

ICOWORKS INC
Form 10QSB
February 27, 2004

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, DC 20549

FORM 10-QSB

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended **December 31, 2003**

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period _____ to _____

Commission file number **000-33163**

ICOWORKS INC.

(Exact name of small business issuer as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

76-0609444
(IRS Employer Identification No.)

114 West Magnolia Street, Suite 400
Bellingham, WA 98225
(Address of principal executive offices)

(360) 392-3960
(Issuer's telephone number)

NOT APPLICABLE

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:
13,786,398 Shares of \$0.001 par value Common Stock outstanding as of February 17, 2003.

PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements.

ICOWORKS INC

Consolidated Financial Statements
(Expressed in U.S. Dollars)
(Unaudited)

December 31, 2003

F-1

ICOWORKS, INC. AND SUBSIDIARIES
(formerly Paragon Polaris Strategies.com, Inc)
CONSOLIDATED BALANCE SHEETS
(Expressed in U.S. Dollars)

| | December 31 | June 30 |
|--|---------------------|---------------------|
| | 2003 | 2003 |
| | (unaudited) | (audited) |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 904,787 | \$ 448,404 |
| Cash held in trust for consignors | 818,977 | - |
| Accounts receivable, less allowance for doubtful accounts of \$63,823 (2003 - \$15,158) | 534,042 | 562,953 |
| Income taxes recoverable | 920 | 920 |
| Inventories | 1,549,806 | 2,087,581 |
| Prepaid expenses | 108,047 | 59,734 |
| Promissory notes | 315,000 | - |
| Other assets | - | 1,012 |
| Deferred tax assets less valuation allowance of 1,602,769 (June 30, 2003 - \$1,236,107) | - | - |
| Total current assets | 4,231,579 | 3,160,604 |
| Equipment , net of accumulated depreciation | 144,918 | 98,394 |
| Land | 370,000 | - |
| Goodwill | 1,109,850 | - |
| Deferred financing costs, net | 433,369 | 266,304 |
| Total assets | \$ 6,289,716 | \$ 3,525,302 |

- continued -

The accompanying notes are an integral part of these consolidated financial statements.

ICOWORKS, INC. AND SUBSIDIARIES
(formerly Paragon Polaris Strategies.com, Inc)
CONSOLIDATED BALANCE SHEETS
(Expressed in U.S. Dollars)

| | December 31 | June 30 |
|---|---------------------|---------------------|
| | 2003 | 2003 |
| | (unaudited) | (audited) |
| <i>Continued</i> | | |
| LIABILITIES AND DEFICIENCY IN ASSETS | | |
| Current liabilities | | |
| Bank overdraft | \$ - | \$ 74,492 |
| Accounts payable and accrued liabilities | 1,431,369 | 1,019,408 |
| Trust liabilities | 899,559 | - |
| Advances payable | 175,874 | 129,486 |
| Obligation to issue shares | 200,000 | - |
| Financial arrangements and guarantees used to acquire inventory | 3,480,176 | 2,449,626 |
| Due to related parties | 1,472,547 | 1,050,455 |
| Total current liabilities | 7,659,525 | 4,723,467 |
| Preferred shares to be issued | 300,000 | 300,000 |
| Total liabilities | 7,959,525 | 5,023,467 |
| Minority interest | (308,143) | (235,476) |
| Contingent liabilities | | |
| Deficiency in assets | | |
| Capital stock | | |
| Authorized | | |
| 100,000,000 common shares with a par value of \$ 0.001 | | |
| 10,000,000 preferred shares with a par value of \$ 0.001 | | |
| Issued and outstanding | | |
| 13,786,398 common shares (2003 12,886,398) | 13,786 | 12,886 |
| Additional paid-in capital | 3,330,196 | 2,388,650 |
| Accumulated other comprehensive loss | (59,943) | (42,327) |
| Deficit | (4,645,705) | (3,621,898) |
| Total deficiency in assets | (1,361,666) | (1,262,689) |
| Total liabilities and deficiency in assets | \$ 6,289,716 | \$ 3,525,302 |

The accompanying notes are an integral part of these consolidated financial statements.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Expressed in U.S. Dollars)

