



ENGINEERING.COM™

ENGINEERING.COM INCORPORATED

MANAGEMENT'S DISCUSSION & ANALYSIS



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MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

To the Shareholders of ENGINEERING.com Incorporated:

The financial statements and other financial information in this Annual Report were prepared by the management of ENGINEERING.com Incorporated (the "Company"), reviewed by the Audit Committee and approved by the Board of Directors.

Management is responsible for the financial statements and believes that they present fairly the Company's financial condition and results of operations in conformity with generally accepted accounting principles. Management has included in the Company's financial statements amounts based on estimates and judgments that it believes are reasonable under the circumstances.

To discharge its responsibilities for financial reporting and safeguarding of assets, management believes that it has established appropriate systems of internal accounting control which provide reasonable assurance that the financial records are reliable and form a proper basis for the timely and accurate preparation of financial statements.

Consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these controls should not exceed their expected benefits. Management further assures the quality of the financial records through careful selection and training of personnel, and through the adoption and communication of financial and other relevant policies. The shareholders have appointed Zeifmans LLP to audit the financial statements. Their report outlines the scope of their examination and their opinion.



John Hayes
President and CFO



Frank Baldesarra, P. Eng.
CEO and Chairman of the Board

December 31, 2009

MANAGEMENT'S DISCUSSION & ANALYSIS

In this Management's Discussion and Analysis ("MD&A"), the terms "the Company", "ENGINEERING.com", "we", "us", and "our" means ENGINEERING.com Incorporated.

This MD&A contains statements and other forward-looking information about potential future circumstances, results and developments. Such statements and information are qualified in their entirety by the inherent risks and uncertainties surrounding future expectations generally and may differ materially from the Company's actual future results or events (see "Forward-Looking Statements").

The financial information presented herein has been prepared on the basis of Canadian generally accepted accounting principles ("GAAP"). Throughout this discussion, percentage changes are calculated using numbers rounded to the decimal to which they appear. All dollar amounts are in Canadian dollars except where otherwise stated.

OVERVIEW

The Corporation is the developer and owner of the "www.engineering.com" Web site and Internet-based business. ENGINEERING.com offers hosted and deployed engineering software and web content to engineers in industry and academia around the world. The Corporation offers these services under three revenue models. The Corporation earns revenue through advertising for those services and content delivered at no charge to the user, through the sale of traditional software licenses and through subscription fees for software provided over the Internet as a service.

In order to deliver leading edge Internet-based applications and hosting, the Company has invested significantly since its inception in computer hardware, software and the development of its Web site and infrastructure. The Company develops and hosts a number of free web-based services and content that it makes available to visitors to its Web sites including job postings, engineering games, file sharing, message boards and calculators. During the fourth quarter of 2009 the Company experienced continued growth in the use of these services as measured by visitors, unique visitors and page views. During the year the Company entered into several partnership agreements with engineering related Internet publishers to sell Internet advertisements on their sites. This strategy is intended to allow the Company to increase advertising revenue faster than organic site traffic growth would otherwise permit. Advertising impressions viewed across all sites grew by 269% from 9,142,000 in the 3 months ended December 31, 2008 to 33,734,000 in the fourth quarter of 2009.

The Corporation holds the exclusive software distribution agreements for certain software applications that it resells. For example, Dassault Systèmes has named the Corporation the only North American distributor to the education market for CATIA, one of the world's leading engineering applications. Licenses for educational sales are primarily annual, such that the Corporation earns a stream of recurring revenues.

The Corporation also owns and develops a proprietary collaborative engineering application that it provides on a hosted basis called "Collaboration Suite".

During 2008 the Corporation derived revenue from the provision of services to Rand Worldwide, a former related party in the amount of \$279,305. Corresponding revenues for 2009 declined to \$nil.

The Company has not yet achieved consistently profitable operations. Certain areas of the company's business are profitable including the resale of engineering software. Earnings in these areas were offset during 2009 by the Company's continued investment in the development of its web site and associated free services. During the year management of the Company sought to build traffic to its web site through offering new services while minimizing operating losses.

