# Financial Statements

# Auditor's Report

To the Shareholders of **Points International Ltd.**

We have audited the consolidated balance sheets of **Points International Ltd.** as at December 31, 2005 and 2004 and the consolidated statements of operations, deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the corporation as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Mintz + Partners LLP

Toronto, Ontario
March 9, 2006

CHARTERED ACCOUNTANTS

# Financial Statements

## POINTS INTERNATIONAL LTD.
## CONSOLIDATED BALANCE SHEETS

| AS AT DECEMBER 31 | 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| CURRENT | | |
| Cash and cash equivalents (Note 4) | $ 19,983,607 | $ 13,754,818 |
| Short-term investments | 2,348,418 | – |
| Accounts receivable | 2,739,224 | 2,024,342 |
| Prepaids and sundry assets | 1,893,605 | 1,229,091 |
| | 26,964,854 | 17,008,251 |
| PROPERTY, PLANT AND EQUIPMENT (Note 5) | 3,606,840 | 2,056,282 |
| GOODWILL AND INTANGIBLE ASSETS (Note 6) | 7,602,503 | 8,282,453 |
| DEFERRED COSTS (Note 22) | 1,699,030 | 2,242,868 |
| FUTURE INCOME TAXES RECOVERABLE (Note 16) | 590,000 | 590,000 |
| | 13,498,372 | 13,171,603 |
| | **$40,463,226** | **$30,179,854** |

APPROVED ON BEHALF OF THE BOARD:

**Douglas Carty**
Chairman of the Board

**Robert MacLean**
Director

# Financial Statements

## POINTS INTERNATIONAL LTD.
## CONSOLIDATED BALANCE SHEETS

| AS AT DECEMBER 31 | 2005 | 2004 |
|---|---|---|
| **LIABILITIES** | | |
| CURRENT | | |
| Accounts payable and accrued liabilities | $ 2,284,257 | $ 1,894,599 |
| Deposits | 15,810,853 | 13,153,623 |
| Current portion of loan payable (Note 7) | 33,515 | 29,860 |
| Current portion of acquisition loan payment (Note 14) | 390,166 | 777,443 |
| Convertible debenture (Note 8) | – | 8,920,373 |
| | 18,518,791 | 24,775,899 |
| LOAN PAYABLE (Note 7) | 35,107 | 67,186 |
| ACQUISITION LOAN PAYABLE (Note 14) | – | 380,118 |
| CONVERTIBLE DEBENTURE (Note 8) | 9,699,180 | – |
| CONVERTIBLE PREFERRED SHARES (Note 9) | 18,396,456 | 13,892,478 |
| | 46,649,533 | 39,115,680 |
| **SHAREHOLDERS' Definciency** | | |
| CAPITAL STOCK (Note 10) | 36,404,342 | 23,730,993 |
| WARRANTS (Note 11) | 2,758,688 | 2,610,992 |
| CONTRIBUTED SURPLUS | 2,079,423 | 2,226,713 |
| DEFICIT | (47,428,760) | (37,504,525) |
| | (6,186,307) | (8,935,826) |
| | **$40,463,226** | **$30,179,854** |

## POINTS INTERNATIONAL LTD.
## CONSOLIDATED STATEMENTS OF OPERATIONS

| FOR THE YEARS ENDED DECEMBER 31 | 2005 | 2004 |
|---|---|---|
| **REVENUES** | | |
| Points operations | $ 9,429,253 | $ 7,560,012 |
| Interest income | 598,556 | 231,579 |
| | 10,027,809 | 7,791,591 |
| **GENERAL AND ADMINISTRATION EXPENSES** | 14,321,370 | 12,148,927 |
| LOSS - Before interest, amortization and other items | (4,293,561) | (4,357,337) |
| Foreign exchange loss | 514,625 | 81,725 |
| Interest on convertible debenture | 778,806 | 884,001 |
| Interest on preferred shares | 1,049,367 | 868,000 |
| Interest, loss on short-term investment and capital tax | 265,974 | 132,843 |
| Amortization of property, plant and equipment, intangible assets and deferred costs | 3,021,902 | 2,322,749 |
| Write-off of ThinApse Corporation | – | 161,629 |
| | 5,630,674 | 4,450,947 |
| NET LOSS | (9,924,235) | (8,808,284) |
| LOSS PER SHARE (Note 12) | $ (0.11) | $ (0.13) |

## POINTS INTERNATIONAL LTD.
## CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (DEFICIT)

| FOR THE YEARS ENDED DECEMBER 31 | 2005 | 2004 |
|---|---|---|
| **DEFICIT – Beginning of year** | | |
| As previously reported | $ (34,734,645) | $ (25,926,361) |
| Adjustment to stock-based compensation (Note 3) | (2,769,880) | (2,769,880) |
| As restated | (37,504,525) | (28,696,241) |
| **NET LOSS – For the year** | (9,924,235) | (8,808,284) |
| **DEFICIT – End of year** | $ (47,428,760) | $ (37,504,525) |

# Financial Statements

## POINTS INTERNATIONAL LTD.
## CONSOLIDATED STATEMENTS OF CASH FLOWS

| FOR THE YEARS ENDED DECEMBER 31 | 2005 | 2004 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net loss | $ (9,924,235) | $ (8,808,284) |
| Items not affecting cash | | |
| Amortization of property, plant and equipment | 1,346,320 | 312,618 |
| Amortization of deferred costs | 531,699 | 601,319 |
| Amortization of intangible assets | 1,143,884 | 1,408,812 |
| Deferred costs on convertible debenture | 12,139 | - |
| Unrealized foreign exchange loss | 3,431 | (25,362) |
| Employee stock option expense (Note 11) | 408,435 | 362,343 |
| Writedown of long term investment | - | 161,629 |
| Cancellation of Warrants issued for services | (1,167) | (1,179) |
| Interest on Series Two and Four Preferred Shares | 1,049,367 | 868,000 |
| Interest accrued on convertible debenture | 778,806 | 884,001 |
| | (4,651,323) | (4,236,102) |
| Changes in non-cash balances related to operations (Note 13 (a)) | 2,390,259 | 2,506,192 |
| CASH FLOWS USED IN OPERATING ACTIVITIES | (2,261,064) | (1,729,910) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of property, plant and equipment | (2,896,877) | (1,855,177) |
| Purchase of intangible assets | (125,191) | (128,428) |
| Purchase (disposal) of short-term investments | (2,348,418) | 9,554,542 |
| Payments for the acquisition of MilePoint, Inc. | (800,000) | (2,300,000) |
| Costs related to the acquisition of MilePoint, Inc. (Note 14) | (306,138) | (728,556) |
| CASH FLOWS USED IN INVESTING ACTIVITIES | (6,476,624) | 4,542,381 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Issuance of Series Four Preferred Share (Note 9) | 3,454,611 | - |
| Loan payable, net of repayments (Note 7) | (28,425) | 97,047 |
| Deferred financing costs | - | 13,967 |
| Issuance of capital stock, net of share issue costs (Note 10) | 12,266,487 | 734,101 |
| CASH FLOWS PROVIDED BY FINANCING ACTIVITIES | 15,692,673 | 845,115 |
| Effect of exchange rate changes on cash held in foreign currency | (726,197) | (623,061) |
| INCREASE IN CASH AND CASH EQUIVALENTS | 6,228,789 | 3,034,524 |
| CASH AND CASH EQUIVALENTS - Beginning of the year | 13,754,818 | 10,720,294 |
| **CASH AND CASH EQUIVALENTS - End of the year** | **$ 19,983,607** | **$ 13,754,818** |

POINTS INTERNATIONAL LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005 and 2004

## 1. BASIS OF PRESENTATION AND BUSINESS OF THE CORPORATION

The accompanying consolidated financial statements of **Points International Ltd.** (the "Corporation") include the financial position, results of operations and cash flows of the Corporation and its wholly owned subsidiaries, Exclamation Inc., **Points International (US) Ltd.** and **Points International (UK) Limited** and its indirect wholly owned subsidiary, **Points.com Inc.**

The Corporation operates the **Points.com** Web site. **Points.com** is an online service allowing consumers to exchange points and miles from one participating loyalty program to another to achieve the rewards they want faster than ever before. **Points.com** also serves as a central resource to help individuals track their account balances with a number of loyalty programs.