(unaudited)

| | Three months ended December 31 | | Six months ended December 31 | |
|--|-----------------------------------|-----------|---------------------------------|------------|
| | 2003 | 2002 | 2003 | 2002 |
| SALES | \$ 7,966,775 | \$ 42,941 | \$ 11,213,648 | \$ 623,383 |
| COST OF SALES | 6,571,765 | 239,017 | 9,365,898 | 369,224 |
| NET AUCTION REVENUE | 1,395,010 | (196,076) | 1,847,750 | 254,159 |
| OTHER REVENUE | 21,627 | 15,337 | 69,336 | 51,750 |
| NET REVENUE | 1,416,637 | (180,739) | 1,917,086 | 305,909 |
| EXPENSES | | | | |
| Depreciation and amortization | 9,553 | 74,686 | 19,248 | 138,401 |
| Bad debts | 61,372 | - | 61,372 | - |
| Bank charges and interest | 151,550 | 3,953 | 242,178 | 34,207 |
| Consulting | 155,892 | - | 186,192 | - |
| Entertainment and promotion | 22,403 | 17,989 | 29,395 | 21,360 |
| Financing fees | 418,148 | - | 605,648 | - |
| General and administrative | 559,479 | 7,592 | 1,186,521 | 354,337 |
| Office and miscellaneous | 307,918 | 9,457 | 433,954 | 229,443 |
| Rent | 164,329 | - | 288,574 | - |
| Travel and related | 68,517 | - | 111,156 | - |
| | 1,919,161 | 113,678 | 3,164,238 | 777,748 |
| Income (loss) before minority interest in net gain (loss) of subsidiaries | (502,524) | (294,417) | (1,247,152) | (471,839) |
| Minority interest in net gain (loss) of subsidiaries | 22,054 | (66,311) | 72,667 | 11,755 |
| Loss before other items and income taxes | (480,469) | (360,728) | (1,174,485) | (460,084) |
| OTHER ITEMS | | | | |
| Foreign exchange loss | (87,583) | - | (86,242) | - |
| Interest income (expense) | (8,291) | 504 | 6,478 | 504 |
| Net proceeds on insurance claim | 230,516 | - | 230,516 | - |
| Loss on sale of assets | (74) | (4,184) | (74) | (4,184) |
| Gain on sale of available for sale equity securities | - | 8,588 | - | 8,588 |
| | 134,568 | 4,908 | 150,678 | 4,908 |
| Loss before income taxes | (345,901) | (355,820) | (1,023,807) | (455,176) |

- continued -

The accompanying notes are an integral part of these consolidated financial statements.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Expressed in U.S. Dollars)

(unaudited)

| | Three months ended December 31 | | Six months ended December 31 | |
|--|-----------------------------------|--------------|---------------------------------|--------------|
| | 2003 | 2002 | 2003 | 2002 |
| Loss before income taxes <i>(continued)</i> | (345,901) | (355,820) | (1,023,807) | (455,176) |
| Income taxes (recovery) | - | - | - | - |
| Net loss | (345,901) | (355,820) | (1,023,807) | (455,176) |
| Cumulative foreign currency translation adjustment | (47,209) | - | (17,616) | - |
| Comprehensive loss | \$ (393,110) | \$ (355,820) | \$ (1,041,423) | \$ (455,176) |
| Basic and diluted net loss per common share | \$ (0.03) | \$ (0.06) | \$ (0.08) | \$ (0.09) |
| Weighted average number of common shares outstanding, basic and diluted | 13,134,224 | 6,311,663 | 13,010,311 | 5,000,604 |

The accompanying notes are an integral part of these consolidated financial statements.

ICOWORKS, INC. AND SUBSIDIARIES
(formerly Paragon Polaris Strategies.com, Inc)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in U.S. Dollars)
(unaudited)

| | Six months ended December 31 | |
|---|---------------------------------|--------------|
| | 2003 | 2002 |
| CASH FROM OPERATING ACTIVITIES | | |
| Net loss | \$ (1,023,807) | \$ (455,176) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Accrued finders fees | 200,000 | - |
| Accrued interest | 250,555 | - |
| Accrued management fees due to a related party | 51,000 | 102,000 |
| Amotization of warrants | 254,935 | - |
| Bad debts | 61,372 | - |
| Compensation cost on options granted | 86,000 | - |
| Depreciation and amortization | 19,248 | 101,531 |
| Loss on sale of marketable securities | - | (8,588) |
| Loss on sale of assets | - | 4,184 |
| Minority interest | (72,667) | (11,755) |
| Net proceeds on fire insurance claim | (230,516) | - |
| Shares issued for consulting services | 11,000 | 42,200 |
| Shares issued for financing fees | - | 61,019 |
| Changes in assets and liabilities: | | |
| Decrease in accounts receivable | (11,401) | (32,794) |
| (Increase) decrease in inventories | 1,204,779 | - |
| (Increase) decrease in prepaid expenses | (48,313) | - |
| Decrease in other assets | 1,012 | - |
| Increase (decrease) in accounts payable and accrued liabilities | 262,026 | (36,394) |
| Increase in trust liabilities | 899,559 | - |
| Increase in advances payable | 46,388 | - |
| Net cash provided by (used in) operating activities | 1,961,170 | (233,773) |
| CASH FROM INVESTING ACTIVITIES | | |
| Purchase of marketable securities | - | (8,527) |
| Sale of available for sale equity securities | - | 20,982 |
| Sale of fixed assets | - | 13,967 |
| Purchase of subsidiary | (1,500,000) | - |
| Purchase of equipment | (58,856) | (36,346) |
| Net cash provided by (used in) investing activities | (1,558,856) | (9,924) |

