1999 Annual Report   Intrinsyc Software, Inc.

INTRINSYC

The stage is set.

The future is clear.

"The Intrinsyc Sales Team will deliver and execute on the company's strategic goals by focusing on our customers' Windows connectivity requirements for e-business. Our opportunity is to anticipate the customer's needs and deliver a personalized, custom solution in a cost-efficient, timely manner."

Deanna McKenzie, EVP, Sales

Corporate Information

Executive Officers
Derek Spratt, P.Eng. (EE)
President & CEO

William Yu, B.S.M.E., MBA
EVP & COO

Roderick Campbell, MBA
CFO & EVP, Strategic Business Development

Deanna L. McKenzie
EVP, Sales

Guylain Roy-MacHabée, P.Eng.
VP, Marketing

David B. Manuel, P.Eng.
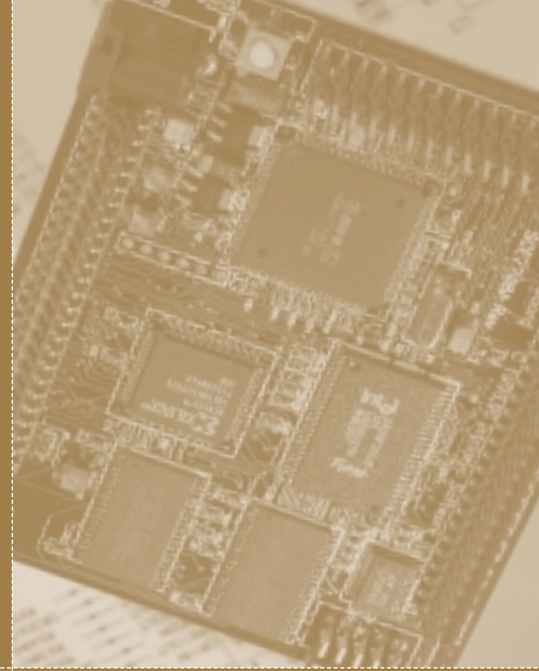VP, Development

Board of Directors
Derek Spratt, P.Eng. (EE)
Chairman, President & CEO
Intrinsyc Software Inc.
Vancouver, BC, Canada

William Yu, B.S.M.E., MBA
EVP & COO
Intrinsyc Software Inc.
Vancouver, BC, Canada

Ronald P. Erickson, B.A., M.A., J.D.
Chairman & CEO
GlobalTel Resources Inc.
Seattle, Washington, USA

Robert Gayton, Ph.D., F.C.A.
VP Finance
Western Copper Ltd.
West Vancouver, BC, Canada

Corporate Profile

Intrinsyc provides leading-edge solutions for creating, linking and managing Internet Devices and Information Appliances. These are specialized, web-enabled, low-cost computers hidden in everyday things such as cars and home security systems, and in commercial and industrial products such as vending machines and factory floor controllers – and they are quickly becoming the PC market of the future.

Intrinsyc's technologies enable manufacturers to rapidly build highly reliable, web- and enterprise-ready Internet Devices and Information Appliances for market segments such as mobile computing, industrial automation, and point-of-sale – all large and rapidly growing global markets.

Intrinsyc's suite of embedded Internet products and solutions include:
> **deviceCOM**, an "Industrial-strength DCOM" framework for embedded Windows
> **deviceWEB**, a powerful embedded Windows web server
> **deviceRMS**, the first Universal Plug-and-Play and COM-based remote management system for embedded Windows Internet Devices
> **deviceOPC** and **deviceFT**, specialized industrial automation and fault-tolerant software for embedded Windows
> **CErfBoard**, a low-cost embedded Windows reference platform for quickly creating Internet Devices

Intrinsyc's products have found acceptance with an expanding list of Fortune 500 companies, which are driven by its innovative business model and world-class technologies. Intrinsyc's ultimate value proposition to its customers is accelerating their time-to-market in the highly competitive embedded systems space.

Intrinsyc's shares are publicly traded on the Canadian Venture Exchange under the symbol ICS.CDNX.