In addition, the Corporation develops technology solutions for the loyalty program industry. The Corporation's portfolio of custom solutions facilitates the online sale, transfer and exchange of miles, points and currencies for a number of major loyalty programs.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### a) Use of Estimates

The preparation of these consolidated financial statements, in conformity with Canadian generally accepted accounting principles, has required management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities as at December 31, 2005 and 2004 and the revenues and expenses reported for the years then ended. Actual results may differ from those estimates.

### b) Revenue Recognition

Revenues from transaction processing are recognized as the services are provided under the terms of related contracts. Membership fees received in advance for services to be provided over a future period are recorded as deferred revenue and recognized as revenue evenly over the term of service. Related direct costs are also recognized over the term of the membership.

Revenues from the sale of loyalty program points are recorded net of costs, in accordance with Abstract 123 of the Emerging Issues Committee ("EIC") of the Canadian Institute of Chartered Accountants ("CICA"), "Reporting Revenue Gross as a Principal Versus Net as an Agent," when the collection of the sales proceeds is reasonably assured and other material conditions of the exchange are met. Gross proceeds received on the resale of loyalty program points, net of the commissions earned, are included in deposits in the attached consolidated balance sheet until remitted.

Nonrefundable partner sign-up fees with no fixed term, and for which the Corporation is under no further obligations, are recognized as revenue when received.

Custom Web site design revenues are recorded on a percentage of completion basis.

### c) Cash and Cash Equivalents

Cash and cash equivalents include amounts on deposit at the Corporation's bank and amounts held for the Corporation by a third party credit card processor. Such amounts represent a reserve in respect of purchases of miles/points. Cash and cash equivalents also include investments in short and mid-term bonds maturing within 90 days.

### d) Short-term Investments

Short-term investments include investment that have a duration of longer than 90 days. Short-term investments are accounted for at the lower of cost and net realizable value.

### e) Property, Plant and Equipment

Property, plant and equipment are recorded at cost less accumulated amortization. Rates and basis of amortization applied by the Corporation to write off the cost of the property, plant and equipment over their estimated useful lives are as follows:

| | |
|---|---|
| Furniture and equipment | 20% declining balance basis |
| Computer equipment | 30% declining balance basis |
| Software | 30% straight-line basis |
| Web site development and technology costs | straight-line over 3 years |
| Leasehold improvements | straight-line over 5 years |

### f) Goodwill and Intangible Assets

The Corporation follows Section 3062 ("Goodwill and Other Intangible Assets") of the CICA Handbook, in accounting for the value of its public listing. Since the public listing has an indefinite life, no amortization is recorded. These public company listing costs were capitalized by the Corporation in the period prior to the implementation of the recommendation of Section 3061 and 3062 of the CICA Handbook.

Patents will be amortized over the remaining life of the patent commencing when the patents have been granted. The remaining life of the patent is determined as 20 years less the time between the date of filing and the patent grant date. Registered trademarks have an indefinite life and will not be amortized unless determined to have become impaired.

Acquired technology, representing the excess of the cost over the values attributed to the underlying net assets of the acquired shares of **Points.com Inc.** will be amortized on a straight-line basis over a period of three years.

The acquisition of **MilePoint, Inc.** represents the fair value of contracts acquired by the Corporation as described in Note 14. The carrying value of these contracts is amortized on a straight line basis over the life of the contracts.

Goodwill represents the excess of the purchase price of acquired companies over the estimated fair value of the tangible and intangible net assets acquired. Goodwill is not amortized. The Corporation currently compares the carrying amount of the goodwill to the fair value, at least annually, and recognizes in net income any impairment in value.

If the Corporation determines that there is permanent impairment in the value of the unamortized portion of the intangible assets, as future earnings will not be realized as projected, an appropriate amount of unamortized balance of intangible assets will be charged to income as an "impairment charge" at that time.

### g) Long-Term Investments

Investments in shares of companies over which the Corporation exercises significant influence are accounted for using the equity method.

Investments in shares of companies over which the Corporation does not exercise significant influence are accounted for using the cost basis.

The Corporation reviews all of its long-term investments regularly and provides for any decline, other than a temporary decline, in the value of the investment to the estimated net recoverable amount.

### h) Deferred Costs

Costs incurred in respect of certain financings are deferred and charged to income over the term of financing. Deferred finance charges represent legal and other related fees incurred to obtain the financing described in Notes 8 and 9. Costs incurred on expanding relationships are amortized over the term of the extended relationships.

### i) Capital Leases

Leases that transfer substantially all of the benefits and risks of ownership of the property to the Corporation are treated as acquisitions of an asset and an obligation.

### j) Costs of Raising Capital

Incremental costs incurred in respect of raising capital are charged against equity proceeds raised.

### k) Translation of Foreign Currency

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at exchange rates prevailing at the balance sheet date for monetary items. Income and expenses are translated at average exchange rates prevailing during the year. Realized and unrealized foreign exchange gains and losses are accounted for and disclosed separately and consequently are included in net earnings.

The results of foreign operations that are financially and operationally integrated with the Corporation are translated using the temporal method. Under this method, monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the rate of exchange prevailing at year-end. Fixed assets have been translated at the rates prevailing at the dates of acquisition. Revenue and expense items are translated at the average rate of exchange for the year.

### l) Income Taxes

The Corporation follows the asset and liability approach to accounting for income taxes.

The income tax provision differs from that calculated by applying the statutory rates to the changes in current or future income tax assets or liabilities during the year.

Current income taxes payable differ from the total tax provisions as a result of changes in taxable and deductible temporary differences between the tax basis of assets and liabilities and their carrying amounts in the balance sheet.

### m) Non-Monetary Transactions

Transactions in which shares or other non-cash consideration are exchanged for assets or services are valued at the fair value of the assets or services involved in accordance with Section 3830 ("Non monetary Transactions") of the CICA Handbook.

### n) Earnings Per Share

The Corporation uses Section 3500 ("Earnings per Share") of the CICA Handbook, which directs that the treasury stock method be used to calculate diluted earnings per share.

Diluted earnings per share considers the dilutive impact of the exercise of outstanding stock options, Warrants, conversion of preferred shares and the convertible debenture, as if the events had occurred at the beginning of the period or at a time of issuance, if later. When the effect of computing diluted loss per share is anti-dilutive, this information is not presented.

o) Stock-based Compensation

*Employees*

For stock-based compensation issued to employees, the Corporation recognizes an expense. The Corporation accounts for its grants in accordance with the fair-value based method of accounting for stock-based compensation.

*Non-employees*

For stock-based compensation issued to non-employees, the Corporation recognizes an asset or expense based on the fair value of the equity instrument issued.

## 3. ADJUSTMENT TO STOCK-BASED COMPENSATION

Effective January 1st, 2004, in accordance with the CICA Handbook Section 3870 "Stock Based Compensation and Other Stock Based Payments", the Corporation adopted the changes required by this policy. The Corporation adopted this policy change in its 2004 audited consolidated financial statements and accounted for compensation and payments for options granted beginning on or after January 1, 2002. As permitted by this standard, the change in accounting policy was applied retroactively without restatement of the prior years' financial statements. Through the adoption of this policy, the Corporation misinterpreted the treatment for a series of employee stock options held in the wholly-owned subsidiary **Points.com Inc.** These **Points.com Inc.** options were issued on various dates in 2000. On February 8, 2002, the option holders were granted a put right which allowed them to have the right to put to the Corporation the Common Shares of **Points.com Inc.** acquired on the exercise of such options for Common Shares in the Corporation.

