP

Stephen Eyre
Principal Strategy Consultant
Microsoft Canada

MANAGEMENT TEAM

Aaron Dagan
President & CEO

Cameron Roe
Vice President and
Chief Software Architect

Serge Brache
Manager Product Development

Morris Bleviss
Chief Financial Officer

* member of Audit Committee

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SHAREHOLDER INFORMATION

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other investor information,
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WEBSITE

www.psinaptic.com

STOCK EXCHANGE LISTING

TSX Venture Exchange

Trading Symbol: PST