Sterne Stackhouse Inc.

Annual Report

2001

For the Year Ended October 31, 2001

Corporate Profile

Sterne Stackhouse Inc. (“SSI”) (CDNX:SSX) is a Canadian software development company providing enterprise-wide Business Intelligence solutions. Since 1981, SSI has focused on data retrieval and analysis. Labrador®, SSI’s flagship product, provides ‘easy to use’ client/server, Internet, and wireless data solutions. With Labrador®, business users and technologists of all skill levels, in any industry, can interact directly with all of their relational data sources.

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AGM

The Annual General Meeting of the Shareholders of Sterne Stackhouse Inc. will be held at 2:00 p.m. on April 26th, 2002 in the SSI Corporate Office at 900, 700 4th Avenue S.W., Calgary, Alberta. All shareholders are encouraged to attend and participate. Those who are unable to attend are requested to return their proxies to the registrar within the times specified in the Notice of Meeting.

Information on Sterne Stackhouse Inc.
is available through our
Internet site at

www.sternestackhouse.com

MESSAGE TO OUR SHAREHOLDERS

Financial Results

Year Ended October 31st, 2001

2001	2000	
	$	$
Revenue	$6,257,408	$2,643,889
Operating Revenue	$1,776,789	$2,643,889
Gain on Sale of Petro-LAB™	4,480,619	-
Operating Expenses	4,760,392	4,607,013
Bad Debt	300,000	-
Net income (loss)	1,197,016	(1,963,124)
Net income (loss) per share basic and diluted	0.14	(0.30)
Outstanding shares	8,549,685	7,593,685

Back to Basics

Over the past two years, it has been reported, to a nauseating degree, how corporations generally, and High Tech particularly, have been impacted by the high growth and profit expectations of shareholders and financial/business analysts. Like so many others, we, too, made a mistake. We tried to grow too quickly. Fortunately, we recognized our mistake. And we have spent an entire year fixing what went wrong, bit-by-bit, and piece-by-piece.

SOP 97-2 and QByte/PwC Agreement Misunderstood

We have been at pains to explain our adoption of accounting policy, SOP 97-2 (Statement of Position of the American Institute of Certified Public Accountants), which necessitated a major change in our revenue recognition policy. Similarly, despite our efforts to clarify our agreement with QByte/PwC, its complexity requires an in-depth review by the reader. Judging by the number of questions received in both regards, we have not yet been successful in making them clear.

Companies, like SSI, that wish to operate in the U.S, must adopt SOP 97-2. Its revenue recognition requirements are reflected in the financial statements and MD&A, and hopefully, will become more understandable over time.

The QByte Agreement is still very much "alive." In addition to the $3.4 Million SSI has already received from QByte as of the end of February 2002, this agreement will also generate $2.38 Million for SSI between March 2002 and February 2003, plus a 25% Royalty on all Petro-LAB™ New Business. The MD&A more completely outlines the ongoing payments from QByte.

Revenue Recognition

In accordance with SOP 97-2 (Statement of Position of the American Institute of Certified Public Accountants), royalty revenue from the QByte transaction is recognized as follows:

- Royalty revenue from Petro-LAB™ license renewals from existing clients is recognized when the license renewals occur. Since $0.50 of each $1.00 of license renewal revenue has already been recognized in the one-time gain of $4,480,619, the remaining $0.50 of each $1.00 of license renewal revenue is recognized when the renewal invoice is sent to the client. As a result, as of October 31, 2001, QByte had invoiced $1,380,500 of Petro-LAB™ license renewal fees. SSI recognized $690,250, or half of these renewal fees, as revenue; and
- Royalty revenue from new Petro-LAB™ business is recognized when QByte pays the royalties to SSI. During the year ended October 31, 2001, SSI received $18,510 of royalty revenue from new Petro-LAB™ business.

Dramatic Reduction in Expenses through Restructuring

The impact of "Back to Basics" has been multi-faceted. By negotiating a perpetual revenue stream for the Company with QByte/PwC for the up-stream and mid-stream rights for Canadian Petro-LAB™, the Company has been able to reduce substantially its Sales/Administration and Research & Development infrastructure. Importantly, the Company has kept its most experienced Research & Development personnel. The ratio of Sales and Administration personnel to Technical is now 25% Sales/Administration to 75% Technical. The employee count has dropped from 44 to 17, and expenses have been reduced from $500,000 to $215,000 per month.

Promissory Notes

The Company has treated certain Promissory Notes in the amount of $300,000, incurred by an Officer of the company, as a Bad Debt Expense. These Promissory Notes were incurred in connection with the Company's private placement. Accordingly, the Company has taken appropriate action. The Officer is no longer with the Company.

Corporate Sales Strategy Reduces Expenses

We reported with our 3rd Quarter Results the following: "SSI's corporate strategy is to work with business experts, across selected industries, to develop Labrador®-based software applications. In this manner, the distinct advantage that the Labrador® technology brings to these markets will be further confirmed. As the company has demonstrated with the Petro-LAB™ to QByte purchase agreement, SSI's goal is to find the "right" distributors for each of these markets."

We have continued to evolve this distribution strategy religiously, as outlined in the Vertical Initiative Summary below. As has been proven with Canadian Petro-LAB™, each well-developed Labrador® vertical is capable of sustaining the Company by itself. Every additional Labrador® vertical provides the opportunity for significant profitability, by virtue of Labrador®'s ability to leverage itself across multiple verticals with minimal increase in SSI expenses. The harsh truth is that it takes extremely experienced personnel to negotiate distribution agreements with multi-nationals. Accordingly, we have been able to further reduce Sales and Administration from 15 employees to 4, with no loss in efficiencies or effectiveness.

