



## Management Discussion and Analysis

# First Quarter Report

# 2006

The following Management Discussion and Analysis is prepared in accordance with National Instrument 51-102F1, and should be read in conjunction with the Company's 2005 Annual Report, in particular, the Management Discussion and Analysis, and the Consolidated Financial Statements and accompanying notes. These documents along with additional information about the Company, including the Annual Information Form, are available at [www.absolute.com](http://www.absolute.com) and [www.sedar.com](http://www.sedar.com)

Certain statements in this quarterly report constitute 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 Absolute's services and products, and other expectations, intentions and plans contained in this analysis 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 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 readers should understand that Absolute Software cannot offer assurance that the forward-looking statements contained in this analysis will be realized.

## Strategic Update of Absolute Software Corporation

Absolute's mission is to be the industry standard in Computer Theft Recovery ("Anti-Theft") and Secure Asset Tracking, and ultimately to become recognized as a world leader in security solutions for computers and other connected devices. As a measure of success toward its industry standard mission, Absolute has set a mid-term objective to have one million paid subscribers by June 30, 2007. At September 30, 2005, Absolute reached an interim milestone by surpassing 500,000 units under subscription.

There are four key strategic areas Absolute is focusing on to drive technology advancement and sales growth, including the Embedded, OEM sales, patent and market vertical strategies. During its first quarter of fiscal 2006, Absolute continued to make progress on each of these strategies.

### Embedded Strategy

Management believes the Embedded Strategy to be the single most important strategy for accelerating sales growth and establishing Absolute's Computrace technology as an industry standard. The Embedded Strategy refers to computer OEMs embedding Absolute's Computrace software into the basic input output system ("BIOS") of the computer hard drive.

From a technology perspective Absolute's software becomes integrated at the chip-level of the computer, making the software extremely difficult to defeat. The result is the best theft recovery solution on the market today, and a secure asset tracking agent that can enable corporate customers to gain the highest level of tracking for their computer population. From a sales perspective, the Embedded Strategy is expected to drive increased OEM sales support, customer demand and sales. Management believes this was a significant contributor to the increased level of sales contracts achieved in the Company's last two fiscal quarters. To the date of this report, Absolute announced that IBM/Lenovo (February 2005), Gateway (August 2005) and Hewlett-Packard (October 2005) have all adopted the Embedded Strategy. Management believes the importance of this strategy is evident in recent sales success through Lenovo and Gateway, as sales through these partners increased to 21% of total first quarter sales contracts from just 4% in the same quarter last year.

### OEM Sales Strategy

Absolute's distribution model is focused on generating sales through OEM channels – primarily DELL, Lenovo, HP, Gateway, Toshiba and Apple. Management believes these distribution channels are a competitive advantage for the Company, and Absolute is expanding programs to maximize market penetration through these channels. In total, Absolute generated \$4.0 million (or 78% of total sales contracts) through its OEM channels, compared to \$2.5 million (or 78%) in the same quarter last year. Note all dollar figures reported herein are in Canadian dollars unless otherwise stated.

DELL continues to be Absolute's largest channel partner, generating \$2.0 million (or 38%) of first quarter sales contracts, a 17% increase from \$1.7 million (or 54%) in the same quarter of last year. However, strategies to increase sales through other OEM channels have necessarily resulted in a reduction in the percent of sales through DELL. In particular, the Embedded Strategy has resulted in an increase in sales through Lenovo and Gateway to \$1.1 million (or 21% of total sales) compared to \$0.2 million (or 4%) last year, and the education strategy has helped sales through Apple increase to \$0.4 million (or 7%) compared to \$40,000 (or 1%) last year.

## Patent Strategy

Absolute has 12 issued and 2 pending patents covering the Computrace technology, which it relies upon as a competitive advantage and to maintain its market leadership position. During fiscal 2005, Absolute began enforcing its patents and these efforts are expected to continue during fiscal 2006. At present, Absolute has commenced proceedings against nine competitors of which six have been resolved and three are on-going. Resolution has taken the form of competitors exiting the business, acquiring licenses to Absolute's patent portfolio, or becoming resellers of Absolute's technology.

## Target Market Strategy

Absolute focuses on the U.S. laptop computer marketplace in three target verticals: corporate, education and consumer. With laptops beginning to outsell desktops in the U.S., each vertical represents a significant potential customer base, and each includes market trends that are favourable to achieving a meaningful adoption rate for Absolute's solutions. In the corporate market for example, there is increased awareness about the need to secure and track laptops as a result of recent legislation and negative publicity. In the education market, laptops are becoming a preferred learning tool. And in the consumer market there's increasing concern about identity theft and protection of the valuable information stored on laptops.

Absolute is executing strategies to capitalize on the opportunities within each market. For the corporate market, the Embedded Strategy and increased OEM sales support are key, while participating in industry events and marketing have been effective in the education market. For the consumer market, the primary strategy is to expand retail presence with the new LoJack for Laptops brand of Absolute's theft recovery solutions launched in August 2005. Management expects to see corporate and consumer market strategies drive second and third quarter sales contracts, as purchasing cycles for these segments tend to offset the strong summer spending in the education market.

For the first quarter of fiscal 2006, sales in the consumer market increased to \$0.8 million (16% of total sales) due to the launch of LoJack for Laptops and back-to-school consumer spending, compared to \$0.1 million (4% of total sales) last year, and \$0.3 million (5% of total sales) last quarter. For the first quarter, approximately half of LoJack for Laptops sales were generated through Absolute and its OEM channels, with the other half coming through CompUSA's 230 retail stores.

