



## **VIQ Solutions Inc.**

---

First Quarter 2006 Management's Discussion and Analysis of  
Financial Condition and Results of Operations

---

## VIQ Solutions Inc. Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three Months Ended March 31, 2006

---

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") covers our interim consolidated financial statements for the three months ended March 31, 2006 ("Interim Consolidated Financial Statements") and updates our MD&A for fiscal 2005. The information herein should be read in conjunction with the audited consolidated financial statements and Auditors' Report for fiscal 2005. The Corporation's Interim Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") for interim financial information. Unless the context otherwise requires, all references to "VIQ Solutions", "Corporation", "our", "us", and "we" refers to VIQ Solutions Inc. and its subsidiaries. Additional information regarding the Corporation is available on SEDAR at [www.sedar.com](http://www.sedar.com). This MD&A is dated May 29, 2006 and all amounts herein are presented in Canadian dollars unless otherwise stated.

### **Forward-looking Statements and Risk Factors**

This MD&A contains forward-looking statements, including statements regarding the future success of our business and technology strategies, and future market opportunities. These statements are neither promises nor guarantees, but involve known and unknown risks and uncertainties that may cause our actual results and levels of activities to be materially different from any future results or levels of activities expressed or implied by these forward-looking statements. These risks include risks related to our revenue growth, operating results, industry and products, as well as other factors discussed in this MD&A. Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date they were made. We disclaim any obligation to publicly update or revise any such statements to reflect any change in our expectations or in events, conditions or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those set forth in the forward-looking statements. Readers are expected to review the section in our 2005 Annual Report entitled "Business Risks" for a more complete discussion of factors that could affect our future performance.

### **Incorporation and Corporate Restructuring**

VIQ Solutions was incorporated by Certificate of Incorporation pursuant to the provisions of the *Business Corporations Act* (Alberta) on November 10, 2004. On December 23, 2004, pursuant to a formal plan of arrangement (the "Arrangement") by VoiceIQ Inc. ("VoiceIQ"), the Corporation purchased all the assets of VoiceIQ, being the voice capture and digitization assets and business of VoiceIQ in exchange for 36,776,310 shares of the Corporation (the "Acquisition"). As part of the Acquisition, VIQ Solutions assumed all of VoiceIQ's contractual obligations and liabilities as of the date of the Arrangement that were not compromised by VoiceIQ under the *Companies Creditors Arrangement Act* (Canada) ("CCAA"). As part of the Arrangement, VIQ Solutions issued 2,000,000 common shares to certain creditors of VoiceIQ and an additional 1,333,333 common shares to a creditor of VoiceIQ as partial consideration of debt settlement under the CCAA.

Until the Arrangement was implemented, VIQ Solutions did not carry on any business and had no material assets or liabilities. The Corporation commenced active business on December 24, 2004.

Under Canadian GAAP, a company is required to comprehensively revalue its assets and liabilities after a financial reorganization that results in a substantial realignment of the equity and non-equity interest in the company. As there was no substantial change in control of the Corporation subsequent to the Arrangement, the assets and liabilities acquired from VoiceIQ have not been revalued.

## **Overview**

We develop software and provide solutions that capture, digitize, compress and store voice from a variety of sources, including microphones, telephones and hand-held recorders. Our software can be used to securely manage the flow of voice files over virtually any computer network, including the Internet. The Corporation supplies, through a network of distributors and channel partners, solutions to end-users including individual medical clinics, legislative assemblies, courthouses and quasi-judicial agencies. NetScribe, a sophisticated web-based workflow management switch, provides anywhere anytime transcription workflow capabilities worldwide.

We also provide recording and transcription services directly or by contracting to various suppliers around the world to a variety of clients including medical, courtrooms, legislative assemblies, hearing rooms, inquiries and quasi-judicial clients in numerous countries including Canada, the United States, Australia, New Zealand, South Africa, and Ireland.