The extension of the put right should have been included in the Corporation's adoption of the above change in accounting policy for fiscal 2004, as it constitutes a commitment to issue Common Shares. As a result of this correction, the 2004 opening deficit was increased by $2,769,880 to $28,696,241 and the 2004 opening capital stock was increased by $666,489, and a $2,103,391 increase to contributed surplus was recorded. During fiscal 2004, contributed surplus was reduced by $358,770 and capital stock was increased by the same amount as a portion of the outstanding stock options were exercised. The above adjustment has no impact on total Shareholders' Equity or any other balance sheet accounts.

## 4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash held at the Corporation's bank and currently invested through an interest rate agreement earning prime rate less 225 basis points for Canadian funds (approximately 2%) and 80% of the U.S. T-Bill rate for U.S. funds (approximately 1%), and cash held by the third-party credit card processor. Cash and cash equivalents also include investments in short and mid-term bonds maturing within 90 days. The investments could be liquidated at any time at the option of the Corporation with no loss in value.

Cash and cash equivalents consists of:

| | 2005 | 2004 |
|---|---|---|
| Cash | $ 9,827,614 | $ 10,086,111 |
| Cash equivalents | 6,409,034 | 544,945 |
| Cash held by credit card processor | 3,746,959 | 3,123,762 |
| | **$ 19,983,607** | **$ 13,754,818** |

## 5. PROPERTY, PLANT AND EQUIPMENT

| 2005 | Cost | Accumulated Amortization | Net Carrying Amount |
|---|---|---|---|
| Furniture and equipment | $ 495,056 | $ 235,333 | $ 259,723 |
| Computer equipment | 668,581 | 387,143 | 281,438 |
| Software | 1,244,700 | 545,017 | 699,684 |
| Technology & Web site development | 6,797,363 | 4,864,840 | 1,932,523 |
| Leasehold Improvements | 798,759 | 365,287 | 433,472 |
| | **$ 10,004,459** | **$ 6,397,393** | **$ 3,606,840** |

| 2004 | Cost | Accumulated Amortization | Net Carrying Amount |
|---|---|---|---|
| Furniture and equipment | $ 468,355 | $ 173,740 | $ 294,615 |
| Computer equipment | 590,619 | 282,616 | 308,003 |
| Software | 443,340 | 372,728 | 70,612 |
| Technology & Web site development | 4,852,551 | 3,982,101 | 870,450 |
| Leasehold Improvements | 752,718 | 240,116 | 512,602 |
| | **$ 7,107,583** | **$ 5,051,301** | **$ 2,056,282** |

## 6. GOODWILL AND INTANGIBLE ASSETS

| 2005 | Cost | Accumulated Amortization | Net Carrying Amount |
|---|---|---|---|
| Public listing | $ 150,000 | $ 100,000 | $ 50,000 |
| **MilePoint, Inc.** acquisition (Note 14) | 8,580,888 | 1,617,444 | 6,963,444 |
| Patents and trademarks | 589,058 | - | 589,058 |
| Acquired technology | 2,258,603 | 2,258,603 | - |
| | **$ 11,578,549** | **$ 3,976,047** | **$ 7,602,503** |

| 2004 | Cost | Accumulated Amortization | Net Carrying Amount |
|---|---|---|---|
| Public listing | $ 150,000 | $ 100,000 | $ 50,000 |
| **MilePoint, Inc.** acquisition (Note 14) | 8,242,146 | 655,945 | 7,586,201 |
| Patents and trademarks | 462,376 | - | 462,376 |
| Acquired technology | 2,258,603 | 2,074,727 | 183,876 |
| | **$ 11,113,125** | **$ 2,830,672** | **$ 8,282,453** |

## 7. LOAN PAYABLE

In August, 2004 the Corporation entered into an agreement with the landlord, whereby the landlord loaned the Corporation $107,000 in respect of amounts that the Corporation had spent on leasehold improvements. The loan is repayable over 43 months and bears an interest rate of 10%.

### 8. CONVERTIBLE DEBENTURE

The Corporation has outstanding $6 million principal amount of 8% convertible debentures (the "Debentures"). The original instrument was issued to CIBC Capital Partners, a division of Canadian Imperial Bank of Commerce ("CIBC") on March 15, 2001 and was subsequently amended and restated prior to the sale thereof by CIBC on April 4, 2005 to a group of investors. These purchasers also acquired from CIBC the Series One Preferred Share.

The Debentures were amended to, among other things, (i) reduce the interest rate from 11% to 8% effective March 15, 2005, (ii) eliminate all negative covenants, (iii) eliminate certain positive covenants, (iv) remove certain events of default and (v) release all security over the assets of **Points** and its subsidiaries.

The Debentures will mature on March 15, 2008 if not previously converted. The Corporation is entitled to pre-pay the Debentures, without interest, within 30 days of a Series One Change in Control of the Corporation resulting from the exercise of the PII Warrants (defined in Note 11); the Debentures may not otherwise be prepaid. If the PII Warrants expire, the $6 million principal amount of the Debentures will be automatically converted on April 12, 2006 into 18,908,070 Common Shares and accrued interest on any principal amount as converted ceases to be payable. The Debentures will also automatically convert into Common Shares in certain other circumstances, including the sale of all outstanding Common Shares for a price per share of at least $1.26928, the sale of all or substantially all of the assets of the Corporation yielding net proceeds per Common Share (after giving effect to the conversion of the Debentures) of at least $1.26928. The Debentures are not convertible into Common Shares at the option of the holders so long as the PII Warrants is outstanding and held by IAC/InterActiveCorp or an affiliate thereof. The Debentures have been classified as long-term for fiscal 2005 since their repayment is only in connection with the exercise of the PII Warrants that would result from a third party transaction.

### 9. PREFERRED SHARES

#### a) Series One Preference Share

The Series One Preferred Share was created by Articles of Amendment dated December 20, 2001, was issued on February 8, 2002 and is a non-voting convertible share.

The Series One Preferred Share will automatically convert into one Common Share upon (i) conversion into Common Shares of greater than $2 million of the $6 million principal amount of the Debentures (defined under "Debentures" below), (ii) repayment in full of the Debentures or (iii) payment of the Dividend (defined below) (each a "Conversion Event").

The Series One Preferred Share is not entitled to dividends other than as set out below:

The holder of the Series One Preferred Share is entitled to a dividend (the "Dividend") in the event that, prior to a Conversion Event, (i) there is a merger or consolidation of the Corporation (or a subsidiary of Corporation which owns all or substantially all of the assets of the Corporation) with another corporation where, following such event, the shareholders of the Corporation will not hold at least a majority of the voting power of the surviving/acquiring corporation, (ii) any person (other than Canadian Imperial Bank of Commerce or its affiliates or associates) or persons acting jointly or in concert acquire greater than 50% voting control or greater than 50% of the equity of the Corporation (a "Series One Change of Control"), or (iii) there is a sale of all or substantially all of the assets of the Corporation. The Dividend is approximately equal to $4 million plus an amount calculated on the basis of a notional dissolution of the Corporation where the holder of the Series One Preferred Share is entitled to share pro rata (on the basis that the Series One Preferred Share represents that number of Common Shares into which the Debentures are then convertible) with the holders of all other participating shares in distributions from the assets of the Corporation and assuming, for this purpose, that the value of the assets of the Corporation available for distribution on this notional dissolution is the value attributable to the equity of the Corporation implied by the transaction giving rise to the dividend event, as adjusted for the value of non Common Share equity not valued in the transaction giving rise to the Dividend. In no event may the Dividend exceed $24 million. Where an event occurs giving rise to the Dividend, the holder of the Debentures is entitled to accelerate all amounts owing under the Debentures and the Corporation is entitled to repay the Debentures.