VISION

There's a lot of talk about "e-business" in the media – connecting everything to the "net" and providing new ways of conducting business-to-business and business-to-consumer transactions. Comdex's theme this year was "Beyond the PC". Clearly, the world of computing is now focusing on Information Appliances and Internet Devices. After years of preparation, the market is coming together for Intrinsyc.

We're a classic technology start-up. We lay claim to some of the best technical minds in the business. Our intellectual property portfolio is second to none. We're first-to-market with the key enabling technologies for a new computing paradigm. Yet we are struggling to get our story heard by the investment community. And we have had to continually operate with very modest financial resources. Finally, we are being tested in our ability to transition from being outstanding developers to competent marketers.

The challenge before us is to execute on the opportunity we have created for ourselves before this window of opportunity closes. The clock is ticking.

After some initial difficulties growing our sales and marketing capabilities, we have assembled a world-class sales and marketing team comprising more than a dozen industry professionals. While we grew our revenues more than 300% to $2.3 million in 1999, we were expecting more momentum than we actually achieved. As we enter fiscal 2000, our expanded sales and marketing team is helping us achieve greater market share, as well as the industry recognition we deserve.

We recognize that we have not effectively told our story to the investment community. We also recognize the limitations placed on the company from listing on a junior exchange. As a result, our stock performance didn't properly reflect the company's true market potential in 1999. This has been a major frustration for our shareholders, and a strategy to address this issue is one of our top priorities as we move forward.

Taking stock of our achievements over the last year, Intrinsyc has grown its customer base to include Fortune 500 companies in industries such as industrial automation and building automation, point-of-sale, and mobile computing. Over the next year, we will add telecommunications to our target markets. Customers are coming to us for turnkey solutions that include our licensable technologies and services. Our commitment is to get their next-generation products to market quickly and equipped with the hot new networking features and capabilities the e-business market is demanding.

Intrinsyc is evolving into a formidable force in the embedded systems market. In addition to revenue growth, our staff size has more than doubled. We have new, modern office premises, and dozens of new customers. One of the most gratifying aspects of our progress is the enhanced

> "I have a great job—working with some of the brightest minds and most highly motivated people in the business. I'm helping to direct these talents and energies into a fiscal and strategic framework that will deliver outstanding shareholder return on investment over the next twenty-four months."
>
> Roderick Campbell, MBA,
> CFO and EVP, Strategic Business Development

industry recognition we've received, including numerous trade press mentions and two significant awards. We're proud of our strategic partnership with BSQUARE and our new corporate identity program. And yes, we continue to be strong innovators with numerous new technology introductions in 1999. We have a lot to be proud of.

One year ago, we set forth three key objectives for the company:
> build a world-class sales and marketing team
> deliver solid revenue growth and initial market share
> complete a strategic financing with a top-tier industry partner

We have already executed on the first two goals, and are close to completing a strategic financing transaction. We expect to use the capital from this transaction to build a stronger presence in our current markets, as well as expand into the telecom space.

For 2000, we have set four new goals:
> dominate each of our chosen market segments
> ramp our revenues by focusing on the top OEMs in each market segment
> achieve sustainable profitability
> most importantly, take the necessary steps to maximize shareholder value and ensure that the value is reflected in the stock price

We will also make it easier for our shareholders to monitor our progress by publishing the number of active development kits that we have shipped to new customers each quarter. Whenever possible, we'll provide the names of our customers and their products at the point that they transition to volume production, and we'll do our best to indicate what the expected downstream licensing potential will be.

In closing, I'd like to thank the company staff, management, board of directors, and investors, who have collectively helped build Intrinsyc. As a team, we are committed to achieving the goals we have set out for the coming year. Thank you in advance for your continued support and contribution to our future successes together.

Sincerely,

Derek W. Spratt
President and CEO

milestones

March 1999 Iconics signs agreement to use deviceCOM in its Pocket Genesis for Windows CE.

March 1999 Eaton Corporation signs contract to use Intrinsyc technologies for mobile in-vehicle computing in transportation.

April 1999 Intrinsyc appoints new CFO and VP of Strategic Business Development, EVP and COO, VP of Marketing, and VP of Development.

April 1999 BSQUARE and Intrinsyc form partnership to deliver Windows-based software solutions to industrial automation OEMs.