At December 31, 2009 the Company had a cash balance of \$106,118. The Company continues to make payments on promissory notes associated with the acquisition of the intellectual property for Collaboration Suite. On March 3, 2009 the Company completed a private placement of 7,374,124 Common Shares at a subscription price of \$0.05 per share for net proceeds of \$354,744. The funds from this transaction are being used for general working capital purposes.

FINANCIAL RESULTS

Revenue for the year ended December 31, 2009 decreased to \$1,433,566, from revenue of \$1,444,768, for the year 2008. The decrease in revenues is attributable to declining sales of information technology services to Rand Worldwide, which declined from \$279,305 in 2008 to \$nil in 2009. This declining related party revenue was offset by the growth in sales of education software and advertising. Gross profit for the year ended December 31, 2009 was down from the prior year to \$933,831 compared to \$949,420 in the year ended December 31, 2008.

Net loss in 2009 was \$482,794 or \$0.01 per Common Share, compared to a net loss of \$520,253 or \$0.02 per Common Share for 2008. Operating Income, which the Company defines as income before interest expense, income taxes, amortization and stock-based compensation decreased to a loss of \$259,247 in 2009 from a loss of \$278,935 in 2008. As at December 31, 2009, the Company had a cash balance of \$106,118 compared to a cash balance of \$311,988 as at December 31, 2008.

Selected Quarterly Information

	Q4 2006	Q4 2007	Q4 2008	Q4 2009
Revenues	\$ 563,969	\$ 572,273	\$ 340,828	\$ 489,163
Net loss	(58,525)	(12,716)	(139,356)	(51,163)
Net loss per share, basic and diluted	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)

RESULTS OF OPERATIONS

Revenue

Revenue in 2009 comprised sales of i) Internet advertising, ii) Engineering Software and iii) Hosted Solutions and Services.

ENGINEERING.com revenue was \$489,163 for the three months ended December 31, 2009 and \$1,433,566 for the twelve months of 2009, compared to revenue of \$340,828 for the fourth quarter of 2008 and \$1,444,768 for the year 2008.

The Company's internal sales and service team focuses on three types of sales opportunities:

i) **Internet Advertising.** The Company sells advertising on its web site under a number of revenue models including cost per impression ("CPM"), cost per click ("CPC") and on a fee per action basis. According to the Interactive Advertising Bureau (IAB) and PricewaterhouseCoopers LLP, Internet advertising revenues reached approximately \$10.9 billion in the United States for the six months ended June 30, 2009, representing a decline of 5.3% as compared to the same period a year earlier. This decline is lower than in traditional media as companies move more of their budgets to digital media. The Company intends to capitalize on this trend by providing ever more valuable features for its web site visitors, which it expects will in turn drive increasing visits and page views. By focusing on the engineering demographic segment, the company intends to grow a valuable niche in the market for Internet advertising. During the course of 2009 the Company recorded \$386,250 of revenue from internet advertising (2008 - \$161,152).

ii) **Engineering software.** The Company sells a focused selection of engineering educational products developed by third parties. The Company targets its sales efforts on software titles that have an element of exclusivity, such as the sale of CATIA, a leading CAD modeling system from Dassault Systèmes, to qualifying educational institutions in North America. The Company recorded \$866,098 from educational sales in 2009 (2008 - \$787,744). Most of the Company's sales to the educational market take the form of annual licenses. Accordingly, the Company has experienced and expects to continue to experience a substantial recurring revenue stream from sales made in previous years.

As in any reseller arrangement, the software inventor may choose to change their distribution model and any such changes may not be beneficial to the Company.

iii) **Hosted solutions and Services.** The Company sells its proprietary Collaboration Suite solution as a hosted software application aimed at delivering leading-edge engineering collaboration to manufacturers with distributed project teams. Collaboration Suite is sold as a subscription service, such that the revenues are recognized ratably over the term that the service is provided, although the services are invoiced up to one year in advance. During the course of 2009 the Company recorded \$181,218 of revenue from hosted solutions and services (2008 - \$125,102).

In 2008 the Company derived a portion of its revenue from the provision of information technology services to Rand Worldwide, a former related party. The Company did not derive any revenue from these services in 2009.