- continued -

The accompanying notes are an integral part of these consolidated financial statements.

ICOWORKS, INC. AND SUBSIDIARIES
(formerly Paragon Polaris Strategies.com, Inc)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in U.S. Dollars)
(unaudited)

| | Six months ended December 31 | |
|--|---------------------------------|-------------------|
| | 2003 | 2002 |
| <i>Continued</i> | | |
| CASH FROM FINANCING ACTIVITIES | | |
| Issuance of common shares, less share issuance costs | - | 88,415 |
| Proceeds from trust assets | - | 24,373 |
| Increase (decrease) in due to related parties | 371,092 | 121,742 |
| Repayments of financial arrangements | (2,700,401) | - |
| Proceeds received from financial arrangements | 4,846,745 | - |
| Repayments of guarantees used to acquire inventory | (1,552,282) | - |
| Net cash provided by (used in) financing activities | 965,154 | 234,530 |
| Effect of foreign exchange on cash and cash equivalents | (17,616) | - |
| Change in cash and cash equivalents during the period | 1,349,852 | (9,166) |
| Cash and cash equivalents, beginning of the period | 373,912 | 134,523 |
| Cash and cash equivalents, end of the period | \$ 1,723,764 | \$ 125,357 |
| Cash and cash equivalents, end of the period consists of the following: | | |
| Cash held at banks | \$ 904,787 | \$ 125,356 |
| Cash held in trust for consignors | 818,977 | - |
| | \$ 1,723,764 | \$ 125,356 |
| Cash paid for: | | |
| Interest | \$ - | \$ 11,395.00 |
| Income taxes | - | - |
| Supplemental disclosure with respect to cash flows (Note 17) | | |

The accompanying notes are an integral part of these consolidated financial statements.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

1. HISTORY OF THE COMPANY

Icworks, Inc. (formerly Paragon Polaris Strategies.com Inc.) (the Company) was incorporated in the State of Nevada on May 27, 1999. On July 1, 1999, the Company acquired limited rights to distribute and produce an oxygen enriched water product for fish farming, aquaculture, mariculture, poultry raising and for treating animal waste from dairies, feedlots of all kinds and for other similar uses. The rights to use this technology were subsequently withdrawn by agreement with the owner. On January 3, 2000, the Company acquired a three-year license to market and sell vitamins, minerals, and nutritional supplements from Vitamineralherb.com Inc. The Company abandoned this business in fiscal 2002.

On February 20, 2003, the Company acquired 56% of the issued and outstanding common stock of Icworks Holdings, Inc. (Icworks Holdings) consisting of 3,593,199 shares from several non-U.S. stockholders. As consideration, the Company issued 7,186,398 common shares to the former non-U.S. stockholders of Icworks Holdings and control of the combined companies passed to the former non-U.S. stockholders of Icworks Holdings. The Company accounted for this acquisition as a business combination (Note 4).

The consolidated statements of operations, stockholders' equity (deficiency in assets) and cash flows of the Company prior to February 20, 2003, are those of Icworks Holdings. The Company's consolidated date of incorporation is considered to be February 27, 1998, the date of inception of Icworks Holdings. Following the acquisition, the Company changed its name from Paragon Polaris Strategies.com Inc. to Icworks, Inc.

