

We know how to find it.

We know how to secure it.

We know how to manage it.

2004 | SECOND QUARTER REPORT

**We know *IT*.**  
**We keep *IT* simple.**  
**We keep *IT* safe.**

#### RESULTS RELATIVE TO FISCAL 2004 GUIDANCE:

Absolute revised its sales contract and cash flow guidance issued for fiscal 2004 on December 30, 2003. Sales contract growth is now expected to be 5% to 25% over the prior fiscal year, and positive cash from operations is expected for the fourth quarter. The original guidance was for sales contract growth of 25% to 50% and positive cash from operations for the year as a whole. The guidance revision is a result of the appreciating Canadian dollar relative to the U.S. dollar, along with a delay in the timing of sales contracts expected for the second quarter.

#### SECOND QUARTER 2004 HIGHLIGHTS:

- Operating revenue of \$1.75 million is up 22% from Q2'03 and is consistent with Q1'04
- Net loss for Q2'04 of \$0.54 million declined 57% from Q2'03 and 41% from Q1'04
- Cash used in operations of \$1.1 million increased from \$0.44 million in Q2'03 and \$0.69 million in Q1'04
- Sales contracts of \$1.41 million (US\$1.07 million) declined 42% (30% in U.S. dollar terms) over the same quarter last year and 42% (40% in U.S. dollar terms) over the prior quarter.
- Operational achievements include:
  - Completed a consumer pilot program with Toshiba for computer recovery services and began initiatives to support a broad-scale rollout of the program.
  - Signed an agreement with Phoenix Technologies Ltd. to enable Absolute's technology to be built-in to the computer firmware for certain models.
  - Continued OEM channel expansion strategies, adding Acer America Corporation and generating 70% of second quarter sales contracts through OEM partners.
  - Upgraded the sales team to replace a number of Vancouver based inside sales staff with customer-facing sales staff located in key US markets.

**OPERATIONS HIGHLIGHTS:**

Absolute made progress on a number of key strategic initiatives during the second quarter of fiscal 2004. The initiatives included completion of a six-month consumer pilot program, a technology agreement with Phoenix Technologies Ltd. announced on January 12, 2004, an upgrade of the sales force, and continued expansion of OEM and reseller distribution channels. The progress on these initiatives is expected to be a key driver for future sales contract and revenue growth.

The six-month consumer pilot program was a success and served to validate the market opportunity for a computer theft recovery product for the consumer market. The pilot program was undertaken with Toshiba. In addition, Absolute achieved a 100% success rate for the recovery of computers reported stolen during the sixth month pilot. Absolute is now in the process of finalizing the go-to-market consumer strategy, and is approaching Toshiba and other distribution partners for a roll out of the new offering. Toshiba will be the first OEM to offer the expanded product during the quarter ending March 31, 2004. Other OEM partners are expected to roll out the offering in subsequent quarters.

Completing an agreement with Phoenix for BIOS support for Absolute's core technology was also a key strategic initiative for establishing Absolute's products as best of breed technology for recovery and tracking software. This is Absolute's first technology agreement with a PC infrastructure partner. The new technology will significantly increase the value proposition for Absolute's products on computers that use the Phoenix technology. Phoenix is the world's largest BIOS manufacturer with its technology used on over 100 million computers world-wide. The BIOS supported technology is expected to add to sales growth starting in the fourth quarter of fiscal 2004.

During the second quarter, Absolute upgraded its sales force to replace inside sales representatives located in Vancouver, with customer-facing sales staff located in key US markets. The new structure has two outside sales staff for each inside sales representative, a reverse of the former structure. While compensation expense will increase in future periods under this new structure, it is expected to be more than offset by increased sales growth.