Summary of Quarterly Results

The following table sets out, for each of the previous eight quarters, information relating to the Company's revenue, net loss and loss per Common Share:

	Q1 2008	Q2 2008	Q3 2008	Q4 2008
Revenues	\$ 387,754	\$ 317,050	\$ 399,136	\$ 340,828
Net loss	(105,358)	(162,536)	(113,003)	(139,356)
Net loss per share, basic and diluted	\$ (0.00)	\$ (0.01)	\$ (0.00)	\$ (0.00)

	Q1 2009	Q2 2009	Q3 2009	Q4 2009
Revenues	\$ 250,926	\$ 329,396	\$ 364,081	\$ 489,163
Net loss	(194,708)	(145,478)	(98,545)	(44,063)
Net loss per share, basic and diluted	\$ (0.01)	\$ (0.00)	\$ (0.00)	\$ (0.00)

The following table sets out the traffic at the Company's primary web site Engineering.com as measured by pages viewed over the past 8 quarters.

	Q1 2008	Q2 2008	Q3 2008	Q4 2008
Pages Viewed	623,138	723,597	686,377	1,406,000

	Q1 2009	Q2 2009	Q3 2009	Q4 2009
Pages Viewed	1,929,000	2,491,000	1,412,000	2,572,848

Gross Profit

The gross profit for the year ended December 31, 2009 was 65%, compared to 66% for 2008. The Company's gross profit margin fluctuates according to the mix of revenue sources, with margins being generally higher from the sale of advertising and hosted services and lower margins being generated from the sale of third-party products.

Cost of sales encompasses purchases of products and services for resale as well as costs associated with advertising placed on the web-sites or through the email distribution of our network partners.

Salaries and Benefits

During 2009 the Company continued to undertake a substantial portion of its development activities, content development, product support and marketing activities through external providers. This strategy is intended to increase the breadth of the Company's skill set and speed deployment of new features while minimizing the cost to the company.

As at December 31, 2009, the Company employed 7 individuals, compared to 8 employees one year earlier.

The Company reported salaries and benefits of \$535,903 for the twelve months of 2009 compared to \$643,082 for 2008. The decline in salaries and benefits expense in the year is attributable to the reduction in staff during the period. Salaries and benefits expense for the fourth quarter of 2009 was \$135,350 compared to \$163,579 for the prior year's fourth quarter.

Related Party Transactions

During 2009, the Company had three related party transactions. These three transactions totaled \$18,247. These transactions and balances are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

During 2008, the Company had revenues of \$279,305 from related party transactions including software development services and outsourced technology services provided to Rand Worldwide. As at September 30, 2008, the Company ceased being a related party to Rand Worldwide and ceased to provide any services.

Other Operating Expenses

Other operating expenses, including software development, marketing and general and administrative expenses for the year ended December 31, 2009, were \$657,175, compared to \$585,273 in 2008. The increase in operating expenses is due in part to accelerated efforts to build additional features and services on our web sites and the associated cost with marketing such services to our community. A proportion of other operating expenses, such as insurance, legal and audit fees, transfer agency and stock exchange fees are fixed such that the total amount of these expenses is relatively constant year over year.

Amortization

Amortization expense amounted to \$197,999 for the year ended December 31, 2009, compared to \$194,970 for the previous year. Assets that were amortized during the period include computer and office equipment, leasehold improvements, and the Alventive software intangible asset. All assets are being amortized on a straight-line basis over periods ranging from three to five years.

Income Taxes

The benefit of losses available for carry forward to be offset against taxable income in future years has not been recognized by the Company in the financial statements. As at December 31, 2009, these losses totaled \$1,533,000. In addition, the Company has recorded property and equipment that have not been amortized for tax purposes of approximately \$6,630,000.

LIQUIDITY & CAPITAL RESOURCES

The Company's operations from its inception have been funded from the proceeds of share offerings. The first such offering was on May 31, 2000, which yielded net proceeds of \$10,685,000. On October 31, 2003, the Company issued 4,587,310 Common Shares in connection with a Rights Offering that yielded net proceeds of \$868,343. On July 1, 2004, ENGINEERING.com completed the issuance of 4,347,826 Common Shares for net proceeds of \$963,219 by way of private placement. On March 3 2009 the Company completed a private placement of 7,374,124 Common Shares for net proceeds of \$354,744.

