

PsiNaptic Inc. ("PsiNaptic" or "the Company") is in the business of developing and marketing proprietary technology, including software and wireless communication technologies, allowing user-transparent transfer of information and services between computing objects, devices and processors in a communications rich, network environment. Management's vision is a world with pervasive unlimited networks of intelligent objects interacting dynamically and seamlessly, on behalf of people, to improve the delivery of existing services and enable new innovative applications.

The Company is in pre-revenue status. All start-up costs have been expensed and research and development costs have not been capitalized. The Company has no long-term debt. The Company has not been profitable since its inception and expects to incur losses in continuing the research and development of its products. PsiNaptic's resources are now targeted at the marketing and sales of its products and engineering services. The Company is planning to take advantage of growth opportunities in the rapidly evolving mobile and embedded market space. The Company's focus is on securing purchase commitments from prospective customers.

TO THE SHAREHOLDERS

We are pleased to present the financial and operating results of PsiNaptic for the three months ended December 31, 2003 and 2002.

At the beginning of our first fiscal quarter, we completed the sale of 200,000 common shares at \$0.25 per share for proceeds of \$50,000 to complete the private placement commenced last year. In addition, management continued discussions towards an initial public offering.

Discussions also continued with prospective customers and partners and we are confident that we will be successful in achieving the milestones set out in the final prospectus dated January 6, 2004.

Subsequent to our first quarter, we closed an initial public offering (5 million shares at \$0.25 per share for gross proceeds of \$1,250,000) and commenced trading on the TSX-Venture exchange under the symbol PST on January 28, 2004. After the closing of our initial public offering, the Company has 18,906,812 common shares issued and outstanding.

This renewed capitalization will support our operations for the next 12-15 months as we go forth to secure the commercialization of our products and the revenue expected therefrom.



Aaron Dagan
President and Chief Executive Officer
February, 2004

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

This management's discussion and analysis of results of operations and financial condition of PsiNaptic should be read in conjunction with the audited financial statements of PsiNaptic for the year ended September 30, 2003. The interim financial statements for the three months ended December 31, 2003 were prepared in accordance with Canadian generally accepted accounting principles.

COMPARISON OF THE QUARTERS ENDED DECEMBER 31, 2003 AND 2002

Highlights

Research and development continued to further its development of CMatos under a contract signed in July 2003 with the National Research Council for a grant under the Industrial Research Assistance Program ("IRAP").

Results of Operations

An operating loss of \$164,935 was incurred in the quarter ended December 31, 2003, which compares to an operating loss of \$91,746 in the quarter ended December 31, 2002. The net loss, after expense recoveries and interest, increased to \$144,542 for the quarter ended December 31, 2003 from a net loss of \$91,727 for the quarter ended December 31, 2002.

Operating Expenses

Total operating expenses increased to \$164,935 in the quarter ended December 31, 2003 from \$91,746 in the quarter ended December 31, 2002. Salaries (including consultants) and benefits were \$107,431 in the quarter ended December 31, 2003 compared to \$34,674 in the quarter ended December 31, 2002. This increase reflects the resumption by the Company of paying salaries, although below market levels. Other general and administrative costs have remained stable, decreasing to \$29,209 in the quarter ended December 31, 2003 from \$34,062 in the quarter ended December 31, 2002.

Other marketing expenses also remained stable, \$15,896 in the quarter ended December 31, 2003 and \$12,903 in the quarter ended December 31, 2002.

Recoveries and Other Income

Net interest income of \$495 was earned in the quarter ended December 31, 2003 compared to \$19 in the quarter ended December 31, 2002.

The Company recorded an IRAP grant of \$19,898 earned in the quarter ended December 31, 2003.

Financial Condition and Liquidity

Funds used in operations was \$94,536 in the quarter ended December 31, 2003, compared to \$36,604 in the quarter ended December 31, 2002.

Financing activities during the quarter ended December 31, 2003 resulted in \$50,000 received from a private placement of Class A Common Shares. In addition, \$82,283 was expended on account of Deferred Financing Costs related to an initial public offering. In the quarter ended December 31, 2002 the Company received Shareholders' loans of \$37,000.