Absolute is continuing to expand its retail store presence in order to increase penetration in the consumer market. On October 25, 2005 the Company announced a distribution agreement with Navarre Corporation, a major U.S. software distributor, through which management expects to increase the number of retail chains distributing the LoJack for Laptops product.

Quarterly Sales Contracts by Market Vertical (In millions of dollars, except % of total sales in brackets)	Q1-F2006	Q1-F2005
Education	\$2.48 (48%)	\$1.55 (48%)
Corporate (all non-education and non-consumer sales)	\$1.85 (36%)	\$1.55 (48%)
Consumer	\$0.83 (16%)	\$0.12 (4%)
<b>Total sales contracts</b>	<b>\$5.16 (100%)</b>	<b>\$3.22 (100%)</b>

## Business Model

Absolute sells its computer asset tracking (AbsoluteTrack) and theft recovery (ComputraceComplete, ComputracePlus and LoJack for Laptops) solutions primarily in a subscription for services model. Subscription sales contracts are available with service terms of 1 to 5 years, with non-refundable payment in full due upon signing. While the entire value of the sales contract is due at the beginning of the contract, the revenue from the contract is recorded as deferred revenue on the balance sheet and amortized to income ratably over the contract term, starting in the month following the invoice date.

Once the customer installs the Computrace software, or activates the BIOS version, Computrace begins its automatic and silent communication with Absolute's monitoring center on a regular basis during the contract term, and provides the data required to support the purchased service. All of Absolute's services are enabled by the Computrace software with updates performed automatically through the monitoring center. Upon completion of the contract term, the customer may renew the subscription, or purchase a new subscription for a new replacement computer.

During the service term, customers can access Absolute's secure customer website to obtain inventory and reporting information about their entire computer population. If theft recovery services are purchased and the computer is stolen, Absolute's theft recovery team will attempt to use the information provided by the Computrace software to locate and co-ordinate with local law enforcement officials to retrieve the stolen computer for the customer. Absolute's software contains persistence qualities that increase the likelihood that the stolen computer will contact Absolute's monitoring center post-theft – a feature that is enhanced through Absolute's Embedded Strategy.

Absolute's service infrastructure, persistent technology and proven theft recovery track record have enabled the Company to stand behind its products with a manufacturer's limited warranty. Introduced in the fourth quarter of fiscal 2004, certain products now include the peace of mind that if Absolute cannot recover their stolen computer, the customer may receive up to \$1,000. This is primarily a corporate and education market offering, and in order to qualify for a guarantee payment, the customer must meet specific requirements which include the timely filing of a police report.

Large customers are also able to purchase a software license to Absolute's offerings. This is a more traditional software model with the customer installing the monitoring servers required to communicate with the Computrace software. In this model, the customer purchases a software license and annual maintenance contract. At present, this license model represents a small portion of total sales as it is made available only to facilitate sales to customers with policies requiring in-house operation of the service. For these sales, revenue from the software license is recognized upon delivery of the software, while the maintenance revenue is deferred and amortized over the maintenance term.

A majority of costs associated with sales contracts are incurred at the beginning of the sales contract term. A portion of these costs, including commissions and warranty accruals, are capitalized as deferred contract costs, which are then charged to income pro-rata with the sales contracts to which they relate. The remaining up-front costs, such as research and development, patent enforcement, direct marketing and selling, training, delivery and customer support, are all charged to income in the period incurred. During the remaining service term, cash costs associated with the contracts are generally less than the initial costs, and include maintenance of the monitoring center and reporting website, upgrades to the Computrace software, and recovery services.

Since revenue from sales contracts is deferred, revenue and gross margin will lag behind sales contracts and operating cash flow (see the Contractual Commitments section of this management discussion and analysis for the amortization schedule of deferred revenue). As a result, management relies upon sales contracts and operating cash flow as the indicators of performance and profitability. Refer to the Net Loss section below for further analysis of this metric. Sales contracts are not a measure under Canadian generally accepted accounting principles ("GAAP") and do not have a standardized meaning prescribed by GAAP. See Note 5 to the September 30, 2005 Interim Consolidated Financial Statements for GAAP reconciliation of deferred revenue to sales contracts and revenue. In general, achieving positive cash from operations by generating sales contracts in excess of operating costs is expected to translate into profitability as GAAP revenues begin to reflect increased sales contract levels.

## Selected First Quarter Information For the Three Months Ended September 30

(In millions, except percent and per share data)	2005	2004
<b>Sales Contracts</b>	<b>\$5.16</b>	\$3.22
<b>% increase over prior year</b>	<b>60%</b>	32%
<b>Revenue</b>	<b>\$2.58</b>	\$1.87
<b>% increase (decrease) over prior year</b>	<b>38%</b>	(1%)
<b>Net Loss</b>	<b>\$ (0.92)</b>	\$ (1.00)
<b>Basic and diluted loss per share</b>	<b>\$ (0.04)</b>	\$ (0.06)
<b>Cash from operations</b>	<b>\$ 0.96</b>	\$ 0.56

## Revenue and Sales Contracts

First quarter revenue for fiscal 2006 of \$2.6 million increased 38% from \$1.9 million last year and 10% from \$2.3 million in the prior quarter. With contract terms averaging nearly 30 months, revenue will reflect the changes in sales contracts over the past three fiscal years. In general, with a 30-month average contract term, 15% to 20% of current fiscal year sales contracts are recognized in revenue in the year of sale.