New Directors Appointed

On March 19th, 2002, the Company announced the appointment of two new independent members to its Board of Directors, effective as of March 18th 2002. Accordingly, SSI has increased the total number of directors to five, comprised of two SSI executive directors and three independent directors.

K. Garry Cook, C.A., a senior partner in the firm of Dick Cook Schulli, Chartered Accountants, replaces the accounting and financial expertise provided by Douglas R. Martin, who served on SSI's Board since 1996. In addition to his accounting/auditing experience, Mr. Cook has performed a number of senior financial services for public companies and other professional firms, including several technology companies, for over 25 years.

Also appointed to the Board is John D. Riddell, M.A., President and principal of Riddell Kurczaba Architecture Engineering Interior Design Ltd. He is a member of the Royal Architectural Institute of Canada, and serves on the Board of Directors of AMS AeroMechanical Services Ltd. Mr. Riddell's penchant for the Aerospace industry and his general business acumen, developed over 25 years of experience, are well suited to SSI's growth plans.

Allocation of Resources to Support Both Web and Client/Server

To ensure that our various initiatives are allocated adequate resources, we have divided our Technical Team, as follows: 1/3 of the team is assigned to Web-LAB™, our web-based version of Labrador® written in Java, and 2/3 of the team is assigned to the client/server version of Labrador®. Once Labrador®'s Model-LAB™ has reverse-engineered/modeled a relational database(s), both the client/server and the web-based versions of Labrador® can query, report, and analyze all of the data.

Vertical/Sector Initiative Summary

U.S./World Petro-LAB™

U.S./World Petro-LAB™ is, by far, the single biggest opportunity for the Company to expand its revenue base, and increase its profile. During the first 10 years of the QByte Agreement, the Company estimates that the Canadian Petro-LAB™ product has the potential to generate over $53 Million CDN, in gross revenue. Successfully meeting Canada's rigorous market requirements has paved the way for Petro-LAB™'s International presence – where U.S./World markets are significantly larger for Petro-LAB™ than in Canada.

Consequently, the Company has allocated half of its client/server team to the U.S./World Petro-LAB™ initiative. Although Labrador® is proving itself to be a truly generic data query, reporting, and analysis capability, the Company must exploit over 21 years in oil and gas. Active pursuits of this market are underway.

Mistahia

As reported in our 3rd Quarter MD&A, SSI worked closely with the Mistahia Health Region, in Grande Prairie, Alberta, implementing the Labrador® software to create "on demand" querying and reporting from Mistahia's large health-care databases. Unfortunately, this and other software development projects at Mistahia were put on hold in October 2001. Mistahia has found Labrador® to be effective in its environment, and remains committed to the project's completion when funds are available. Mistahia's next major budget review will be held in April/May of 2002.

Transamerica Life

In Fiscal 2001, Transamerica Life Insurance Company of Canada purchased four concurrent seats of Labrador®. The implementation of Labrador® is awaiting formal project definition.

Raytheon

SSI continues to work with Raytheon Systems Canada Ltd., Services and Support Division, as Raytheon works to expand its markets in Australia and Great Britain. Raytheon and SSI have an informal agreement whereby Raytheon will distribute SSI's Labrador® software in the Aerospace and Defense Sector. In the past few months, SSI has also established a relationship with Raytheon Technical Services Company (RTSC) in the U.S. RTSC, in Tucson, has installed the Labrador® software and is using it to reverse engineer its EAGLE™ Logistics Engineering database to provide enhanced query and reporting capabilities.

Avante

In our third quarter summary, we reported that SSI was working closely with Avante Solutions Inc. in the Customer Relationship Management (CRM) sector to offer "on demand" query and reporting to Avante's Canadian clients. Labrador® continues to work well with HEAT® and Goldmine®, the two major product offerings that Avante redistributes for FrontRange Solutions Inc. Although the Avante marketing initiative has not been formally launched, Avante has introduced SSI to several prospective clients, including DIRECTCash ATM.

DIRECTCash ATM

DIRECTCash ATM has successfully installed and implemented Labrador® for its financial transaction database. The DIRECTCash implementation has provided an excellent opportunity to demonstrate Labrador®'s "on demand" query and reporting in the financial sector. DIRECTCash is a full service retailer of ATMs including transaction processing and ATM systems management.

Summary

We researched and built Labrador® in the oil and gas market, so that it could work across a multitude of verticals. We tried to push too hard, too fast, into these new markets. And, we have had to slow down. Regardless, the results continue to be encouraging. We believe that our technology is capable of servicing many markets concurrently, with a minimal increase in costs to the Company. Our lesson has been to stick to basics – good, sound, business fundamentals, starting with minimizing our expenses.

Despite what has been accomplished, the reality is that quarterly financial reporting does not accurately reflect the prospects of the Company. Negotiations/sales cycles with multi-national distributors for Labrador® and/or Petro-LAB™ often take between six and eighteen months before generating significant income, and this creates "lumpy" revenue streams. Thus, shareholders and business analysts alike should reference the Statements of Cash Flows to accurately track the Company's status – bearing in mind that Statements of Cash Flows are generally difficult to understand. In any event, the blunt truth is that there will be quarterly "famines" before there can be "feasts."

