"The mark of a company committed to long-term shareowner value is not how it performed yesterday but rather how it will perform tomorrow."

1996 Annual Report

gandalf™

"Our strategy is to deliver the best solutions our customers want at a price that makes sense for their business, through technological leadership and world-class comprehensive support."

April 9, 1996
XpressConnect
LANLine 5242i

April 9, 1996
XpressStack BRI

July 1995
XpressConnect 5242i

September 25, 1995
XpressConnect 5242i

November 1995
Xpressway RLAN

Photos of All@once℠ applications courtesy of Bell Atlantic. Bell Atlantic® All@once℠ Solutions is a fully integrated marketing program for large business customers. It is a strategic commitment to providing a seamless communications environment, packaging voice, data, video, interactive multimedia, network consulting, information management and communications equipment with the support and teamwork that deliver success.

CORPORATE PROFILE

Gandalf Technologies Inc., a publicly held company with over 25 years of networking experience, is a leading designer and international supplier of remote access and internetworking solutions. Gandalf's vision is to provide people with access to information through technology. The Company creates value for its customers by integrating a variety of technologies and a range of telephone company services with its customers' information applications. Gandalf accomplishes this through four lines of business: access, concentration, backbone, and services. Gandalf specializes in teleworking and offers customers one of the most comprehensive ranges of remote access and concentration options available on the market today, giving customers the flexibility to choose the exact level of performance, functionality, features and price that makes sense for their individual applications. Additionally, Gandalf provides total turnkey solutions that simplify the implementation of teleworking programs.

Gandalf's leadership stems from its technology innovation, operational support excellence and a market-driven management system. Gandalf's technology innovation is demonstrated through its industry-leading data compression and encryption, superior interoperability results, high density concentration and involvement in the development of current standards and protocols. With its partners, Gandalf provides its customers with a unique worldwide support and services infrastructure, demonstrating excellence in operational support. Gandalf's market-driven management system, the Customer Value Architecture (CVA), ensures its remote access solutions meet customers' specific needs while maximizing and protecting their investment in network infrastructure.

SELECTED FINANCIAL DATA

THOUSANDS OF U.S. DOLLARS EXCEPT PER SHARE AMOUNTS

Years Ended March 31	1996	1995	1994	1993	1992*
Income Statement Data:					
Revenues	$116,533	$120,511	$131,323	$160,900	$119,181
Gross margin	45.9%	44.4%	41.7%	43.7%	46.5%
Selling, general and administration	39,996	40,661	54,772	62,807	45,778
Research and development	11,524	10,197	14,316	17,279	13,679
Net income (loss)	260	1,406	(47,238)	(19,507)	(9,912)
Basic earnings (loss) per share	0.01	0.05	(2.27)	(1.24)	(0.63)
Balance Sheet Data:					
Total assets	79,375	81,508	89,186	129,603	141,408
Fixed assets	16,253	18,619	20,214	30,768	38,416
Working capital	29,361	21,057	13,978	25,596	19,276
Current ratio	2.0	1.6	1.3	1.5	1.3
Cash and cash equivalents net of current bank debt	13,602	5,963	(5,239)	(688)	(17,918)
Long-term debt	2,496	1,877	2,020	22,980	23,729
Convertible debentures	-	10,051	21,681	23,862	-
Shareholders' equity	48,586	34,442	19,109	34,308	55,491

Thomas A. Vassiliades
Chairman, President and
Chief Executive Officer

MESSAGE TO SHAREHOLDERS

Last year I told you it was time to address the next step, that is, the need to get back on the growth path and achieve sustainable profitable growth.

In the fourth quarter ended March 31, 1996, we reported revenues of $32.4 million, fifteen percent higher than the third quarter and six percent higher than the fourth quarter a year ago. Product revenue grew twenty-four percent from the third quarter to the fourth quarter of fiscal 1996. Income before restructuring charges for the full 1996 fiscal year was $1.8 million compared to income for the 1995 fiscal year of $67,000, exclusive of restructuring charges and a one-time gain on the sale of a portfolio investment. The Company's reported cash flow of $1.8 million for the fourth quarter of fiscal 1996 was the seventh consecutive quarter of positive cash performance, resulting in a net cash position at March 31, 1996 that was more than double the level of last year. Cash and unused credit lines were $30.9 million, up forty-nine percent from a year ago, and bank debt has been reduced to zero. Revenue from the Company's remote access products, sold under the names Gandalf Xpressway®, XpressStack® and XpressConnect®, represented sixty-five percent of product revenue in fiscal 1996, compared to forty-nine percent in 1995 and twenty-five percent in 1994. Having worked through the survival and stability stages on our way to recovery, the fourth quarter was a good start. Nonetheless, one quarter's performance does not achieve our target of sustainable profitable growth, despite the fact that this is the first time we have seen double digit quarter-over-quarter revenue growth in over five years.

"...the next step...is the need to get back on the growth path and achieve sustainable profitable growth."

The fourth quarter of fiscal 1996 saw the commencement of many necessary changes. The realignment of our international operations introduced three operating entities where there was previously one, establishing regional headquarters for the Europe, Middle East and Africa Group (EMEA) in Bracknell, U.K., the Northern Europe Group (NEG) in Amsterdam, and the Asia Pacific Group (APG) in Tokyo. The purpose of the realignment is to increase the focus on these three key international markets. The creation of APG allows us to work more effectively those relationships in which we have been well positioned to achieve faster and improved results. EMEA and NEG will focus on achieving the proper balance of growing existing markets and penetrating new markets.

The restructuring of our sales and distribution organizations worldwide is designed to focus the necessary skills and resources on developing distribution channels that more appropriately suit today's and tomorrow's changing product mix and to reduce costs by eliminating redundant and unproductive activity. With these changes we continue to execute our channel strategy, which places particular emphasis on the National Resellers, service providers, OEM relationships and named corporate

accounts in high-growth markets in Asia, Europe, and North America. Over the past year, we have established partnerships with four National Resellers in the U.S., three in the U.K., three in Canada, one in France, and one in Japan. We have announced relationships with several influential telephone companies including the Nippon Telegraph and Telephone Corporation (NTT), the largest telephone company in the world. The end of the fourth quarter saw the beginnings of the installation of many key marketing skills. These skills have been lacking in our business for several years and are absolutely necessary if we are to achieve the demand creation that generates pull-through of our products from the value added resellers and distributors, through the National Resellers.

> *"We have built the process that focuses us on achieving and maintaining market leadership."*

Beyond those which we have already discussed, cost reduction activities continue, primarily through outsourcing non-strategic, non-core functions. We have outsourced our worldwide maintenance delivery to IBM; are in the process of outsourcing manufacturing repair in the U.K.; will announce shortly the outsourcing of high volume manufacturing; and will be consolidating worldwide manufacturing distribution in Nepean, Canada. We plan to continue to fund our growth and opportunities through increased efficiency and productivity; develop partnerships that enhance performance in service delivery and product development, delivery, manufacturing, and repair; and outsource all non-strategic, non-core businesses, thereby enabling us to increase the focus on mission-critical, core functions, such as engineering and development, marketing, and services.

As you can see, our 1996 performance reflects Gandalf's commitment to shareowner value — value in the solutions we provide to our customers for their business, as well as the value those solutions permanently provide to our business — however, the mark of a company committed to long-term shareowner value is not how it performed yesterday but rather how it will perform tomorrow. The objective we set for ourselves when we defined our vision of being a leading, international, remote access product and services company was to deliver the best solutions our customers want at a price that makes sense for their business, through technological leadership and world-class, comprehensive, operational support. We have built the process that focuses us on achieving and maintaining market leadership. We call that process Gandalf's Customer Value Architecture (CVA), a process derived from customer requirements. For our customers this means change — necessary, significant, yet evolutionary change and rapid, yet orderly, controlled change — with benefits that are realized immediately and over the long term.

In my view, Gandalf's greatest strength comes from its people. As we pursue the opportunities of the remote access market, it is the experience and dedication of our people that will make the difference — experience based on technological leadership and dedication to providing outstanding, comprehensive support to our customers,

From left to right: Richard Busto, Vice President, Strategy, Business Development and Network Services; Thomas Vassiliades, Chairman, President and Chief Executive Officer; Jeff Singer, Director, Human Resources; Diana Cianciusi, Corporate Secretary and Legal Counsel; John McGoldrick, President, Asia Pacific Group; Michael Chawner, Vice President, Product Operations and Chief Technology Officer; Maureen Kelly, Vice President, Information Systems and Administration; Walter MacDonald, Vice President, Finance and Chief Financial Officer; Ken Stess, Vice President, North American Sales; Joceline Lemieux, Vice President, Worldwide Marketing; Wendy Burgess, Vice President, Communications and Investor Relations; Gerry Geraghty, Vice President, Manufacturing and Supply.

Absent from photo: Peter Merrifield, Managing Director, Europe, Middle East and Africa; Frank van der Poll, Managing Director, Northern Europe.

whether they be the providers of remote access such as the Intranet and Internet providers or the end users of remote access themselves.

We define remote access as the extension of corporate and Internet resources to remote branch offices, teleworkers, and mobile users. Our view looking forward is that the remote access market is expected to grow at a compound annual growth rate of fifty percent, with faster growth rates expected in full-time teleworking, in the provision of access to small and medium branch offices and in Internet access. The types of users accessing Intranet/corporate resources and Internet resources remotely are increasing to include the more sophisticated power users, remote location users, mobile users, full-time teleworkers, part-time teleworkers, and casual users. In our customers' environments we see a convergence of product requirements, but with differences in priorities. Casual users are looking for price, ease of use, maximum throughput, and the ability to connect to multiple destinations. Power users require maximum throughput, the best in price/performance, the ability to connect to many destinations, increased functionality, and ease of use. The Intranet provider is looking for improved productivity, access to a broader labor pool, reduced facility costs, environmental compliance, the best in throughput and price/performance, maximum security, manageability, minimal line charges, investment protection, and ease of use. The Internet provider wants the lowest costs, both in terms of infrastructure cost and cost of ownership, embracing the maximum number of users with investment protection and value-add capabilities such as manageability, billing systems, and increased vendor support.

Our strategy for meeting these market requirements is to deliver the specific features and functionality required at a price that is the most appropriate for each application. In other words, our strategy is to deliver value in the form of targeted price/performance deliverables. Our introduction in the spring of 1996 of a suite of XpressConnect remote access devices, including analog modems, ISDN bridges and routers, and an integrated hub/router, delivers increased choice to our customers. For example, the XpressConnect 5232i, a high-performance ISDN router with a variety of modular, upgradeable options, targets the teleworker who wants access to the Internet or corporate data. The XpressStack Internet Access Server (IAS), a high density central site concentrator, supporting both analog and high speed ISDN connections, is designed for the Internet Service Provider.