April 1999 Microsoft endorses Intrinsyc's deviceCOM for extending Windows Distributed interNet Applications Architecture (DNA) to Windows systems in industrial automation.

May 1999 Intrinsyc expands corporate headquarters and launches new visual identity.

June 1999 At the Windows CE Developers Conference Intrinsyc releases new embedded web technologies.

June 1999 Intermec uses deviceCOM for its web-enabled Data Collection PC.

June 1999 The BC Technology Industries Association names Intrinsyc New Venture of the Year Runner-up.

June 1999 U.S. publisher Cahners Electronics Group chooses Intrinsyc product as one of Top 10 for 1998.

July 1999 Digital Electronics signs contract to use Intrinsyc technologies in its human-machine interface (HMI) products for industrial automation.

September 1999 Intrinsyc significantly upgrades deviceCOM.

September 1999 Intrinsyc releases new Intel StrongARM-based microCErfBoard-SA 1110 reference platform.

September 1999 At Embedded Systems Conference (ESC) Fall, Intrinsyc unveils deviceRMS, a break-through embedded network management system.

October 1999 At ISA/TECH '99 Intrinsyc launches deviceOPC.

November 1999 At Comdex '99 Intrinsyc demonstrates breakthrough post-PC technologies.

November 1999 Deanna L. McKenzie appointed EVP, Sales, along with significantly expanded sales and marketing team.

Questions and Answers

In this candid interview, Derek Spratt, President and CEO of Intrinsyc, shares his views and insights on the challenges and opportunities facing the company in the post-PC era.

First off, could you explain what you mean by the post-PC era?

Certainly. Driven by faster, cheaper chips, as well as the exploding use of the Internet, low-cost "Internet Devices" or "Information Appliances" are heralding a new era in information processing. At the heart of this post-PC era are embedded computers invisible to the user that perform critical functions affecting literally every facet of our modern lives. This includes such things as Internet-enabled cell-phones, personal organizers, digital TVs and set-top boxes, and a huge range of products for commercial and industrial use. Basically, anything with a power switch on it will contain a computer chip and will be networked through the Internet in the not too distant future. So much so, that in the next five years machines will outnumber people surfing the Internet.

A lot of investors have a hard time grasping what Intrinsyc does. Could you put Intrinsyc into perspective?

To understand what Intrinsyc does, you first have to understand a little bit about the embedded market. Embedded systems include everything from tiny computers found in commercial electronics and automated teller machines to things like traffic lights and security systems – devices that can usually benefit from being monitored and controlled from remote locations. A hot new growth area for embedded systems are so-called "Information Appliances" or "Internet Devices", in effect, specialized, web-enabled, low-cost computers that are poised to become the PC market of the future.

According to leading industry analyst International Data Corporation (IDC), US shipments of Information Appliances and Internet Devices will reach 42 million units by the year 2002, a compound annual growth rate (CAGR) of 96.3%, while PCs will only experience a CAGR of 12.2%.

Intrinsyc helps its customers, who are original equipment manufacturers (OEMs), develop these new generations of products by using a combination of our licensable technologies and our support and design services. We specialize in providing networking technologies for these devices that allow them to be linked to each other, as well as to a company's other computing systems (what's often referred to as the "enterprise"). Our newest technologies also address the management aspects of these new networks of embedded Information Appliances and Internet Devices.

How do customers use Intrinsyc's technologies?

The trend across virtually all industry segments is to use the Internet to streamline operations and provide new, compelling product features. This means instant and reliable access to information at all levels. OEMs who want to benefit from this trend use Intrinsyc technologies to address three fundamental needs: the need to create devices that are "smart enough" to take advantage of the Internet; the need to link these devices to the rest of a company so information can be reliably accessed; and the need to minimize ongoing operational costs by remotely administering this huge pool of equipment.