The Company had cash on hand at December 31, 2009 of \$106,118 compared to a cash balance of \$311,988 as at December 31, 2008.

The Company continues to make payments on promissory notes associated with the acquisition of the intellectual property for Collaboration Suite. The Company pays approximately \$4,000 (U.S.) per month on this note. This note is expected to be paid off in its entirety by the end of June 2010.

Working Capital

As at December 31, 2009, the Company had working capital of (\$350,490) compared to working capital as at December 31, 2008 of (\$399,501).

PROPERTY AND EQUIPMENT

During 2009 the Company purchased \$17,515 of property and equipment.

Intangible Assets

On August 11, 2005 the Company acquired the Alventive software and intellectual property from BlueSky Solutions LLP. This software is sold on a hosted basis by the Company under the name "Collaboration Suite". The value of the intellectual property is recorded at cost and amortized over a period of 5 years (see Note 6 to the accompanying Financial Statements).

Intangible Assets also include the ENGINEERING.com domain name, which is not amortized.

EVALUATION AND EFFECTIVENESS OF DISCLOSURE CONTROLS AND PROCEDURES

The Company has designed disclosure controls and procedures that provide reasonable assurance that all material information relating to the Company has been made known to senior management of the Company. The purpose of these controls is to provide reasonable rather than absolute assurance that all control issues and fraud will be detected. The CEO and CFO are responsible for designing and maintaining these controls and procedures. As at the date of these financial statements, we conducted an evaluation of the effectiveness of these controls and have concluded that they are operating in such a way as to provide reasonable assurance that all

material disclosures have been brought to the attention of management and have been accurately disclosed in these financial statements.

The Company has designed internal controls over financial reporting that provide reasonable assurance that;

- Financial statements are prepared in accordance with generally accepted accounting principles
- Transactions are recorded as necessary and in sufficient detail to permit the accurate and timely preparation of financial statements
- Receipts and expenditures are made in accordance with the instructions of the Company's management
- Unauthorized use of the Company's assets will be detected in order to prevent material error in the Company's interim or annual financial statements.

The Company has 7 employees, only one of whom is dedicated to maintaining its financial records on a full-time basis. Accordingly, the Company has not and cannot economically segregate duties to prevent unauthorized acquisition, use or disposition of the Company's assets. The Company has taken steps to mitigate this risk and to detect incidents after the fact primarily through detailed management review of all financial reporting.

There is a risk that the Company may be materially affected by a sudden departure of the single full-time accounting staff person. Due to the limited resources of the Company, there are no plans to change the number of accounting staff to mitigate this risk.

The Company has put in place certain procedures that mitigate the risk of management over-ride of internal controls regarding financial reporting and the use of Company assets, including adoption of general disclosure guidelines for employees. There remains a risk that management may over-ride these procedures and that any such over-ride may not be detected or reported on a timely basis.

The Company uses an internal documentation and control methodology to enhance its management of financial reporting. This methodology and the Company's adherence to the reporting steps within that methodology are retained in an online documentation repository that is accessible to the Company's auditors and its Audit Committee.

The Company has completed the first phase of a three phase approach towards transitioning to International Financial Reporting Standards. The Company has identified that there are areas in which IFRS may impact the Company's reporting, particularly in the area of asset valuation and stock based compensation. At this time, the Company cannot quantify the impact that future adoption of IFRS will have on our financial statements. Additional information will be provided as we progress towards implementation.

PRESENT STATUS AND RISK FACTORS

Operational Risks

The Company has not yet realized consistently profitable operations and has relied on non-operational sources of financing to fund operations. The Company had losses before interest, taxes, stock-based option compensation and amortization (EBITDA – see Non-GAAP Disclosure) in the current year of \$259,247 and has an accumulated deficit of \$15,441,292.

At December 31, 2009, the Company had \$106,118 in cash on hand. This cash balance is relatively small when compared to the Company's continued obligations with respect to payroll and other expenses. As at December 31, 2009 the Company had negative working capital of \$350,490. The Company does not have access to any operating loan facilities. Accordingly, the realization of any of the risks set out in this MD&A could have a swift and significant negative impact on the Company.

