

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 since inception have been expensed and research and development costs have not been capitalized. The Company has no long-term debt. PsiNaptic's resources are 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.

## FINANCIAL HIGHLIGHTS

	For the three months ended June 30,		For the nine months ended June 30,	
	2005	2004	2005	2004
Revenue	\$ 29,282	\$ 31,439	\$ 70,102	\$ 75,284 <sup>(1)</sup>
Net earnings (loss)	\$ (184,229)	\$ (202,055)	\$ (512,372)	\$ (557,998)
per share - basic	\$ (0.0083)	\$ (0.0107)	\$ (0.0252)	\$ (0.0336)
Cash flow from operations	\$ (164,416)	\$ (222,725)	\$ (512,992)	\$ (553,111)
Working capital			\$ 519,091	\$ 610,753
Total assets			\$ 602,836	\$ 702,722
Capital expenditures			\$ 4,077	\$ 4,498
Long-term debt			\$ —	\$ —
Shareholders' equity			\$ 562,729	\$ 676,369
Weighted average shares outstanding basic	22,075,274	18,906,812	20,297,618	16,582,782
Shares outstanding at period end			23,786,812	18,906,812

(1) includes IRAP expense recovery of \$56,038

## TO THE SHAREHOLDERS

We are pleased to present the financial and operating results of PsiNaptic for the three and nine months ended June 30, 2005 with comparables for the corresponding periods of 2004.

On May 26, 2005 we closed a private placement of 2,770,000 Units, at \$0.15 per Unit for gross proceeds of \$415,500. Each Unit consisted of one common share and one-half of one common share purchase warrant. This money will be used to support general operations.

During this past quarter we continued to concentrate our efforts on marketing and sales and we have expanded these activities to the European market.

We have secured a new long-term software development contract with a U.S. Digital Service Provider to provide Jini development services and expertise, and we are working to further expand our relations with that company.

In May we participated in three conferences where we had the chance to further promote PsiNaptic and its products:

- Telematics Update 2005 - The world's largest conference on automotive telematics was held in Detroit MI. PsiNaptic organized a workshop which included a panel of experts from Ford, Sun Microsystems and Delphi. The session was a great success, attracting about 150 attendees, the highest turnout for a session in the conference.
- Wireless Connections 2005 - This annual conference was held in Calgary and addresses the wireless (primarily cell phones) industry, bringing together speakers and participants from all over the world. Aaron Dagan participated on a panel of experts addressing the future of mobile devices.
- WiCon 2005 - This annual conference is the world's largest for Bluetooth, WiFi and other short-range wireless communication protocols and was held in London (UK). Aaron Dagan made a presentation on the merit of dynamic software and the solutions that the PsiNaptic products provide. The conference was very well attended and provided a number of leads.

We plan to participate in additional conferences through the balance of the year to increase our exposure level among potential customers.

A handwritten signature in black ink, appearing to read 'A. Dagan', with a long, sweeping horizontal line extending to the right.

Aaron Dagan  
President and Chief Executive Officer  
August, 2005

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

As of July 25, 2005

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, 2004. The interim financial statements for the three and nine months ended June 30, 2005 were prepared in accordance with Canadian generally accepted accounting principles.

## **FORWARD –LOOKING STATEMENTS**

This MD&A contains forward-looking statements, including the Company's expectations as to the success of its research and development programs related to its JMatos® and Cmatos products. These development programs involve known and unknown risks and uncertainties that could cause the Company'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 Company does not undertake to update these forward-looking statements.

## **COMPARISON OF THE NINE-MONTH PERIODS ENDED JUNE 30, 2005 AND 2004**

### *Highlights*

The Company has secured a software development contract which is generating revenues, and has also raised \$619,900 gross to date this year through private placements.

### *Results of Operations*

PsiNaptic incurred an operating loss of \$517,520 for the nine months ended June 30, 2005, which compares to an operating loss of \$633,282 for the nine months ended June 30, 2004. The net loss, after expense recoveries and interest, decreased to \$512,372 for the current year from a net loss of \$557,998 for the corresponding nine months of 2004.

### *Operating Expenses*

Total operating expenses decreased to \$582,474 for the nine months ended June 30, 2005 from \$633,282 for the nine months ended June 30, 2004. Salaries, including consultants and benefits, were \$337,668 for the current nine months compared to \$423,824 for the corresponding nine months of 2004. This decrease reflects senior officers accepting reduced salaries in order to preserve cash and reduce operating costs. Other general and administrative costs remained relatively stable at \$121,412 for the nine months ended June 30, 2005 compared to \$112,532 for the nine months ended June 30, 2004.