A typical application is in factory automation or mobile computing, where our technology extends Microsoft Windows, making it reliable enough for industrial use.
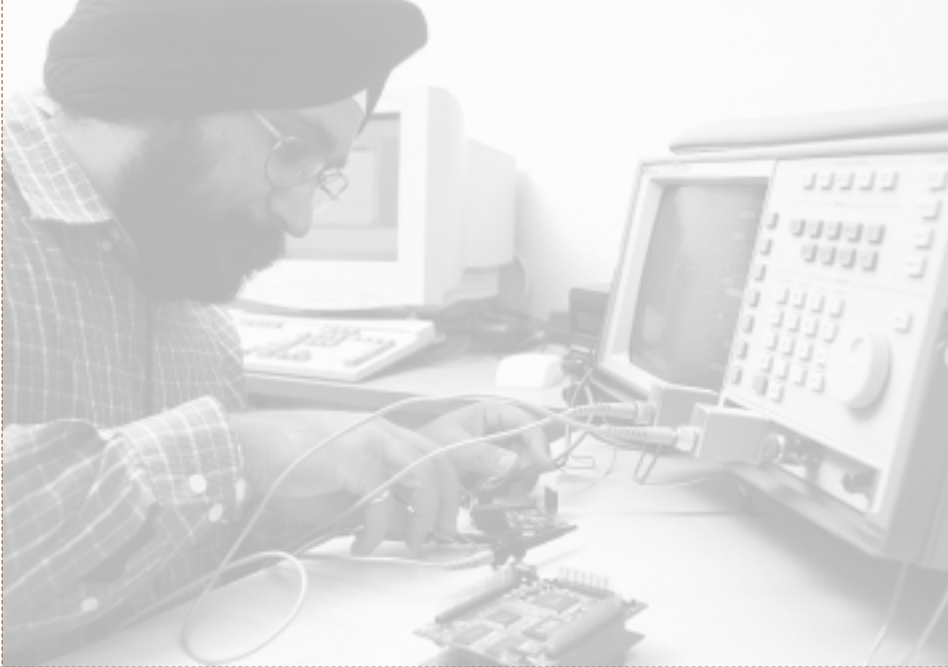
In point-of-sale markets, our technologies may be found inside "smart" vending machines, allowing vendors to monitor a machine's stock and whether it needs to be serviced, via a web browser on their desktop PC.

Another application of our technologies is an in-vehicle mobile PC, where we provide the wireless networking solutions for the monitoring of the location, performance and maintenance requirements of the vehicles – from head office or another remote location via the web.

Could you explain Intrinsyc's business model?

Intrinsyc's business model involves selling development kits to manufacturers and providing follow-on development services to help get new products based on our technologies into production as quickly as possible. Customers sign licensing agreements and pre-purchase blocks of licenses before they commence production.

To date, about 40 Fortune 500 companies have purchased Intrinsyc's kits and services, including well-known entities such as AT&T, Bosch, Cannon, Eaton Corporation, Fisher-Rosemount, Groupe Schneider, Hitachi, Honeywell, Iconics, Intermec, Intellution, Johnson Controls, Motorola, Raytheon, Rockwell, and Siemens. Total annual licensing revenues are approaching $400,000 for the Company. We also work with processor vendors such as Hitachi, Intel and Motorola by providing development services and technology licensing to their customers, and have a technology licensing and distribution agreement with BSQUARE.

Where is Intrinsyc currently making most of its revenue – consulting or licensing software – and when will these revenues pick up?

Most of our revenue to date has come from the sale of development kits and the provision of design and support services to OEMs who are in the developmental stages of their new product lines. As more and more of these OEMs enter volume production, we anticipate an increasing portion of our revenues will come from run-time licenses, which will produce a highly scalable source of earnings for the company.

What does Intrinsyc offer customers?

Intrinsyc brings far more than just technology to the table. We have exceptional engineering talent with a deep knowledge of the embedded environment, allowing us to be very solutions-oriented in our customer relationships.

Our technologies form a complete framework to build leading-edge products. For example, our deviceCOM technology meets the need for connectivity between embedded devices and other levels of a company, a critical need that no other company can currently meet.

This year, our deviceCOM technology was officially endorsed by Microsoft as being able to provide connectivity between Windows CE devices and Windows NT workstations in industrial automation applications. And we now have an exciting network management solution in deviceRMS, which dramatically simplifies the task of deploying, configuring and managing these new networks of embedded devices.

"In 2000, the product development group will continue to add to our top-notch engineering, quality assurance, and test capacity. The group will continue to update and create new Internet-enabled products, all the while helping our early-adopter customers effectively get to market in this new post-PC and PC-plus era."