Absolute continued to develop its reseller channels during Q2'04, adding Acer America Corporation as a new OEM partner. For the second quarter, 70% of sales contracts were generated through OEM partners compared to 56% for the same quarter last year. For the year-to-date period OEMs generated 71% of sales contracts compared to 61% last year. Dell continues to be Absolute's strongest OEM partner and is responsible for a majority of OEM sales contracts. Absolute will continue to develop its channel partners, with a focus on OEMs as a means to efficiently access the market for Absolute's products. As Absolute rolls out its consumer offering, and adds new commercial products, these channel relationships are essential for an efficient and effective roll out.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF SECOND QUARTER FISCAL 2004 RESULTS:***Operating revenue and sales contracts*

	Three Months Ended			Six Months Ended		
	% Increase	Dec'03 (000's)	Dec'02 (000's)	% Increase	Dec'03 (000's)	Dec'02 (000's)
Operating revenue	22%	\$1,747	\$1,435	25%	\$3,500	\$2,797
Sales contracts *	-42%	\$1,409	\$2,415	-18%	\$3,851	\$4,721

\* Sales contracts are a non-GAAP measure without a standardized meaning prescribed by GAAP, and represent prepaid bookings from customer subscription contracts for periods of 1 to 4 years, and customer purchases of license software and annual maintenance. Reconciliation to GAAP measures is provided with the discussion of deferred revenue below.

The increase in revenue for the second quarter and year-to-date for fiscal 2004 over the prior year reflects sales contract growth from prior periods. Revenue from sales contracts is deferred and recognized as income upon meeting performance criteria, which occurs on a straight-line basis over the contract term for subscription and maintenance contracts, and upon software delivery for license software sales. A majority of Absolute's sales are from subscription contracts with terms averaging approximately 30 months. Accordingly, sales contract growth rates from prior periods will determine the operating revenue growth rates. In addition, with over 85% of sales contracts generated in U.S. dollars, fluctuations in the Canadian-U.S. exchange rates will impact the revenue value recognized. For the current quarter and year-to-date, revenue actually increased 45% over fiscal 2003 in U.S. dollar terms.

Relative to the first quarter of fiscal 2004, second quarter revenues were consistent at \$1.75 million. This is largely due to the decrease in sales contracts for the second quarter, combined with first quarter sales contracts being consistent with fiscal 2003 sales contract levels.

The following table illustrates the portion of revenue generated from current and prior period sales contracts:

Revenue from:	Three Months Ended		Six Months Ended	
	Dec'03 (000's)	Dec'02 (000's)	Dec'03 (000's)	Dec'02 (000's)
Prior period subscriptions	\$1,621	\$1,383	\$ 3,015	\$2,165
New current period subscriptions	99	52	411	602
License software and other	27	-	74	30
<b>Total operating revenue for the period</b>	<b>\$1,747</b>	<b>\$1,435</b>	<b>\$3,500</b>	<b>\$2,797</b>

Sales contracts of \$1.41 million for Q2'04 were 42% below both Q2'03 and Q1'04 sales contracts. On a year-to-date basis, sales contracts of \$3.85 million are 18% below the prior year. With over 85% of Absolute's sales contracts generated in U.S. dollars, the appreciation in the Canadian dollar relative to the U.S. dollar has negatively impacted sales contract performance for the current year. In U.S. dollar terms, sales contracts are down 18% instead of 42% from the same quarter last year and are down 6% instead of 18% on a year-to-date basis. In addition, delays in the timing of certain sales contracts that were expected to close during the second quarter of fiscal 2004, along with an updating of the sales team, resulted in the remainder of the decrease in second quarter and year-to-date sales contract performance.

An example of a delay due to a change in customer timelines is the School District of Philadelphia agreement announced January 20, 2004. This agreement to service their entire computer population was expected to generate up to U.S. \$500,000 in second quarter sales contracts, followed by smaller annual purchases over the next three years as they expand their user base. Instead, a potentially larger agreement with lower initial sales contracts was reached that will result in up to US\$1.5 million of new sales contracts over the next three years. The School District of Philadelphia is the seventh largest district in the U.S. and has also agreed to act as a reference account for Absolute's products.

#### *Gross margin*

The gross margin for Q2'04 of \$1.24 million improved from \$0.99 million for the second quarter of last year and the \$1.12 million for last quarter. For the six months to December 31, 2003, the gross margin of \$2.36 million improved from \$1.79 million for the same period last year. The improved margin for the current periods is primarily due to the increased revenue, partially offset by increases in cost of sales as more technical resources were allocated to maintenance and operational type activities. As a result, the gross margin as a percent of revenue has improved to 71% in Q2'04 from 69% for Q2'03, and on a year-to-date basis has improved to 67% from 64% last year.