Other marketing expenses increased to \$95,404 for the nine months ended June 30, 2005 from \$56,734 for the nine months ended June 30, 2004. This reflects the additional travel and promotion costs related to securing licensing and consulting revenues.

### *Recoveries and Other Income*

PsiNaptic generated \$17,856 on account of initial licensing fees in the nine months ended June 30, 2005. These are the first such fees to be recorded.

In addition, PsiNaptic recorded consulting revenue of \$47,098 for the nine months ended June 30, 2005. No such revenue was earned in the nine months ended June 30, 2004.

Net interest income of \$5,148 was earned in the nine months ended June 30, 2005 compared to \$7,697 in the nine months ended June 30, 2004.

The Company completed its IRAP contract in July 2004, and consequently it did not record any IRAP grant revenue for the nine-month period ended June 30, 2005. The Company recorded an IRAP grant of \$56,038 earned in the nine months ended June 30, 2004.

#### *Financial Condition and Liquidity*

Funds used in operations were \$512,992 for the nine months ended June 30, 2005, compared to \$553,111 for the nine months ended June 30, 2004.

Financing activities during the nine months ended June 30, 2005 resulted in gross proceeds of \$626,500 from the private placement of 2,110,000 Class A common shares at \$0.10 in the second quarter and 2,770,000 Units at \$0.15 in the third quarter. Each Unit consisted of one common share and one-half common share purchase warrant. One whole warrant will allow the holder to purchase one Class A common share at \$0.25. These warrants expire two years after issuance. Net proceeds, after financing costs of \$11,921 were \$614,579. During the nine months ended June 30, 2004 the Company raised \$1,300,000 of which \$1,250,000 was received from the initial public offering (IPO) of 5 million Class A common shares at \$0.25 each. Net proceeds of the IPO, after financing costs of \$356,266 were \$893,734.

Investing activities during the nine months ended June 30, 2005 consisted of the investment of funds in excess of the Company's immediate operating requirements.

### **COMPARISON OF THE THREE-MONTH PERIODS ENDED JUNE 30, 2005 AND 2004**

#### *Highlights*

The closing of a private placement on May 26, 2005 generated gross proceeds of \$415,500.

#### *Results of Operations*

PsiNaptic incurred an operating loss of \$186,310 for the quarter ended June 30, 2005, which compares to an operating loss of \$233,494 for the quarter ended June 30, 2004. The net loss, after expense recoveries and interest, decreased to \$184,229 for the quarter ended June 30, 2005 from a net loss of \$202,055 for the quarter ended June 30, 2004.

#### *Operating Expenses*

Total operating expenses decreased to \$213,511 for the quarter ended June 30, 2005 from \$233,494 for the quarter ended June 30, 2004. Salaries, including consultants and benefits, were \$118,114 for the current quarter compared to \$156,539 for the corresponding quarter of 2004. This decrease reflects senior officers accepting reduced salaries in order to reduce operating costs and preserve cash. Other general and administrative costs increased to \$40,916 for the quarter ended June 30, 2005 from \$34,242 for the quarter ended June 30, 2004. This reflects additional travel costs this year and the costs of the annual general meeting held in the third quarter this year instead of in the second quarter last year.

Due to increased travel expenses and conference sponsorship costs, other marketing expenses increased to \$43,677 for the quarter ended June 30, 2005 from \$24,048 for the quarter ended June 30, 2004.

#### *Recoveries and Other Income*

PsiNaptic earned consulting revenue of \$26,133 in the quarter ended June 30, 2005. No such revenue was earned in the comparable prior period.

Interest of \$2,081 was earned in the quarter ended June 30, 2005 compared to \$3,277 in the quarter ended June 30, 2004. This reflects the reduced amount of cash available for investment.

The Company recorded an IRAP grant of \$16,613 earned in the quarter ended June 30, 2004. The contract was completed in July 2004.

#### *Financial Condition and Liquidity*

Funds used in operations were \$164,416 for the quarter ended June 30, 2005, compared to \$222,725 for the quarter ended June 30, 2004.

Financing activities during the quarter ended June 30, 2005 resulted in net proceeds of \$408,878 received from the closing of a private placement on May 26, 2005.

Investing activities during the quarters ended June 30, 2005 and June 30, 2004 consisted of the investment of funds in excess of its immediate needs.

#### **CASH REQUIREMENTS OUTLOOK**

As a result of the successful fund raising to date, the Company has sufficient cash to pursue its business plan and continue operations for the next three quarters.

At June 30, 2005 PsiNaptic had working capital of \$519,092.

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 third quarter interim 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 4 of the audited financial statements for September 30, 2004.

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, in the opinion of management, does not warrant such a review.