David B. Manuel, P. Eng.,
VP, Development

What is Intrinsyc's relationship with Microsoft?

Microsoft is a key partner of Intrinsyc's. We've been working with Microsoft since the advent of embedded Windows. Intrinsyc was among the first companies to develop technologies so the embedded Windows operating system could be applied to different niche markets. In recognition of our technological innovations, Microsoft highlighted Intrinsyc during Comdex 1997 as one of 14 exceptional emerging software companies worldwide. We continue to work with Microsoft in developing new markets together.

While there's always the possibility that Microsoft will incorporate components of Intrinsyc's technology into Windows, the potential market for complementary technology to Windows is far larger than Microsoft's ability to access or service this market alone.

Five years ago, Microsoft's main focus was the desktop PC. Yet, only 3% of microprocessors shipped today run PCs. The other 97% run embedded systems. The Internet is revolutionizing the reach and capabilities of networked embedded systems. No company, not even Microsoft, can effectively service 97% of the microprocessor market. There will always be the need for third-parties to provide specialized applications. This is where Intrinsyc fits in. Because we enhance and extend the capabilities of embedded Windows, we can help Microsoft enter markets it can't on its own.

Are you limiting the growth prospects of Intrinsyc by closely aligning yourself to Microsoft and the Windows operating system?

Presently, Windows is the industry standard for industrial and commercial applications. Technologically, we're not bound to the Windows operating system. Our technology can operate on virtually any platform. Part of our R&D efforts focuses on wider applications of our technology so we can take advantage of new market opportunities as they arise.

Why has Intrinsyc's stock underperformed?

The stock performance in 1999 has been a disappointment, and there are a number of reasons why Intrinsyc's stock did not realize its full potential.

Intrinsyc has a back-end loaded business model. Intrinsyc sells "run-time" software licences to manufacturers who incorporate these technologies into their final products. Customers sign licencing agreements and pre-pay blocks of licences before commencing volume production. Many of our customers are still in the R&D phase, so their products won't be commercially available for a while. However, we're getting closer to the point where our royalty streams will become a major contributor to our revenue.

We also recognize that we haven't told our story effectively to the investment community, and we're making a more concerted effort to get our story out in 2000.

Who are the most influential brokerage firms and analysts following your industry and your company?

There's no ongoing analyst coverage or research reports on Intrinsyc at this time. However, a number of analysts are monitoring the company such as International Data Corporation (IDC), Venture Development Corporation (VDC), CIBC World Markets (Oppenheimer & Wood Gundy), H&Q, Everen Securities, and Lehman Brothers. Intrinsyc is on analysts' radar screens. We're confident that as the company continues to grow and reaches new milestones that our story will gain increased coverage in 2000.

What does the future hold for Intrinsyc?

We're very optimistic about the future. The growth potential for the embedded systems market is huge. Industry analysts predict that the software portion of the embedded systems market alone will grow from US$3 billion to more than US$7 billion by the year 2001. The overall embedded systems market includes shipments of more than 5 billion microprocessors per year to OEMs who produce nearly $1 trillion in products for customers in a wide range of market segments. This is truly a huge and dynamic industry. As a leading provider of interconnectivity solutions for embedded systems, Intrinsyc is well positioned to capitalize on this exploding market.

"Along with gathering critical marketing intelligence, we'll further expand the company's profile by being omnipresent at trade shows and in trade publications. We'll also increase our participation in key industry movements, such as the OPC Foundation, OMAC, and Microsoft's Universal Plug-and-Play (UPnP)."
Guylain Roy-MacHabée, P.Eng.,
VP, Marketing

Management Discussion and Analysis

Results from Operations

Intrinsyc Software, Inc. has posted revenues for the year ended August 31, 1999 of $2,250,978, an increase of 300% over the prior year.

The revenue increase was primarily due to increased services relating to the incorporation of the Company's licensable software components into OEM products. Sales of our development kits and production run-time licenses, which are expected to rapidly increase as our technology is deployed in more Information Appliances, continue to increase.

General and Administrative costs decreased 10% to $1,283,117 compared to $1,429,923 in the prior year. Share financing costs decreased significantly by completing non-brokered rather than brokered private placement and by raising funds from the exercising of options and warrants.