Sales contracts for first quarter fiscal 2006 were \$5.2 million, a 60% increase from \$3.2 million last year and a 3% increase from \$5.0 million in the prior quarter. The increases reflect the Embedded Strategy with Lenovo and Gateway, increased penetration in the education market vertical and expanded consumer strategies with LoJack for Laptops.

Over 90% of sales contracts continue to be denominated in U.S. dollars, while the Company reports in Canadian dollars. As a result of the continued devaluation in the U.S. dollar, the underlying business has actually increased at faster rates than reported in Canadian dollars. In U.S. dollar terms first quarter fiscal 2006 sales contracts were U.S. \$4.3 million, a 76% increase from U.S. \$2.5 million generated in first quarter last year, and a 7% increase over U.S. \$4.0 million last quarter. Sales in the education market tend to be concentrated in the summer months. As a result, the first and fourth fiscal quarters tend to be Absolute's strongest for sales contracts. Management expects to mitigate the level of seasonality through the Embedded Strategy and expansion in the consumer vertical.

Sales contracts are recorded at the value received by Absolute from either the reseller or directly from the customer. The value received from the reseller is net of reseller discounts. Accordingly, the retail price paid for Absolute's solutions is higher than the amount reported by Absolute as sales contracts. In the first quarter of fiscal 2006, the average price per unit increased over the prior year due to an increase in the proportion of theft recovery sales. The first quarter of last year included an unusually high proportion of asset tracking sales, which are a lower priced product.

	Q1-F2006	Q1-F2005
<b>Total subscriptions in units</b>	<b>96,225</b>	99,441
<b>Theft recovery sales as a percent of total units</b>	<b>88%</b>	35%
<b>Average selling price</b>	<b>\$ 53.26</b>	\$32.28
<b>Average contract term</b>	<b>28 months</b>	23 months

## Operating Expenses

(in millions, except employee data)

In millions, except employee data	Q1-F2006	Q1-F2005
Cost of goods sold	\$ 0.78	\$ 0.54
Sales and Marketing	\$ 1.59	\$ 1.07
Research and development ("R&D")	\$ 0.43	\$ 0.41
General and administration ("G&A")	\$ 0.73	\$ 0.61
<b>Total operating expenses</b>	<b>\$ 3.53</b>	<b>\$ 2.63</b>
Number of employees, end of period	85	72
Units under subscription, end of period	0.51	0.33

Total operating expenses have increased in the past two quarters as the employee base and selling and marketing efforts have been expanded in order to effectively execute on Absolute's strategic plan. Management believes it is critical that Absolute expand its sales, marketing and cost infrastructure in order to capitalize on current growth opportunities. As a result, sales and marketing expenses have increased significantly from the prior year.

The increase in cost of goods sold primarily reflects costs associated with the theft guarantee program launched in the fourth quarter of fiscal 2004, and with expansion of the consumer strategy. The estimated cost of the guarantee program is accrued and charged to deferred contract costs at the beginning of each sales contract and amortized to cost of sales over the contract life. Now in its second year, the full impact of this program is beginning to be reflected in cost of sales. In addition, the consumer program carries increased costs associated with delivering a box product to retailers, which includes amortization of the branding costs associated with warrants granted to LoJack Corporation.

R&D has remained relatively consistent with the prior year, reflecting the maturity of Absolute's core product offerings. However, in order to capitalize on the BIOS-embedded status with OEM partners, management is planning to increase its R&D investment in enhanced and new product development.

G&A expenses have increased over last year and the prior quarter primarily due to an increase in legal expenses associated with enforcing the patent portfolio, the hire of in-house legal counsel and share-based employee compensation expense. Currently, there are three competitors with which Absolute has commenced legal action for potential patent infringement. Absolute is expecting to commence court proceedings against one of these competitors during the second quarter of fiscal 2006. It is not yet determinable if the remaining two will go to court or be settled outside of court.

In September 2005, Absolute hired Mr. Trevor Wiebe as General Counsel in response to an increasing number of partner contracts associated with the consumer market and embedded strategies. For the five years prior to joining Absolute, Mr. Wiebe was in-house counsel for Pivotal Corporation and was called to the Bar in 1990.

## Other Income (Expense)

Absolute earns interest income on its cash resources beyond immediate operating requirements. These cash balances are invested in treasury bills, bankers' acceptances and investment grade bonds. Interest income increased to \$68,000 in Q1-F2006 from \$23,000 in Q1-F2005 and \$53,000 in Q4-F2005 as a result of increased cash balances and interested rates.

Absolute reports foreign exchange gains and losses primarily on the translation of cash and receivable balances carried in U.S. dollars. Generally, foreign exchange losses will be reported in periods where the U.S. dollar declines relative to the Canadian dollar. The U.S. dollar devalued relative to the Canadian dollar in the first quarter of fiscal 2006 and 2005, with the decline being larger in the first quarter of last year. As a result, Absolute reported foreign exchange losses of \$199,000 in Q1-F2006 compared to \$263,000 in Q1-F2005. At September 30, 2005 Absolute held U.S. dollar cash balances of U.S. \$2.9 million and account receivable balances of U.S. \$3.0 million, compared to U.S. \$1.0 million and U.S. \$3.2 million respectively at June 30, 2005. Over 50% of Absolute's costs are denominated in U.S. dollars, and excess cash balances are converted to Canadian dollars on a regular basis. Accordingly, Absolute has not entered into hedging arrangements as management believes the cost would outweigh the benefit. However, as over 90% of sales contracts are denominated in U.S. dollars, changes in the value of the U.S. dollar relative to the Canadian dollar will impact the rate of sales contract growth in future periods.