The Company has a substantial reliance on transactions with Dassault Systèmes, the author of certain software products that the Company resells. The current reseller agreement with Dassault was signed in October 2007. If Dassault is unwilling or unable to renew this reseller agreement, the Company may lose its arrangement to resell CATIA and DELMIA to the educational market. Should that occur, the Company's operations would be negatively affected. The Company recorded approximately \$797,043 of software sales related to Dassault products in 2009.

The Company has invested substantially in free online applications for engineers, which it monetizes through the sale of advertising. The Company is dependant on continued growth in its web site traffic and corresponding continued growth in advertising revenue to generate operating income from these activities.

The Company has launched a series of hosted services called Collaboration Suite. There is a risk that the market will not accept hosted solutions as an alternative for conventionally delivered software and that the Company will not earn sufficient revenue from these services to achieve profitable operations.

The Company operates a complex technology environment for its customers, web site visitors and on its own behalf. There is a risk that certain elements of this environment may be incompatible with new components as they are installed. The Company and its customers may experience service outages to the extent that the Company's quality control procedures fail to detect such incompatibilities prior to deployment. Any such service outages may negatively affect the Company's relationships with its customers and web site visitors.

After allowing for the cash raised through the private placement on March 3 2009, the Company may still determine that the cash on hand is not adequate to fund future growth objectives or acquisitions and the Company may seek to raise additional operating funds. If the Company completes a share offering, the proportionate ownership of the shareholders of the Company will be reduced, and shareholders may experience additional dilution and such securities may have rights senior to those of the Company's Common Shares.

Foreign Currency Risks

The Company incurs substantially all of its expenses other than the purchase of software in Canadian dollars, and derives most of its revenue in U.S. dollars. Fluctuations in the U.S./Canadian exchange rate will impact the Company's reported results, given that the Company reports in Canadian dollars. During periods of strength in the Canadian dollar, revenue reported in Canadian dollars will be affected in a negative manner.

The Company will also be exposed to foreign currency fluctuations to the extent that it has a net investment in foreign denominated assets and liabilities. The Company does not have any hedging programs in place to manage the potential exposure to fluctuations in the U.S./Canadian dollar exchange rate. The Company may be exposed to foreign exchange losses in the future that are not offset by gains.

Reliance on Internet Infrastructure

The Company's web site and hosted offerings rely on the Internet as a platform for communications. The Internet has experienced, and is expected to continue to experience, significant growth in the number of users and amount of traffic. There can be no assurance that the Internet infrastructure will be able to support the demands placed on it. Interruptions in the Company's operations or the ability of its customers to access its systems as a result of any of the foregoing could have a material adverse effect on the Company's business, results of operations and financial condition.

Attraction and Retention of Key Personnel

The Company's performance is substantially dependent on the performance of its key technical, sales, and senior management personnel. The loss of the services of any of such personnel could have a material adverse effect on the business, results of its operations and the financial condition of the Company.

Off Balance Sheet Arrangements

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

Non-GAAP Disclosure

EBITDA is defined by the Company as operating income before interest expense, income taxes, stock based compensation, amortization and asset write-downs or sales. The Company has included information concerning EBITDA because it believes that it may be used by certain investors as one measure of the Company's financial performance. EBITDA is not a measure of financial performance under Canadian generally accepted accounting principles and is not necessarily comparable to similarly titled measures used by other companies. EBITDA should not be construed as an alternative to operating income or to cash flows from operating activities

(as determined in accordance with Canadian generally accepted accounting principles) as a measure of liquidity.

Forward-Looking Statements

This Management's Discussion and Analysis of financial condition and operating results contains forward-looking statements concerning the future prospects of the Company's products and services and its position in the Internet-based solutions and content provider marketplace. Forward-looking statements include statements of plans, objectives, strategies and expectations. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

The Company considers the assumptions on which these forward-looking statements are based to be reasonable, but cautions the reader that these assumptions regarding future events, many of which are beyond our control, may ultimately prove to be incorrect since they are subject to risks and uncertainties that affect us. There are a number of factors that could cause results or events to differ from current expectations including, among other matters: the pace of development of the market for Internet-based applications; changes in the level of marketing and other operating expenses to support future growth; competitive factors; and general economic conditions. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.