## **Highlights of Business Development Activity for the Quarter**

- In January 2006, the Corporation announced that the balance of the \$1.28 million secured convertible debenture had been converted into shares and warrants of the Corporation;
- On January 30, 2006, the Corporation finalized a \$500,000 six-month secured bridge loan from the Dynamic Technology Fund;
- The Corporation announced the release of RecordIAB version 2.0, VIQ Solution's complete 8-channel enclosed recording console which enables users to record, playback and store digital audio, allowing the Corporation to expand its market opportunities into new vertical markets including military, transportation, insurance and other markets;
- The Corporation solidified its global distribution model and entered into a regional distribution agreement for VIQ Solutions products and services with Smoltz Distributing for the North American region; and
- Subsequent to the period, the Corporation raised \$587,100 in a non-brokered private placement.

## **Critical Accounting Policies and Estimates**

### ***General***

The preparation of the Interim Consolidated Financial Statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. These estimates and assumptions are based upon management's historical experience and are believed by management to be reasonable under the circumstances. Such estimates and assumptions are evaluated on an ongoing basis and form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ significantly from these estimates. The Corporation's critical accounting policies have been reviewed and discussed with the Corporation's Audit Committee.

### ***Going Concern Uncertainty***

These Interim Consolidated Financial Statements have been prepared on the basis of accounting principles applicable to a "going concern", which assumes that the Corporation will continue in operation for the foreseeable

future and will be able to realize its assets and discharge its liabilities in the normal course of its operations. The Corporation has incurred operating losses, and, as at March 31, 2006, the Corporation had a working capital deficiency.

In January 2005, the Corporation placed a twelve-month, \$1,280,000 secured convertible debenture. The convertible debenture bears interest at a rate of 12% per annum compounded and payable monthly. The debenture is convertible into 7,111,111 units at a conversion price of \$0.18 per unit. Each unit is comprised of one common share of the Corporation and one half of one common share purchase warrant. Each whole warrant entitles the debenture holder to purchase one common share at a price of \$0.30 for a period of 18 months from the date of closing.

By January 2006, the secured convertible debenture was fully converted to common shares and warrants of the Corporation.

In January 2006, the Corporation placed a six-month \$500,000 secured bridge loan. The bridge loan bears interest at a rate of 10% payable upon repayment of the loan.

Subsequent to the period, the Corporation finalized a private placement in the amount of \$587,100 for 3,090,000 common shares at a price of \$0.19 per share.

Management believes that these actions make the going concern basis appropriate. If the going concern basis is not appropriate, adjustments may be necessary to the carrying amounts and/or classification of assets and liabilities and expenses in these financial statements.

The Corporation's ability to continue as a going concern is dependent on its ability to achieve and maintain profitable operations. These Interim Consolidated Financial Statements do not reflect any adjustments to reflect the possible future effects on the recoverability and the classification of assets and of the amounts and the classification of liabilities that may result if the going concern assumption were not appropriate. Such adjustments may be material.

### ***Basis of Consolidation***

On December 23, 2004, the Corporation acquired all the assets and assumed all the associated contractual obligations and liabilities (to the extent that they were not compromised under the CCAA) from VoiceIQ including its wholly-owned subsidiary VIQ Australia Pty. Limited and VIQ Australia Pty. Limited's wholly-owned subsidiaries Spark & Cannon Pty. Ltd., Spark & Cannon (SA) Pty. Ltd. (collectively referred to as "Spark & Cannon") and VIQ Solutions NZ Limited (formally VoiceIQ NZ Limited). In 2005, the Corporation incorporated a new subsidiary, VIQ Solutions (U.S.) Inc., which has been included in the Interim Consolidated Financial Statements. On December 23, 2005, the Corporation acquired all the outstanding common shares of International Reporting Inc. ("International Reporting").

The Interim Consolidated Financial Statements include the accounts of VIQ Solutions, the operations of the acquired assets of VoiceIQ as of the date of acquisition being December 23, 2004 and the operations of International Reporting as of the date of acquisition being December 23, 2005. The Corporation commenced active business on December 24, 2004.

### ***Use of Estimates***

In preparing the Corporation's Interim Consolidated Financial Statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and reported amounts of revenue and expenses. Actual results could differ from these estimates.

Significant areas requiring the use of management estimates relate to the determination of the valuation of intangibles and goodwill, the useful lives of property, plant and equipment, and other assets for amortization purposes and amounts recorded as accrued liabilities.