## Net Loss Before Income Taxes

For the first quarter of fiscal 2006, the Company's net loss before income taxes was \$1.1 million, an 8% increase compared to the pre-tax loss of \$1.0 million last year. The increase was expected due to the deferral of sales contracts as revenue levels have yet to reflect the 60% increase in sales contracts over the prior year. Conversely, Absolute has increased its cost infrastructure in order to support current growth strategies.

Since inception, Absolute has invested in establishing the market for Computer Theft Recovery and Secure Asset Tracking, building an effective distribution channel, and evolving its product offering. This investment has resulted in the Company operating in a net loss position to date. The primary strategy for becoming profitable is to grow revenue through sales contract growth. Consistently operating at a cash positive level is expected to result in income statement profitability as revenue begins to reflect increasing sales contract levels. With sales contracts increasing 60% in Q1-F2006 and 50% in fiscal 2005, the model is now producing cash positive operations and setting the stage for profitability. The following table is produced to illustrate the importance of sales contracts and cash flow as key performance metrics:

(In millions of dollars)	Q1-F2006	Q1-F2005
Sales contracts	\$ 5.16	\$ 3.22
Revenue	\$ 2.58	\$ 1.87
Net (loss) before income taxes	\$ (1.09)	\$ (1.00)
Cash from operations	\$ 0.96	\$ 0.56

## Net Loss After Income Taxes

The Company reported a net loss after income taxes of \$922,000 or \$0.04 per share, compared to \$1.0 million or \$0.06 per share in the first quarter of fiscal 2005. The reduction in fiscal 2006 is due to future income tax benefits of \$0.2 million in fiscal 2005 compared to \$1.9 million in fiscal 2004. Absolute began recording the future period benefits from current and prior period losses in fiscal 2004, and increased the benefited value of its tax losses based on Q1-F2006 results. Absolute has total potential future tax assets in excess of \$12.9 million, including tax losses of \$8.2 million in Canada and U.S. \$10.6 million in the U.S., available to reduce taxable income in future years. Of this value, \$2.3 million is recognized on Absolute's balance sheet as future income tax assets.

## Cash From Operations

Absolute reported positive cash from operations of \$962,000 in Q1-F2006, its fifth consecutive quarter of cash positive operations, compared to cash from operations of \$563,000 in the same quarter last year. The increased cash from operations reflects sales contract growth rates in Q1-F2006 and Q4-F2005 in excess of the rate of increase in operating expenses.

## Liquidity and Capital Resources

### Cash position

Absolute is in a strong financial position, with the financial resources necessary to fund its operating and capital requirements and to execute on its growth strategies. At September 30, 2005 Absolute carried cash, cash equivalents and short-term investments of \$12.9 million, up from \$11.9 million at June 30, 2005. The increase is primarily due to Absolute generating positive cash from operations in Q1-F2006.

### Accounts receivable

Accounts receivable balances of \$4.0 million at September 30, 2005 are up from \$2.4 million at September 30, 2004. The increase is consistent with the increased sales contract levels. Sales contracts tend to be concentrated toward the end of each quarter, and as a result, receivables balances tend to average between 75% and 85% of sales for the quarter. Receivable balances at September 30, 2005 were 77% of Q1-F2006 sales contracts, compared to 82% at June 30, 2005 and 74% at September 30, 2004.

## Deferred contract costs

Direct contract costs are capitalized as deferred contract costs on the balance sheet and are charged to income over the term of the contract to which they relate. Direct contract costs include expenditures incurred at the beginning of the contract period (commissions, prepaid service fees, prepaid contract insurance, direct delivery costs, etc.), plus the amount of warranty costs estimated over the life of each contract.

At September 30, 2005, deferred contract costs of \$3.9 million (21% of deferred revenue) increased from \$3.2 million (20% of deferred revenue) at June 30, 2005. The overall increase is consistent with the increase in deferred revenue. The increase as a percent of deferred revenue reflects an increasing proportion of deferred revenue from products that include Absolute's theft recovery guarantee. At present, sales of these products represent approximately 60% of total sales contracts. Management expects deferred contract costs as a percent of deferred revenue to climb toward 25% as the overall deferred revenue balances begin to reflect the current product mix.

## Accrued warranty

With the introduction of guaranteed theft recovery services, Absolute began recording a warranty provision for potential guarantee payments under the program. Warranty costs for each sales contract are estimated at between 15% and 20% of the sales contract value based on Absolute's experience across its subscriber base. A portion of this warranty exposure is underwritten with third-party contract insurance, and the remainder is included in accrued warranty. The corresponding expense is recorded as deferred contract costs and charged to cost of sales over the term of each contract. The accrued warranty accrual is reduced as payments are incurred for insurance premiums and net warranty claims.

Accrued warranty increased to \$1.6 million at September 30, 2005 from \$1.3 million at June 30, 2005. During the first quarter of fiscal 2006, a total of \$287,000 was paid in insurance premiums and guarantee claims, net of insurance proceeds, compared to warranty accrual on new sales of \$625,000. Each period, management evaluates its guarantee payment experience and considers whether changes are required to the estimated warranty provision. Experience to date suggests that a change in the accrual rate is not required. Management expects the Embedded Strategy to enable the Company to achieve actual warranty costs below the current estimated accrual rate over time.