On behalf of the Board of Directors

Ron Sterne

H. Ronald Sterne
Chief Executive Officer
March 20, 2002

MANAGEMENT'S REPORT

The consolidated financial statements of Sterne Stackhouse Inc. were prepared by management to fairly present the financial position of the company in all material respects and are in accordance with accounting principles generally accepted in Canada. Management is responsible for ensuring that the financial and operating information presented in this annual report is consistent with that shown in the consolidated financial statements.

The consolidated financial statements have been prepared by management in accordance with the accounting policies as described in the notes to the consolidated financial statements. Timely release of financial information sometimes necessitates the use of estimates when transactions affecting the current accounting period cannot be finalized until future periods. When necessary, such estimates are based on informed judgments made by management.

Management has designed and maintains an appropriate system of internal controls to provide reasonable assurance that all assets are safeguarded and financial records properly maintained to facilitate the preparation of financial statements for reporting purposes.

KPMG LLP, an independent firm of Chartered Accountants appointed by the shareholders, have conducted an examination of the corporate and accounting records in order to express their opinion on the consolidated financial statements. The Audit Committee, consisting of a majority of non-management directors, has met with representatives of Sterne Stackhouse Inc. and management in order to determine if management has fulfilled its responsibilities in the preparation of the consolidated financial statements. The Board of Directors has approved the consolidated financial statements on the recommendation of the Audit Committee.

H. Ronald Sterne
Ron Sterne
Chief Executive Officer
Sterne Stackhouse Inc.

Darryl Stackhouse
D K Stackhouse
President & CFO
Sterne Stackhouse Inc.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Sterne Stackhouse Inc. as at October 31, 2001 and 2000 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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 financial statements present fairly, in all material respects, the financial position of the Corporation as at October 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

KPMG LLP

Calgary, Canada
January 11, 2002

October 31, 2001

The following discussion should be read in conjunction with the audited financial statements presented in accordance with accounting principles generally accepted in Canada. All amounts are stated in Canadian dollars.

Corporate Profile

Since 1981, Sterne Stackhouse Inc. (SSI) has focused on data retrieval and analysis software. Labrador®, SSI's flagship product, provides 'easy to use' client/server, Internet, and wireless data query, reporting and analysis solutions. With Labrador®, business users and technologists of all skill levels can interact directly with their relational data sources.

Revenue

SSI's total revenue for the year ended October 31, 2001 was $6,257,408 ($1,776,789 from Operations and $4,480,619 from the gain on sale of Petro-LAB™). The increased revenue is due primarily to the successful negotiation of an agreement to sell SSI's Petro-LAB™ assets for the Canadian up-stream and mid-stream oil and gas industry to QByte Services Ltd. (QByte), a subsidiary of PricewaterhouseCoopers LLP, Canada (PwC). As a result of this transaction, $4,480,619 of the reported revenue of $6,257,408 is a one-time gain attributable to the QByte transaction. Of the remaining $1,776,789 of reported revenues, $187,844 is from consulting services related to Labrador® ($181,844 from QByte), $880,185 is from license fees ($809,585 from Petro-LAB™ license fees prior to the effective date of the QByte transaction and $70,600 from Labrador® license fees), and $708,760 is from royalties arising from the QByte transaction ($18,510 from new business royalties and $690,250 from existing client royalties).

Petro-LAB™ - QByte Transaction

On March 16th, 2001, the Company negotiated a cash and royalty-bearing transaction with QByte, a leading provider of software to the Canadian oil and gas industry. Under the agreement, QByte will acquire the rights to SSI's Petro-LAB™ application over five years. The effective date of the transaction was February 28th, 2001.

As part of the agreement, QByte subscribed for $500,000 (500,000 Units) in a private placement by SSI, previously announced on January 19th, 2001. Each Unit consists of one common share of SSI and one half of one common share purchase warrant. Each whole warrant is convertible into one common share at $2.00 per share for 18 months from March 16th, 2001, the closing date of the transaction.

Terms of the Agreement

Under the terms of the agreement, SSI has agreed to grant to QByte an exclusive, royalty-bearing license to develop, market, and license Petro-LAB™, as well as a Petro-LAB™/Web solution, a web-based product based on Petro-LAB™ functionality. SSI has granted these rights for the Canadian oil and gas up-stream and mid-stream market for 5 years. Title to the existing Petro-LAB™ software becomes QByte's at the end of the 5 year term provided all payments have been made, and all obligations have been fulfilled. Since the Petro-LAB™ software requires the use of Labrador®, SSI's proprietary dynamic query generation engine, to function, SSI has also granted QByte an exclusive, perpetual, royalty-bearing license to use, market, and license Labrador® to the mid- and up-stream oil and gas market in Canada.

The Agreement provides for the following payments to SSI:

- A royalty prepayment of $1,500,000 that was paid on signing;
- An annual payment, paid monthly, of $1,900,000 from March 2001 to February 2002; $2,380,000 from March 2002 to February 2003; $530,000 from March 2003 to February 2004 ($530,000 is the net royalty payment after deduction of the royalty prepayment of $1,500,000); $398,750 from March 2004 to February 2005; and $290,000 from March 2005 to February 2006;
- SSI's payments will be adjusted, after the end of years 2, 3, 4, and 5 of the agreement, based on a

comparison of actual Petro-LAB™ license renewal revenues from existing clients to the following forecast of license renewal revenues from existing clients: $1,900,000 from March 2001 to February 2002; $2,380,000 from March 2002 to February 2003; $2,030,000 from March 2003 to February 2004; $1,595,000 from March 2004 to February 2005; and $1,160,000 from March 2005 to February 2006. SSI will receive 50% of any excess of actual revenues above, and QByte will reduce its royalty obligation by 50% of any shortfall of actual revenues below, the agreed to Petro-LAB™ license renewal revenue forecast from existing clients;

- A 25% royalty, in perpetuity, on all revenue from new clients of Petro-LAB™, on all new business from existing Petro-LAB™ clients, and on all business from existing Petro-LAB™ clients after year 5 using Labrador®; and
- 65% of all revenue generated from Labrador® licenses not associated with the Petro-LAB™ software.