Aaron Dagan  
President and Chief Executive Officer  
July 25, 2005



Morris Bleviss  
Chief Financial Officer

## Balance Sheets

	<b>June 30, 2005</b>	September 30, 2004
	<i>(unaudited)</i>	
<b>ASSETS</b>		
Current Assets		
Cash	<b>\$ 6,570</b>	\$ 2,208
Short-term investments	<b>511,816</b>	398,668
Accounts receivable	<b>29,683</b>	4,127
Prepaid expenses	<b>11,129</b>	13,185
	<b>559,198</b>	438,188
Capital assets	<b>33,913</b>	37,868
Intellectual property	<b>9,725</b>	20,352
	<b>602,836</b>	496,408
<b>LIABILITIES</b>		
Current Liabilities		
Accounts payable and accrued liabilities	<b>40,107</b>	36,559
<b>SHAREHOLDER'S EQUITY</b>		
Share capital	<b>4,668,196</b>	4,052,944
Deficit	<b>(4,105,467)</b>	(3,593,095)
	<b>562,729</b>	459,849
	<b>602,836</b>	496,408

## Statements of Income (Loss) and Deficit

(unaudited)

	9 months ended June 30, 2005	9 months ended June 30, 2004	3 months ended June 30, 2005	3 months ended June 30, 2004	Cumulative from inception on Dec. 16, 1999
<b>REVENUES</b>					
Licensing	\$ 17,856	\$ —	\$ 1,068	\$ —	\$ 17,856
Consulting	47,098	—	26,133	—	65,503
	<b>64,954</b>	<b>—</b>	<b>27,201</b>	<b>—</b>	<b>83,359</b>
<b>EXPENSES</b>					
Depreciation and amortization	18,658	25,209	6,322	6,982	248,256
General and administrative	213,081	247,844	76,109	83,392	1,566,195
Marketing	219,199	201,458	91,631	75,584	1,320,665
Research and consulting	131,536	158,771	39,449	67,536	1,992,205
	<b>582,474</b>	<b>633,282</b>	<b>213,511</b>	<b>233,494</b>	<b>5,127,321</b>
<b>LOSS BEFORE OTHER INCOME</b>	<b>(517,520)</b>	<b>(633,282)</b>	<b>(186,310)</b>	<b>(233,494)</b>	<b>(5,127,321)</b>
<b>OTHER INCOME</b>					
Interest income	5,148	7,697	2,081	3,277	107,146
IRAP expense recovery	—	56,038	—	16,613	211,197
SR&ED tax credits	—	11,549	—	11,549	620,152
	<b>5,148</b>	<b>75,284</b>	<b>2,081</b>	<b>31,439</b>	<b>938,495</b>
<b>NET LOSS</b>	<b>(512,372)</b>	<b>(557,998)</b>	<b>(184,229)</b>	<b>(202,055)</b>	<b>(4,105,467)</b>
<b>DEFICIT, beginning of period</b>	<b>(3,593,095)</b>	<b>(2,818,218)</b>	<b>(3,921,238)</b>	<b>(3,174,161)</b>	<b>—</b>
<b>DEFICIT, end of period</b>	<b>(4,105,467)</b>	<b>(3,376,216)</b>	<b>(4,105,467)</b>	<b>(3,376,216)</b>	<b>(4,105,467)</b>
Loss per share	<b>(0.0252)</b>	(0.0336)	<b>(0.0083)</b>	(0.0107)	
Weighted average number of shares	<b>20,297,618</b>	16,582,782	<b>22,075,274</b>	18,906,812	

## Statements of Cash Flows

(unaudited)