Icworks Holdings is a Nevada corporation whose principal business activity consists of the conduct of customized auctions for corporate assets such as wholesale and retail inventories, used industrial equipment and other related goods. During the year ended June 30, 2002, and prior to the acquisition of the Company, Icworks Holdings purchased all the issued and outstanding capital stock of two companies, Icworks Services Ltd. ("Icworks Services") and DM International Appraisals & Consulting Ltd. Icworks Holdings also has two other subsidiaries, being Icworks Eastern Ltd. and Icworks Joint Venture Ltd. Icworks Joint Venture Ltd. is a bare trustee corporation with no assets or liabilities, which was formed for the sole purpose of holding assets on behalf of a number of participants. On August 29, 2003, Icworks Holdings acquired Premier Auctioneers International Inc. (Note 5).

Interim reporting

The accompanying unaudited consolidated interim financial statements have been prepared by the Company in accordance with the rules and regulations of Regulation S-B as promulgated by the Securities and Exchange Commission. In the opinion of management, the accompanying unaudited consolidated interim financial statements contain all adjustments necessary (consisting of normal recurring accruals) to present fairly the financial information contained therein. The accompanying unaudited interim consolidated financial statements do not include all disclosures required by generally accepted accounting principles in the United States of America. The results of operations for the six-month period ended December 31, 2003, are not necessarily indicative of the results to be expected for the year ending June 30, 2004.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

2. GOING CONCERN

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business rather than through a forced process of liquidation. However, certain conditions noted below currently exist which raise substantial doubt about the Company's ability to continue as a going concern. These consolidated financial statements do not include any adjustments to the amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

The operations of the Company have primarily been funded by the issuance of common stock and advances from related parties, shareholders and others. Continued operations of the Company are dependent on the Company's ability to complete additional equity financings, obtain continued support from related parties or generate profitable operations in the future. Management's plan in this regard is to secure additional funds through future equity financings. Such financings may not be available or may not be available on reasonable terms.

| | December 31 2003 | June 30 2003 |
|------------------------------|---------------------|-----------------|
| Net loss | \$ (1,023,807) | \$ (1,790,551) |
| Accumulated deficit | (4,645,705) | (3,621,898) |
| Working capital (deficiency) | (3,427,946) | (1,562,863) |

3. BASIS OF PRESENTATION

These interim statements have been completed using the same accounting policies and measurement criteria as those utilized in the preparation of the Company's audited financial statements dated June 30, 2003, and should be read in conjunction with these annual statements, which provide information on the Company's accounting policies and more comprehensive note disclosures of certain financial statement line items. Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

4. BUSINESS COMBINATION WITH ICOWORKS HOLDINGS

On November 20, 2002, the Company entered into an agreement to merge with Icoworks Holdings. On February 20, 2003, the Company acquired a 56% interest in Icoworks Holdings (subsequently reduced to 53% as at December 31, 2003 through the issuance of 164,500 additional shares of Icoworks Holdings) through the private acquisition of 3,593,199 shares of Icoworks Holdings from several non-U.S. stockholders and, accordingly, the Company is considered to be the legal acquirer. As consideration, the Company issued 7,186,398 common shares to the former non-U.S. stockholders of Icoworks Holdings and control of the combined companies passed to the former non-U.S. stockholders of Icoworks Holdings and therefore, Icoworks Holdings is considered the accounting acquirer.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

4. BUSINESS COMBINATION WITH ICOWORKS HOLDINGS (continued)

Consequently, the consolidated statements of operations, stockholders' equity (deficiency in assets) and cash flows include Icoworks Holdings' results of operations, deficit and cash flows from February 27, 1998 (date of inception) and the Company's results of operations and cash flows from February 20, 2003. The issued number of shares of common stock is that of the Company. The acquisition was accounted for as a business combination. The Company plans to complete the merger with Icoworks Holdings as contemplated by the merger agreement. As the merger was not consummated by May 1, 2003, the terms of the original merger agreement expired. The Company intends to enter into a new merger agreement to complete the acquisition of the minority interest of Icoworks Holdings.

Under the terms of the merger agreement, the Company agreed to issue shares of its common stock to the shareholders of Icoworks Holdings on a two-for-one basis. The Company anticipates issuing an aggregate of 12,865,920 shares in order to complete the acquisition of all of the outstanding shares of Icoworks Holdings, inclusive of the 7,186,398 shares already issued by the Company. In addition, the Company will issue options and warrants to the current option holders and warrant holders of Icoworks Holdings on a two-for-one basis if the new merger agreement is signed.