## Deferred revenue

Deferred revenue represents sales contracts invoiced for which the non-refundable payment is received or due to be paid in full, but for which the revenue is not yet recognizable under GAAP. Refer to Note 5 of the Notes to the Interim Consolidated Financial Statements of September 30, 2005 for a reconciliation of deferred revenue to sales contracts and revenue.

Deferred revenue grew to \$18.9 million at September 30, 2005 on first quarter sales contracts of \$5.2 million, up from \$16.3 million at June 30, 2005. Future sales contracts will continue to increase this balance and will generate increases in revenue in future periods. This provides considerable visibility for future period revenues, with the current portion showing the amount that will be included in revenue over the next twelve months.

## Quarterly Operating Data

Past 8 Quarters, Un-audited (in millions of dollars, except per share data)

	Q1-'06	Q4-'05	Q3-'05	Q2-'05	Q1-'05	Q4-'04	Q3-'04	Q2-'04
Sales contracts	\$ 5.16	\$ 5.03	\$ 2.70	\$ 2.27	\$ 3.22	\$ 3.20	\$ 1.78	\$ 1.41
Revenue	\$ 2.58	\$ 2.34	\$ 2.21	\$ 2.15	\$ 1.87	\$ 1.84	\$ 1.93	\$ 1.95
Operating expenses	\$ 3.53	\$ 3.12	\$ 2.81	\$ 2.39	\$ 2.63	\$ 2.84	\$ 2.75	\$ 2.65
Net (loss) income	\$ (0.92)	\$ (0.54)	\$ (0.51)	\$ (0.47)	\$ (1.00)	\$ 0.94	\$ (0.72)	\$ (0.81)
Basic and diluted (loss) income per share	\$ (0.04)	\$ (0.03)	\$ (0.03)	\$ (0.03)	\$ (0.06)	\$ 0.06	\$ (0.04)	\$ (0.05)
Cash from (used in) operations	\$ 0.96	\$ 0.31	\$ 0.21	\$ 0.24	\$ 0.56	\$ (0.77)	\$ (0.42)	\$ (1.09)

## Shareholder's Equity and Outstanding Share Data

At September 30, 2005, Absolute had shareholder's equity of \$3.0 million. In evaluating shareholder's equity, management believes it is important to consider the \$18.9 million of deferred revenue carried on the balance sheet. This represents prepaid and non-refundable revenue, which management expects to deliver high margins as much of the associated contract costs are already included in the operating deficit.

The Company's common shares trade on the TSX Venture Exchange (TSX-V: ABT), and at September 30, 2005, the Company had 21,137,498 (21,180,798 at November 7, 2005) fully issued and outstanding common shares.

The following common share stock options and warrants are issued and outstanding:

- **Broker Warrants:** The Company issued 440,000 Broker Warrants in conjunction with a private placement on March 22, 2005, of which 376,900 were outstanding at September 30, 2005 (363,600 at November 7, 2005). The Broker Warrants have an exercise price of \$1.40 and expire on September 22, 2006.
- **LoJack Warrants:** Effective July 1, 2005, the Company issued 500,000 warrants to acquire rights to the "LoJack" brand name. All 500,000 warrants were outstanding at September 30, 2005. The warrants have an exercise price of \$2.00 per share, vest 20% per year starting on July 1, 2006 and expire the earliest of two years after each vesting, termination of the agreement, or July 1, 2010.
- **Employee Stock Options:** At September 30, 2005, a total of 2,755,235 (2,756,985 at November 7, 2005) common stock options were granted and outstanding under the Company's Employee Share Option Plan. The options have a weighted average strike price of \$1.13 per share, and a weighted average term to expiry of 2.9 years. During the first quarter of fiscal 2006, a total of 538,500 stock options were granted to employees at an average strike price of \$2.38. Of these, 285,000 were granted to insiders at an average strike price of \$2.50 per share.

## Critical Accounting Policies and Estimates

Management considers the Company's accounting for sales contracts, deferred contract costs, warranty accruals and future tax assets to be critical accounting policies. An understanding of the accounting policies for these items is important for meaningful analysis of Absolute's business.

Sales contracts and deferred contract costs represent sales receipts and expenses that are generated or incurred at the start of each sales contract. These items are recorded on the balance sheet as deferred revenue or deferred contract costs, and are recognized as revenue or expense ratably over the contract term.

Warranty accruals require management estimates of the amount of warranty claims that will be paid over the life of each sales contract. The value of the accrued warranty estimate is recorded with deferred contract costs and charged to cost of sales ratably over the contract term. Accrual estimates are established based on Absolute's experience with loss and recovery rates, and are reviewed for reasonableness based on actual experience on a regular basis.

The Company had future tax assets of \$12.9 million at June 30, 2005, of which \$2.3 million have been recognized on the balance sheet at September 30, 2005. The remaining future tax assets have not been recognized in the financial statements. Each reporting period, management assesses the likelihood of realizing future tax assets. Where management considers it is more likely than not that some portion or all of the future tax assets will be realized, the estimated realizable value of the future tax asset is recognized on the balance sheet. The net income or loss after income taxes can vary widely in periods where tax assets are recognized.