	<b>9 months ended June 30, 2005</b>	9 months ended June 30, 2004	<b>3 months ended June 30, 2005</b>	3 months ended June 30, 2004	Cumulative from inception on Dec. 16, 1999
<b>OPERATING ACTIVITIES</b>					
Net Loss	\$ (512,372)	\$ (557,998)	\$ (184,229)	\$ (202,055)	\$ (4,105,467)
Adjustments for:					
Depreciation and amortization	18,658	25,209	6,323	6,982	248,256
Non-cash marketing expense	–	–	–	–	100,000
Stock-based compensation	673	–	301	–	1,032
	<b>(493,041)</b>	(532,789)	<b>(177,605)</b>	(195,073)	(3,756,179)
Changes in non-cash working capital					
Accounts receivable	(25,557)	(2,460)	(4,418)	298	(29,683)
Prepaid expenses	2,056	(1,222)	5,208	4819	(11,129)
Accounts payable and accrued liabilities	3,550	(16,640)	12,399	(32,769)	40,109
	<b>(512,992)</b>	(553,111)	<b>(164,416)</b>	(222,725)	(3,756,882)
<b>INVESTING ACTIVITIES</b>					
Redemption (Purchase) of short-term investments	(113,148)	(600,003)	(250,081)	213,891	(511,816)
Purchase of capital assets	(4,077)	(4,498)	(4,077)	(4,498)	(237,275)
Purchase of intellectual property	–	(3,326)	–	(2,300)	(73,139)
SR&ED recovery on capital assets					18,518
	<b>(117,225)</b>	(607,827)	<b>(254,158)</b>	207,093	(803,712)
<b>FINANCING ACTIVITIES</b>					
Issuance of shares (net of expenses)	614,579	943,734	408,878	(3,014)	2,554,334
Deferred financing costs	–	60,000	–	–	–
Issuance of warrants (net of expenses)					2,012,830
	<b>614,579</b>	1,003,734	<b>408,878</b>	(3,014)	4,567,164
<b>CASH, PERIOD CHANGE</b>	<b>(15,638)</b>	(157,204)	<b>(9,696)</b>	(18,646)	6,570
<b>CASH, beginning of period</b>	<b>22,208</b>	161,310	<b>16,266</b>	22,752	–
<b>CASH, end of period</b>	<b>6,570</b>	4,106	<b>6,570</b>	4,106	6,570

# Notes to the Financial Statements

For the Nine Months ended June 30, 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 June 30, 2005 and the results of operations and the cash flows for the nine months ended June 30, 2005 and 2004.

These interim financial statements have been prepared using the same accounting policies as the September 30, 2004 year-end 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, 2004.

## 2. SHARE CAPITAL

	Number of Shares	Amount \$
<i>Issued</i>		
<i>Common Shares</i>		
Balance, September 30, 2003	13,049,809	1,096,021
Private placement at \$0.25 per share	200,000	50,000
Balance, December 31, 2003	13,249,809	1,146,021
Initial public offering at \$0.25 per share	5,000,000	1,250,000
Conversion of special warrants	3,657,003	2,012,830
Reduction in shares held by founders	(3,000,000)	–
Less financing costs	–	(445,016)
Balance September 30 and December 31, 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 share	2,770,000	415,500
Less related expenses	–	(11,921)
Balance, June 30, 2005	23,786,812	4,578,414
<i>Contributed Surplus</i>		
Balance, September 30, 2004	–	89,109
Stock based compensation	–	673
Balance, June 30, 2005	–	89,782
Total, June 30, 2005	23,786,812	4,668,196

There are 800,000 Common Shares reserved for the exercise of Private Placement Warrants issued in 2002. Each Private Placement Warrant is convertible into one Common Share at an exercise price of \$0.35 per share for a period of two years from the date of issuance. The last closing under the Private Placement was October 16, 2004.

There are an additional 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

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
September 12, 2005	53,000	\$ 0.50	0.20	53,000
March 31, 2007	261,000	\$ 0.75	1.75	261,000
September 15, 2008	1,054,500	\$ 0.25	3.20	1,054,500
November 21, 2008	40,000	\$ 0.25	3.40	30,000
January 5, 2009	10,000	\$ 0.37	3.52	6,666
June 14, 2010	88,000	\$ 0.15	4.95	88,000
	<b>1,506,500</b>			<b>1,493,166</b>

	2005		2004	
	Number Outstanding	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
Outstanding, beginning of year	1,498,500	\$ 0.37	1,448,500	\$ 0.37
Granted	88,000	\$ 0.15	50,000	\$ 0.27
Exercised	—	—	—	—
Expired	80,000	\$ 0.625	—	—
Outstanding, end of year	<b>1,506,500</b>	<b>\$ 0.34</b>	1,498,500	\$ 0.37

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, 2004, the Company recorded \$673 on account of stock-based incentive expense for the nine months ended June 30, 2005.

## 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 the Company can be located on SEDAR at [www.sedar.com](http://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

## MANAGEMENT TEAM

Aaron Dagan  
President & CEO

Cameron Roe  
Vice President and  
Senior Technical Architect

Serge Brache  
Manager Product Development

Morris Bleviss  
Chief Financial Officer

\* member of Audit Committee

## CORPORATE OFFICES

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1400, 700 Second Street SW  
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## BANKER

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Calgary Alberta Canada T2V 5A8  
Telephone: 403.503.7583

## REGISTRAR AND

### TRANSFER AGENT

Computershare Trust Company  
of Canada  
600, 530-8 Avenue SW  
Calgary Alberta Canada T2P 3S8  
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## OFFICES

For annual and quarterly reports, news releases and other investor information, please contact:

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## WEBSITE

[www.psinaptic.com](http://www.psinaptic.com)

## STOCK EXCHANGE LISTING

TSX Venture Exchange  
Trading Symbol: PST