In the event of the exercise of the PII Warrants resulting in a Series One Change of Control under the Series One Preferred Share, the application of the terms of the Series One Preferred Share in that situation results in the Dividend equaling the lesser of (i) $24 million and (ii) $4 million plus the number of Common Shares into which the Debentures are then convertible, multiplied by the exercise price paid per Common Share on the exercise of the Warrants.

In the event of the liquidation, dissolution or winding-up of the Corporation prior to a Conversion Event, the holder of the Series One Preferred Share is entitled to (a) receive $4 million before any payment to holders of any Common Shares and (b) share pro-rata (on the basis that the Series One Preferred Share represents that number of Common Shares into which the Debentures are convertible immediately prior to the liquidation event), with the holders of the Common Shares and all other participating shares ranking junior to the Series One Preferred Share in further distributions from the assets of the Corporation to an aggregate maximum of $20 million in addition to the sum specified in (a).

**b) Series Two Preferred Share**

The Series Two Preferred Share was created by Articles of Amendment dated April 10, 2003 and was issued on April 11, 2003. It is a voting, convertible share and ranks equally with the Series One Preferred Share, the Series Three Preferred Share, the Series Four Preferred Share and the Series Five Preferred Share, in priority to the Common Shares. The Series Two Preferred Share is convertible until 5:00 p.m. on March 31, 2013 (Eastern Standard Time), for no additional consideration, into 19,999,105 Common Shares (as at March 10, 2006), subject to adjustment in accordance with its anti-dilution protection provisions (the "Underlying Shares"). In addition to anti-dilution adjustments for stock splits, consolidations, etc., the number of Common Shares issuable on the conversion of the Series Two Preferred Shares is subject to adjustment in connection with any issuance of Common Shares to extinguish rights to acquire securities in the Corporation's subsidiaries and in connection with the conversion of the CIBC Debentures, if convertible.

The Corporation is not entitled to declare or pay any dividend on the Common Shares unless it concurrently declares and pays a dividend on the Series Two Preferred Share in an amount equal to the product of the number of Common Shares comprising the Underlying Shares and the dividend declared or paid per Common Share. Any such dividend is to be paid to the holder of the Series Two Preferred Share in the same form as it is paid to the holders of the Common Shares.

The Series Two Preferred Share will automatically convert into one Series Three Preferred Share on the earlier of the date that (i) the Series Two Preferred Share is directly or indirectly transferred to a person that is not an affiliate of IAC/InterActiveCorp, and (ii) the holder of the Series Two Preferred Share ceases to be an affiliate of IAC/InterActiveCorp.

If not converted, the Series Two Preferred Share will be redeemed upon the earlier of (i) March 31, 2013 and (ii) the third business day following a Change of Control of the Corporation (defined on page 54). If (i) occurs, the Series Two Preferred Share will be redeemed by the Corporation for the greater of $12,400,000 plus 7% per annum calculated on a daily basis from the date of issue of the Series Two Preferred Share to the date on which the Series Two Preferred Share is redeemed and the market value of the Common Shares into which the Series Two Preferred Share then could be converted. If (ii) occurs, the Series Two Preferred Share will be redeemed for an amount equal to the greater of (i) 125%

of $12,400,000 plus 7% per annum calculated on a daily basis from the date of issue of the Series Two Preferred Share and (ii) the product of the number of Underlying Shares and the greater of (A) the weighted average closing price of the Common Shares on the principal stock exchange on which the Common Shares then are traded for the 10 days ending on the trading day immediately prior to public announcement of the Change of Control and (B) the fair market value of the consideration paid per Common Share in the transaction resulting in the Change of Control.

A "Change of Control" of the Corporation will be deemed to have occurred if, before the expiry of the PII Warrants, any combination of a person (other than the holder of the Series Two Preferred Share Series), its affiliates or associates and persons acting jointly or in concert with any of them becomes the beneficial owner of shares of the Corporation sufficient to elect a majority of the Board of Directors.

In the event of the liquidation, dissolution or winding up of the Corporation or other distribution of assets of the Corporation among its shareholders for the purpose of winding up its affairs, the holder of the Series Two Preferred Share will be entitled to receive from the assets of the Corporation an amount equal to the greater of (i) $12,400,000 plus 7% per annum calculated on a daily basis from the date of issue of the Series Two Preferred Share to the date on which the liquidation event occurred and (ii) the product of the number of Underlying Shares and the per share amount to be distributed to the holders of the Common Shares upon the liquidation event after giving effect to any payments to be paid on the Series Two Preferred Share and any other shares (other than the Series Two Preferred Share) ranking prior to the Common Shares upon the liquidation event.

The Series Two Preferred Share entitles the holder to the right to vote with the holders of Common Shares on an "as converted" basis (until the PII Warrants have been exercised, in whole or in part, to a maximum of 19.9% of the votes that may be cast), vote separately as a series with respect to certain material transactions and certain other matters involving the Corporation, and elect two members to the board of directors of the Corporation and have one member sit on each committee of the Board of Directors.

**c) Series Four Preferred Share**

In 2005, the Corporation issued one Series Four Preferred Share for aggregate cash consideration of $3,454,611.

The Series Four Preferred Share is a voting, convertible share and ranks equally with the Series One Preferred Share, the Series Two Preferred Share, the Series Three Preferred Share and the Series Five Preferred Share, and in priority to the Common Shares. The Series Four Preferred Share is convertible until March 31, 2013, for no additional consideration, into 4,504,069 Common Shares (as at the date hereof), subject to adjustment in accordance with its anti-dilution protection provisions. In all material respects, including anti-dilution protection, the terms of the Series Four Preferred Share are identical to the Series Two Preferred Share.

If not converted, the Series Four Preferred Share will be redeemed by the Corporation on March 31, 2013 for the greater of $3,454,611 plus 7% per annum calculated on a daily basis from the date of issue of the Series Four Preferred Share and the market value of the Common Shares into which the Series Four Preferred Share then could be converted. The Series Four Preferred Share will also be redeemed if certain Change of Control events occur, for an amount equal to the greater of (i) 125% $3,454,611 plus 7% per annum calculated on a daily basis from the date of issue of the Series Four Preferred Share and (ii) the greater of (A) the value of the Common Shares into which the Series Four Preferred Share then could be converted on the day immediately prior to public announcement of the Change of Control and (B) the product of the Common Shares into which the Series Four Preferred Share then could be converted and the value of the consideration paid per Common Share in the transaction resulting in the Change of Control. For this purpose a “Change of Control” of the Corporation will be deemed to have occurred if, before the expiry of the PII Warrant, any combination of a person (other than the holder of the Series Four Preferred Share), its affiliates or associates and persons acting jointly or in concert with any of them becomes the beneficial owner of shares of the Corporation suffiecient to elect a majority of the Board of Directors.

In the event of the liquidation, dissolution or winding up of the Corporation, the holder of the Series Four Preferred Share will be entitled to receive an amount equal to the greater of $3,454,611 plus 7% per annum from the date of issuance and the product of the number of Common Shares into which it could then be converted and the per share amount to be distributed to the holders of the Common Shares after giving effect to any payments to be paid on shares ranking prior to the Common Shares. The Series Four Preferred Share entitles the holder to various rights, including to receive dividends with the holders of Common Shares on an "as converted" basis, vote with the holders of Common Shares on an "as converted" basis (in certain circumstances, to a maximum of 19.9% of the votes that may be cast including the votes cast by the holder of the Series Two Preferred Share), vote separately as a series with respect to certain material transactions and certain other matters involving the Corporation, and elect one member to the board of directors of the Corporation. If the Series Four Preferred Share ceases to be held by an IAC/InterActiveCorp or an affiliate of IAC/InterActiveCorp, it will automatically convert into a Series Five Preferred Share.