## Contractual Commitments

The Company does not have minimum purchase commitments and does not have significant contractual commitments except its leased premises, LoJack branding agreement (see subsequent events) and fulfillment of services under its sales contracts. There has been no change in the lease and LoJack commitments since June 30, 2005. The following table presents the deferred revenue amortization schedule at September 30, 2005 relating to contractual commitments for the provision of monitoring and recovery services under the Company's sales contracts

(In millions of dollars)	Remainder of Fiscal 2006	Fiscal 2007	Fiscal 2008	Fiscal 2009	Fiscal 2010	Fiscal 2011 to 2015	Total
Sales contract revenue to be recognized	\$ 7.56	\$ 6.57	\$ 3.78	\$ 0.84	\$ 0.16	–	\$ 18.91

## Off Balance Sheet Arrangements

The Company has not entered into any off balance sheet arrangements.

## Related Party Transactions

The Company does not generally enter into related party transactions. The only material related party transactions relate to loans to directors and employees agreed to as part of financing arrangements during the fiscal years ended June 30, 1999 and 2000.

## Subsequent Events

Up to the date of this report, November 7, 2005, there have not been any significant subsequent events or transactions that would require disclosure in, or adjustment to, the consolidated financial statements as at September 30, 2005.

## Evaluation and Effectiveness of Disclosure Controls and Procedures

The Company has established and maintains disclosure controls and procedures over financial reporting. The certifying officers have evaluated the effectiveness of the issuer's disclosure controls and procedures as of June 30, 2005 and have concluded that such procedures are adequate and effective to ensure accurate and complete disclosures in annual filings. There have not been any material changes in these controls to the date of this report.

## Risks and Uncertainties

The Company is selling and developing products and services for new and emerging markets and, as a result, faces a number of risks. See the Company's Fiscal 2005 Management Discussion and Analysis for discussion of these risks.

## Financial Statements

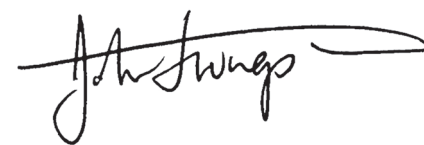
The interim consolidated financial statements included herein dated September 30, 2005 have not been reviewed by the Company's external auditors, nor have the external auditors been involved in the preparation of these interim financial statements.

### ABSOLUTE SOFTWARE CORPORATION Consolidated Balance Sheets (Unaudited) (Expressed in Canadian dollars)

	As At	
	September 30, 2005	Jun
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and cash equivalents	\$ 3,945,538	\$ 11,778
Short-term investments	8,998,413	133
Accounts receivable	3,970,751	4,132
Prepaid expenses and deposits	233,543	190
Current portion of deferred contract costs (Note 2)	1,976,194	1,626
Current portion of future income tax assets (Note 3)	469,537	469
	<b>19,593,976</b>	<b>18,330</b>
DEFERRED CONTRACT COSTS (Note 2)	1,897,814	1,570
PROPERTY AND EQUIPMENT	758,508	790
FUTURE INCOME TAX ASSETS (Note 3)	1,782,365	1,619
INTANGIBLE ASSET (Note 4)	606,929	
	<b>\$ 24,639,592</b>	<b>\$ 22,311</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	\$ 1,109,796	\$ 1,617
Current portion of accrued warranty (Note 5)	688,781	546
Current portion of deferred revenue (Note 6)	9,734,253	8,067
	<b>11,532,830</b>	<b>10,231</b>
ACCRUED WARRANTY (Note 5)	903,565	707
DEFERRED REVENUE (Note 6)	9,172,520	8,274
	<b>21,608,915</b>	<b>19,213</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital and other equity (Note 7 (a))	36,096,116	35,967
Contributed surplus (Note 7 (b))	7,510,298	6,784
Loans to directors and employees	(629,908)	(630)
Deficit	(39,945,829)	(39,022)
	<b>3,030,677</b>	<b>3,098</b>
	<b>\$ 24,639,592</b>	<b>\$ 22,311</b>

See accompanying Notes to the Interim Consolidated Financial Statements.

APPROVED ON BEHALF OF THE BOARD:



John Livingston  
Director



Ian Reid  
Director

**ABSOLUTE SOFTWARE CORPORATION****Consolidated Statements of Operations and Deficit (Unaudited)****Three months ended September 30, 2005 and 2004****(Expressed in Canadian dollars)**

	2005	2004
REVENUE		
Monitoring revenue	\$ 2,471,873	\$ 1,810,144
Installation services, licensing fees and other revenues	106,572	64,831
	<u>2,578,445</u>	<u>1,874,975</u>
COST OF GOODS SOLD		
Monitoring, support and recovery	538,722	270,854
Technical support and product maintenance	241,814	265,873
	<u>780,536</u>	<u>536,727</u>
GROSS MARGIN	<u>1,797,909</u>	<u>1,338,248</u>
EXPENSES		
Sales and marketing	1,594,526	1,069,821
Research and development	421,896	414,408
General and administration	729,161	611,953
	<u>2,745,583</u>	<u>2,096,182</u>
OPERATING LOSS	<u>(947,674)</u>	<u>(757,934)</u>
OTHER INCOME (EXPENSE)		
Interest and other income	67,908	22,673
Interest and bank charges	(5,968)	(4,472)
Foreign exchange loss	(199,336)	(262,867)
	<u>(137,396)</u>	<u>(244,666)</u>
LOSS FOR THE PERIOD BEFORE INCOME TAXES	<u>(1,085,070)</u>	<u>(1,002,600)</u>
FUTURE INCOME TAXES (Note 3)	162,761	-
NET LOSS FOR THE PERIOD	<u>(922,309)</u>	<u>(1,002,600)</u>
DEFICIT, BEGINNING OF PERIOD	<u>(39,022,768)</u>	<u>(36,515,709)</u>
INTEREST AND EXCHANGE ON LOANS TO		
DIRECTORS AND EMPLOYEES	(752)	(1,920)
DEFICIT, END OF PERIOD	<u>\$(39,945,829)</u>	<u>\$ (37,520,229)</u>
BASIC AND DILUTED LOSS PER COMMON SHARE	<u>\$ (0.04)</u>	<u>\$ (0.06)</u>
WEIGHTED AVERAGE NUMBER OF COMMON		
SHARES OUTSTANDING	<u>21,034,199</u>	<u>16,249,716</u>

See accompanying Notes to the Interim Consolidated Financial Statements.