Growth in personnel, including the addition of senior management, resulted in increased salaries and benefits.

Sales and Marketing costs increased 19% to $1,175,130 from $986,897. This increase is largely due to higher salaries and recruitment costs to build our sales team. During the year the U.S. Sales office was closed, resulting in cost savings.

Research and Development costs increased 17% to $1,760,444 from $1,504,879 in 1998, a result of the higher number of personnel required, increased salaries and benefits, professional fees, and material purchases.

Liquidity and Capital Resources

As of August 31, 1999, the cash position was $201,780. Working capital was $429,026, which represents a current ratio of 1.6:1. Subsequent to August 31, 1999, the Company completed a shares for debt transaction to settle $294,711 in obligations and a private placement for $900,000. This significantly improved the company's cash and working capital position. The Company continues to have no long-term debt.

Cash consumed in 1999 operations was $1,873,535 compared to $3,674,148 in 1998.

In fiscal 1999, all financing activities were done with the issuance of shares, exercise of options and warrants. During the current fiscal year, shares were issued at various prices providing financing of $1,404,623 compared to $4,297,219 in fiscal 1998. Capital assets, primarily computer equipment of $163,927, were purchased as a result of increased staff.

Risk and Risk Management

The growth and success of the Company depends on our ability to retain, train, attract, and motivate highly skilled personnel. There is significant competition for employees with the skills required to perform the services that we offer and this condition is expected to continue into the foreseeable future.

During the next fiscal year, the Company will need to raise substantial additional funds to continue to conduct its marketing plans and research and development projects. The Company intends to seek additional funding through public or private financing. There can be no assurance that such funds will be available on favourable terms, or at all. If adequate funding is not available, the Company may be required to delay, reduce or eliminate one or more of its marketing strategies or research and development programs.

As we are selling products into a new market, the sales cycle is lengthy and makes our revenue susceptible to fluctuations. Our solutions and technologies are complex and typically undergo a lengthy approval process before companies make an investment in them, and that approval process may be subject to a number of risks over which we have little or no control. Also, to successfully sell our technologies, we frequently must educate our potential customers about the full benefits, which can take a significant amount of time.

We believe the purchasing patterns of our customers and potential customers may be affected by Year 2000 issues, as companies delay their decisions to purchase our technologies. The Company feels this will negatively impact first and second quarter revenue in fiscal 2000.

Revenue in 1999 was dependent on a few customers. In particular, Eaton Corporation accounted for 66% of revenue. There can be no assurance that the Company's growth will continue at its present pace. The Company continues to sign contracts with world-class companies, with recent contracts with Iconics and one of the world's largest building automation companies. This adds to earlier contracts signed with Intermec, Digital Electronics, Universal, Western Money Systems, and BSQUARE.

Outlook

The Company is extremely well positioned to take advantage of the burgeoning Information Appliance market. According to leading industry analyst IDC, US shipments of Information Appliances will reach 42 million units by 2002, a compound annual growth rate of 96.3%. Our sales forecasts for 2000 indicate continued revenue growth from an increasingly diverse customer base. Telecom will also be added to our target markets, which currently include industrial and building automation, point-of-sale, and mobile in-vehicle computing.

"Year 2000 will see the company grow even more, especially in key areas such as Marketing and Development, and Intrinsyc will continue to build our team. As our team grows, we'll continue to ensure that the company has adequate resources and facilities. We'll be working hard to keep our people happy."

William Yu, B.S.M.E., MBA
EVP and COO

In 1999, we continued to sell our technical solutions to leading companies, which use them to create Internet Devices or Information Appliances, link the devices to other areas of the enterprise, and help companies manage these hundreds and thousands of devices once they're out in the field.

Our reputation for technical innovation also continued in 1999 with numerous new technologies being showcased to the embedded software industry, most notably deviceRMS, which will help position Intrinsyc as a network management solution provider, in addition to being an embedded device solution provider. This will help the Company move into the telecom market in mid-2000.

Finally, and most significantly, in 1999 we built the sales and marketing team from two to twelve people by recruiting experienced, proven sales professionals into the Company. Increased revenues and market share attributable to this expanded team is expected in 2000.