## 10. CAPITAL STOCK

### Authorized

| | |
|---|---|
| Unlimited | Common Shares |
| 1 | Series One Preferred Share, non-voting, convertible into one Common Share |
| 1 | Series Two Preferred Share |
| 1 | Series Three Preferred Share |
| 1 | Series Four Preferred Share |
| 1 | Series Five Preferred Share |

### Issued

The balance of capital stock is summarized as follows:

| | 2005 | 2004 |
|---|---|---|
| Common Shares | $ 36,404,339 | $ 23,730,991 |
| Series One Preferred Share | 1 | 1 |
| Series Two Preferred Share | 1 | 1 |
| Series Four Preferred Share | 1 | - |
| | **$ 36,404,342** | **$23,730,993** |

| Common Shares | Number | Amounts |
|---|---|---|
| Balance January 1, 2004 | 62,609,622 | $ 18,449,907 |
| Issued on the acquisition of MilePoint, Inc.(i) | 4,000,000 | 4,000,000 |
| Issued on exercise of Warrants(ii) | 2,318,006 | 752,984 |
| Issued on exercise of stock options(iii) | 816,789 | 194,008 |
| Issued on exchange for property (shares in subsidiary)(iv) | 1,313,433 | 369,317 |
| | **71,057,850** | **23,766,215** |
| Less: share issue costs | - | 35,224 |
| Balance December 31, 2004 | **71,057,850** | **23,730,991** |
| Issued on exercise of Warrants(v) | 458,667 | 37,825 |
| Issued on exercise of stock options(vi) | 2,102,227 | 1,025,318 |
| Issued on exchange for property (shares in subsidiary)(vii) | 1,964,664 | 555,870 |
| Issued in private placement(viii) | 18,134,300 | 12,385,405 |
| | **93,717,708** | **37,735,409** |
| Less: share issue costs | - | 1,331,070 |
| **Balance December 31, 2005** | **93,717,708** | **$ 36,404,339** |

**(i)** 4,000,000 shares (valued at $4 million) of the Corporation were issued as part consideration in the acquisition of MilePoint, Inc. (see Note 14).

**(ii)** 2,268,006 common share purchase Warrants, issued in connection with restructuring and acquisition of the interest in Points.com Inc. that the Corporation did not already own, were exercised at $0.25 per share. In addition, 50,000 Warrants issued in respect of a financing engagement were exercised at $0.25 per share.

**(iii)** 816,789 options previously issued to employees, directors, advisors and consultants were exercised at prices ranging from $0.20 to $0.50 per share.

**(iv)** 524,554 options previously issued to Points.com Inc. founders, employees, directors and advisors were exercised in Points.com Inc. and put to the Corporation at fair market value for 1,313,433 of the Corporation's common shares.

**(v)** 458,667 common share purchase Warrants (valued at $37,825), issued in connection with restructuring and acquisition of the interest in Points.com Inc. that the Corporation did not already own, were exercised for nil consideration.

**(vi)** 2,102,227 options previously issued to employees, directors, advisors and consultants were exercised at prices ranging from $0.20 to $0.50 per share.

**(vii)** 784,641 options previously issued to **Points.com Inc.** founders, employees, directors and advisors were exercised in **Points.com Inc.** and put to the Corporation at fair market value for 1,964,664 of the Corporation's common shares.

**(viii)** On April 4, 2005, the Corporation issued 18,134,300 common shares at $0.683 per share in a Private Placement.

## 11. OPTIONS AND WARRANTS

### a) Stock option plan

The Corporation has a stock option plan under which employees, directors and consultants are periodically granted stock options to purchase common shares at prices not less than the market price of the share on the day of grant. The options vest over a three year period and expire five years from the grant date.

| | 2005 | 2004 |
|---|---|---|
| Options Authorized by Shareholders | 10,206,948 | 10,206,948 |
| Less: Options Exercised | (4,484,539) | (2,382,312) |
| Net Options Authorized | 5,722,409 | 7,824,636 |
| Less: Options Granted | (4,866,913) | (6,184,558) |
| Options Available to Grant | 855,496 | 1,640,078 |

### b) Stock options

#### Stock-based compensation plan

At December 31, 2005, the Corporation had one stock-based compensation plan, which is described in Note 11 (a). The Corporation accounts for stock options granted in this plan in accordance with the fair value based method of accounting for stock-based compensation. The compensation cost that has been charged against income for this plan is $408,435 for 2005.

#### Fair Value

The fair value of each option grant is estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2003, 2004 and 2005, respectively: dividend yield of nil for all three years; expected volatility of 73, 46 and 30%, risk-free interest rates of 4.0, 4.0 and 3.6% and expected lives of 3.0, 3.0, and 3.0 years.

A summary of the status of the Corporation's stock option plan as of December 31, 2004 and 2005, and changes during the years ending on those dates is presented below.

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Beginning of Year | 6,184,558 | $ 0.71 | 5,598,127 | $ 0.51 |
| Granted | 1,162,836 | 0.84 | 1,639,407 | 1.17 |
| Exercised | (2,102,227) | 0.47 | (816,789) | 0.22 |
| Forfeited | (378,254) | 0.83 | (236,187) | 1.04 |
| End of year | 4,866,913 | $ 0.83 | 6,184,558 | $ 0.71 |
| **Exercisable at end of year** | **2,429,095** | **$ 0.69** | **3,832,429** | **$ 0.50** |
| **Weighted average fair value of options granted** | **$ 0.20** | | **$ 0.41** | |

| | OPTIONS OUTSTANDING | | | OPTIONS EXERCISABLE | |
|---|---|---|---|---|---|
| **Range of Exercise Price** | **Number of Options** | **Weighted Average Remaining Contractual Life (years)** | **Weighted Average Exercise Price** | **Number of Options** | **Weighted Average Exercise Price** |
| $ 0.01 to $ 0.49 | 888,510 | 1.30 | $ 0.25 | 800,000 | $ 0.26 |
| $ 0.50 to $ 0.99 | 2,084,836 | 2.83 | $ 0.75 | 777,145 | $ 0.61 |
| $ 1.00 and over | 1,893,567 | 3.15 | $ 1.19 | 918,750 | $ 1.16 |

Subsequent to year-end, as described in Note 21, 5,000 options were exercised.

**c) Stock options of Points.com Inc.**

In addition to the stock options described above, Points.com Inc., the Corporation's indirect wholly-owned subsidiary has one stock compensation plan. No further Points.com Inc. common shares are authorized for issuance under this plan. Under this plan, Points.com Inc. founders, employees, directors and advisors were previously issued and, therefore, have outstanding stock options. No options were granted in this plan in 2003, 2004 or 2005. The options outstanding are as follows:

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Beginning of Year | 2,590,498 | $ 0.04 | 3,115,052 | $ 0.04 |
| Granted | - | - | - | - |
| Exercised | (784,641) | 0.05 | (524,554) | 0.02 |
| Forfeited | - | - | - | - |
| End of year | 1,805,857 | $ 0.04 | 2,590,498 | $ 0.04 |
| **Exercisable at end of year** | **1,805,857** | **$ 0.04** | **2,590,498** | **$ 0.04** |

| | OPTIONS OUTSTANDING | | | OPTIONS EXERCISABLE | |
|---|---|---|---|---|---|
| **Range of Exercise Price** | **Number of Options** | **Weighted Average Remaining Contractual Life (years)** | **Weighted Average Exercise Price** | **Number of Options** | **Weighted Average Exercise Price** |
| $ 0.01 to $ 0.49 | 1,805,857 | 1.13 | $ 0.04 | 1,805,857 | $ 0.04 |

The holders of 1,805,857 options (all with strike prices at or below $0.055 per share) have the right to put to the Corporation the common shares of **Points.com Inc.** acquired on the exercise of such options for common shares in the Corporation. The Corporation has used a ratio of 2.5039 common shares per **Points.com Inc.** common share (equivalent to 4,521,684 common shares) for this purpose. In 2005, 784,641 options were exercised and all of the **Points.com Inc.** common shares received were put to the Corporation for 1,964,664 common shares of the Corporation.