Investing activities during the quarter ended December 31, 2003 consisted of the investment of funds from the proceeds of the private placement in excess of its immediate needs.

Also during the quarter ended December 31, 2002, the Company expended \$5,451 related to the protection of its intellectual property.

CASH REQUIREMENTS OUTLOOK

As a result of the successful closing of the initial public offering on January 21, 2004, the Company has sufficient cash to pursue its business plan and continue operations for the next 12 to 15 months.

FORWARD –LOOKING STATEMENTS

The MD&A contains forward-looking statements, including the Company'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, which 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.

Balance Sheets

| | (unaudited) December 31, 2003 | September 30, 2003 |
|--|----------------------------------|--------------------|
| ASSETS | | |
| Current Assets | | |
| Cash | 9,671 | 161,310 |
| Short-term investments | 25,000 | – |
| Accounts receivable | 22,578 | 20,215 |
| Prepaid expenses | 7,942 | 9,100 |
| | 65,191 | 190,625 |
| Deferred financing costs | 142,283 | 60,000 |
| Capital assets | 43,980 | 47,455 |
| Intellectual property | 31,182 | 35,545 |
| | 282,636 | 333,625 |
| LIABILITIES | | |
| Current Liabilities | | |
| Accounts payable and accrued liabilities | 86,545 | 42,992 |
| SHAREHOLDER'S EQUITY | | |
| Share capital | 3,158,851 | 3,108,851 |
| Deficit | (2,962,760) | (2,818,218) |
| | 196,091 | 290,633 |
| | 282,636 | 333,625 |

Statements of Income (Loss) and Deficit

Three month period ending December 31,
(unaudited)

| | 2003 | 2002 |
|--------------------------------------|--------------------|--------------------|
| EXPENSES | | |
| Depreciation and amortization | \$ 7,840 | \$ 10,178 |
| General and administration | 65,391 | 39,405 |
| Marketing | 60,796 | 38,386 |
| Research and engineering | 30,908 | 3,777 |
| | 164,935 | 91,746 |
| INCOME (LOSS) | (164,935) | (91,746) |
| OTHER INCOME | | |
| IRAP expense recovery | 19,848 | – |
| Interest income | 495 | 19 |
| | 20,393 | 19 |
| NET LOSS | (144,542) | (91,727) |
| DEFICIT , beginning of period | (2,818,218) | (2,762,859) |
| DEFICIT , end of period | (2,962,760) | (2,854,586) |
| Loss per share | (0.0109) | (0.0076) |
| Number of shares outstanding | 13,249,809 | 12,049,809 |

Statements of Cash Flows

Three Months Ending December 31,
(unaudited)

| | 2003 | 2002 |
|--|------------------|-----------------|
| CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES: | | |
| Loss for the period | \$ (144,542) | \$ (91,727) |
| Depreciation and amortization | 7,840 | 10,178 |
| | (136,702) | (81,549) |
| CHANGE IN NON-CASH WORKING CAPITAL: | | |
| Accounts receivable | (2,363) | 1,996 |
| Prepaid expenses | 1,158 | 3,995 |
| Accounts payable | 43,551 | 38,954 |
| | (94,356) | (36,604) |
| CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES: | | |
| Purchase of short-term investments | (25,000) | 8,981 |
| Purchase of intellectual property | – | (5,451) |
| | (25,000) | 3,530 |
| CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES: | | |
| Issuance of shares for cash | 50,000 | – |
| Deferred financing costs | (82,283) | – |
| Shareholders' loans | – | 37,000 |
| | (32,283) | 37,000 |
| CASH, PERIOD CHANGE | (151,639) | 3,926 |
| Cash, beginning of period | 161,310 | 11,299 |
| Cash, end of period | 9,671 | 15,225 |

Notes to the Financial Statements

For the Three Months ended December 31, 2003

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, 2003 and the results of operations and the cash flows for the three months ended December 31, 2003 and 2002.