Based on the above, if actual Petro-LAB™ license renewals were equal to the license renewal revenue forecast stated above and there was no new business (i.e. no revenue from the 25% royalty in perpetuity), SSI would still receive total payments of $6,998,750.

As of October 31, 2001, SSI has received cash payments from QByte of $2,785,177 ($1,500,000 from the royalty prepayment, $1,266,667 being eight-twelfths of the first year payment of $1,900,000, and $18,510 from new business royalties). As of October 31, 2001, actual Petro-LAB™ license renewal revenue from existing clients was $1,380,500. Only one client did not renew its Petro-LAB™ license, and this client was taken over by a non-Petro-LAB™ company.

Gain on Sale

As a result of the QByte transaction, the Company recognized a gain on the sale of Petro-LAB™ of $4,480,619 (see note 6 to the financial statements). The gain is equal to the sum of $3,499,375 (the minimum amount of cash that SSI can receive from the transaction), plus deferred revenue of $1,674,314, less associated software development costs of $693,070.

The addition of deferred revenue of $1,674,314 arises from revenue previously deferred for Petro-LAB™ licenses that included obligations to deliver maintenance over the life of the license. The Company's revenue recognition policies require that revenue from the sale of licenses that includes undelivered elements, such as maintenance and other post-customer support services, be recognized ratably over the contract period (see note 1 to the financial statements). As a result of the QByte transaction, all post-customer support services became the responsibility of QByte, thereby requiring the Company to include the deferred revenue attributable to Petro-LAB™ licenses in the gain on sale of Petro-LAB™.

The deduction of software development costs of $693,070 is based on software development costs related to the Petro-LAB™ application that were previously capitalized. Capitalized software development costs represent salaries and consulting fees directly attributable to the development of software products that have a clearly defined market.

On the effective date of the transaction, February 28th, 2001, the Company recorded a cash receipt of $1,500,000 from the QByte transaction and an account receivable of $1,999,375. The account receivable is reduced by the monthly payments received from QByte, and is increased by an amount equal to the royalty revenue recognized when a license renewal occurs. As a result, the account receivable from QByte at October 31, 2001, was equal to $1,422,959 (i.e. $1,999,375 less $1,266,667, being eight-twelfths of the first year forecasted license renewal of $1,900,000, plus $690,251, the royalty revenue recognized from Petro-LAB™ license renewals from existing clients).

Revenue Recognition

In accordance with SOP 97-2 (Statement of Position of the American Institute of Certified Public Accountants), royalty revenue from the QByte transaction is recognized as follows:

- Royalty revenue from Petro-LAB™ license renewals from existing clients is recognized when the license renewals occur. Since $0.50 of each $1.00 of license renewal revenue has already been recognized in the one-time gain of $4,480,619, the remaining $0.50 of each $1.00 of license renewal revenue is recognized when the renewal invoice is sent to the client. As a result, as of October 31, 2001, QByte had invoiced $1,380,500 of Petro-LAB™ license renewal fees. SSI recognized $690,250, or half of these renewal fees, as revenue; and

- Royalty revenue from new Petro-LAB™ business is recognized when QByte pays the royalties to SSI. During the year ended October 31, 2001, SSI received $18,510 of royalty revenue from new Petro-LAB™ business.

Expenses

General and Administrative (G&A)

This category of expenses is comprised primarily of office rent, office equipment rentals, administrative salaries, corporate expenses related to shareholder reporting, and professional fees. G&A expenses for the year ended October 31, 2001 were $1,788,496 compared to $1,403,737 for the year ended October 31, 2000, an increase of $384,759. The increase is largely made up of increased legal and accounting expenses directly attributable to the QByte transaction, increased rent expense due to a full year of rent for expansion in office space undertaken in the prior year, and increased salary expenses arising from staff increases in the prior year.

Sales, Marketing and Support

Sales and marketing expenses include expenses for sales and support salaries, sales commissions, and promotion/advertising. For the fiscal year ended October 31, 2001, sales and marketing expenses were $1,569,541 compared to $1,803,916 for the comparable period in the previous year. The decrease of $234,375 relates to staff reductions, reduced promotion/advertising expenses, and reduced consulting fees. Nine former SSI staff are now at QByte. Six are sales and support employees. In addition, the Company generally reduced costs, including staff, to better match expenses with cash receipts.

Computer and Related Costs

Computer and Related Costs include hardware maintenance, programmer's salaries, and software costs. This category of expenses totaled $1,159,669 for the current fiscal period, compared to $743,981 for the prior fiscal year ended October 31, 2000. The increase is due primarily to increased salary costs that were previously capitalized. These costs, related to the development of Petro-LAB™ in the Canadian oil and gas market, have now been expensed, as Canadian Petro-LAB™ has been sold to QByte.

Amortization of Software Development Costs

The Company's accounting policy is to amortize capitalized software development costs on a straight-line basis over three years. For the year ended October 31, 2001, the amortization expense was $120,000 compared to $507,600 for the previous year. The reduction is directly attributable to management's decision to write-off previously capitalized software development costs against the QByte gain, as discussed above.