#### *Operating expenses*

Sales and marketing costs of \$0.89 million declined 23% from \$1.17 million in Q2'03 and 16% from \$1.06 million in Q1'04. On a year-to-date basis, sales and marketing costs of \$1.95 million are down 21% from \$2.46 million for the same period last year. The reduction for the second quarter relates to reduced compensation expense both from the lower level of sales contracts and from a reduced average head count during upgrade of the sales team. On a year-to-date basis, efforts to streamline marketing and promotional expenditures also contributed to the overall reduction.

Research and development (“R&D”) expense for the second quarter of fiscal 2004 decreased 16% to \$0.58 million from \$0.69 million in Q2’03, but increased 15% from \$0.50 million in Q1’04. On a year-to-date basis, R&D expense is \$1.08 million, down 21% from \$1.37 million from the prior year period. The reduction from the prior year periods relates primarily to staff and consulting expenses as Absolute streamlined its R&D teams.

General and administrative (“G&A”) costs of \$0.56 million for Q2’04 increased 13% from \$0.50 million in Q2’03, and 9% from \$5.16 million in the prior quarter. For the six months to December 31, 2003, G&A costs of \$1.08 million increased 10% from \$0.98 million in the prior year. The increase is primarily due to costs related to staffing changes made during the end of fiscal 2003.

Interest and other income decreased 45% to \$0.05 million for Q2’04 compared to \$0.09 million for Q2’03 and decreased 23% from \$0.06 million last quarter. The decrease is consistent with the decline in the average cash balance during the period and the year-over-year decline in interest rates. In addition, as higher yield short-term investments have matured, they have been replaced with lower yield cash equivalents.

The foreign exchange gain for Q2’04 of \$0.21 million increased from a gain \$0.03 million in Q2’03 and a loss of \$0.02 million in Q1’04 following the continued appreciation in the Canadian dollar relative to the U.S. dollar. With a majority of Absolute’s assets in Canadian dollars and a majority of the deferred revenue liability in U.S. dollars, exchange gains will arise as the Canadian dollar strengthens. Conversely, sales contracts and revenue are reduced with the strengthening Canadian dollar.

The Q2’04 net loss of \$0.54 million (\$0.03 per share) declined 57% from \$1.25 million (\$0.06 per share) in Q2’03 and 41% from \$0.92 million (\$0.06 per share) in Q1’04. On a year-to-date basis, the net loss of \$1.46 million has declined 52% relative to \$3.04 million for the prior year. Revenue growth and cost control have been the primary drivers of the reduced loss. Cost control initiatives have resulted in a 9% decrease in total operating costs to \$2.54 million in Q2’04 compared to \$2.80 million in Q2’03, and a 6% decrease from \$2.71 million in Q1’04. On a year-to-date basis, cost control efforts have decreased total operating costs to \$5.25 million, down 10% from \$5.81 million last year. On a net loss per share basis, the current period amount reflects a reduction in the weighted average number of shares outstanding following the repurchase and cancellation of 3,700,132 common shares completed during the first six months of fiscal 2003.

Cash used in operating activities of \$1.09 million for Q2’04 increased from \$0.44 million used in Q2’03 and \$0.69 million in Q1’04. For the six months to December 31, 2003, cash used in operating activities has increased to \$1.78 million from \$0.53 million for the prior year-to-date. The increase in the cash used in operations is primarily the result of the decreased sales contracts for the periods, along with an increase in accounts receivable balances.

#### *Liquidity and Financial Resources*

Absolute continues to maintain a strong balance sheet and is well positioned to finance its growth and development objectives. At December 31, 2003, Absolute had cash, cash equivalent, and short-term investment balances totaling \$6.97 million (\$0.43 per share), compared to \$8.77 million (\$0.55 per share) at June 30, 2003. Absolute continues to hold excess cash resources in investment grade banker’s acceptances, bonds and certificates.

Accounts receivable balances of \$1.69 million at December 31, 2003 have increased from \$1.58 million at June 30, 2003. Days sales contracts in accounts receivable increased to 73 from 64 at June 30, 2004 due to a collection delays with a key account that is expected to be collected in Q3’04. Overall, collection risk on the receivable balances is low as a majority of the underlying sales contracts are generated through first tier OEM partners.