**ABSOLUTE SOFTWARE CORPORATION****Consolidated Statements of Cash Flows (Unaudited)****Three months ended September 30, 2005 and 2004****(Expressed in Canadian dollars)**

	2005	2004
OPERATING ACTIVITIES		
Net loss for the period	\$ (922,309)	\$ (1,002,600)
Items not involving cash		
Amortization	91,624	93,903
Share-based compensation to employees	86,744	27,820
Warrant expense	31,944	-
Future income taxes	(162,761)	-
Change in non-cash operating working capital		
Accounts receivable	19,776	254,042
Prepaid expenses and deposits	(43,166)	36,664
Deferred contract costs	(676,823)	(292,302)
Accounts payable and accrued liabilities	(365,746)	(164,232)
Accrued warranty	338,283	223,771
Deferred revenue	2,564,773	1,385,666
Cash from operating activities	<u>962,339</u>	<u>562,732</u>
INVESTING ACTIVITIES		
Property and equipment purchased	(59,725)	(54,370)
Intangible assets acquired (Note 4)	(638,873)	-
Short-term investments (acquisition) disposal	(8,864,604)	913,176
Cash (used in) from investing activities	<u>(9,563,202)</u>	<u>858,806</u>
FINANCING ACTIVITIES		
Common shares issued on exercise of options and warrants	129,116	1,845
Warrants issued under LoJack branding agreement (Note 7(d))	638,873	-
Cash from financing activities	<u>767,989</u>	<u>1,845</u>
NET CASH INFLOW (OUTFLOW)	<u>(7,832,874)</u>	<u>1,423,383</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>11,778,412</u>	<u>3,020,331</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 3,945,538</u>	<u>\$ 4,443,714</u>
COMPOSITION OF CASH AND CASH EQUIVALENTS:		
Cash	\$ 3,346,282	\$ 3,190,552
Cash equivalents	599,256	1,253,162
	<u>\$ 3,945,538</u>	<u>\$ 4,443,714</u>
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITY:		
Intangible asset acquired	\$ (638,873)	-
Warrants issued under LoJack branding agreement	\$ 638,873	-

See accompanying Notes to the Interim Consolidated Financial Statements.

**ABSOLUTE SOFTWARE CORPORATION**

Notes to the Interim Consolidated Financial Statements (Unaudited)

Three months ended September 30, 2005 and 2004 (Expressed in Canadian dollars)

**1. SIGNIFICANT ACCOUNTING POLICIES**

The accompanying unaudited interim consolidated financial statements do not include all information and footnote 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 months ended September 30, 2005 have been included. Interim results for the three months ended September 30, 2005 and 2004 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., Computer Recovery Inc., and 609713 BC Ltd. All intercompany balances and transactions have been eliminated. These interim financial statements follow the same accounting policies and methods of application as the most recent audited financial statements, and should be read in conjunction with the annual consolidated financial statements and notes thereto included in the Company's 2005 Annual Report for the fiscal year ended June 30, 2005.

**2. DEFERRED CONTRACT COSTS**

	As at	
	September 30, 2005	June 30, 2005
Prepaid sales commissions	\$ 1,945,218	\$ 1,767,115
Accrued warranty and prepaid insurance costs	1,784,676	1,358,405
Other prepaid / accrued contract costs	144,114	71,665
	<u>3,874,008</u>	<u>3,197,185</u>
Less: Current portion	(1,976,194)	(1,626,747)
	<u>\$ 1,897,814</u>	<u>\$ 1,570,438</u>

**3. FUTURE INCOME TAX ASSETS**

At June 30, 2005 Absolute reported total future tax assets of \$12.9 million, of which \$2.1 million had been valued and recorded on the Company's balance sheet. The future tax assets relate to, among other things, timing differences relating to deferred revenue balances and to tax losses carry forward balances. Based on actual performance for the three months ended September 30, 2005, management determined that the value of tax assets that are more likely than not to be realized has increased to \$2,251,902. The increase of \$162,761 represents previously unrecognized tax assets.

**4. INTANGIBLE ASSET**

In the three months ended September 30, 2005, the Company acquired an intangible asset relating to common share purchase warrants issued for acquisition of a consumer product brand-name. The intangible asset is amortized to cost of sales on a straight line basis over a five year period, which matches the life of the warrants granted for acquisition of the brand name.

Under the branding agreement with LoJack® Corporation, Absolute retained the worldwide rights to brand its consumer offering "LoJack for Laptops" for a 10 year period ending June 30, 2015. In addition to an annual and per unit royalty, Absolute issued 500,000 common share purchase warrants to LoJack. The fair value of each warrant 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 five years, and volatility of 77%.