## **Business Acquisitions**

### ***Acquisition of International Reporting***

On December 23, 2005, the Corporation signed and closed a share purchase agreement to acquire all of the common shares of International Reporting, a transcription and recording services company. The aggregate purchase price was \$950,000 satisfied by \$500,000 of cash and two unsecured notes of \$225,000 each bearing interest at 5% to be repaid on the first and second anniversaries of the acquisition. The Corporation may be required to pay additional consideration of varying amounts to the vendors in the event that certain sales and net earnings targets are met.

## **Employee Stock-based Compensation Expense**

Employee stock-based compensation was \$29,228 for the period ended March 31, 2006 as compared to \$84,336 for the three month period ended March 31, 2005. Stock options are expensed over their expected life and are charged to selling and administrative expenses.

## **Shares Outstanding**

The weighted average number of common shares used in calculating the loss per share was 69,413,852 for the three month period ended March 31, 2006 (three months ended March 31, 2005 – 53,540,065). We have included 4,000,000 special warrants in the weighted average number of common shares as these warrants are deemed exercised as they have no exercise price and are automatically exercised prior to expiry. The number of common shares outstanding as at March 31, 2006 was 66,081,753 (March 31, 2005 – 56,767,642). The increase in the number of common shares outstanding was primarily attributable to the common shares issued from the private placements that took place in 2005, the conversion of \$1,280,000 of the secured convertible debenture, and the inclusion of the special warrants.

Options granted under our stock option plan and outstanding warrants, have not been included in the calculation of the diluted loss per share as the effect would be anti-dilutive.

Stock options outstanding were 5,387,333 as at March 31, 2006 (March 31, 2005 – 2,539,333), of which 2,787,989 were exercisable (March 31, 2005 – 1,320,666).

Warrants outstanding at March 31, 2006 were 13,214,555 (March 31, 2005 – 12,036,077) and special warrants outstanding were 3,900,000 (March 31, 2005 – 4,000,000). As at March 31, 2006, 2,400,000 of the special warrants remained in escrow pursuant to the terms of the special warrants.

## **Results of Operations**

Revenue for the three months ended March 31, 2006 was \$2.47 million, a decrease of \$0.075 million, or 3% compared to the three months ended March 31, 2005. This decrease reflects a decline in our transcription services primarily due to the foreign currency translation of our Australian operations (\$233,000) and due to slightly slower business activity (\$206,000) and was partially offset by increased revenues as a result of the revenues from International Reporting (\$350,000).

Revenue from computer products and services included revenue from the sale of our software and hardware products, NetScribe services, service support and maintenance agreements and the sale of our new RecordIAB product. Revenue from computer products and services was slightly higher for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005. We expect that the sale of our RecordIAB will represent a substantial portion of our revenue in 2006 as our global network of value added resellers and distributors become more familiar with the product and begin to access new market verticals. At March 31, 2006, we had \$120,000 of confirmed orders for the RecordIAB product, all of which are anticipated to be delivered and recognized as revenue in our second quarter.

The following table provides a breakdown of our revenues for the reported period:

| (\$000s)                       | Three months ended March 31 |                 |
|--------------------------------|-----------------------------|-----------------|
|                                | 2006                        | 2005            |
| Transcription services         | \$ 2,156                    | \$ 2,245        |
| Computer products and services | 314                         | 300             |
|                                | <u>\$ 2,470</u>             | <u>\$ 2,545</u> |

Gross profit for the three months ended March 31, 2006 was \$804,633 or 33% gross margin as compared to \$934,030 or 37% gross margin for three months ended March 31, 2005.

Gross margin from computer products and services was 64% for the three months ended March 31, 2006 remaining unchanged from the three months ended March 31, 2005. We would expect that this margin would decline slightly in subsequent quarters as a result of anticipated changes in our revenue mix. We have plans to continue to improve our gross margins by further standardizing and enhancing our manufacturing process for RecordIAB.

Gross margin from our transcription and court reporting services was 28% for the three months ended March 31, 2006 as compared to 33% for the three months ended March 31, 2006 primarily due to a decline in the gross margin from Spark & Cannon and partially offset by the increased margin from International Reporting. Our gross margin for transcription services is typically low in the first three months of the fiscal year due to seasonality of the business operations.