A cornerstone of our strategy is differentiation through technology innovation. We continue to lead the market in terms of throughput, performance, ease of use,

manageability, and interoperability, as evidenced by recent product awards from *PC Magazine*, and similar recognition earlier in fiscal 1996 from *Data Communications*, *InfoWorld* and *Communications News*. On March 27, 1996 we announced our ability to deliver the industry's first encryption within compression software which ensures the private transmission of data over remote links without sacrificing performance. Other technological enhancements include the introduction of integral dial-up capability, new networking protocols, a high density ISDN module, sophisticated bandwidth management protocols, and the ability to use the Internet for private networking, all of which create a more powerful, higher density Xpressway central site concentrator.

A second cornerstone to our strategy is to be best-of-breed at satisfying the needs of our customers by providing the full life cycle of support solutions. This year Gandalf improved its breadth and depth of service ability through a worldwide partnership with IBM. As a result of our relationship with IBM and other partners, we are initiating the delivery of complex, customized, value-added services to our customers. RemoteConnect, a turnkey, teleworking deployment program announced in March, 1996, delivers a value-add, integrated services package encompassing installation, project management, ISDN line provisioning and end user support, and is one of the first such service offerings in the industry.

It is my experience that it takes three years to turn a company around, and Gandalf is no exception. We have managed through seven profitable quarters during a period of transition. The next couple of quarters address the final stages of the transition, specifically the move from an end user sales force to an indirect model that more appropriately suits the products we market today; centralized product distribution; high volume manufacturing; and additional outsourcing.

I want to personally thank our employees, many of whom are shareholders, who brought this company from the brink of two years ago to where we are today, and more importantly, where we need to be tomorrow. I am proud of them and consider it a privilege to work side by side with such professionals. However, we still have a considerable way to go before we can say we are satisfied with our results. We believe our strategy to be right; the risk is in the quality of our implementation. Therefore, our next step is to achieve impressive and consistent results through the professional implementation and execution of our strategies and programs.

"We believe our strategy to be right; the risk is in the quality of our implementation. ... our next step is to achieve impressive and consistent results through the professional implementation and execution of our strategies and programs."

Thomas A. Vassiliades
Chairman, President and
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CUSTOMER PROFILES

In today's fast-moving, high technology marketplace, companies are looking for solutions that can meet their changing networking needs. Solution providers must evolve their products, service offerings and business practices to remain competitive in addressing those requirements and satisfying customers.

In this Annual Report, Gandalf profiles three of its customers: NEC Corporation, Bell Atlantic, and Pacific Gas and Electric. Gandalf enjoys a mutually beneficial alliance with each of these companies. Gandalf's remote access expertise and deployment and ongoing service and support of innovative solutions have helped these customers leverage change in their business to meet market demand in an evolving environment. NEC required a means of securing its competitiveness in the evolving and growing Japanese ISDN market. Bell Atlantic wanted to increase revenue through ISDN solutions, specifically through targeting large teleworking programs by packaging services and products. Pacific Gas and Electric was looking to maximize the value of remote access solutions that would allow employees to telework instead of driving long distances to work.

NEC CORPORATION

NEC Corporation packages communications technology, systems integration, and computer, semiconductor, electronic component, and home electronics operations to provide better services and better products to the public, business and home markets. NEC's corporate direction embodies networking, empowerment and creativity with the goal of realizing an overall structure that maintains respect for the individual. NEC is based in Tokyo, Japan and has over 150,000 employees.

Currently there are over 1.2 million ISDN (Integrated Services Digital Networks) B-channels in use in Japan, with expansion predicted at 50% per year. NEC, one of the largest electronics suppliers in Japan and a driving force in ISDN, wanted to contribute to that expansion and continue to be a major player in the Japanese ISDN market.

NEC had two choices: it could develop its own products, or it could seek a partner to help leverage change in its business by supplying the products and expertise necessary to capitalize on the growing ISDN market. NEC chose to partner with an equipment vendor to provide total solutions for key remote access applications which utilize Japan's ISDN network. NEC chose Gandalf as a strategic partner because it recognized its expertise and market leadership in both ISDN technology and remote access.

Under a private label agreement, NEC relabels the XpressConnect 5242i, the XpressStack BRI, and the XpressStack PRI with NEC's C&C-NET brand logo for sale in the Japanese market. NEC, itself a remote access customer, also deploys Gandalf's

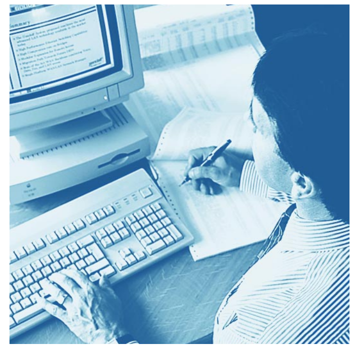
Xpress family of high-performance remote access and concentration products in its subsidiaries to provide remote users with Internet access. In establishing a remote access scenario in its own business, NEC has benefitted from understanding the value and requirements of this ISDN application.

Elements of Gandalf's Customer Value Architecture, including resilience, security, adaptability and useability, were important values for NEC to address its need to change and meet its corporate business requirements of delivering high value while minimizing cost of ownership.

The Japanese telecommunications market is known for its high operational standards. With NEC's assistance, Gandalf exceeded the strict requirements of the JATE and VCCI regulatory approvals testing, proving that its products offer the resilience and security NEC demands for its customers. Through the security features integrated into Gandalf products, NEC can assure its customers protected networks without the purchase of additional hardware or software. To maintain NEC's leadership in the Japanese ISDN market, Gandalf demonstrated the adaptability of its products by incorporating new features that the more powerful Japanese ISDN service can accommodate. These adaptations ensure useability in all marketplaces. Features such as ease of installation and comprehensive, clear user interfaces and documentation help vendors and customers overcome language barriers, making it easier for partners, like NEC, to market Gandalf products to their customers.

Gandalf has benefitted greatly from meeting NEC's changing needs. The partnership with NEC has created inroads into an ISDN market where Gandalf can introduce its best-of-breed remote access products. Furthermore, the Company's presence in both the North American market and the Japanese market ensures customers worldwide have access to a combination of innovative technology and operational support and excellence that meets the demands of the global market.

The partnership between NEC and Gandalf is a winning combination of Gandalf's knowledge of remote access and NEC's knowledge of the Japanese market. By combining Gandalf's best-of-breed, remote access products with the service excellence offered through NEC, the Company capitalizes on the growth of the ISDN market by providing its customers with competitive, innovative products that satisfy their remote access needs.



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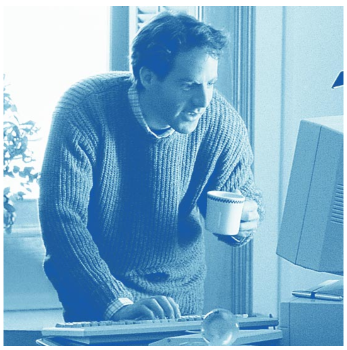
BELL ATLANTIC

Bell Atlantic is a customer-focused, innovative, and diversified communications company (a Regional Bell Operating Company) operating in some of the world's most competitive and fastest moving markets. Its lines of business offer a wide range of basic and advanced communications, network integration, management, analysis, and professional consulting products and services. With a commitment to increasing revenue through ISDN solutions, Bell Atlantic has become one of the most aggressive companies in deploying ISDN in the United States.



"Gandalf's remote access solutions have enabled Bell Atlantic to meet the needs of our customers as well as our own internal teleworking program."

Walter Sebastian
Director of End User Networking
for Bell Atlantic

Bell Atlantic is committed to increasing revenues through ISDN deployment and usage. To achieve this goal, Bell Atlantic chose to offer total, remote access, ISDN solutions for large teleworking programs. To accomplish this goal and to establish a competitive edge, Bell Atlantic looked for business allies with whom it could jointly provide its customers with complete remote access solutions.

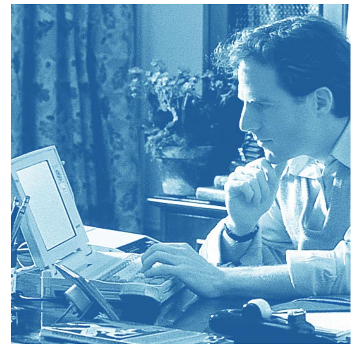
Bell Atlantic's criteria for selecting a business ally focused on the remote access product functionality required by its corporate users with large-scale teleworking requirements. Bell Atlantic chose Gandalf as one of its key suppliers based on superior throughput and bandwidth capabilities, industry-leading, patented data compression, and the Company's ability to provide the best central site solution for the remote access applications of Bell Atlantic's corporate customers. Four elements were key in providing Bell Atlantic maximum value and reduced cost of ownership in its chosen solution. Scaleability, offered by the modular nature of Gandalf's Xpressway concentrator, protects customers' investments by accommodating the growth of teleworking programs. A solution that exhibited manageability, like Gandalf's standards-compliant Xpressway and XpressConnect remote access products, allows a central, flexible means of managing the entire network. The resilience of the Gandalf solution was important to Bell Atlantic and its customers, who expect the same 100% uptime as their telephone service. Xpressway features such as redundant power supplies, hot-swappable modules to minimize system downtime, and high port density to support a large volume of teleworkers, help Bell Atlantic meet its business goal of addressing intensive, teleworking programs. In any large network, security is essential; the Gandalf solution, supporting industry-standard security methods, ensures that the networks of Bell Atlantic's customers remain private and secure. Gandalf's recent

announcement of encryption support further demonstrates to Bell Atlantic and its customers its leading edge in the delivery of security features and options.

Bell Atlantic has also deployed Gandalf's high-performance, remote access products in an internal teleworking program that allows Corporate Account Managers (salespeople) and Systems Engineers to work from home. In future, employees in departments such as the Operating Systems Network group will connect remotely through the XpressConnect 5242i to a central site Xpressway concentrator to provide after-hours support to information technology users.

Along with assisting Bell Atlantic in adapting to the changing needs of the market, Gandalf realizes significant benefits from engaging in an alliance with this U.S. ISDN market leader. In Bell Atlantic, Gandalf has a powerful, knowledgeable business ally, an effective, well-developed distribution channel, and a heightened profile.

Gandalf and Bell Atlantic work together in a strategic relationship designed to meet the requirements of a changing market. Bell Atlantic has recognized that by capitalizing on its own ISDN strengths and reputation, while incorporating a business ally's product innovation, it can offer total solutions that are competitive in the large business, teleworking market and can increase its ISDN revenues. Gandalf's end-to-end, remote access solution is the perfect match for Bell Atlantic's expectations for product performance. At the same time, Bell Atlantic's widespread influence contributes to Gandalf's success in the U.S. ISDN market and furthers a better understanding of customer requirements. Walter Sebastian, Director of End User Networking for Bell Atlantic, says, "Gandalf's remote access solutions have enabled Bell Atlantic to meet the needs of our customers as well as our own internal teleworking program. Gandalf's philosophy for product development mirrors our own concern for providing both our large and small corporate customers with flexible solutions that meet their evolving business and technology needs."