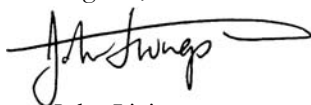
Deferred revenue declined to \$9.60 million at December 31, 2003 from \$9.68 million at June 30, 2003 following the reduced sales contracts for Q2’04. Deferred revenue represents sales contracts invoiced and/or paid, but not yet recognized as revenue. The current quarter change in deferred revenue is detailed in the following table.

Deferred Revenue (000's):

Open balance, June 30, 2003	\$9,683
Sales contracts for the period	3,851
Operating revenue for the period	(3,500)
Foreign exchange and other adjustments	(430)
Closing balance, December 31, 2003	\$9,604

The closing deferred revenue balances provide visibility into Absolute's future revenue stream. The current portion of deferred revenue at December 31, 2003 of \$5.05 million will be recognized as revenue over the next twelve months, and the remainder in following periods. This balance is expected to grow as new sales contracts are added in future periods, and will also increase or decrease with fluctuations in the value of the Canadian dollar relative to the U.S. dollar.

Regards,



John Livingston  
Chief Executive Officer

***Risks and Uncertainties***

*Absolute's risks and uncertainties continue to be the same as those set out in the management discussion and analysis section of the Company's fiscal 2003 annual report. This quarterly report attached financial statements should be read in conjunction with Absolute's fiscal 2003 annual report.*

***Forward-Looking Statements***

*This quarterly report contains forward-looking statements that involve risks and uncertainties. These forward-looking statements relate to, among other things, plans and timing for the introduction or enhancement of our services and products, and other expectations, intentions and plans contained in this quarterly report that are not historical fact. When used in this quarterly report, the words "plan," "expect," "believe," and similar expressions generally identify forward-looking statements. These statements reflect our current expectations. They are subject to a number of risks and uncertainties, including, but not limited to, changes in technology and general market conditions. In light of the many risks and uncertainties you should understand that we cannot assure you that the forward-looking statements contained in this quarterly report will be realized.*

**ABSOLUTE SOFTWARE CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
 (Expressed in Canadian Dollars)

	December 31, 2003		June 30, 2003	
	(unaudited)		(audited)	
<b>Assets</b>				
Current Assets:				
Cash and cash equivalents	\$	6,396,031	\$	4,900,156
Short term investments		570,278		3,865,727
Accounts receivable		1,686,605		1,583,697
Current portion of loans to directors and employees		92,839		96,491
Prepaid expenses and deposits		199,387		233,956
		8,945,140		10,680,027
Loans to directors and employees		521,950		513,987
Property and equipment		895,819		986,078
	\$	10,362,909	\$	12,180,092

**Liabilities and Shareholders' Equity**

Current Liabilities:				
Accounts payable and accrued liabilities	\$	408,119	\$	750,281
Current portion of deferred revenue		5,049,027		5,439,404
		5,457,146		6,189,685
Deferred revenue		4,555,468		4,243,973
		10,012,614		10,433,658
Shareholders' equity				
Share capital (Note 2(i))		30,732,314		30,669,676
Contributed surplus		6,608,485		6,608,485
Deficit		(36,990,504)		(35,531,727)
		350,295		1,746,434
	\$	10,362,909	\$	12,180,092

Subsequent Events (Note 4)

**ABSOLUTE SOFTWARE CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT**  
 (Expressed in Canadian Dollars)

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2003	2002	2003	2002
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenue:				
Monitoring revenue	\$	1,720,111	\$	3,426,403
Installation services, licencing fees & other revenues		27,141		73,845
		1,747,252		3,500,248
Cost of goods sold:				
Monitoring, support and recovery		285,921		589,575
Technical support and product maintenance		225,967		552,494
		511,888		1,142,069
Gross margin		1,235,364		2,358,179
Expenses:				
Sales and marketing		891,683		1,949,518
Research and development		578,767		1,082,415
General and administration		561,451		1,076,979
		2,031,901		4,108,912
Operating loss		796,537		1,750,733
Interest and other income		47,294		108,388
Interest and bank charges		(4,854)		(9,095)
Foreign exchange gain (loss)		212,530		192,663
Loss for the period		541,567		1,458,777
Deficit, beginning of period		36,448,937		33,327,559
Deficit, end of period		\$ 36,990,504		\$ 34,577,326
Basic and diluted loss per common share		\$ (0.03)		\$ (0.06)
Weighted number of common shares outstanding		16,016,145		19,451,564
		15,981,056		19,521,500