Depreciation

Depreciation expense for the year ended October 31, 2001 was $112,193 compared to $98,769 for the previous fiscal period. The increase is related to the inclusion of a full-year of depreciation charges on the previous year's capital asset additions of $215,973, and on a half-year of depreciation charges on new capital asset additions of $73,944, during the current fiscal year.

Bad Debt Expense

The bad debt expense of $300,000 relates to common shares purchased by a previous officer of the Company. During the year, the Company loaned $300,000 to an officer of the Company to purchase 300,000 common shares of the Company's private placement. The officer executed a promissory note for the amount of the indebtedness and signed a Pledge Agreement to pledge the stock as security for the loan. On February 13, 2002, a demand for payment was sent by registered letter giving the former officer 30 days to pay. Payment was not received during the specified time period and as a result, the Company is taking the necessary steps to repossess and cancel the shares.

Operating Segments

The Company has two operating segments, the development and marketing of data retrieval technology for the oil and gas industry (Petro-LAB™), and the development and marketing of data retrieval technology and tools for generic markets (Labrador®).

Financing and Investing

During the year, the Company improved its cash position from a deficit of $49,745 to a surplus of $273,656, an increase of $323,401. In addition, the Company paid out debts of $397,736.

Operations consumed $1,526,858 and expenditures on software development and capital asset additions consumed $122,061 and $73,944 respectively. Cash of $1,500,000 was provided from the QByte transaction, and $944,000 was provided from the sale of equity. The $944,000 of equity included 906,000 common shares issued for cash at a price of $1.00 per common share and 50,000 common shares issued on the exercise of options: 40,000 common shares at $0.80 per share and 10,000 common shares at $0.60 per share. The 906,000 common shares were also accompanied by one-half of one common share purchase warrant at no additional cost. Each whole purchase warrant entitles the holder to receive one common share at a price of $2.00, exercisable until 18 months from the closing date of the offering. The 906,000 common shares included 500,000 common shares purchased by QByte as part of the QByte transaction.

Financial Condition, Liquidity and Requirements Outlook

At October 31, 2001, SSI had cash of $273,656, no long-term debt, and working capital of $1,593,285.

SSI's ability to expand its operations is dependent on its ability to generate sufficient cash to fund its strategic business plan. The Company's cost cutting program has reduced the monthly cash requirements to approximately $215,000 per month, without risking the Company's ability to continue to develop and market its products.

The Company had guaranteed monthly cash inflow from QByte of $158,333 until February 2002 and has $198,333 from March 2002 to February 2003 (see Petro-LAB™ - QByte Transaction above). In addition, the Company expects to receive additional royalties from new business as QByte begins to aggressively market Petro-LAB™ as a key element in its expanding product portfolio. The payments from QByte substantially achieve the goal of matching cash receipts and expenses. With the new business royalties from QByte, cash payments from QByte alone should meet the Company's cash requirements until March 2003.

Forward Looking Statements

Certain statements in the Message to Shareholders and the Management's Discussion and Analysis, other than statements of historical fact, are forward-looking information that involve various risks and uncertainties. These risks and uncertainties include, but are not restricted to, the Company's continuing ability to promote and license its products, the Company's ability to attract and retain key employees, and the Company's ability to raise capital on acceptable terms when needed. These uncertainties may cause actual results to differ from information contained herein. There can be no assurance that such statements will prove to be accurate. Actual results and future events could differ materially from those anticipated in such statements. These forward-looking statements are based on the estimates and opinions of management on the dates they are made and are expressly qualified in their entirety by this notice. The Company assumes no obligation to update forward-looking statements should circumstances or management's estimates or opinions change.

STERNE STACKHOUSE INC.

Balance Sheets

October 31, 2001 and 2000

	2001	2000
ASSETS		
Current assets:		
Cash	**$ 273,656**	$ –
Accounts receivable (notes 6 and 10)	**1,467,635**	1,275,658
Prepaid expenses	**45,845**	61,671
	1,787,136	1,337,329
Capital assets (note 2)	**264,849**	303,098
Software development costs, less accumulated amortization totaling $nil (2000 - $917,233) (note 6)	**–**	691,009
	$ 2,051,985	$ 2,331,436
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current liabilities:		
Loans and bank indebtedness (note 3)	**$ –**	$ 447,481
Accounts payable and accrued liabilities	**161,851**	171,086
Deferred revenue	**32,000**	1,568,758
	193,851	2,187,325
Deferred revenue	**–**	426,993
	193,851	2,614,318
Shareholders' equity (deficiency):		
Share capital (note 4)	**5,081,178**	4,137,178
Deficit	**(3,223,044)**	(4,420,060)
	1,858,134	(282,882)
Commitments (note 9)		
	$ 2,051,985	$ 2,331,436

See accompanying notes to financial statements.

STERNE STACKHOUSE INC.

Statements of Operations and Deficit

Years ended October 31, 2001 and 2000

	2001	2000
REVENUES (note 10):		
License fees	**$ 880,185**	$ 2,585,290
Royalty income	**708,760**	–
Consulting fees	**187,844**	–
Interest income	–	58,599
	1,776,789	2,643,889
EXPENSES:		
General and administration	**1,788,496**	1,403,737
Sales and marketing	**1,569,541**	1,803,916
Computer and related costs	**1,159,669**	743,981
Amortization of software development costs	**120,000**	507,600
Depreciation	**112,193**	98,769
Interest	**10,493**	49,010
	4,760,392	4,607,013
Loss before the following	**(2,983,603)**	(1,963,124)
Other income (expense) items:		
Gain on sale of Petro- LAB (note 6)	**4,480,619**	–
Bad debt expense	**(300,000)**	–
	4,180,619	–
Net income (loss)	**1,197,016**	(1,963,124)
Deficit, beginning of year	**(4,420,060)**	(2,456,936)
Deficit, end of year	**$(3,223,044)**	$(4,420,060)
Net income (loss) per share (note 8):		
Basic and diluted	**$ 0.14**	$ (0.30)

See accompanying notes to financial statements.