### d) Warrants

The Corporation issued Warrants (the "PII Warrants") on April 11, 2003 to **Points Investments Inc.** ("PII") that are exercisable to acquire up to 55% of the Common Shares (calculated on an adjusted fully diluted basis) less the number of Common Shares issued or issuable on conversion of the Series Two Preferred Share and/or Series Four Preferred Share. The PII Warrants expire on April 11, 2006. If PII had exercised the PII Warrants in full on March 10, 2006, IAC/InterActiveCorp would have indirectly received 102,861,615 Common Shares.

| | 2004 | | 2005 | |
|---|---|---|---|---|
| | **Number of Warrants** | **Weighted Average Exercise Price** | **Number of Warrants** | **Weighted Average Exercise Price** |
| Beginning of Year | 84,160,489 | $ 1.03 | 79,431,399 | $ 0.94 |
| Granted(1) | 906,248 | 0.83 | - | n/a |
| Issued - Anti-Dilution Provision | 19,225,127 | 0.01 | 7,049,596 | 1.03 |
| Exercised | (458,667) | 0.25 | (2,318,006) | 0.25 |
| Forfeited | (303,667) | 0.25 | (2,500) | 0.28 |
| End of year | 103,529,530 | $ 0.93 | 84,160,489 | $ 1.03 |
| **Exercisable at end of year** | **103,529,530** | **$ 0.93** | **84,160,489** | **$ 1.03** |

**Note** : (1) The strike price of the PII Warrants (Note 9) will change in accordance with its anti-dilution provisions. For example, as the number of Common Shares that the PII Warrants is exercisable into increases, the strike price will decrease proportionately.

| | WARRANTS OUTSTANDING | | | WARRANTS EXERCISABLE | |
|---|---|---|---|---|---|
| **Range of Exercise Price** | **Number Warrants** | **Weighted Average Remaining Contractual Life (years)** | **Weighted Average Exercise Price** | **Number of Warrants** | **Weighted Average Exercise Price** |
| $ 0.01 to $ 0.49 | - | - | $ 0.25 | - | - |
| $ 0.50 to $ 0.99 | 103,529,530 | 0.30 | $ 0.93 | 103,529,530 | $ 0.93 |
| $ 1.00 and over | - | - | $ 1.03 | - | - |

In connection with the Private Placement, 906,248 broker Warrants valued at $186,687 were issued.

### e) Warrants of Points.com Inc.

On September 5, 2003, the Corporation acquired Warrants and Warrant acquisition rights exercisable to acquire 4,827,255 common shares in the Corporation's indirect wholly owned subsidiary, Points.com Inc., from an airline partner.

In addition to the Warrants and Warrant acquisition rights acquired by the Corporation, Points.com Inc., has issued or committed to issue an additional 4,103,378 Warrants to airline partners with expiry dates between March 28, 2006 and April 1, 2007. Each warrant entitles the holder to acquire one common share of Points.com Inc. with an exercise price of US$1.96. The exercise of these Warrants would dilute the Corporation's interest in Points.com Inc. by 11%.

### f) Fair value

906,248 Warrants were granted during 2005 and no Warrants were granted in 2004. The weighted average grant date fair value of Warrants granted during 2005 has been estimated at $0.21 using the Black Scholes option pricing model. The pricing model assumes a weighted average risk-free interest rate of 3.8%, weighted average expected dividend yield of nil, weighted average expected common stock price volatility of 30% and a weighted average expected life of 3 years.

## 12. LOSS PER SHARE

### a) Loss per share

Loss per share is calculated on the basis of the weighted average number of common shares outstanding for the year that amounted to 88,093,523 shares (2004 – 67,744,345).

### b) Fully-diluted loss per share

The fully diluted loss per share has not been computed, as the effect would be anti dilutive.

## 13. STATEMENT OF CASH FLOWS

### a) Changes in non-cash balances related to operations are as follows:

| | 2005 | 2004 |
|---|---|---|
| (Increase) in accounts receivable | $ (818,592) | $ (1,149,990) |
| (Increase) in prepaids and sundry assets | (720,497) | (485,001) |
| (Increase) in deferred costs | - | (123,390) |
| Increase in accounts payable and accrued liabilities | 422,914 | 783,344 |
| Increase in deposits | 3,506,434 | 3,481,230 |
| | **$ 2,390,259** | **$ 2,506,192** |

### b) Supplemental information

Interest, taxes and loss on short-term investments

Interest of $15,054 (2004, $4,196) was paid during the year. In addition to this, the Corporation incurred $150,158 in losses on short-term investments and capital taxes of $45,763 were paid in 2005. Interest revenue of $420,229 (2004, $230,294) was received during the year.

**Non-cash transactions in 2005 were as follows:**

**(i)** 784,641 options previously issued to **Points.com Inc.** founders, employees, directors and advisors were exercised in **Points.com Inc.** and put to the Corporation at a fair market value of 1,964,664 of the Corporation's Common Shares. (Note 10 (vii)).

**(ii)** $36,348 of revenue earned for hosting services provided was paid in loyalty currency comprised of partner miles. The currency was valued at the purchase price of the miles and the amount is included in prepaid and sundry assets. The expense will be recognized as the currency is used.

**(iii)** $156,498 of revenue earned for membership fees provided was paid in one-week accommodation certificates. The certificates are valued at their average cost and are included in prepaid and sundry assets. The expense will be recognized as the accommodation certificates are used.

**(iv)** The Corporation received $137,972 of loyalty currency from a partner as reimbursement of a portion of the partner's direct expenses for the services provided by the Corporation. This amount is included in prepaid and sundry assets and will be expensed as the currency is used.

**(v)** Interest of $2,499 was accrued on the acquisition of **MilePoint, Inc.**

**(vi)** Interest of $778,806 was accrued on the convertible debenture (Note 8).

**(vii)** Interest on $1,049,367 was accrued on the Series Two Preferred Share (Note 9 (b)) and Series Four Preferred Share (Note 11 (d)).

**(viii)** 906,248 broker Warrants valued at $186,687 were issued in connection with the Private Placement Transaction (see Note 11 (d)). This amount has been recorded as an increase to Warrants with the offset as share issue costs charged against share capital.

**(ix)** 1,162,836 options were issued to employees and 378,254 options previously granted were cancelled (see Note 11 (b)).

**(x)** 458,667 broker Warrants were exercised for nil consideration (see Note 10 (v)).

**Non-cash transactions in 2004 were as follows:**

**(xi)** 524,554 shares of **Points.com Inc.** were acquired in exchange for 1,313,433 shares of the Corporation (Note 10 (iv)).

**(xii)** 4,000,000 shares (valued at $4 million) of the Corporation were issued as part consideration in the acquisition of **MilePoint, Inc.** (see Notes 14 and 10 (i)).

**(xiii)** $38,959 of revenue earned for hosting services provided was paid in loyalty currency comprised of partner miles. The currency was valued at the purchase price of the miles. The prepaid asset will be charged to income as the currency is used.

**(xiv)** $125,809 of revenue earned for membership fees provided was paid in one-week accommodation certificates. The certificates are valued at their average cost. The prepaid asset will be charged to income as the accommodation certificates are used

**(xv)** The Corporation received $136,416 of loyalty currency from a partner as reimbursement of a portion of the partner's direct expenses for the services provided by the Corporation.

**(xvi)** The Corporation's long-term investment of $161,629 in ThinApse Corporation was written off, as the asset was determined to be impaired.