"Gandalf's philosophy for product development mirrors our own concern for providing both our large and small corporate customers with flexible solutions that meet their evolving business and technology needs."

Walter Sebastian
Director of End User Networking
for Bell Atlantic

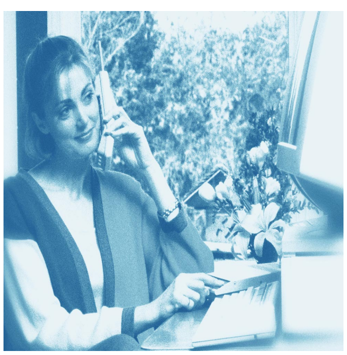
PACIFIC GAS AND ELECTRIC

PG&E required a partner who could help it adapt its work environment to satisfy employees’ new work styles.

Pacific Gas and Electric (PG&E) is the largest investor-owned energy utility in the U.S. It provides gas and electricity to more than 13 million people in northern and central California. PG&E is based in San Francisco and has 21,000 employees.

In today’s business climate, companies must be prepared to adapt their environment to accommodate internal change. PG&E first considered teleworking when the span of service territories assigned to network operations employees increased, resulting in much longer travel time. John Kennedy, ISDN project manager for PG&E’s computer and telecom services group, faced a three hour commute, and as a result, became one of PG&E’s first full-time teleworkers. Having gained insight into the benefits of teleworking, Kennedy recommended that full-time teleworking be adopted for a larger group of users, to meet the changing needs of the business.

PG&E’s early teleworkers were equipped with analog modems and remote control software. Dissatisfied with response times, users complained that the system was slow and unreliable. Central site personnel found the system difficult to manage. The company’s objective was to provide high-performance, manageable connections from anywhere, to any place, at any time. PG&E required a partner who could help it adapt its work environment to satisfy employees’ new work styles.



After a formal vendor evaluation, PG&E selected Gandalf’s Xpress family of products to handle the requirements of its large-scale teleworking program. Gandalf’s ability to bridge product innovation and customers' business needs helped it meet PG&E’s criteria and increase the network’s value while decreasing the cost of ownership. PG&E covers two-thirds of the geographic area of California; therefore, the ability to manage multiple remote locations from a central location is critical. Gandalf was the only company in the market to have the extensive, standards-based, enterprise-wide remote network management that fit with PG&E’s existing management system. In addition, PG&E sought a solution that could address future growth in the number of users supported. Gandalf provided scaleability in Xpressway, which gave PG&E the

modular, large-capacity chassis that was essential for the system to grow with the user community. Scaleability helps lower the cost of ownership of a product by allowing customers to extend their remote access solution as their users increase. Says Kennedy, "Gandalf Xpress proved to be the only system capable of meeting the potentially high number of ISDN channels while providing a network management system consistent with our own. The selection of Gandalf allows us at this point the greatest flexibility within one product line to meet our unspecified needs well into the future."

While working to help PG&E leverage change in its business environment, Gandalf is learning how to better evolve its products to meet the needs of large-scale teleworking. The partnership with PG&E has initiated quarterly strategic update meetings between Gandalf's product development team and customers with large-scale programs. These meetings provide an opportunity for Gandalf to learn more about the needs of its target markets and to share new product ideas with key customers.

John Kennedy also introduced and now moderates a Gandalf Users' Group on the Internet. Customers worldwide use this forum to ask questions of other Gandalf customers, to highlight features of Gandalf products, or to share tips based on their experience. By monitoring the Users' Group's concerns, Gandalf learns about issues that are of importance to customers. Through the Users' Group and strategic meetings, PG&E suggests many ideas for product innovation that apply to the entire market.

Through the mutually beneficial relationship with PG&E, Gandalf has been able to address PG&E's need for change in its business environment through remote access products and services. An extensive vendor evaluation demonstrated that, for PG&E's growing teleworking program, Gandalf's equipment is unrivaled in manageability and scaleability, which contribute to the corporate business goals of high value and low cost of ownership. As Gandalf progresses through the implementation of PG&E's teleworking program, it continues to gain knowledge about the features and functionality that will reinforce Gandalf as a competitive force in the remote access market.

"Gandalf Xpress proved to be the only system capable of meeting the potentially high number of ISDN channels while providing a network management system consistent with our own."

John Kennedy
Project Manager, Computer and Telecom Services Group for Pacific Gas and Electric

While working to assist its business partners with their needs, Gandalf has acquired greater knowledge of international markets, vertical markets, and customer requirements. The NEC relationship allows Gandalf a better understanding of the Japanese market and its stringent standards, and knowledge of advanced ISDN capabilities. Bell Atlantic provides Gandalf with expanded brand-name recognition and a new perspective on the opportunities available through working with an influential telephone company. Pacific Gas and Electric contributes many ideas on product innovation, increases Gandalf's understanding of the needs of large-scale teleworking programs and expands the Company's arena of customer contacts.

Gandalf measures its contribution to each alliance on the value provided to shareholders, customers, and employees. Gandalf's strengths are in its ability to bridge between technological innovation and customers' business problems. Gandalf ensures the delivery of premier solutions and services through adherence to the Customer Value Architecture. The CVA is a forward-looking architecture that provides a planning and design framework for all new products, ensuring consistency and relevance in the way Gandalf plans, designs, reviews and scrutinizes products, while adapting to technology changes and new applications.

The Customer Value Architecture (CVA) ensures that Gandalf will consistently address the full range of customer needs in a framework that supports their values.

The elements of the CVA represent customers' specific business needs. When embodied in a product, these elements contribute to increased value and reduced cost of ownership. Value means price/performance — customers receive best-of-breed products, functionality and services at a highly competitive price. Cost of ownership includes cost factors beyond the product itself, such as line charges, maintenance and support costs. The CVA ensures that customers have the flexibility to choose the exact level of performance, functionality, features and price that makes sense for their business. Gandalf delivers low cost of ownership through reducing the operational costs of customers' increasingly complex networks. As customers' requirements evolve, they will always require maximum value for their business dollar. The CVA ensures that Gandalf will consistently address the full range of customer needs in a framework that supports their values.

The alliances that have been profiled highlight how Gandalf is bringing together customers' business requirements and Gandalf's leading-edge technology. Together with its business partners, Gandalf shares knowledge and experiences to help address the changing demands of today's market and business operations.

GLOSSARY OF TERMS

Access Product — A product that provides users with connection to information at another location.

Analog Modem — A product that changes data signals into voice signals for sending data over telephone lines.

B-channel (Bearer channel) — The part of an ISDN line that sends and receives users' data, voice, and video information. A B-channel sends and receives information at speeds up to 64 kilobits per second (Kbps). There are two B-channels in an ISDN Basic Rate Interface (BRI) line and either 23 or 30 B-channels in an ISDN Primary Rate Interface (PRI) line.

Bandwidth — A measurement of the rate at which information can travel over a cable or phone line in a single second.

Basic Rate Interface (BRI) — The name given to an ISDN circuit that delivers two 64 kilobit per second (Kbps) lines for voice, video and data transfer, and a single 16 Kbps signaling line (2B+D).

Bridge — A product that forwards information between two or more similar LAN-based networks.

Casual Users — People who work from a remote location and require occasional access to central office resources.

Customer Value Architecture — Gandalf's forward-looking design architecture is made up of ten elements that ensure customers' requirements are met by each product Gandalf develops.

> Adaptability — The ability to change a solution to meet customers' new business needs without requiring them to replace the product.
>
> Choice — Designing products that adhere to open standards so that they can work with any other vendors' equipment.
>
> Cost of Ownership — The cost of operating and maintaining a product.
>
> Manageability — Providing products that customers can easily control and monitor.
>
> Range — Providing a breadth of products that match the varied requirements of customers.
>
> Resilience — Providing products that are durable and remain accessible at all times.
>
> Scaleability — Providing products that can easily expand in capacity in order to grow customers' networks while maintaining their investment.
>
> Security — Providing products that ensure customers' information is kept private and safe from unauthorized access.
>
> Useability — Providing products that are easy to install, configure and maintain.
>
> Value — Providing products or services that help customers perform business better by reducing costs, adding value, or increasing productivity.

Data Compression — A technique that reduces data in size, without loss of information, before it is sent over the line.

Encryption — A method used to keep data private through random scrambling of data.

Internet — A public infrastructure that connects networks globally and allows worldwide exchange of information.

Internet Service Provider (ISP) — A company that offers subscribers access to the Internet for a fee.

Intranet — An Intranet takes the World Wide Web model, which allows companies to communicate with the marketplace via the Internet, and adapts it to the specific boundaries of an organization so certain information is accessible only to its employees, and not the Internet public. An Intranet allows an organization to share internal information with its employees using any Web Browser on any computer platform.

ISDN (Integrated Services Digital Network) — A high-speed, digital service offered by the telephone companies capable of carrying voice, data and video traffic. ISDN is available in either Basic Rate or Primary Rate interfaces.

Mobile Users — People who work from multiple remote locations and generally operate out of a home or branch office.

National Reseller — An organization that resells Gandalf products to VARs (Value Added Resellers) or VADs (Value Added Dealers) who in turn sell the Gandalf products to end users.

OEM (Original Equipment Manufacturer) — Relationships where companies integrate another vendor's product(s) into their own product offerings.

Power Users — Full or part-time users who work from a remote location such as a small office or home office. Typically, they are expert users who heavily use the equipment and lines that connect them to the central office, other corporate offices and the Internet.

Primary Rate Interface (PRI) — The name given to an ISDN circuit that delivers twenty-three (North America) or thirty (Europe) 64 kilobit per second (Kbps) lines for voice, video and data transfer, in addition to one (North America) or two (Europe) 16 Kbps signaling lines (23B +D or 30B + 2D).

Router — A product that forwards information between two or more networks. Routers are more "intelligent" than bridges. They have the capability to restrict access to defined resources and selectively route to different destinations.

SOHO (Small Office Home Office) — Remote users working from small offices or home offices.

Teleworking — The concept of working from home, on a full-time or part-time basis, using telecommunications devices to communicate with corporate offices or the Internet.

Xpress® — Gandalf's family of remote access and concentration products.

XpressConnect® — A family of remote access products that provides network access to the Internet or Intranet from the home, regional or branch office.

XpressConnect 5232i — A single-user, multiple-destination, high-performance ISDN remote access product that can be customized to address the specific needs of a customer.

XpressConnect 5242i — A teleworker or SOHO ISDN router that includes the performance and features required by teleworkers and branch office employees who heavily use the equipment and lines that connect them to remote resources.

XpressStack® — A family of products that allows multiple remote users access to and from a central network. XpressStack products provide access for small to medium-sized offices and Internet Service Providers.

XpressStack BRI — A product that provides multiple users access over eight ISDN Basic Rate Interfaces to and from a central network.

XpressStack PRI — A product that provides multiple users access over a single ISDN Primary Rate Interface to and from a central network.