STERNE STACKHOUSE INC.

Statements of Cash Flows

Years ended October 31, 2001 and 2000

	2001	2000
Cash provided by (used in):		
Operating activities:		
Net income (loss)	**$ 1,197,016**	$(1,963,124)
Items not involving cash:		
Gain on sale of Petro-LAB	**(4,480,619)**	-
Depreciation and amortization	**232,193**	606,369
Bad debt expense	**300,000**	-
	(2,751,410)	(1,356,755)
Changes in non-cash working capital (note 7)	**1,224,552**	(479,447)
	(1,526,858)	(1,836,202)
Financing activities:		
Issuance of share capital	**944,000**	324,904
Repayment of loans	**(397,736)**	(134,004)
Issuance of convertible debenture	-	2,033,533
Increase in loans	-	240,000
	546,264	2,464,433
Investing activities:		
Proceeds on the sale of Petro-LAB	**1,500,000**	-
Expenditures on software development	**(122,061)**	(340,171)
Capital assets additions	**(73,944)**	(215,973)
	1,303,995	(556,144)
Net increase in cash position	**323,401**	72,087
Bank indebtedness, beginning of year	**(49,745)**	(121,832)
Cash (bank indebtedness), end of year	$ 273,656	$ (49,745)

Bank indebtedness consists of cheques issued in excess of cash in bank.

See accompanying notes to financial statements.

Sterne Stackhouse Inc. (the "Corporation") is engaged in the research and development and marketing of data retrieval technology for customers.

1. Significant accounting policies:

(a) Revenue recognition:

Revenue from the sale of licenses as well as revenue attributable to undelivered elements, including maintenance and other post-customer support services, is recognized ratably over the contract period. Revenue from consulting services and royalties are recognized when the services are performed and/or when earned.

(b) Software development costs:

Capitalized software development costs represent salaries and consulting fees directly attributable to the development of computer software products, which have a clearly defined market and for which technological feasibility has been established. These costs are amortized straight-line over three years with amortization commencing when the software products begin to be commercially marketed. Management reviews the valuation and amortization of software development costs, taking into consideration the nature of the industry and the circumstances, which may impair their value. The amount of impairment, if any, is determined based on estimated future cash flows. Any impairment in the value of the software development costs is written-off against earnings.

(c) Capital assets:

Capital assets are stated at cost. Depreciation is provided annually over the estimated useful lives of the assets as follows:

Asset	Basis	Rate
Computer equipment	Declining balance	30%
Leasehold improvements	Straight line	5 years
Furniture and equipment	Declining balance	20%
Purchased computer software	Declining balance	50%

(d) Stock based compensation plans:

Consideration paid by employees or directors on the exercise of stock options under the employee stock option plan is recorded as share capital.

(e) Per share amounts:

Effective October 31, 2001, the Corporation retroactively adopted the new standards for the presentation and disclosure of earnings per share (see note 8). Under the new standards, the treasury stock method is used instead of the imputed earnings method to determine the dilutive effect of stock options and other dilutive instruments.

1. Significant accounting policies (continued):

(f) Income taxes:

Effective November 1, 2000 the Corporation adopted the liability method of accounting for income taxes (see note 5). Under this method, future income tax liabilities and future income tax assets are recorded based on temporary differences – the difference between the carrying amount of an asset and liability in the balance sheet and its tax basis using income tax rates enacted at the balance sheet date. The effect of changes in rates on future income tax liabilities and assets is recognized in the period that the change occurs.

(g) Short-term investments:

Short-term investments are investments that are generally held to maturity and have terms less than one year. Short-term investments are carried at cost, which approximates their fair value.

(h) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Capital assets:

2001	Cost	Accumulated depreciation	Net book value
Computer equipment	$ 430,919	$ 330,935	$ 99,984
Leasehold improvements	76,045	41,237	34,808
Furniture and equipment	181,807	120,192	61,615
Purchased computer software	274,483	206,041	68,442
	$ 963,254	$ 698,405	$ 264,849

2000	Cost	Accumulated depreciation	Net book value
Computer equipment	$ 400,115	$ 294,685	$ 105,430
Leasehold improvements	75,941	30,543	45,398
Furniture and equipment	174,012	105,763	68,249
Purchased computer software	239,240	155,219	84,021
	$ 889,308	$ 586,210	$ 303,098

3. Loans and bank indebtedness:

		2001		2000
Bank indebtedness:				
Cheques issued in excess of cash in bank	$	–	$	49,745
Bank Demand loan		–		305,000
		–		354,745
Patient capital loan		-		92,736
	$	-	$	447,481

During the year ended October 31, 2001, the Corporation repaid the bank indebtedness and patient capital loan in entirety. In addition, the bank facility was not renewed.

4. Share capital:

(a) Authorized:

Unlimited preferred shares, Series A and Series B; and

Unlimited common shares.