**(xvii)** Interest of $2,499 was accrued on the acquisition of **MilePoint, Inc.**

**(xviii)** Interest of $884,001 was accrued on the convertible debenture (Note 8).

**(xiv)** Interest on $868,000 was accrued on the Series Two Preferred Share (Note 9 (b)).

## 14. MILEPOINT, INC. ACQUISITION

### MilePoint, Inc. Acquisition

On March 31, 2004, the Corporation acquired substantially all of the assets of **MilePoint, Inc.**, a loyalty program technology provider and operator. The purchase price of $7.5 million was satisfied through a combination of $3.5 million in cash payable over two years without interest, and four million common shares. The loan payable, which had a face value of $3.5 million, was discounted to its fair value as it is non-interest bearing and due over two years.

The cost of the acquisition and the fair values assigned are as follows:

| | |
|---|---|
| Intangibles | $ 225,000 |
| Contracts with Partners | 3,555,166 |
| Goodwill | 4,800,722 |
| | **$ 8,580,888** |
| **Consideration:** | |
| Cost of Transaction | $ 1,090,722 |
| Capital Stock Issued | 4,000,000 |
| Acquisition Loan Payable | 3,490,166 |
| | **$ 8,580,888** |

The acquired contracts with partners are amortized over the life of the contracts. The goodwill and other intangibles will not be amortized; goodwill and other intangibles were reviewed as at March 31, 2005 and were found not to have any impairment. Goodwill and other intangibles will be reviewed annually and any permanent impairment will be recorded and charged to income in the year that the impairment occurred.

In 2005, the Corporation incurred $306,138 of additional incremental costs in connection with the acquisition. These costs have been added to goodwill.

Remaining payments under the terms of the acquisition loan payable are as follows:

| | |
|---|---|
| **Acquisition Loan Payable:** | |
| Current Portion | $ 390,166 |
| Long-Term Portion | - |
| Accretion of Interest | 9,834 |
| **Total** | **$ 400,000** |

## 15. FINANCIAL INSTRUMENTS

The Corporation's significant financial assets and liabilities are cash and cash equivalents, short term investments and convertible loans, which are substantially stated at fair value. Interest rates, maturities and security affecting the currency, interest and credit risk of the Corporation's financial assets and liabilities have been disclosed in Notes 4 and 8.
The Corporation is not exposed to financial risk that arises from fluctuations in interest rates as all of its interest-bearing obligations are fixed-rate. As well, the Corporation has sufficient foreign currency to satisfy its foreign currency based obligations.

**a) Fair Value:**

In accordance with the disclosure requirements of the CICA Handbook Section 3860 (paragraphs 3860.78, .101), the Corporation is required to disclose certain information concerning its "financial instruments," defined as a contractual right to receive or deliver cash or other financial asset. The fair value of the majority of the Corporation's financial assets and liabilities approximate their recorded values at December 31, 2005. In these circumstances, the fair value of the assets or liabilities is determined to be the lower of cost and market value.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect estimates.

**b) Summary of Significant Financial Instruments**

The significant financial instruments of the Corporation, their carrying values and exposure to U.S.-dollar denominated monetary assets and liabilities, are as follows:

| | C$ Total | US$ Denominated | Other Denominated |
|---|---|---|---|
| Cash and cash equivalents | $ 19,983,606 | US$ 13,965,677 | € 1,559,669 |
| | | | GBP 454,599 |
| | | | CHF 12,713 |
| Short-term investments | $ 2,348,418 | US$ 2,014,081 | |
| Accounts receivable | $ 2,797,921 | US$ 2,017,709 | € 105,009 |
| | | | GBP 17,500 |
| Accounts payable and accrued liabilities | $ 2,284,257 | US$ 805,323 | GBP 7,820 |
| Deposits | $ 15,810,853 | US$ 11,309,494 | € 1,164,924 |
| | | | GBP 419,422 |
| | | | CHF 5,919 |

## 16. INCOME TAXES

The total provision for income taxes differs from that amount which would be computed by applying the Canadian federal income tax rate to the loss before provision for income taxes. The reasons for these differences are as follows:

| | 2005 | 2004 |
|---|---|---|
| Income tax recovery at statutory rate | $ (3,584,000) | $ (2,917,000) |
| Non deductible items for which there is no tax effect | 11,000 | 16,000 |
| Temporary differences | 1,008,000 | 858,000 |
| Losses for which no benefit has been recorded | 2,565,000 | 2,043,000 |
| **Net income tax recovery** | **$ -** | **$ -** |

The Corporation has non-capital losses carry-forward for income tax purposes in the amount of approximately $32,693,000 which may be applied against future years' taxable income. The losses may be used to reduce future years' taxable income and expire approximately as follows:

| | |
|---|---|
| **2006** | **$ 890,000** |
| **2007** | **$ 2,767,000** |
| **2008** | **$ 6,976,000** |
| **2009** | **$ 5,932,000** |
| **2010** | **$ 3,597,000** |
| **2014** | **$ 5,428,000** |
| **2015** | **$ 7,103,000** |

The nature and tax effects of the temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities are as follows:

| **Future income tax assets are comprised of:** | **2005** | **2004** |
|---|---|---|
| Losses carried forward | $ 11,808,000 | $ 8,629,000 |
| Property, plant and equipment | 2,045,000 | 1,427,000 |
| Share issue costs | 393,000 | 77,000 |
| | 14,246,000 | 10,133,000 |
| Valuation allowance | (13,656,000) | (9,543,000) |
| **Net future income tax asset** | **$ 590,000** | **$ 590,000** |

## 17. RELATED PARTY TRANSACTIONS

The following are the transactions and balances with related parties:

In fiscal 2005, certain officers and directors exercised stock options in the Corporation and the Corporation's subsidiary **Points.com Inc**. (Note 10 (vi) and Note 10 (vii)).

## 18. COMMITMENTS

The Corporation is obligated under various operating leases for premises, purchase commitments and equipment and service agreements for web-hosting services expiring through 2009 to aggregate annual rentals as follows:

| | |
|---|---|
| **2006** | **$ 2,048,063** |
| **2007** | **$ 1,797,450** |
| **2008** | **$ 505,658** |
| **2009** | **$ 447,415** |
| **2010** | **$ 194,613** |

## 19. SEGMENTED INFORMATION

### a) Reportable Segments

The Corporation has only one operating segment, the portfolio of technology solutions to the loyalty program industry (refer to the Management Discussion and Analysis for a description of **Points Solutions**), in each of 2005 and 2004, whose operating results were regularly reviewed by the Corporation's chief operating decision maker and for which complete and discrete financial information is available.

**b) Enterprise-wide Disclosures - Geographic Information**

$9,274,067 (2004, $7,129,901) representing 93% of the Corporation's revenues were generated in the U.S., $248,330 (2004, $396,218) representing 3%, were generated in Canada and the remaining revenues generated outside North America.

At December 31, 2005 and 2004, substantially all of the Corporation's assets were in Canada.

## 20. MAJOR CUSTOMERS

Approximately 47% of the Corporation's revenues are from its three largest customers. In 2004, three customers represented 54% of the Corporation's revenues. In addition, 71% (2004, 61%) of the Corporation's deposits are due to these three customers.

## 21. SUBSEQUENT EVENTS

Subsequent to year-end, 5,000 options in the Corporation were exercised at a weighted average exercise price of $0.22 per share (Note 11(b)).