**5. ACCRUED WARRANTY AND GUARANTEE**

	As at	
	September 30, 2005	June 30, 2005
Balance at the beginning of the period	\$ 1,254,063	\$ 185,071
Warranty accrual on new sales contracts	624,815	1,433,683
Insurance premiums and warranty claims paid, net of insurance proceeds	(286,532)	(364,691)
	<u>1,592,346</u>	<u>1,254,063</u>
Less: Current portion	(688,781)	(546,287)
Balance at the end of the period	<u>\$ 903,565</u>	<u>\$ 707,776</u>

**6. DEFERRED REVENUE**

	As at	
	September 30, 2005	June 30, 2005
Balance at the beginning of the period	\$ 16,342,000	\$ 11,743,300
Add: Sales contracts during the period	5,163,314	13,227,582
Less: Revenue recognized during the period	(2,578,445)	(8,567,729)
Other adjustments	(20,096)	(61,153)
	<u>18,906,773</u>	<u>16,342,000</u>
Less: Current portion	(9,734,253)	(8,067,891)
Balance at the end of the period	<u>\$ 9,172,520</u>	<u>\$ 8,274,109</u>

**7. SHAREHOLDERS' EQUITY***(a) Issued*

	Number of Shares	Number of Warrants	Amount
Common shares			
Balance at June 30, 2005	20,985,773	440,000	\$ 35,967,000
Shares issued on options exercised (c)	88,625	-	40,776
Shares issued on broker warrants exercised	63,100	(63,100)	88,340
Warrants issued on LoJack agreement (d)	-	500,000	-
<u>Balance September 30, 2005</u>	<u>21,137,498</u>	<u>876,900</u>	<u>\$ 36,096,116</u>

*(b) Contributed surplus*

	As at	
	September 30, 2005	June 30, 2005
Contributed surplus, beginning of the period	\$ 6,784,681	\$ 6,665,707
Stock compensation expense recorded on stock options granted to employees	86,744	118,974
Intangible asset recorded on granting of Warrants under LoJack agreement (d)	638,873	-
<u>Contributed surplus, end of the period</u>	<u>\$ 7,510,298</u>	<u>\$ 6,784,681</u>

*(c) 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 options exercised under the Plan, there are a total of 3,313,706 available to be allocated to participants under the Plan, all but 558,471 of which have been granted. At September 30, 2005, the total share options outstanding were:

Share options outstanding, beginning of period	2,309,860
Exercised during the period	(88,625)
Forfeited during the period	(4,500)
<u>Granted during the period</u>	<u>538,500</u>
<u>Outstanding, end of period</u>	<u>2,755,235</u>
Weighted average exercise price	\$ 1.13
<u>Weighted average term remaining</u>	<u>2.66 years</u>
Number of options exercisable at September 30, 2005	957,194
<u>Weighted average price of exercisable options</u>	<u>\$ 0.94</u>

*(d) LoJack Warrants*

Effective July 1, 2005, the Company issued 500,000 warrants in connection with a 10 year branding agreement entered with LoJack Operating Company L.P. whereby the Company acquired the rights to use "LoJack" as a brand name for certain of its consumer theft recovery products. Each warrant is exercisable for one common share at an exercise price of \$2.00 per share. The warrants vest 20% per year on June 30, 2006, 2007, 2008, 2009 and May 31, 2010. All unexercised warrants expire on the earlier of 2 years after the vesting date, June 30, 2010 or termination of the branding agreement.

*(e) Pro forma fair value stock-based compensation expense*

The Company has adopted the amended recommendations of the CICA Handbook Section 3870 prospectively from July 1, 2003. Accordingly, the Company only recognized compensation expense for stock options granted to employees and directors commencing July 1, 2003. Had the Company determined compensation expense for options granted to employees and directors since adoption of the new stock-based compensation standard on July 1, 2002 based on the fair value method of accounting for stock-based compensation, the Company's pro forma loss and loss per share for the three months ended September 30, 2005 and 2004 would have been as follows:

	Three Months Ended September 30,	
	2005	2004
Loss for the period	\$ (922,309)	\$ (1,002,600)
Add: share-based compensation included in operations for the period	86,744	27,820
Less: share-based compensation determined for all awards from the original effective date of July 1, 2002	(100,378)	(41,800)
<u>Pro forma loss for the period</u>	<u>\$ (935,943)</u>	<u>\$ (1,016,580)</u>

**8. SEGMENTED INFORMATION**

The Company carries on business in the computer security monitoring industry and all sales are made in this segment. Its activities are carried out in the United States, Canada and internationally through resellers in the United Kingdom, Australia and South Africa. For the quarter ended September 30, 2005, total revenues in the United States were \$2,133,572 (2004 - \$1,715,416), in Canada were \$116,509 (2004 - \$113,489). A majority of the Company's long-lived assets are located in Canada.

## 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

### Rob Chase

Chief Financial Officer

### Rich Cohen

Vice President, Sales

### Ben Haidri

Vice President, Marketing and Business Development

### Don Hughes

Area Vice President, Channel Sales

## CORPORATE INFORMATION

### Auditors

Deloitte & Touche 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

### Rob Chase – Chief Financial Officer

(604) 730-9851 ext 119

rchase@absolute.com

### Dave Mason – The Equicom Group

(416) 815-0700 ext 237

dmason@equicomgroup.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

### U.S. Headquarters

#### Absolute Software Inc.

Suite 400, 10655 NE 4th Street

Bellevue, WA, USA 98004



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\* Chairman of Compensation Committee

\*\* Chairman of Audit Committee