XpressStack Internet Access Server (IAS) — A product designed for the specific needs of Internet Service Providers. The XpressStack IAS allows simultaneous access by multiple ISDN and analog users and supports up to 46 (North America) or 60 (Europe) ISDN B-channels and 48 (North America) or 60 (Europe) analog connections.

Xpressway® — A chassis-based product that allows a large number of users to connect to and from a central network over a wide variety of line types.

Xpressway RLAN — A product that allows a large number of users to connect to and from a central network over ISDN or analog circuits. RLAN supports up to 248 ISDN 64 kilobit per second (Kbps) interfaces and 120 analog connections.

CONSOLIDATED BALANCE SHEETS
(THOUSANDS OF U.S. DOLLARS)

As at March 31	1996	1995
Assets		
Current assets:		
Cash and cash equivalents	$ 13,602	$ 11,817
Accounts receivable	28,694	26,880
Inventories (note 2)	13,491	15,230
Other	1,867	2,268
Total current assets	57,654	56,195
Fixed assets (note 3)	16,253	18,619
Goodwill, net of accumulated amortization of $3,172 (1995 - $2,952)	3,242	3,462
Other assets	2,226	3,232
Total assets	$ 79,375	$ 81,508
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank operating lines (note 4)	$ -	$ 5,854
Accounts payable and accrued liabilities (note 5)	21,755	21,369
Deferred revenue	6,178	7,758
Current portion of long-term debt (note 6)	360	157
Total current liabilities	28,293	35,138
Long-term debt (note 6)	2,496	1,877
Convertible debentures (note 7)	-	10,051
Shareholders' equity:		
Capital stock (notes 8 and 9)		
Common shares, 42,939,523 issued and outstanding (1995 - 35,238,064)	54,198	91,644
Retained earnings (note 8)	260	(52,364)
Cumulative translation adjustment	(5,872)	(4,838)
Total shareholders' equity	48,586	34,442
Total liabilities and shareholders' equity	$ 79,375	$ 81,508

Commitments and contingencies (note 15)

On behalf of the Board of Directors:

T.A. Vassiliades, Director

D.M. Gleklen, Director

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME
(THOUSANDS OF U.S. DOLLARS, EXCEPT PER SHARE AMOUNTS)

Years Ended March 31	1996	1995	1994
Revenues:			
Product	$ 81,076	$ 83,801	$ 90,813
Service	35,457	36,710	40,510
	116,533	120,511	131,323
Operating expenses:			
Cost of product sales	38,941	43,630	49,509
Service expenses	24,053	23,316	27,024
Sales and marketing	31,942	33,148	43,678
Administration and general	8,054	7,513	11,094
Research and development	11,524	10,197	14,316
Restructuring and other costs (note 10)	1,531	685	28,662
Income (loss) from operations	488	2,022	(42,960)
Gain on sale of portfolio investment	-	2,024	-
Interest expense	(487)	(2,969)	(4,127)
Interest income and foreign exchange	259	329	991
Income taxes (note 11)	-	-	(1,142)
Net income (loss) for the year	$ 260	$ 1,406	$ (47,238)
Basic earnings (loss) per share (note 12)	$ 0.01	$ 0.05	$ (2.27)
Weighted average number of common shares outstanding (thousands)	40,359	28,589	20,802

See accompanying notes to consolidated financial statements.

AUDITORS' REPORT

To the Shareholders of Gandalf Technologies Inc.

We have audited the consolidated balance sheets of Gandalf Technologies Inc. as at March 31, 1996 and 1995 and the consolidated statements of income, changes in financial position and shareholders' equity for each of the years in the three year period ended March 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 1996 and 1995 and the results of its operations and the changes in its financial position for each of the years in the three year period ended March 31, 1996, in accordance with generally accepted accounting principles.

KPMG Peat Marwick Thorne

Chartered Accountants
Ottawa, Canada
May 10, 1996

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

(THOUSANDS OF U.S. DOLLARS)

Years Ended March 31	1996	1995	1994
Operating activities:			
Cash provided by (applied to) operations (note 13)	$ 5,687	$ 4,958	$ (14,395)
Decrease (increase) in operating working capital (note 14)	(785)	4,212	775
Cash provided by (applied to) operating activities	4,902	9,170	(13,620)
Financing activities:			
Issue of capital stock	15,273	12,242	34,226
Conversion of debentures (note 7)	(10,336)	(11,533)	-
Long-term debt incurred	1,020	-	-
Long-term debt retired	(251)	(446)	(20,841)
Cash provided by financing activities	5,706	263	13,385
Investing activities:			
Purchase of fixed assets	(2,671)	(2,919)	(4,411)
Proceeds on disposal of investments	-	3,857	1,158
Proceeds on disposal of fixed assets	-	298	1,088
Other	39	293	(2,041)
Cash provided by (applied to) investing activities	(2,632)	1,529	(4,206)
Effect of exchange rate changes on cash balances	(337)	240	(510)
Increase (decrease) in cash position in the year	7,639	11,202	(4,951)
Cash position at beginning of year	5,963	(5,239)	(288)
Cash position at end of year	$ 13,602	$ 5,963	$ (5,239)
Cash position is comprised of:			
Cash and cash equivalents	$ 13,602	$ 11,817	$ 5,273
Bank operating lines	-	(5,854)	(10,512)
	$ 13,602	$ 5,963	$ (5,239)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(THOUSANDS OF U.S. DOLLARS)

	1996		1995		1994	
Years Ended March 31	Shares	Dollars	Shares	Dollars	Shares	Dollars
Capital Stock:						
Consisting of an unlimited number of common shares authorized, without par value						
Balance at beginning of year	35,238,064	$ 91,644	28,072,333	$ 79,811	15,864,833	$ 45,585
Issued:						
On conversion of debentures (note 7)	5,983,372	9,839	6,782,519	11,124	-	-
On public offering, net of share issue costs	-	-	-	-	12,000,000	33,863
Exercise of stock options (note 9)	1,582,685	3,531	182,214	354	207,500	363
Other	135,402	1,548	200,998	355	-	-
Reduction in stated capital (note 8)	-	(52,364)	-	-	-	-
Balance at end of year	42,939,523	$ 54,198	35,238,064	$ 91,644	28,072,333	$ 79,811
Retained Earnings:						
Balance at beginning of year		$ (52,364)		$ (53,770)		$ (6,532)
Net income (loss)		260		1,406		(47,238)
Reduction in stated capital (note 8)		52,364		-		-
Balance at end of year		$ 260		$ (52,364)		$ (53,770)
Cumulative Translation Adjustment:						
Balance at beginning of year		$ (4,838)		$ (6,932)		$ (4,745)
Adjustment arising on translation of foreign subsidiaries' financial statements to U.S. dollars		549		1,091		(3,122)
Adjustment relating to subsidiary loans designated as long-term investments		(1,583)		1,003		935
Balance at end of year		$ (5,872)		$ (4,838)		$ (6,932)

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All amounts are stated in U.S. dollars unless otherwise indicated. C$ refers to Canadian dollars. Tabular amounts are in thousands except per share data. References to years are to fiscal years ended March 31.

1. SUMMARY OF ACCOUNTING PRINCIPLES

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. These principles are also generally accepted in the United States in all material respects except as disclosed in note 17. The significant accounting principles are outlined below.

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Gandalf Technologies Inc. and its subsidiaries. All significant intercompany transactions and balances are eliminated.

(b) Foreign Currency Translation

Operations using a unit of measurement and presentation other than the U.S. dollar, including the Company's Canadian parent, represent foreign operations. The Company considers that for translation purposes all of its foreign operations are self-sustaining.

The assets and liabilities of self-sustaining foreign operations are translated into U.S. dollars at year-end exchange rates and the resulting unrealized exchange gains or losses are included in the cumulative translation adjustment as a separate component of shareholders' equity. The income statements of such operations are translated at exchange rates prevailing during the year.

(c) Revenue Recognition

Revenue from the sale of products is recognized at the time goods are shipped to customers, net of appropriate provisions for estimated returns. Revenue from services is recognized at the time services are rendered. Billings in advance of services are included in deferred revenue.

(d) Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments purchased with an original maturity of three months or less.

(e) Inventories

Work-in-process and finished goods inventories are valued at the lower of cost and net realizable value. Raw materials are valued at the lower of cost and replacement cost. Cost is determined on a first-in first-out basis and includes material, labour and manufacturing overhead where applicable.

(f) Fixed Assets

Fixed assets are recorded at cost net of government assistance. Equipment is depreciated using the declining balance method at an annual rate of 20%, with the exception of service spares, which are depreciated using the straight-line method over five years. Buildings are depreciated using the straight-line method based on a useful life of 20 years. Leasehold improvements are amortized using the straight-line method over the term of the related lease.

(g) Research and Development Costs

Research costs are expensed as incurred. Development costs are expensed in the year incurred unless management believes a development project meets the generally accepted accounting criteria for deferral and amortization.

(h) Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired of subsidiary companies and is amortized using the straight-line method over a period not exceeding 20 years. When warranted by events or circumstances that might indicate that recoverability is impaired, management will evaluate recoverability by use of the undiscounted cash flow method.

(i) Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent 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.

NOTES (CONT'D)

2. INVENTORIES

As at March 31	1996	1995
Raw materials	$ 2,905	$ 3,336
Work-in-process	3,821	4,591
Finished goods	6,765	7,303
	$ 13,491	$ 15,230

3. FIXED ASSETS

As at March 31	1996	1995
Cost:		
Land	$ 218	$ 232
Buildings	4,627	4,725
Equipment	58,336	55,879
Leasehold improvements	1,966	1,930
	65,147	62,766
Accumulated depreciation	48,894	44,147
Net book value	$ 16,253	$ 18,619

4. BANK OPERATING LINES

At March 31, 1996 the Company's authorized bank operating lines totaled $20.8 million. These committed credit facilities are provided by a Canadian chartered bank and bear interest at the bank's prime rate plus 0.5% to 1.5%.

The operating lines are secured by certain of the accounts receivable, inventories and other assets of the Company. The amount available for borrowing at any time under the facilities is based on margin formulas relating to levels of accounts receivable, inventories and other bank covenants. Under such formulas, $17.3 million was available to, but not utilized by, the Company at March 31, 1996. Cash and cash equivalents held as of that date represented a further $13.6 million of cash resources available to the Company. Cash and unused credit lines totaled $30.9 million at March 31, 1996, compared to $20.8 million at March 31, 1995.

5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

As at March 31	1996	1995
Trade accounts payable	$ 7,376	$ 7,341
Payroll, commissions and related taxes	3,873	4,072
Accrued restructuring costs	2,747	3,033
Other payables	6,434	5,266
Income and other taxes payable	1,325	1,657
	$ 21,755	$ 21,369

NOTES (CONT'D)

6. LONG-TERM DEBT

As at March 31			1996	1995
Description	Interest Rates	Security		
Various capital lease obligations denominated in Canadian dollars lease terms ending 1999–2009	8%–12.9%	Certain equipment and facilities	$ 2,856	$ 2,034
Classified as current			(360)	(157)
			$ 2,496	$ 1,877

The aggregate amount of long-term debt scheduled to be repaid in the five years ending March 31, 2001 is $1,359,000, with the balance of $1,497,000 due thereafter.