(0.16)

**ABSOLUTE SOFTWARE CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Expressed in Canadian Dollars)

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2003	2002	2003	2002
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Cash provided by (used in) operations:				
Loss for the period	\$ (541,567)	\$ (1,249,767)	\$ (1,458,777)	\$ (3,044,504)
Items not involving cash:				
Amortization	84,732	78,292	174,593	158,397
Interest and exchange on loans to directors and employees	(76)	(3,212)	(4,311)	(12,196)
Changes in non-cash operating working capital:				
Accounts receivable	227,455	(147,337)	(102,908)	197,860
Prepaid expenses and deposits	57,477	(30,304)	34,569	(18,008)
Accounts payable and accrued liabilities	(135,013)	(120,699)	(342,162)	(48,634)
Deferred revenue	(779,528)	1,035,996	(78,882)	2,232,650
	(1,086,520)	(437,031)	(1,777,878)	(534,435)
Cash provided by (used in) investments:				
Property and equipment purchased	(45,461)	(99,311)	(84,334)	(145,991)
Disposition (acquisition) of short term investments	973,517	3,903,568	3,295,449	(542,560)
	928,056	3,804,257	3,211,115	(688,551)
Cash provided by (used in) financing:				
Common shares repurchased	48,430	(1,513,904)	62,638	(1,553,447)
Common shares issued on exercise of options	48,430	(1,513,904)	62,638	(1,553,447)
Increase (decrease) in cash and cash equivalents	(110,034)	1,853,322	1,495,875	(2,776,433)
Cash and cash equivalents, beginning of period	6,506,065	2,010,547	4,900,156	6,640,302
Cash and cash equivalents, end of period	\$ 6,396,031	\$ 3,863,869	\$ 6,396,031	\$ 3,863,869

**ABSOLUTE SOFTWARE CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Expressed in Canadian Dollars)

For the Six Months Ended December 31, 2003

**1. Significant accounting policies**

These unaudited consolidated financial statements do not include all information and note disclosures required for an annual set of financial statements under Canadian generally accepted accounting principles. In the opinion of management, all adjustments (consisting solely of normal recurring adjustments) considered necessary for a fair presentation of the financial position, results of operations and cash flows as at and for the three and six months ended December 31, 2003 have been included. Interim results for the three months ended December 31, 2003 and 2002 are not necessarily indicative of the results that may be expected for the fiscal year as a whole.

These interim consolidated financial statements include the accounts of Absolute Software Corporation and its wholly owned subsidiaries, Absolute Software Inc. and 609713 B.C. Limited. All intercompany balances and transactions have been eliminated. The statements should be read in conjunction with the annual consolidated financial statements and notes thereto included in the Company's annual report for the fiscal year ended June 30, 2003.

**2. Share Capital**

(i) Issued Common Shares:	Number of Shares	Amount
Balance at June 30, 2003	15,932,898	\$ 30,669,676
Common shares issued on exercise of options	154,750	62,638
Balance at December 31, 2003	16,087,648	\$ 30,732,314

(ii) Stock options:

The 2001 Employee Share Option Plan provides that a maximum of 4,065,206 common shares may be allocated to participants. After adjusting for stock options exercised under the Plan, there are a total of 3,905,956 common shares available to be allocated to participants under the Plan. As at December 31, 2003, the total share options outstanding were as follows:

Share options outstanding at June 30, 2003	3,238,746
Add: share options granted during the period	368,353
Less: share options exercised during the period	(154,750)
Less: share options forfeited during the period	(696,897)
Share options outstanding at December 31, 2003	2,755,452

The options outstanding at December 31, 2003 have an average term to expiry of 2.9 years and an average exercise price of \$1.29 per share. As at December 31, 2003, there were 2,031,500 (603,000 at December 31, 2002) potentially dilutive stock options outstanding when compared to the period average stock price.