Other than as stated in the paragraph following, these interim financial statements have been prepared using the same accounting policies as the September 30, 2003 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, 2003.

Effective October 1, 2003 the Company has adopted the fair value based method to account for its stock based compensation plan. The fair value method establishes the standards of recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services provided by employees and non-employees. No restatement of prior periods was required as a result of the adoption of the new standard.

2. DEFERRED FINANCING COSTS

The deferred financing costs relate to the pending initial public offering. They comprise deposits on account of expenses with the broker agent, fees to December 31, 2003 on account of legal expenses of the Company, and filing fees paid in advance to the Alberta Securities Commission, the British Columbia Securities Commission and the TSX- Venture Exchange.

3. SHARE CAPITAL

| | Number of Shares | Amount |
|---|------------------|--------------|
| Issued | | |
| <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 |
| <i>Special Warrants</i> | | |
| Balance, September 30 and December 31, 2003 | — | 2,012,830 |
| Total December 31, 2003 | 13,249,809 | 3,158,851 |

There are 800,000 Common Shares reserved for the exercise of Private Placement Warrants. 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.

Stock Options

On November 21, 2003, the Company granted options to 40,000 common shares at an exercise price of \$0.25. These options expire November 21, 2008. At December 31, 2003, there are options outstanding totalling 1,488,500 at a weighted average exercise price of \$0.37.

3. SHARE CAPITAL (CONTINUED)

| | December 31, 2003 | | September 30, 2003 | |
|----------------------------------|-------------------|---------------------------------------|--------------------|---------------------------------------|
| | Share Options | Weighted Average Exercise Price | Share Options | Weighted Average Exercise Price |
| Outstanding, beginning of period | 1,448,500 | \$ 0.37 | 654,000 | \$ 0.71 |
| Granted | 40,000 | \$ 0.25 | 1,448,500 | \$ 0.37 |
| Exercised | — | — | — | — |
| Forfeited | — | — | (654,000) | \$ 0.71 |
| Outstanding, end of period | 1,488,500 | \$ 0.37 | 1,448,500 | \$ 0.37 |

The Company has estimated the value of the options granted during the period using the Black-Scholes option pricing model. As the Company was privately held throughout the period, the common shares did not trade and management is unable to determine the volatility of the common shares at the time the options were granted. Therefore, volatility has been excluded from the determination of compensation expense. The value of the options granted during the period is \$0.0477 per share based on the exercise price of \$0.25 per share, a risk-free interest rate of 4.25%, an expected life of five years, and no dividends paid.

Based on the assumptions above, the stock options granted during the period have an immaterial impact on the net loss for the period.

4. EVENT SUBSEQUENT TO DECEMBER 31, 2003

On January 21, 2004, the Company closed on its initial public offering of 5 million Class "A" common shares at \$0.25 per share for gross proceeds of \$1,250,000. In addition, 3,657,003 common shares were issued in conjunction with the exercise of previously issued Series A, Series B, and Series C Special Warrants.

The broker acting as agent for the offering received a commission of 7% of the gross proceeds and also received a non-transferrable 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.

Subsequent to the closing, the Company has 18,906,812 Common Shares issued and outstanding.

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
Chief Software Architect

Serge Brache
Manager Engineering

Morris Bleviss
Chief Financial Officer

CORPORATE OFFICES

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Facsimile: 403.720.2537

AUDITORS

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SOLICITORS

Gowling Lafleur Henderson LLP
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Calgary, Alberta T2P 4V5
Telephone: 403-298-1000

BANKER

Bank of Montreal
D161, 1600-90 Avenue SW
Calgary Alberta Canada T2V 5A8
Telephone: 403.503.7583

REGISTRAR AND TRANSFER AGENT

Computershare Trust Company
of Canada
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Calgary Alberta Canada T2P 3S8
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SHAREHOLDER INFORMATION

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

www.psinaptic.com

STOCK EXCHANGE LISTING

TSX-Venture Exchange
Trading Symbol: PST



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