7. CONVERTIBLE DEBENTURES

	Aggregate Principal Amount		%	Shares Issued Upon Conversion
Balance at March 31, 1994	C$ 30,000	$ 21,681	100%	
Converted during year	(15,939)	(11,533)	(53)	6,782,519
Impact of foreign exchange	-	(97)	-	
Balance at March 31, 1995	14,061	10,051	47	
Converted during year	(14,061)	(10,336)	(47)	5,983,372
Impact of foreign exchange	-	285	-	
Balance at March 31, 1996	C$ -	$ -	-	

In November 1992 the Company issued 8.5% convertible debentures with an aggregate principal amount of C$30.0 million which were due to mature in November 2002. At any time prior to maturity they were convertible into common shares of the Company at the option of the holder at a conversion price of C$2.35 (approximately $1.72) which would yield 425.53 common shares for each C$1,000 (approximately $732) of principal amount of debentures held. During 1995 debentures with an aggregate principal amount of $11,533,000 were converted into 6,782,519 common shares.

During 1996 all remaining debentures were converted into 5,983,372 common shares. The resulting increase in capital stock of $9,839,000 was determined as the sum of the principal amount of the debentures converted ($10,336,000) plus interest accrued, but unpaid to the date of conversion ($135,000), net of the pro rata share of the associated unamortized deferred financing costs ($632,000).

8. REDUCTION IN STATED CAPITAL

On August 10, 1995 the shareholders of the Company passed a special resolution authorizing a reduction in statutory stated capital in respect of the common shares by $52,364,000. This resulted in a corresponding reduction in the accumulated deficit as shown on the consolidated balance sheets and the consolidated statements of shareholders' equity.

9. STOCK OPTIONS

The following table summarizes the activity for the stock option plans in effect during the year ended March 31, 1996 and for each of the preceding two years.

	Shares Available for Grant	Outstanding Options
Balance at March 31, 1993	228,460	1,148,000
Reserved for issuance	1,000,000	-
Granted	(700,000)	700,000
Terminated	376,000	(376,000)
Exercised	-	(207,500)
Balance at March 31, 1994	904,460	1,264,500
Reserved for issuance	438,000	-
Granted	(1,790,000)	1,790,000
Terminated	532,500	(532,500)
Exercised	-	(182,214)
Balance at March 31, 1995	84,960	2,339,786
Reserved for issuance	3,000,574	-
Granted	(1,743,000)	1,743,000
Terminated	640,876	(640,876)
Exercised	-	(1,582,685)
Balance at March 31, 1996	1,983,410	1,859,225

The options to purchase common shares granted under the above stock option plans expire between January 10, 1997 and March 17, 2006. Of the 1,859,225 options outstanding at March 31, 1996, 583,857 were exercisable as of that date, and the prices at which the outstanding options may be exercised approximated the market value on the dates of grant. The exercise prices for outstanding options granted on or before March 31, 1995 range from C$0.88 to C$6.00 (approximately $0.65 to $4.40) per share. The exercise prices for options granted during the year ended March 31, 1996 range from C$5.25 to C$23.00 (approximately $3.85 to $16.87) per share. Directors and executive officers as a group held 1,167,165 options as at March 31, 1996.

10. RESTRUCTURING AND OTHER COSTS

Years Ended March 31	1996	1995	1994
Restructuring	$ 1,531	$ 685	$ 15,760
Other	-	-	12,902
	$ 1,531	$ 685	$ 28,662

Over the past several years the Company has undertaken significant restructuring activities in order to reposition the Company in line with its strategy, reduce costs and improve competitiveness. The size of the Company's workforce, after taking into account restructuring activities which were accrued in 1996, is now less than 700 employees, approximately one-third the level of five years ago.

Restructuring charges in the fourth quarter of 1996 were recorded in connection with certain consolidation and outsourcing activities carried out since the end of the third quarter in the areas of manufacturing distribution and repair in Europe, outsourcing to partners for the delivery of field service maintenance, and changes in the sales structure to continue the implementation of the Company's distribution channel strategy. These charges primarily related to severance and facilities costs.

Restructuring costs recorded in 1995 represented severance costs associated with the elimination of approximately 70 positions at the end of the first fiscal quarter in connection with an internal functional realignment.

Restructuring costs recorded in 1994 related to decisions made by the Company in February 1994 to reduce its workforce by approximately 300 positions worldwide and consolidate its North American operations under a single organization structure. Restructuring costs included $5.3 million relating to severance, $4.2 million in provisions for redundant facilities representing the estimated future lease costs and the unamortized cost of leasehold improvements for vacant facilities worldwide, and $6.3 million in fixed asset writedowns to adjust the net book value of surplus equipment and spare parts inventory in North America to their estimated net realizable value.

During 1994, other costs included a writedown of $7.5 million in deferred tax assets which primarily related to investment tax credits earned in Canada prior to the third quarter of 1993 on research and development expenditures. For financial reporting purposes, as a result of sustaining several consecutive years of losses up to the end of 1994, management believed that the accounting criteria for continuing to recognize these amounts as an asset were no longer met. These tax credits remain available to the Company and the benefit of these tax credits will instead be recorded in the financial statements as they are utilized to reduce future federal income taxes payable in Canada. Other costs in 1994 also included a writedown of $4.5 million in deferred software development costs which were not expected to be recovered through future cash flows and a $0.9 million writedown of assets held for disposal to their net realizable value.

11. INCOME TAXES

Years Ended March 31	1996	1995	1994
Current:			
Canadian	$ -	$ -	$ (342)
Foreign	-	-	(800)
	$ -	$ -	$ (1,142)

The income tax expense reported differs from the amount computed by applying Canadian tax rates to the income (loss) before income taxes.

Years Ended March 31	1996	1995	1994
Expected tax rate	44.6%	44.3%	44.3%
Expected tax expense (recovery)	$ 116	$ 623	$ (20,420)
Utilization of losses not previously recorded	(116)	(623)	-
Losses for which no tax benefit has been recorded	-	-	20,420
Other	-	-	(1,142)
	$ -	$ -	$ (1,142)

At March 31, 1996, the Company had available, subject to audit and certain restrictions, accumulated accounting losses of approximately $70 million, the potential tax benefit of which has not been recorded in the consolidated financial statements. These include loss carry-forwards for income tax purposes of approximately $50 million ($39 million related to U.S. operations) which begin to expire after the 1999 fiscal year. The remaining amount relates to items expensed in the consolidated financial statements which have not yet been claimed for income tax purposes. The Company also had available at March 31, 1996, subject to audit, investment tax credits of approximately $11 million which can be applied to reduce federal taxes payable in Canada. These investment tax credits expire between 1997 and 2006.

Tax authorities in the Netherlands have reassessed income taxes for the years 1989 through 1991, disallowing certain amounts which have been claimed for income tax purposes. The Company has filed objections to these reassessments and is in discussion with the tax authorities. The Company anticipates that the resolution of this matter will lead to amended reassessments which, after taking into consideration available loss carry-forwards, would be unlikely to result in a material adverse effect on the Company's consolidated financial position or its future results of operations.

The loss before income taxes attributable to all foreign operations for the year ended March 31, 1996 was $1,933,000 (1995 - $735,000; 1994 - $31,074,000).

At March 31, 1996 the balance of unremitted earnings of subsidiaries was $9,599,000 (1995 - $11,113,000; 1994 - $7,761,000). The Company does not currently anticipate repatriating earnings of foreign subsidiaries where such repatriation would give rise to withholding taxes.

12. EARNINGS PER SHARE

Basic earnings (loss) per share figures are presented on the consolidated statements of income. These figures are calculated using the monthly weighted average number of common shares outstanding during the year. Fully diluted earnings per share information has not been presented as potential conversions are anti-dilutive.

Adjusted earnings per share for 1996 was $0.01 (1995 - $0.07). The calculation assumes that the conversion of debentures, which occurred during 1996 and 1995, had occurred at the beginning of each applicable fiscal year.

13. CASH PROVIDED BY OPERATIONS

Cash provided by (applied to) operations is computed as follows:

Years Ended March 31	1996	1995	1994
Income (loss) from operations	$ 488	$ 2,022	$ (42,960)
Depreciation and amortization	5,408	5,616	9,658
Reserves and writedowns not involving an outlay of cash	-	-	22,004
Interest paid	(468)	(2,803)	(3,546)
Interest received and foreign exchange	259	329	991
Other	-	(206)	(542)
	$ 5,687	$ 4,958	$ (14,395)

14. CHANGES IN OPERATING WORKING CAPITAL

The decrease (increase) in operating working capital is computed as follows:

Years Ended March 31	1996	1995	1994
Accounts receivable	$ (1,814)	$ 3,302	$ 4,103
Inventories	1,739	5,647	1,750
Other current assets	401	78	73
Accounts payable and accrued liabilities	513	(6,160)	(1,132)
Deferred revenue	(1,580)	334	(1,075)
Foreign currency translation adjustment	(44)	1,011	(2,944)
	$ (785)	$ 4,212	$ 775

15. COMMITMENTS AND CONTINGENCIES

(a) The Company has entered into various lease commitments under leases and other contracts. At March 31, 1996, the minimum amounts payable under such commitments in future fiscal years were as follows:

1997	$ 12,793
1998	10,674
1999	2,059
2000	1,926
2001	1,733
Thereafter	6,689
	$ 35,874

(b) Since 1991, the Company has received funding of approximately $1.4 million and $2.5 million respectively under two projects approved through the Canadian federal government's Microelectronics and Systems Development Program ("MSDP"). While the repayment terms of the two projects differ slightly, both are tied to future sales, with the liability to repay the funding arising from product revenues earned following both the commercialization of the resulting technology and the completion of the MSDP project. The amount that is potentially repayable is calculated without interest as a royalty on revenues earned in the ten years following the project completion date and is limited to the amount of the funding received.

The Company commenced accruing royalties during 1996 upon completion of each project and expects that the funding will be fully repaid within three to five years. At March 31, 1996, $785,000 had been accrued related to these projects.

(c) In the normal course of business, various litigation, claims and assessments have arisen involving the Company and its subsidiaries. In certain instances, substantial amounts are being sought. Management is vigorously defending its position in all such actions. While the outcome of such proceedings is currently not determinable, management believes, after consideration of all relevant facts, that their outcome would be unlikely to result in a material adverse effect on the Company's consolidated financial position or its future results of operations.

16. SEGMENTED INFORMATION

The Company operates in one business segment, providing networking solutions to customers through designing, manufacturing, marketing and servicing a broad line of computerized communications systems.