The following table provides a breakdown of our gross margins for the reported period:

|                                | Three months ended March 31 |            |
|--------------------------------|-----------------------------|------------|
|                                | 2006                        | 2005       |
| Computer products and services | 64%                         | 64%        |
| Transcription services         | 28%                         | 33%        |
|                                | <u>33%</u>                  | <u>37%</u> |

Selling and administrative expenses were \$1.06 million for the three months ended March 31, 2006 as compared to \$1.31 million for the three months ended March 31, 2005, declining by \$0.25 million or 19%. Selling and administrative expenses declined primarily due to continued rationalization of our business operations (\$389,000) and partially offset by additional selling and administrative expenses associated with International Reporting of \$147,000.

Research and development expenses were \$221,379 for the three months ended March 31, 2006 as compared to \$395,582 for the three months ended March 31, 2005 representing a decline of \$174,203 or 44%. The reduction in research and development cost is primarily due to the additional development costs associated with the launching of our RecordIAB product in 2005.

Our net loss for the three month period ended March 31, 2006 was \$667,777 as compared to \$1,616,299, a decrease of \$948,522 or 59%. The net loss for the three months ended March 31, 2005 included a one-time expense of \$720,000 relating to the issuance and expensing of special warrants.

Net loss per common share for the three months ended March 31, 2006 was \$0.01, compared to a net loss of \$0.03 per common share for the three months ended March 31, 2005. This decrease in net loss per common share was predominately the result of the one time management retention bonus issued and expensed in 2005 combined with the increase in the weighted average number of shares outstanding. Options granted under our stock option plan and warrants have not been included in the calculation of the diluted loss per share as the effect would be anti-dilutive.

## Financial Condition, Liquidity and Capital Resources

As at March 31, 2006, the Corporation had \$287,438 of cash and cash equivalents (March 31, 2005 - \$2,792,703). Cash and cash equivalents used in operating activities was \$430,043 for the three month period ended March 31, 2006 as compared to \$1,205,437 for the three month period ended March 31, 2005. The decrease in cash used in operations was primarily due to less investment in working capital and the decline in operating losses for the period. Cash and cash equivalents used in investing activities increased to \$104,547 for the three months ended March 31, 2006 as compared to \$69,404 for the three months ended March 31, 2005, primarily for the purchase of fixed assets and the increase in restricted cash. Cash and cash equivalents from financing activities decreased to \$521,462 for the three month period ended March 31, 2006 as compared to \$2,231,884 for the three month period ended March 31, 2005 primarily from proceeds from shares issued for cash in 2005.

We intend to use our funds to meet net funding requirements for the development and commercialization of our computer products and transcription services based on anticipated market demand. Our actual funding requirements will vary depending on a variety of factors, including our success in executing our business plan, the progress of our research and development efforts, our commercial sales and our ability to manage our working capital requirements. We believe that our existing cash balances and cash generated from operations will not be sufficient to meet our anticipated cash needs for working capital and capital expenditures for the balance of the year. Accordingly, we finalized a private placement for \$587,100 subsequent to the period and may raise additional capital to allow us to execute our business plan.

The “Liquidity and Capital Resources” section above contains certain forward-looking statements. By their nature forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Please refer to the caution regarding Forward-looking Statements on page 10 of our 2005 Annual Report and page 18 of our 2005 Annual Report for a discussion of such risk and uncertainties and the material factors and assumptions related to the statements set forth in those sections.