## 22. DEFERRED COSTS

Deferred costs include finance charges as well as costs incurred in connection with commercial contract arrangements. Deferred finance charges represent legal, accounting and other related fees incurred to obtain the financings.

| **2005** | **Cost** | **Accumulated Amortization** | **Net Carrying Amount** |
|---|---|---|---|
| Convertible Debenture | $ 986,289 | $ 986,289 | $ - |
| Series Two Preferred Share and Warrants | 717,050 | 197,189 | 519,861 |
| Technology Costs of Partner Relationships & Other | 135,529 | 58,524 | 77,005 |
| Share Issuance to Partner | 2,112,568 | 1,010,404 | 1,102,164 |
| | **$ 3,951,436** | **$ 2,252,406** | **$ 1,699,030** |

| **2004** | **Cost** | **Accumulated Amortization** | **Net Carrying Amount** |
|---|---|---|---|
| Convertible Debenture | $ 986,289 | $ 986,289 | $ - |
| Series Two Preferred Share and Warrants | 717,050 | 125,084 | 591,966 |
| Technology Costs of Partner Relationships & Other | 135,529 | 21,707 | 113,822 |
| Share Issuance to Partner | 2,112,568 | 575,088 | 1,537,480 |
| | **$ 3,951,436** | **$ 1,708,568** | **$ 2,242,868** |

$123,390 of **Points.com Solutions** technology costs incurred have been deferred over the expected lifetime of certain partner relationships. The technology costs will be amortized over a 30-month period.

## 23. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified in accordance with the current year's presentation.

## 24. U.S. GAAP RECONCILIATION

### Canada and United States Accounting Policy Differences

The consolidated financial statements of the Corporation have been prepared in accordance with Canadian GAAP. The significant differences between Canadian and U.S. GAAP, and their effect on the consolidated financial statements of the Corporation, are described below.

Consolidated statements of operations:

The following table reconciles net loss as reported in the accompanying consolidated statements of loss to net loss that would have been reported had the financial statements been prepared in accordance with U.S. GAAP:

| FOR THE YEARS ENDED DECEMBER 31 | 2003 | 2004 | 2005 |
|---|---|---|---|
| Net loss in accordance with Canadian GAAP | $ (6,991,673) | $ (8,808,284) | $ (9,924,235) |
| Web Site Development (a) | - | (295,585) | - |
| Web Site Development Amortization (a) | 174,605 | - | 73,896 |
| Non-employee stock options (b) | (130,063) | - | - |
| **Net Loss in accordance with U.S. GAAP** | **$ (6,947,131)** | **$ (9,103,868)** | **$ (9,850,339)** |
| **Loss per share** | **$ (0.12)** | **$ (0.13)** | **$ (0.11)** |

The cumulative effect of these adjustments on shareholders' equity is as follows:

| AS AT DECEMBER 31 | 2003 | 2004 | 2005 |
|---|---|---|---|
| Shareholders Equity in accordance with Canadian GAAP | $ (5,222,809) | $ (8,935,826) | $ (6,186,307) |
| Web Site Development (a) | (523,815) | (819,400) | (819,400) |
| Web Site Development Amortization (a) | 523,815 | 523,815 | 597,711 |
| Public Status (d) | (50,000) | (50,000) | (50,000) |
| **Shareholders Equity in accordance with U.S. GAAP** | **$ (5,272,809)** | **$ (9,281,411)** | **$ (6,457,996)** |

Effect of these adjustments on the consolidated statement of cash flows is as follows:

| AS AT DECEMBER 31 | 2003 | 2004 | 2005 |
|---|---|---|---|
| Assets in accordance with Canadian GAAP | $ 27,481,286 | $ 30,179,854 | $ 40,463,226 |
| Web Site Development Costs (a) | (523,815) | (819,400) | (819,400) |
| Web Site Development Amortization (a) | 523,815 | 523,815 | 597,711 |
| Public Status (d) | (50,000) | (50,000) | (50,000) |
| **Assets in accordance with U.S. GAAP** | **$ 27,431,286** | **$ 29,834,269** | **$ 40,191,537** |

Effect of these adjustments on the consolidated statement of cash flows is as follows:

| FOR THE YEARS ENDED DECEMBER 31 | 2003 | 2004 | 2005 |
|---|---|---|---|
| **Cash Flows used in Operating Activities** | | | |
| Cash flows used in operating activities in accordance with Canadian GAAP | $ (1,406,454) | $ (1,729,910) | $ (2,261,064) |
| Web Site Development (a) | - | (295,585) | - |
| **Cash flows used in operating activities in accordance with U.S. GAAP** | **$(1,406,454)** | **$ (2,025,495)** | **$ (2,261,064)** |
| **Cash Flows used in Investing Activities** | | | |
| Cash flows provided by (used in) investing activities in accordance with Canadian GAAP | $ (469,083) | $ 4,542,381 | $ (6,476,624) |
| Web Site Development (a) | - | 295,585 | - |
| **Cash flows provided by (used in) investing activities in accordance with U.S. GAAP** | **$ (469,083)** | **$ 4,837,966** | **$ (6,476,624)** |

a) Canadian GAAP allows the capitalization and amortization of Web site development costs incurred, subject to there being reasonable assurance that future benefits will be realized. Under United States GAAP, American Institute of Certified Public Accountants, Statement of Position "SOP" 98-1 provides specific guidance on when capitalization may commence, and what direct costs may be capitalized. For United States GAAP purposes, costs incurred in the preliminary project phase have been expensed at the time the costs were incurred and the amortization recorded under Canadian GAAP would have been reversed.

b) Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards 123 ("SFAS No. 123"), Accounting for Stock-based Compensation, requires recognition of compensation expense costs at fair value for stock options and Warrants issued after December 15, 1995, to non-employees, such as members of the Board of Advisors, and other consultants and advisors. The fair value of the non-employee stock options and Warrants granted after December 15, 1995 has been estimated as the performance occurs and the options are earned using the Black-Scholes option pricing model. Under Canadian GAAP, all stock-based compensation granted to non-employees prior to January 1, 2002 has not been accounted for; however, the Corporation has accounted for all stock-based compensation granted to non-employees after January 1st, 2002 using the fair value method.

Accordingly, for United States GAAP purposes the Corporation has calculated the fair value of stock options granted to non-employees prior to January 1st, 2002 and recorded the cost of $1,534,467 by increasing the deficit with the offsetting increase to contributed surplus (with no impact to total shareholders' equity).

c) Prior to 2002, the Corporation accounted for the stock option plans under the recognition and measurement provisions of AFB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations using the intrinsic value method of accounting.  No expense had been recorded prior to 2002 as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of the grant. Starting January 1, 2002 the Corporation adopted the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, prospectively to all employee awards granted, modified or settled after January 1, 2002 for United States GAAP and Canadian GAAP purposes.

In accordance with United States GAAP, pro forma disclosure of all stock options issued prior to January 1, 2002 that are not accounted for under SFAS No. 123 is required.  Below is the pro forma disclosure showing the effect on the Corporation's loss had the Corporation accounted for these options using the fair-value method prescribed in SFAS No. 123.

The pro forma disclosure for United States GAAP is as follows:

| FOR THE YEARS ENDED DECEMBER 31 | 2003 | 2004 | 2005 |
|---|---|---|---|
| Net Loss in Accordance with U.S. GAAP | $ (6,947,131) | $ (9,103,868) | $ (9,850,339) |
| Deduct: Stock based compensation costs using fair value method for options issued prior to Jan. 1, 2002 | (102,831) | (16,964) | - |
| **Pro forma net loss in accordance with U.S. GAAP** | **$ (7,049,962)** | **$ (9,120,832)** | **$ (9,850,339)** |
| Loss per share: | | | |
| Basic - as reported | $ (0.12) | $ (0.13) | $ (0.11) |
| Basic - pro forma | $ (0.12) | $ (0.13) | $ (0.11) |

d) In accordance with Canadian GAAP- EIC 10, the Corporation capitalized $150,000 of its going public costs incurred prior to March 2003; $100,000 of these costs were subsequently amortized.  Effective fiscal 2002, in accordance with the CICA Handbook Section 3061 and 3062, the Corporation ceased amortization of these costs as the balance of intangible assets was not subject to amortization.

United States GAAP requires costs related to public status be charged to shareholders' equity when incurred.  As a result, share capital prior to 2002 would be decreased by $150,000, intangible assets would be decreased by $50,000 and the deficit would be reduced by $100,000.