At the date of acquisition, the fair market value of the net assets of the Company was as follows:

| | | |
|--|----|----------|
| Cash and cash equivalents | \$ | 49 |
| Accounts receivable | | 2,592 |
| Prepaid expenses | | 10,868 |
| Accounts payable and accrued liabilities | | (17,066) |
| Due to related parties | | (82,892) |
| Net liabilities assumed | \$ | (86,449) |

5. ACQUISITIONS**Acquisition of Premier Auctioneers International Inc.**

On August 29, 2003, the Company acquired the business of Premier Auctioneers International Inc. (Premier) and certain lands related to Premier's auction business from Network International (Network). The purchase price of the acquisition was \$1,500,000 and agreement to repay certain expenses of Network that had been incurred to prepare for several auctions that were held in September 2003. Concurrent with the acquisition of Premier, the Company agreed to issue a total of 2,700,000 common shares of the Company to three key employees of Premier. These shares will be issued over a three-year period as follows: i) 25% on closing of the acquisition (which had not been issued as of December 31, 2003); and ii) 25% on

each of the first, second and third anniversary dates of the closing subject to the employees continued employment with Premier. The shares will be valued at the fair value based on market value on the date of closing and the subsequent anniversary dates and the Company will record a compensation expense equal to the fair value.

F-10

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

5. ACQUISITIONS (continued)

The acquisition of Premier has been accounted for using the purchase method and accordingly, these consolidated financial statements include the results of operations and cash flows of Premier from the date of acquisition.

The total purchase price of \$1,500,000 was allocated as follows:

| | | |
|--------------------|----|-----------|
| Land | \$ | 370,000 |
| Office equipment | | 6,916 |
| Account receivable | | 21,060 |
| Accounts payable | | (7,826) |
| Goodwill | | 1,109,850 |
| | \$ | 1,500,000 |

Acquisition of Santiago Custom and Classic Car Auctions Inc.

On September 9, 2003, the Company agreed to purchase the business of Santiago Custom and Classic Car Auctions Inc. for \$250,000. The transaction was completed on January 21, 2004.

Acquisition of R.T. Components

During the period ended December 31, 2003, the Company purchased 100% of the outstanding shares of R.T. Components for the sole purpose of liquidating and winding up the Company. The purchase price was \$557,333 (CDN\$752,623).

6. CASH HELD IN TRUST FOR CONSIGNORS

The Company is holding cash in trust of \$818,977 for consignors of two auctions held by Premier prior to December 31, 2003, to discharge the trust liabilities in the amount of \$892,863 as disclosed in the liabilities for the Company which includes amounts due to consignors, reimbursable expenses incurred by the Company and commissions on sales made by the Company. The difference between the trust liabilities and the cash held in trust represents cash that belongs to the Company in the cash held in trust account that

has been transferred out by the Company while certain non-trust liabilities relating to the Company have not been paid off.

F-11

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

7. INVENTORIES

| | December 31, 2003 | June 30, 2003 |
|---|----------------------|------------------|
| Wood products and associated equipment | \$ 1,046,384 | \$ 1,615,519 |
| Industrial fabrication equipment | 48,089 | - |
| Vehicle | 13,000 | - |
| Books | 333,845 | 467,618 |
| Miscellaneous and other goods held for resale | 108,488 | 4,444 |
| | \$ 1,549,806 | \$ 2,087,581 |

During the three-month period ended September 30, 2003, certain associated equipment held for resale with a book value of \$111,285 was destroyed in a fire. Settlement of the insurance claim under the receiver's insurance coverage resulted in a reduction of the Company's guarantee to the receiver of \$341,800 as at December 31, 2003, and a corresponding net gain of \$230,515 during the three-month period ended December 31, 2003.

8. PROMISSORY NOTES

During the three-month period ended December 31, 2003, the Company received promissory notes totalling \$315,000 as consideration for 900,000 stock options issued to a consultant of the Company. Prior to December 31, 2003, the 900,000 stock options were exercised (Note 15) and subsequent to December 31, 2003, the promissory notes were sold (Note 22).

9. EQUIPMENT

| | December 31, 2003 | | |
|------------------------|-------------------|--|-------------------|
| | Cost | Accumulated Depreciation and Amortization | Net Book Value |
| Auction equipment | 34,720 | 12,492 | 22,228 |
| Automotive equipment | 53,839 | 23,021 | 30,818 |
| Computer equipment | 41,128 | 26,837 | 14,291 |
| Computer software | 25,247 | 10,554 | 14,693 |
| Leasehold improvements | 13,104 | 2,445 | 10,659 |
| Office equipment | 56,490 | 12,749 | 43,741 |
| Sign | 7,584 | 2,802 | 4,782 |
| Tools and equipment | 16,132 | 12,426 | 3,706 |
| | \$ 248,244 | \$ 103,326 | \$ 144,918 |