(b) Issued and outstanding:

	2001		2000	
Common shares	Number of shares	Amount	Number of shares	Amount
Balance, beginning of year	7,593,685	$ 4,137,178	5,640,496	$ 1,778,741
Issued for cash	906,000	906,000	577,500	577,500
Issued on exercise of stock options	50,000	38,000	20,000	12,000
Conversion of debt	–	–	1,355,689	2,033,533
Less share issue costs	–	–	–	(264,596)
Balance, end of year	8,549,685	$ 5,081,178	7,593,685	$ 4,137,178

Effective March 20, 2000, a convertible debenture issued on January 31, 2000 totaling $2,000,000 was converted to 1,335,689 common shares of the Corporation. The convertible debenture bore interest at the coupon rate of 8% per annum payable monthly and was unsecured.

4. Share capital (continued):

(c) Stock option plan:

The Corporation has a stock option plan for its directors, officers and employees. At October 31, 2001, stock options outstanding under this plan were as follows:

	Number	Exercise price	Weighted average exercise price
Outstanding at October 31, 1999	470,000	$ 0.60	$ 0.60
Granted	235,000	1.00 – 1.55	1.12
Exercised	(20,000)	0.60	0.60
Outstanding at October 31, 2000	685,000	0.60 - 1.55	0.78
Granted	415,000	0.25 – 1.05	0.49
Exercised	(50,000)	0.60 – 0.80	0.76
Cancelled	(195,000)	0.60 – 1.00	0.94
Outstanding at October 31, 2001	855,000	$ 0.25 – 1.55	$ 0.60

Range of exercise price outstanding	Number outstanding at October 31, 2001	Weighted average remaining contractual life (months)	Weighted average exercise price	Number exercisable October 31, 2001	Weighted average exercise price
$ 0.25 – 0.30	260,000	17	$ 0.26	18,750	$ 0.30
0.60	430,000	2	0.60	430,000	0.60
0.80	35,000	14	0.80	-	-
1.00 – 1.50	75,000	2	1.03	8,750	1.00
1.50 – 1.55	55,000	9	1.51	55,000	1.52
$ 0.25 – 1.55	855,000	7.5	$ 0.60	512,500	$ 0.69

4. Share capital (continued):

(d) Warrants:

Information with respect to the outstanding warrants is as follows:

Outstanding at October 31, 1999	–
Granted	288,750
Outstanding at October 31, 2000	288,750
Granted	568,000
Cancelled	(75,000)
Outstanding at October 31, 2001	781,750

Expiry Date	Exercise Price	Number Outstanding and Exercisable
January 31, 2002	$ 1.50	40,000
March 13, 2002	$ 2.00	288,750
September 16, 2002	$ 2.00	250,000
June 11, 2002	$ 2.00	53,000
December 26, 2002	$ 2.00	150,000
		781,750

5. Income taxes:

Effective November 1, 2000, the asset and liability method of accounting for income taxes was retroactively adopted without restatement of the prior years' financial statements. No adjustment was required to the financial statements as a result of the new accounting standard.

Total income taxes are different from the amount computed by applying the combined expected Canadian Federal and Provincial tax rate of 42.6% (2000 – 44.6%) to income before income taxes and other items. The reasons for the difference are as follows:

	2001	2000
Computed expected tax provision (recovery)	$ 510,000	$ (876,000)
Add (deduct) the following:		
Recognized benefit of losses	(472,000)	-
Non-deductible expenses	(38,000)	15,000
Unrecognized benefit of losses	–	861,000
	$ –	$ –

5. Income taxes (continued):

The components of the future income tax assets and liabilities at October 31, 2001 is as follows:

Future income tax assets:	
Share issue costs	$ 60,000
Non-capital losses	1,580,000
Future income tax liabilities:	
Accounts receivable reserve	(449,000)
Capital assets	(7,000)
	1,184,000
Less valuation allowance	(1,184,000)
Net future income tax asset	$ –

As at October 31, 2001, management expects the Corporation to have investment tax credits carryforward of approximately $363,000 (2000 - $423,000) which may be used to offset federal taxes payable in future years. These investment tax credits commence to expire in 2007. As at October 31, 2001, the Company had non-capital losses totalling approximately $4,241,000 which begin to expire in the year 2006. The potential income tax benefit arising from these amounts has not been reflected in these financial statements.

6. Gain on sale of Petro-LAB:

Effective February 28, 2001, the Corporation closed a transaction with a provider of software to the Canadian oil and gas industry which resulted in the sale of the Petro-LAB software and the granting of an exclusive, perpetual, royalty-bearing license to use, market and license Labrador to the mid and up-stream oil and gas market in Canada. The rights to use Petro-LAB outside of Canada have not been sold and have been retained by the Corporation. Under the terms of the agreement, the Corporation received an immediate $1,500,000 royalty pre-payment and will receive additional payments based on the following:

(a) an annual royalty, paid monthly, of 100% of the mutually agreed to revenue stream of $6,310,000 from existing clients of the Corporation over the next 3 years;

(b) an annual royalty, paid monthly, of 25% of the mutually agreed to revenue stream of $2,755,000 from existing clients of the Corporation over 4 and 5 years;

(c) the royalty will be adjusted against actual revenue at the end of years 2, 3, 4 and 5. The Corporation will receive 50% of any excess of actual revenue above agreed revenue, and the purchaser will reduce its royalty obligation by 50% of any shortfall of actual revenue below agreed revenue; and

6. Gain on sale of Petro-LAB (continued):

(d) a 25% royalty, in perpetuity, on all revenue from new clients for Petro-LAB and the Petro-LAB/Web Solution, on all new business from existing Petro-LAB clients, and on all business from existing clients of the Corporation after year 5 using Labrador.