## Quarterly Results of Operations

The following table sets forth our unaudited consolidated statements of operations for each of the past quarters since the Corporation’s inception. This information was obtained from our quarterly unaudited financial statements, which have been prepared in accordance with Canadian GAAP. We expect our operating results to vary significantly from quarter to quarter and they should not be relied upon to predict future performance.

|   | Quarter Ended (Unaudited) (000s of dollars – except per share amounts) |                  |                 |                  |                 |                  |
|---|--|------------------|-----------------|------------------|-----------------|------------------|
|   | Dec. 31<br>2004<br>(8 days)  | March 31<br>2005 | June 30<br>2005 | Sept. 30<br>2005 | Dec. 31<br>2005 | March 31<br>2006 |
| Revenue   | \$ 86  | \$2,545          | \$3,212         | \$2,631          | \$2,504         | \$2,470          |
| Net Loss  | (76)   | (1,616)          | (577)           | (851)            | (557)           | (668)            |
| Net Loss per Common<br>Share<br>(Basic and Fully Diluted) | (\$0.00)   | (\$0.03)         | (\$0.01)        | (\$0.01)         | (\$0.01)        | (\$0.01)         |

## Contingencies

A statement of claim was filed against International Reporting by a former contractor for damages related to breach of contract as well as for interest and damages and for costs of the action. The total amount of the claim for damages is approximately \$500,000. Pursuant to the share purchase agreement with International Reporting, the vendors have indemnified the Corporation for any potential exposure in excess of \$50,000 in connection with this matter. Management is of the opinion that the action is without merit. The outcome is not determinable and accordingly, no amount has been accrued in the Interim Consolidated Financial Statements.

## **Related Party Transactions**

The secured convertible debenture in the amount of \$920,000 was from a company of which a director of the Corporation is a senior officer. During the period, \$2,489 of interest was paid in connection with the secured convertible debenture.

## **Subsequent Events**

The following events occurred subsequent to the period:

(i) Private Placement

Subsequent to the period, the Corporation finalized a private placement in the amount of \$587,100 for 3,090,000 common shares at a price of \$0.19 per share.

(ii) Warrant Amendment

Subsequent to the period, certain warrant holders owning collectively 4,832,278 warrants agreed to amend their warrant terms such that the expiry date of the warrants was accelerated to April 3, 2006 for no consideration.

(iii) Extension of Bridge Loan

Subsequent to the period, the secured bridge loan was extended to March 31, 2007 with all other terms and conditions of the loan remaining the same.

## **Disclosure Controls and Procedures**

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Corporation is accumulated and communicated to the Corporation's management as appropriate to allow timely decisions regarding required disclosure. The Corporation's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the interim filings, that the Corporation's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the Corporation, including its consolidated subsidiaries, is made known to them by others within those entities. It should be noted that while the Corporation's Chief Executive Officer and Chief Financial Officer believe that the Corporation's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal controls over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

## **Outlook and Strategy**

This "Outlook" section contains certain forward-looking statements. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Please refer to the section "Forward-looking Statements".

We are well positioned to capitalize on the potential growth and heightened interest in our software solutions in North America and globally. During 2006, we anticipate that we will benefit from a series of market trends including (i) the transition in the courts from analog audio recording systems to digital recording systems; (ii) the end of life cycle for most analog audio recording devices; and (iii) the increasing market demand for digital recording in various market verticals including the medical, insurance, law enforcement, military and transportation industries.

Our newest offering, RecordIAB, is an innovative and fully enclosed recording console for the recording, playback

and storing of digital audio. RecordIAB is ideally suited for entry-level and sophisticated customers requiring a feature-rich, simple to use, touch screen product. RecordIAB is a complete solution which is easy to use but also has expansion capabilities to meet the needs of sophisticated end users by adding features as the operator's skill set evolves. RecordIAB is designed to be completely compatible with all of our other product offerings. We believe that RecordIAB will allow us to service existing markets as well as penetrate new markets that require easy to use, mobile digital recording.

We are working to develop new partnerships and expand existing partnerships among large systems integrators and strategic entry point partners. These partners have geographic and technical presence in the market and accelerate our ability to attain and keep new contracts. As these relationships flourish, they should result in valuable and long-term recurring revenues for the Corporation.

Our development teams are producing significant new product offerings to augment our full spectrum of solutions from entry to enterprise level. Our clients, dealers and resellers continue to provide valuable input to the design and feature-set being delivered in our solutions. New product releases and new opportunities continue to evolve and subsequently, new releases are occurring each quarter.

These products and offerings continue to be integrated with our NetScribe services, providing a complete solution set spanning easy-to-use entry-level solutions to sophisticated full-featured systems. This solution set allows the customer to adopt the level of sophistication suitable to their needs.