The Company has defined five geographic regions for the segments in which it operates: the United States, Canada, the United Kingdom, Holland/France and other international markets. The following table sets forth information concerning these geographic segments for each of the years in the three year period ended March 31, 1996.

Years Ended March 31	1996	1995	1994
Sales to customers:			
United States	$ 32,758	$ 32,547	$ 35,157
Canada	21,675	22,473	23,341
United Kingdom	31,644	37,939	39,309
Holland/France	20,066	16,052	15,441
Other	10,390	11,500	18,075
Segment transfers:			
United States	-	964	5,360
Canada	27,601	22,822	24,702
United Kingdom	1,031	977	2,385
Holland/France	6	9	476
Eliminations	(28,638)	(24,772)	(32,923)
Total revenues	$ 116,533	$ 120,511	$ 131,323
Segment operating profit:			
United States	$ 6,416	$ 4,739	$ (1,621)
Canada	3,433	1,764	(226)
United Kingdom	5,722	8,242	6,908
Holland/France	4,276	3,527	2,550
Other	(1,107)	(65)	2,574
Total segment operating profit	18,740	18,207	10,185
Expenses:			
Research and development	11,524	10,197	14,316
General corporate	5,197	5,303	10,167
Restructuring and other costs	1,531	685	28,662
Gain on sale of portfolio investment	-	(2,024)	-
Interest expense	487	2,969	4,127
Interest income and foreign exchange	(259)	(329)	(991)
Income taxes	-	-	1,142
Net income (loss)	$ 260	$ 1,406	$ (47,238)
Identifiable assets:			
United States	$ 10,845	$ 10,015	$ 14,919
Canada	31,530	27,376	33,440
United Kingdom	21,201	24,315	23,336
Holland/France	10,727	10,800	7,308
Other	5,072	9,002	10,183
Total assets	$ 79,375	$ 81,508	$ 89,186

17. UNITED STATES ACCOUNTING PRINCIPLES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP") which in the case of the Company differ in the following material respects from those generally accepted in the United States ("U.S. GAAP").

(a) Under U.S. GAAP, financing and investing activities not involving a receipt or outlay of cash are excluded from the consolidated statements of changes in financial position. Accordingly, the following financing activities would not be presented in the consolidated statements of changes in financial position for the years ended March 31, 1996 and 1995 but would be shown supplementally.

	1996	1995
Issue of capital stock on conversion of debentures	$ 10,336	$ 11,533
Conversion of debentures	$ (10,336)	$ (11,533)

(b) Under U.S. GAAP, bank operating lines would not be included as a component of the cash position presented in the consolidated statements of changes in financial position. The change in bank operating lines would be presented as a financing activity and would therefore be included in the determination of the increase or decrease in cash position in the year.

(c) The Company follows the deferral method of accounting for income taxes. Under U.S. GAAP the asset and liability method is used. In the case of the Company the application of the asset and liability method does not result in a difference in the amount of the deferred tax asset. U.S. GAAP also requires the disclosure of the tax effect of temporary differences that give rise to deferred tax assets and liabilities. This information is provided in the following table.

	1996	1995
Operating loss carry-forwards	$ 20,300	$ 21,600
Depreciation	1,700	2,500
Restructuring reserves	200	800
Investment tax credits	11,000	11,000
Other	4,800	2,900
	38,000	38,800
Valuation allowance	(37,496)	(38,296)
Net non-current deferred tax asset	$ 504	$ 504

(d) Reductions in stated capital and deficit as described in note 8 do not fall within the definition of a quasi-reorganization under U.S. GAAP and, accordingly, under U.S. GAAP, capital stock and retained earnings (deficit) would not each be reduced by $52,364,000 as shown in the consolidated statements of shareholders' equity.

(e) U.S. GAAP requires the calculation of primary earnings per share. This figure is not materially different from the basic earnings per share figure calculated under Canadian GAAP.

QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly unaudited financial information for each of the years ended March 31, 1996 and 1995 is as follows:

1996	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues:				
Product	$ 19,414	$ 18,401	$ 19,326	$ 23,935
Service	9,236	8,956	8,845	8,420
	28,650	27,357	28,171	32,355
Operating expenses:				
Cost of product sales	9,663	8,572	9,179	11,527
Service expenses	5,869	5,910	6,096	6,178
Sales and marketing	8,198	7,659	7,892	8,193
Administration and general	2,071	2,142	2,102	1,739
Research and development	2,595	2,839	2,895	3,195
Restructuring costs	-	-	-	1,531
Income (loss) from operations	254	235	7	(8)
Interest expense	(206)	(136)	(108)	(37)
Interest income and foreign exchange	18	(64)	193	112
Net income	$ 66	$ 35	$ 92	$ 67
Basic earnings per share	$ -	$ -	$ -	$ -

1995	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues:				
Product	$ 20,745	$ 21,754	$ 20,363	$ 20,939
Service	8,973	8,906	9,388	9,443
	29,718	30,660	29,751	30,382
Operating expenses:				
Cost of product sales	10,896	11,094	10,661	10,979
Service expenses	5,871	5,739	5,754	5,952
Sales and marketing	8,742	8,002	7,854	8,550
Administration and general	1,929	1,907	1,957	1,720
Research and development	2,413	2,581	2,658	2,545
Restructuring costs	685	-	-	-
Income (loss) from operations	(818)	1,337	867	636
Gain on sale of portfolio investment	-	-	2,024	-
Interest expense	(798)	(823)	(795)	(553)
Interest income and foreign exchange	57	88	58	126
Net income (loss)	$ (1,559)	$ 602	$ 2,154	$ 209
Basic earnings (loss) per share	$ (0.06)	$ 0.02	$ 0.08	$ 0.01
Fully diluted earnings per share			$ 0.06	

Quarterly earnings per share figures are calculated based on the monthly weighted average number of common shares outstanding during the quarter. Fully diluted earnings per share is calculated assuming convertible debentures had been converted at the beginning of the fiscal period, and all outstanding options had been exercised on the date which is the later of the beginning of the fiscal period and the dates the options were granted. With the exception of the third fiscal quarter of 1995, potential conversions are anti-dilutive for each quarter during the two year period ended March 31, 1996.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

The consolidated financial statements together with accompanying notes should be read as an integral part of this review. These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Note 17 to the consolidated financial statements describes the impact, in the case of the Company, of differences between accounting principles generally accepted in Canada and the United States. All amounts are stated in U.S. dollars unless otherwise indicated. "C$" refers to Canadian dollars. References to years are to fiscal years ended March 31.

GENERAL SUMMARY DISCUSSION

The Company reported net income for the 1996 fiscal year of $260,000 or $0.01 per share on revenues of $116.5 million, compared to net income of $1.4 million or $0.05 per share on revenues of $120.5 million for the fiscal year ended March 31, 1995. The 1995 results included a one-time gain of $2.0 million on the sale of a portfolio investment. Income before restructuring charges for 1996 was $1.8 million, representing $0.04 per share. Income for 1995, exclusive of restructuring charges and a one-time gain on the sale of a portfolio investment, was $67,000, break even on a per share basis. Restructuring charges of $1.5 million were recorded in 1996 in connection with certain consolidation and outsourcing activities carried out in the areas of manufacturing distribution and repair in Europe, outsourcing to partners for the delivery of field service maintenance, and changes in the sales structure to continue the implementation of the Company's distribution channel strategy.

The Company operates in one business segment, providing a broad range of internetworking products and services. Within this segment the Company derives revenue from four main product areas: remote access products; modems, multiplexers and local connectivity products; wide-area networking (WAN) backbone products; and other. The majority of new product introductions and enhancements during 1996 occurred in the remote access area. Revenues from the sale of these products in 1996 increased more than 25% compared to 1995 and represented 65% of total product revenue compared to 49% in 1995 and 25% in 1994.

The combined gross margin on product and service revenues improved in 1996 to 45.9% compared to 44.4% in 1995 and 41.7% in 1994. Operating expenses for sales and marketing, and administration and general expenses, declined approximately 2% in 1996 compared to 1995 after declining close to 26% in 1995 compared to 1994. Research and development expenses increased 13% in 1996 compared to 1995, and during the three year period 1994 to 1996 the Company has made expenditures on research and development which on average have been in excess of 14% of its annual revenues derived from the sale of products.

The Company's net cash position more than doubled during 1996, from $6.0 million at March 31, 1995 to $13.6 million at March 31, 1996. Cash and unused credit lines were $30.9 million at March 31, 1996, an increase of 49% over the balance of $20.8 million at March 31, 1995. In addition, all remaining debentures issued in 1992 were converted to common shares of the Company in accordance with the terms of the debentures.

FACTORS THAT MAY AFFECT FUTURE FINANCIAL PERFORMANCE

The Company's quarterly and annual operating results are affected by various trends and factors including, but not limited to, competition, the Company's success in developing, introducing and gaining market acceptance for new products, the timing of orders from customers, the levels of inventory held by resellers and distributors, as well as factors such as changes in general economic conditions or conditions in the specific markets for the Company's products, government regulation, tariffing of carrier services, and industry consolidation.

The networking industry is intensely competitive and subject to rapid change. As the market for the Company's products continues to develop, additional competitors are expected to enter the market and competition is anticipated to intensify. This may result in price reductions and margin erosion. Many of the Company's current and potential competitors have larger technical staffs, more established and larger marketing and sales organizations, and significantly greater financial resources than does the Company. The Company also competes with other data networking vendors for access to distribution channels.

The Company's success is substantially dependent upon its ability to manage changes in its operations. Over the past several years the Company has undertaken significant restructuring activities in order to reposition the Company in line with its strategy, reduce costs and improve competitiveness. During the most recent fiscal year, examples of such changes included the establishment of new marketing and distribution channels, the restructuring of international operations and the outsourcing of the delivery of field service maintenance. In addition, the successful establishment and implementation of relationships with strategic partners and distributors is critical to the future success of the Company. During the past year, the Company has changed the way it distributes its products by establishing multiple-tiered distribution channels and entering into agreements with several large resellers and distributors in North America, Europe and the Asia Pacific region. These new distribution channels, while viewed by the Company as critical to its future success, also bring additional new risks. These include less predictability regarding product demand and ordering patterns, reduced gross margins on sales to indirect channels and the time associated with reseller training and increasing awareness for the Company's products.

The Company's quarterly operating results fluctuate as a result of a number of factors including pricing, distributor ordering patterns, product returns and reserves, product mix, operating expense levels as well as the timing of new product announcements and introductions by the Company and its competitors. The Company's revenues are difficult to predict due to shipment patterns. A substantial portion of the Company's expenses are fixed, and consequently any significant fluctuations in revenue will impact earnings. Products are generally shipped as orders are received, and accordingly, the Company operates with a relatively small backlog. As a result, sales in any quarter are dependent on orders booked and shipped in that quarter. A high percentage of the Company's revenues are typically earned in the third month of each fiscal quarter and tend to be concentrated in the latter half of that month. Accordingly, quarterly financial results will be difficult to predict prior to the end of the quarter and a shortfall in shipments at the end of any particular quarter may cause the results of that quarter to fall significantly short of anticipated levels.