(iii) Pro forma fair value stock-based compensation expense:

Under the intrinsic value method, the Company has not recognized any compensation expense for share options issued to employees and directors. Had the Company determined compensation expense for share options granted to employees and directors since the adoption of the new stock-based compensation standard on July 1, 2002 based on the fair value method of accounting for stock compensation, the Company's loss and loss per share for the period would have been the proforma amounts indicated below:

	Three Months Ended		Six Months Ended	
	Dec 31/03	Dec 31/02	Dec 31/03	Dec 31/02
Loss reported for the period as reported	\$ 541,568	\$ 1,249,767	\$ 1,458,778	\$ 3,044,504
Pro forma adjustment	18,588	8,303	38,503	14,434
Pro forma loss for the year	\$ 560,156	\$ 1,258,070	\$ 1,497,281	\$ 3,058,938
Pro forma basic and diluted loss per share	\$ (0.03)	\$ (0.06)	\$ (0.09)	\$ (0.16)

The fair value of each stock option was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 3.25%, dividend yield of 0%, expected life of four years, and volatility of 104% for December 31, 2003 (106% for December 31, 2002).

**3. Segmented Disclosures**

The Company carries on business in computer tracking and security monitoring and all sales are made in this segment. Business is conducted in the United States, Canada and internationally through resellers in South Africa, the United Kingdom and Australia. For the three months ended December 31, 2003, monitoring revenues in the United States were \$1,524,635 (2002 - \$1,253,896), and in Canada were \$156,463 (2002 - \$153,233). For the six months ended December 31, 2003, monitoring revenues in the United States were \$3,023,326 (2002 - \$2,416,675), and in Canada were \$333,077 (2002 - \$305,502). All installation services, licensing fees and other revenues are made in the United States for the three and six months ended December 31, 2003 and 2002.

**4. Subsequent Events**

On January 7, 2003, the maturity date for US dollar loans with a carrying value of C\$92,839 was extended from January 7, 2004 to January 7, 2005. The carrying value is included in current assets. No other terms were amended.

**We know.**

## **BOARD OF DIRECTORS**

### **John Livingston**

Chairman, Chief Executive Officer  
Absolute Software Corporation  
Vancouver, BC

### **Christian Cotichini**

Vancouver, BC

### **Terry Libin**

Calgary, AB

### **Ian Reid**

Vancouver, BC

## **OFFICERS AND SENIOR MANAGEMENT**

### **John Livingston**

Chief Executive Officer

### **Bob Chow**

President and Chief Operating Officer

### **Phil Gardner**

Chief Technology Officer

### **Michael Anfield**

Vice President, Recovery Services

### **Rob Chase**

Vice President, Finance

### **Rich Cohen**

Vice President, Sales

### **Ben Haidri**

Vice President, Marketing and Business Development

### **Don Hughes**

Area Vice President, Channel Sales

### **Mark St. Quintin**

Vice President, Development and Operations

## **CORPORATE INFORMATION**

### **Auditors**

KPMG LLP  
Vancouver, BC

### **Trust Agent**

CIBC Mellon Trust  
www.cibcmellon.com

### **Legal Counsel**

Lang Michener  
Vancouver, BC

### **Common Shares**

Absolute Software common shares are traded on the TSX Venture Exchange (TSX-VEN) under the trading symbol ABT.

## **ADDITIONAL INFORMATION**

John Livingston – Chief Executive Officer

(604) 730-9851 ext. 104  
jliving@absolute.com

Rob Chase – Vice President, Finance

(604) 730-9851 ext. 119  
rchase@absolute.com

### **Corporate Office**

Absolute Software Corporation  
Suite 800, 111 Dunsmuir  
Vancouver, BC Canada V6B 6A3  
Tel: 1-800-220-0733 or (604) 730-9851  
Fax: (604) 730-2621  
info@absolute.com

### **US Office**

Absolute Software Inc.  
Suite 400, 10655 NE 4th Street  
Bellevue, WA, USA 98004

**Visit our website at [www.absolute.com](http://www.absolute.com)**