As a result of the transaction, the Corporation recognized a gain on the sale of the Petro-LAB assets totaling $4,480,619 based upon the minimum level of cash to be received. Details of the gain are as follows:

Cash	$ 1,500,000
Accounts receivable	1,999,375
Deferred revenue	1,674,314
	5,173,689
Less associated software development costs	693,070
Gain on sale of Petro-LAB	$ 4,480,619

The portion of the gain related to deferred revenue results from the inclusion of revenue previously deferred. The acceleration of the deferred revenue arises because of the transfer of Petro-LAB maintenance and support obligations to the purchaser of the Petro-LAB assets.

The reduction in license fees results primarily from the sale of the Petro-LAB assets.

At October 31, 2001 accounts receivable included $1,422,959 relating to the gain on sale of Petro-LAB.

7. Supplemental cash flow disclosure:

(a) Changes in non-cash working capital are as follows:

	2001	2000
Accounts receivable	$ 1,507,398	$ 33,200
Prepaid expenses	15,826	(30,339)
Accounts payable and accrued liabilities	(9,235)	(111,122)
Deferred revenue	(289,437)	(971,186)
Short-term investments	–	600,000
	$ 1,224,552	$ (479,447)

7. Supplemental cash flow disclosure (continued):

(b) The following cash payments were made:

	2001	2000
Interest	$ 10,493	$ 49,010
Taxes	–	–

8. Per share amounts:

Effective October 31, 2001, the Corporation retroactively adopted the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. The following table illustrates the number of weighted average common shares outstanding, the number of shares which were added to the weighted average number of common shares outstanding for the dilutive effect of stock options and warrants, and what the reported amounts would have been had the imputed earnings method been used:

	2001	2000
Weighted average number of common shares outstanding	8,267,575	6,537,010
Dilutive effect of stock options	236,181	338,831
Dilutive effect of warrants	-	-
Fully-diluted net income (loss) per share	0.14	(0.30)

9. Commitments:

The Corporation has leases on its premises and certain computer and office equipment, which expire through 2005. Minimum annual payments under the leases are approximately as follows:

2002	$ 476,000
2003	358,000
2004	336,000
2005	83,000

10. Segmented information and customer concentration:

(a) Segment information:

The Corporation has two operating segments for the development and marketing of data retrieval technology: 1) for the oil and gas industry (Petro-LAB); and 2) for other commercial applications (Labrador).

Information with respect to the industry segments is as follows:

October 31, 2001	Petro-LAB	Labrador	Total
License fees	$ 809,585	$ 70,600	$ 880,185
Royalty income	–	708,760	708,760
Consulting fees	–	187,844	187,844
	809,585	967,204	1,776,789
Expenses:			
General and administrative	306,666	1,481,830	1,788,496
Sales and marketing	279,266	1,290,275	1,569,541
Computer and related costs	134,027	1,025,642	1,159,669
Amortization of software development costs	–	120,000	120,000
Depreciation	19,200	92,993	112,193
Interest	3,694	6,799	10,493
	742,853	4,017,539	4,760,392
Other income (expense) items:			
Gain on sale of Petro-LAB	4,480,619	–	4,480,619
Bad debt expense	–	(300,000)	(300,000)
	4,480,619	(300,000)	4,180,619
Net income (loss)	$ 4,547,351	$ (3,350,335)	$ 1,197,016

10. Segmented information and customer concentration:

(a) Segment information (continued):

October 31, 2000	Petro-LAB	Labrador	Total
License fees	$ 2,585,290	$ –	$ 2,585,290
Interest income	58,599	–	58,599
	2,643,889	–	2,643,889
Expenses:			
General and administrative	612,503	791,234	1,403,737
Sales and marketing	671,501	1,132,415	1,803,916
Computer and related costs	371,991	371,990	743,981
Amortization of software development costs	–	507,600	507,600
Depreciation	49,384	49,385	98,769
Interest	24,505	24,505	49,010
	1,729,884	2,877,129	4,607,013
Net income (loss)	$ 914,005	$ (2,877,129)	$ (1,963,124)

	Year ended October 31, 2001			Year ended October 31, 2000		
	Expenditures on capital assets	Expenditures on software development costs	Total identifiable assets	Expenditures on capital assets	Expenditures on software development costs	Total identifiable assets
Petro-LAB	$ 36,972	$ –	$ 1,422,959	$ 107,987	$ –	$ 1,488,878
Labrador	36,972	122,061	629,026	107,986	340,171	842,558
	$ 73,944	$ 122,061	$ 2,051,985	$ 215,973	$ 340,171	$ 2,331,436

Inter-segment transactions were not significant.

(b) Customer concentration:

As a result of the Corporation's sale of Petro-LAB, substantially all the Corporation's current revenues are derived from one customer.

11. Fair values:

As at October 31, 2001 and 2000, the fair values of the Corporation's monetary assets and liabilities approximated their carrying values.

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CORPORATE INFORMATION

Management and Officers
H. Ronald Sterne
Chief Executive Officer &
Chief Operating Officer

Darryl K. Stackhouse
President &
Chief Financial Officer

Directors
H. Ronald Sterne
Calgary, Alberta

Darryl K. Stackhouse
Calgary, Alberta

George A. Wilson, Q.C.
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K. Garry Cook, C.A.
Calgary, Alberta

John D. Riddell
Calgary, Alberta

Stock Exchange Listing
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(Trading Symbol: SSX)

Bankers
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Calgary, Alberta

Auditors
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