At the end of each quarter, the Company's distributors typically hold significant inventories of the Company's products. The Company has established reserves for returns based on experience. New channel relationships introduce additional uncertainty in this area. Setting reserves involves making judgments about future competitive conditions, product acceptance and other factors which by their nature involve uncertainties at the time the reserves are established.

RESULTS OF OPERATIONS

The following table sets forth items derived from the consolidated statements of income, expressed as a percentage of revenues, for the year ended March 31, 1996 and for each of the preceding two years.

Years Ended March 31	1996	1995	1994
		(Percentage of Revenues)	
Revenues:			
Product	69.6%	69.5%	69.2%
Service	30.4	30.5	30.8
	100.0%	100.0%	100.0%
Gross margin:			
Product	52.0%	47.9%	45.5%
Service	32.2	36.5	33.3
Combined	45.9	44.4	41.7
Expenses:			
Sales and marketing	27.4	27.5	33.3
Administration and general	6.9	6.2	8.4
Research and development	9.9	8.4	10.9
Restructuring and other costs	1.3	0.6	21.8
Income (loss) from operations	0.4	1.7	(32.7)
Gain on sale of portfolio investment	-	1.7	-
Interest expense	(0.4)	(2.5)	(3.1)
Interest income and foreign exchange	0.2	0.3	0.7
Income taxes	-	-	(0.9)
Net income (loss)	0.2%	1.2%	(36.0)%

REVENUES

The following table sets forth, for the year ended March 31, 1996 and for each of the two preceding fiscal years, product revenues by geographic segment and product group expressed as a percentage of total product revenues. These amounts have been calculated assuming constant rates of exchange in the translation of foreign currency amounts to U.S. dollars. Remote access products primarily include internetworking products sold under the names Gandalf Xpressway, XpressStack and XpressConnect. Remote access products represent a subset of the Company's total LAN internetworking product line. The other three product groups shown below represent traditional product areas for the Company which include wide area networking (WAN) backbone products; modems, multiplexers and local connectivity products; and other products which primarily represent third-party products.

Years Ended March 31	Remote Access	WAN Backbone	Modems/ Multiplexers/ Local Connectivity	Other	Total
1996					
United States	25%	1%	5%	1%	32%
Canada	12	1	4	1	18
United Kingdom	11	2	7	3	23
Holland/France	9	1	2	2	14
Other	8	3	2	-	13
	65%	8%	20%	7%	100%
1995					
United States	15%	1%	8%	4%	28%
Canada	9	2	7	1	19
United Kingdom	12	3	9	4	28
Holland/France	6	1	3	1	11
Other	7	3	2	2	14
	49%	10%	29%	12%	100%
1994					
United States	7%	3%	9%	7%	26%
Canada	5	1	9	2	17
United Kingdom	6	6	10	5	27
Holland/France	3	1	4	3	11
Other	4	7	5	3	19
	25%	18%	37%	20%	100%

Revenues in the fiscal year ended March 31, 1996 were $116.5 million compared to $120.5 million in 1995 and $131.3 million during 1994. Approximately 70% of revenues in 1996 were derived from the sale of products with the balance represented by service revenues. The mix of revenues between the sale of products and services has not changed significantly over the last three years.

Product revenues for the year ended March 31, 1996 were $81.1 million. For 1995 and 1994 such revenues were $83.8 million and $90.8 million respectively. Revenues from the Company's remote access products showed growth of 26% in 1996 compared to 1995 and represented 65% of product revenues in 1996 compared to 49% in 1995 and 25% in 1994. A decline in sales during 1995 and 1996 of other products sold by the Company, including third-party products, more than offset the growth in remote access products during this two year period, resulting in a decline in total product revenues of 3.3% in 1996 compared to 1995, and 7.7% in 1995 compared to 1994.

Revenues from services were $35.5 million in 1996 compared to $36.7 million in 1995 and $40.5 million in 1994. Service revenues declined in 1996 compared to 1995 and 1994 as a result of lower revenues during each of the last two fiscal years on products which the Company has traditionally derived the majority of its service revenues.

GROSS MARGIN

The combined gross margin (total revenues minus cost of product sales and service expenses expressed as a percentage of total revenues) was 45.9% in 1996 compared to 44.4% in 1995 and 41.7% in 1994. The improvement in the combined gross margin in 1996 compared to 1995 largely mitigated the reduction in revenues of $4.0 million from 1995 to 1996. The combined gross profit (total revenues minus cost of product sales and service expenses) in 1996 was $53.5 million on revenues of $116.5 million compared to $53.6 million on revenues of $120.5 million in 1995.

The gross margin on product revenues (product revenues minus cost of product sales expressed as a percentage of product revenues) improved to 52.0% in 1996, compared to 47.9% in 1995 and 45.5% in 1994. In general, the combined effect of lower manufacturing costs following restructuring actions taken in the fourth quarter of 1994 and the first quarter of 1995 and a more favourable product mix, primarily due to a reduction in the volume of third-party product sales, has resulted in improvements since 1994 in the gross margin earned on product revenues. However, the Company anticipates that it will continue to experience quarterly fluctuations in the gross margin on product revenues such as those that were experienced in 1996, during which the gross margin on product revenues fluctuated in a range between 50.2% and 53.4% over the four fiscal quarters.

The gross margin on service revenues (service revenues minus service expenses expressed as a percentage of service revenues) was 32.2% in 1996, 36.5% in 1995 and 33.3% in 1994. The decline in 1996 compared to 1995 occurred as a result of a 6% decline in service revenues in 1996 compared to 1995, when applying constant exchange rates for translation purposes for both periods. Service expenses, when translated in the same way, were unchanged in 1996 compared to 1995.

OPERATING EXPENSES

Sales and marketing, and administration and general expenses were $40.0 million in 1996 compared to $40.7 million in 1995 and $54.8 million in 1994. Reductions in these operating expenses in 1996 and 1995 related to restructuring and downsizing actions undertaken between 1993 and 1995. Research and development expenses in 1996 were $11.5 million, 13.0% higher than in 1995. Research and development expenses have averaged more than 14% of product revenues during the three years 1994 to 1996.

Since 1991, the Company has received funding of approximately $1.4 million and $2.5 million respectively under two projects approved through the Canadian federal government's Microelectronics and Systems Development Program ("MSDP"). This funding is repayable, without interest, as a royalty on revenues earned in the ten years following the project completion date and is limited to the amount of funding received. The Company commenced accruing royalties during 1996 upon completion of each project and expects that the funding will be fully repaid within three to five years. At March 31, 1996, $785,000 had been accrued related to these projects.

Restructuring charges of $1.5 million in the fourth quarter of 1996 were recorded in connection with certain consolidation and outsourcing activities carried out in the areas of manufacturing distribution and repair in Europe, outsourcing to partners for the delivery of field service maintenance, and changes in the sales structure to continue the implementation of the Company's distribution channel strategy. These charges primarily related to severance and facilities costs.

The Company recorded restructuring costs of $0.7 million during the first quarter of 1995, representing severance costs associated with the elimination of approximately 70 positions in connection with an internal functional realignment.

Restructuring costs of $15.8 million recorded during the 1994 fiscal year related to decisions made by the Company in February 1994 to reduce its workforce by approximately 300 positions worldwide and consolidate its North American operations under a single organization structure. Other costs recorded in the fourth quarter of fiscal 1994 included the writedown of $7.5 million in deferred tax assets which primarily related to investment tax credits earned in Canada prior to the third quarter of 1993 on research and development expenditures. These tax credits remain available to the Company and the benefit of these tax credits will instead be recorded in the financial statements as they are utilized to reduce federal income taxes payable in Canada. Other costs in 1994 also included a writedown of $4.5 million in deferred software development costs which were not expected to be recovered through future cash flows and a $0.9 million writedown of the carrying value of assets held for disposal to their estimated net realizable value.

INCOME FROM OPERATIONS

The Company reported income from operations, net of restructuring charges, of $488,000 in 1996 compared to income from operations of $2.0 million in 1995 and a loss from operations of $43.0 million in 1994. Income from operations, before restructuring charges, was $2.0 million in 1996 and $2.7 million in 1995, compared to a loss from operations, before restructuring charges and other costs, of $14.3 million in 1994.

NET FINANCIAL EXPENSES

Interest expense was $487,000 in 1996 compared with $3.0 million in 1995 and $4.1 million in 1994. Interest expense declined in 1996 compared to 1995 and 1994 as a result of the conversion of interest-bearing debentures to common shares during 1996 and 1995 and lower utilization of bank operating lines.

NET INCOME

Net income for the year ended March 31, 1996 was $260,000 or $0.01 per share compared to net income of $1.4 million or $0.05 per share in 1995. Income before restructuring charges in 1996 was $1.8 million, representing $0.04 per share. Income for 1995, exclusive of restructuring charges and a one-time gain on the sale of a portfolio investment, was $67,000, break even on a per share basis.

SEGMENT OPERATING RESULTS

Note 16 to the consolidated financial statements contains information concerning the geographic segments in which the Company operates. The following table sets forth supplemental information regarding product and service revenues by geographic segment for the year ended March 31, 1996 and for each of the preceding two years.

Years Ended March 31	1996	1995	1994
Product Revenues:			
United States	$ 24,769	$ 23,341	$ 24,177
Canada	15,033	15,539	15,431
United Kingdom	18,540	24,059	24,602
Holland/France	12,344	9,362	8,528
Other	10,390	11,500	18,075
	$ 81,076	$ 83,801	$ 90,813
Service Revenues:			
United States	$ 7,989	$ 9,206	$ 10,980
Canada	6,642	6,934	7,910
United Kingdom	13,104	13,880	14,707
Holland/France	7,722	6,690	6,913
	$ 35,457	$ 36,710	$ 40,510

Product and service revenues in North America (United States and Canada) were $54.4 million in 1996, compared to $55.0 million in 1995 and $58.5 million in 1994. The Company's European direct sales markets (United Kingdom, Holland and France) reported total revenues of $51.7 million in 1996, compared to $54.0 million in 1995 and $54.8 million in 1994. Other international markets represented revenues of $10.4 million in 1996, $11.5 million in 1995 and $18.1 million in 1994.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT'D)

Segment operating profit for North America (United States and Canada) in 1996, expressed as a percentage of revenues, was 18.1% compared to 11.8% in 1995. In 1994, the segment operating loss in North America represented 3.2% of revenues. The improvement in operating performance for this segment between 1994 and 1996 is primarily attributable to a reduced cost infrastructure and an improved product mix.

Segment operating profit, expressed as a percentage of revenues, for the Company's operations in the United Kingdom, Holland and France was 19.3% in 1996, 21.8% in 1995 and 17.3% in 1994. The decrease in operating profit in Europe during 1996 is primarily attributable to a 30% decline in traditional product revenues in the United Kingdom.

The Company's other international markets reported a segment operating loss of 10.7% of revenues in 1996 compared to a segment operating loss of 0.6% of revenues in 1995, and a segment operating income of 13.8% of revenues in 1994. This reduction in profitability is primarily due to the combined effect of a change in product mix and the higher costs associated with developing these markets.

LIQUIDITY AND CAPITAL RESOURCES

The Company recorded positive cash flow of $7.6 million during 1996. At March 31, 1996 the net cash position (cash and cash equivalents net of bank operating lines) was $13.6 million compared to $6.0 million a year ago. The increase in cash included positive cash flow from operating activities of $4.9 million. Non-operating sources of cash in 1996 included net proceeds of $4.9 million from the issue of capital stock, primarily from the exercise of stock options and shares issued under the employee stock purchase plan.

At March 31, 1996 the Company's authorized bank operating lines totaled $20.8 million. These committed facilities are provided by a Canadian chartered bank and bear interest at the bank's prime rate plus 0.5% to 1.5%.

The operating lines are secured by certain of the accounts receivable, inventories and other assets of the Company. The amount available for borrowing at any time under the facilities is based on margin formulas relating to levels of accounts receivable, inventories and other bank covenants. Under such formulas, $17.3 million was available to, but not utilized by, the Company at March 31, 1996. Cash and cash equivalents held as of that date represented a further $13.6 million of cash resources available to the Company. Cash and unused credit lines totaled $30.9 million at March 31, 1996, compared to $20.8 million at March 31, 1995.

During 1995 and 1996 all outstanding 8.5% convertible debentures, issued in November 1992, were converted to common shares of the Company in accordance with the terms of the debentures.

The Company believes that its current financial base together with available credit facilities provides sufficient financial resources to meet its short-term operating requirements. The Company currently anticipates that its long-term cash requirements will be satisfied through future operating cash flows.

Capital spending was $2.7 million in 1996, $2.9 million in 1995 and $4.4 million in 1994. The Company believes it must continue to invest in its capital asset base at 1996 or moderately higher levels.

The ratio of term debt to shareholders' equity at March 31, 1996 was 0.05:1. The corresponding figure at March 31, 1995 was 0.35:1. The Company's current ratio improved to 2.0:1 at March 31, 1996 compared to 1.6:1 at March 31, 1995.

MARKET FOR GANDALF STOCK AND RELATED SECURITY HOLDER MATTERS

MARKETS INFORMATION

The common shares of Gandalf Technologies Inc. are listed on The Toronto Stock Exchange in Canada (Symbol GAN) and on The Nasdaq Stock Market (NMS) in the United States (Symbol GANDF).

	The Toronto Stock Exchange *(Canadian Dollars)*				The Nasdaq Stock Market *(U.S. Dollars)*			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Fiscal 1996								
High	23	27 3/8	17.00	13 3/8	17 1/8	20 1/16	12 1/8	9 3/4
Low	16 5/8	6 3/8	7 4/8	4.85	12 3/32	4 7/8	5 5/8	3 1/2
Volume (000's)	8,705	33,241	15,958	24,240	93,368	168,536	89,217	69,536
Fiscal 1995								
High	6 7/8	2.33	1.58	1.74	4 7/8	1 11/16	1 3/16	1 3/8
Low	1.80	1.26	0.85	0.75	1 1/4	7/8	9/16	1/2
Volume (000's)	52,236	8,886	9,765	10,037	49,876	2,478	1,475	2,810
Fiscal 1994								
High	3.75	4.60	4.00	4.60	3	3 1/2	3 1/4	3 19/32
Low	0.95	3.40	2.85	3.60	13/16	2 1/2	2 1/8	2 3/4
Volume (000's)	20,284	9,167	1,633	3,008	1,418	798	453	605

VOLATILITY OF STOCK PRICES

The market price of the Company's common stock has been, and may continue to be, extremely volatile. The Company believes that the market price for the Company's stock at any particular time is heavily dependent on expectations in the market, including analysts' expectations, of future performance and growth which may be based on trends existing generally in the industry. There can be no assurance that the Company's performance will meet such expectations and, accordingly, a shortfall in earnings in any given period can be expected to have an immediate and significant adverse effect on the trading price of the Company's common stock. Factors such as new product announcements by the Company or its competitors, strategic alliances, mergers or acquisitions announced by the Company's competitors, general conditions in the data networking market, the general volatility of stocks of high technology companies and other factors that may be unrelated to the performance of the Company may also have a significant impact on the market price of the Company's common stock.

SHAREHOLDERS

As at June 1, 1996, there were 43,262,941 shares issued and outstanding with 1,867 record holders. The stock closed on The Toronto Stock Exchange at C$19.35 on May 31, 1996, and on The Nasdaq Stock Market at $13 56/64.

DIVIDENDS

Individuals and corporations resident in the United States are subject generally to a 15% withholding tax on dividends, and individuals and corporations resident in countries that do not have a treaty with Canada are subject to a 25% withholding tax. For United States corporations only, however, the United States/Canada Tax Treaty reduces the withholding tax to 10% if the United States corporation owns at least 10% of the Company's voting shares.

It is the Company's present policy not to pay cash dividends and to retain its earnings to finance expansion and growth. Future dividends, if any, would be expected to be paid in Canadian dollars. Payment of future dividends will be at the discretion of the Board of Directors and will be dependent on earnings, capital requirements and the financial condition of the Company.

Capital gains derived in Canada from the sale or exchange of the Company's shares by an individual or corporation resident in the United States and without a permanent establishment in Canada are exempt from taxation in Canada with limited exceptions.

FIVE-YEAR FINANCIAL SUMMARY

Years Ended March 31	1996	1995	1994	1993	1992*
	(Thousands of U.S. dollars, except per share and employee data)				
INCOME STATEMENT DATA					
Revenues	$ 116,533	$ 120,511	$ 131,323	$ 160,900	$ 119,181
Cost of sales	62,994	66,946	76,533	90,570	63,753
Sales and marketing	31,942	33,148	43,678	47,928	35,777
Administration and general	8,054	7,513	11,094	14,879	10,001
Research and development	11,524	10,197	14,316	17,279	13,679
Restructuring and other costs	1,531	685	28,662	5,547	3,678
Income (loss) from operations	488	2,022	(42,960)	(15,303)	(7,707)
Gain on sale of portfolio investment	-	2,024	-	-	-
Net financial expenses	(228)	(2,640)	(3,136)	(4,204)	(2,205)
Income taxes	-	-	(1,142)	-	-
Net income (loss)	$ 260	$ 1,406	$ (47,238)	$ (19,507)	$ (9,912)
Basic earnings (loss) per share	$ 0.01	$ 0.05	$ (2.27)	$ (1.24)	$ (0.63)
Weighted average shares outstanding (thousands)	40,359	28,589	20,802	15,702	15,658
	(Amounts expressed as a percentage of revenue)				
Gross margin	45.9%	44.4%	41.7%	43.7%	46.5%
Sales and marketing	27.4	27.5	33.3	29.8	30.0
Administration and general	6.9	6.2	8.4	9.2	8.4
Research and development	9.9	8.4	10.9	10.7	11.5
Restructuring and other costs	1.3	0.6	21.8	3.5	3.1
Income (loss) from operations	0.4	1.7	(32.7)	(9.5)	(6.5)
Gain on sale of portfolio investment	-	1.7	-	-	-
Net financial expenses	(0.2)	(2.2)	(2.4)	(2.6)	(1.8)
Income taxes	-	-	(0.9)	-	-
Net income (loss)	0.2%	1.2%	(36.0)%	(12.1)%	(8.3)%
BALANCE SHEET DATA					
Working capital	$ 29,361	$ 21,057	$ 13,978	$ 25,596	$ 19,276
Current assets	57,654	56,195	60,354	74,049	81,464
Current liabilities	28,293	35,138	46,376	48,453	62,188
Current ratio	2.0	1.6	1.3	1.5	1.3
Total assets	79,375	81,508	89,186	129,603	141,408
Cash and cash equivalents, net of current bank debt	13,602	5,963	(5,239)	(688)	(17,918)
Long-term debt	2,496	1,877	2,020	22,980	23,729
Convertible debentures	-	10,051	21,681	23,862	-
Shareholders' equity	48,586	34,442	19,109	34,308	55,491
Book value per share	1.13	0.98	0.68	2.16	3.54
EMPLOYEE DATA					
Number of employees (year-end)	812	897	1,127	1,366	1,616
Revenue per employee	$ 143,513	$ 134,349	$ 116,524	$ 117,789	$ 73,751
Assets per employee	$ 97,752	$ 90,867	$ 79,138	$ 94,878	$ 87,505

**For eight months only*

CORPORATE HEADQUARTERS

Gandalf Technologies Inc.
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Tel: 613-274-6500
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BOARD OF DIRECTORS

Thomas A. Vassiliades
Chairman, President
and Chief Executive Officer

Desmond Cunningham*

Alexander Curran*

John F. Gamba

Charles J. Gardner

Donald M. Gleklen

Robert E. Keith

A. Graham Sadler*

Albert Sinyor

* Retiring from the Board of Directors

EXECUTIVE OFFICERS

Thomas A. Vassiliades
Chairman, President and
Chief Executive Officer

Richard Busto
Vice President, Strategy,
Business Development and
Network Services

Michael Chawner
Vice President, Product Operations
and Chief Technology Officer

Joceline Lemieux
Vice President,
Worldwide Marketing

Walter MacDonald
Vice President, Finance and
Chief Financial Officer

John McGoldrick
President,
Asia Pacific Group

Peter Merrifield
Managing Director, Europe, Middle
East and Africa

Ken Stess
Vice President,
North American Sales

Frank van der Poll
Managing Director,
Northern Europe

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K1P 5T6

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Fax: 416-813-4555
Toll Free: 1-800-387-0825
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Chemical Mellon Shareholder
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Overpeck Center
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Ridgefield Park, New Jersey 07660
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& Kronick
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Lace Mawer
King's House
42 King Street West
Manchester, England
M3 2NU

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

The Annual and Special
Meeting of shareholders
will be held at 2:00 p.m.
Thursday, August 1, 1996,
at the Delta Ottawa Hotel
361 Queen Street
Ottawa, Ontario, Canada

For further information and copies of the Annual Report or Form 10-K as filed with the United States Securities and Exchange Commission, this Annual Report and Quarterly Reports of the Company please contact:

Investor Relations
(613) 274-6555

or write to:
The Secretary
Gandalf Technologies Inc.
130 Colonnade Road South
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Canada K2E 7M4

Financial results and news on new Gandalf products and services are also available through our faxback service by calling (613) 274-6500 and asking for extension 3000 or through Gandalf's home page on the Internet. Our Internet address is http://www.gandalf.ca

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