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

9. EQUIPMENT (continued)

| | Cost | June 30, 2003 Accumulated Depreciation and Amortization | Net Book Value |
|------------------------|------------|---|-------------------|
| Auction equipment | \$ 16,977 | \$ 9,294 | \$ 7,683 |
| Automotive equipment | 50,111 | 18,523 | 31,588 |
| Computer equipment | 32,842 | 24,999 | 7,843 |
| Computer software | 25,247 | 6,608 | 18,639 |
| Leasehold improvements | 13,104 | 935 | 12,169 |
| Office equipment | 20,977 | 9,568 | 11,409 |
| Sign | 7,584 | 2,170 | 5,414 |
| Tools and equipment | 15,630 | 11,981 | 3,649 |
| | \$ 182,472 | \$ 84,078 | \$ 98,394 |

10. DEFERRED FINANCING COSTS

During the year ended June 30, 2003, the Company issued 1,531,029 warrants to an investor group that has made available to the Company funds totaling \$2,398,638 (CDN\$3,100,000). These warrants were exercisable at \$0.71 per warrant and expire on March 28, 2005. As the warrants were considered to be a separate financial instrument separate from the debt, the Company reflected \$228,054 in the consolidated balance sheets, being the fair value calculated using the Black-Scholes option pricing model of \$306,000, less accumulated amortization of \$77,946 as at September 30, 2003.

During the three-month period ended December 31, 2003, the Company amended its agreement with the investor group increasing the number of warrants to 4,018,518 from 1,531,029. These warrants expire on June 30, 2004 and have an exercise price \$0.54 per warrant. The revised fair value of the warrants calculated using the Black-Scholes option pricing model is \$185,000. At December 31, 2003, the Company has amortized \$113,631, including \$38,250 from the original valuation of the warrants, and the balance of \$71,369 will be amortized over the remaining life of the warrants, which is six months.

The total amortization charge to operations for the six-month period ended December 31, 2003, relating to these warrants is \$73,935.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

10. DEFERRED FINANCING COSTS (continued)

The Company used the Black-Scholes option pricing model to compute estimated fair value, based on the following assumptions:

| | |
|--|-------------|
| Risk free interest rate | 3.0% - 4.0% |
| Dividend yield rate | 0.0% |
| Volatility | 45.0 66.3% |
| Weighted average expected life of warrants | 9 months |

11. ADVANCES PAYABLE

Advances payable consist of working capital loans that have been advanced from time-to-time from third parties. These working capital loans are unsecured, non-interest bearing and have no fixed terms of repayment other than these working capital loans are expected to be repaid as cash is available.

12. FINANCIAL ARRANGEMENTS AND GUARANTEES USED TO ACQUIRE INVENTORY

| | December 31, 2003 | June 30, 2003 |
|--------------------------------------|----------------------|------------------|
| Financial arrangements | \$ 2,127,029 | \$ 1,243,017 |
| Guarantees used to acquire inventory | 1,353,147 | 1,206,609 |
| | \$ 3,480,176 | \$ 2,449,626 |

a) Financial arrangements***Canadian financial arrangement (CDN\$3.1 million)***

The Company has entered into an arrangement in which it has guaranteed profits to participants who provide funds (CDN\$3.1 million) to the Company that are to be used to guarantee minimum return to clients who wish to sell assets or to acquire assets outright to be held for resale. These participants will share in the profits from these transactions on the basis of 65% of the profits to the Company and 35% to the participants. The Company has, in turn, guaranteed to those participants a minimum return of 15% per annum on the funds advanced. Further, the Company issued warrants to those participants to purchase shares of restricted common stock up to the value of their participation. Management believes that the arrangement will yield the participants sufficient return so that the guarantee will not result in any additional expense to the Company.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

12. FINANCIAL ARRANGEMENTS AND GUARANTEES USED TO ACQUIRE INVENTORY (continued)

a) Financial arrangements (continued)

Canadian financial arrangement (CDN\$3.1 million) (continued)

The Company would be liable for a minimum of \$359,796 (CDN\$465,000) on guaranteed payments in each of the 12-month periods ended June 30, 2004 and 2005 based on \$2,398,638 (CDN\$3,100,000) being made available by the participants as at June 30, 2003.

US financial arrangement (US\$2.0 million)

On August 1, 2003, the Company entered into an arrangement with a group of participants for bridge financing in the principal amount of \$2,000,000. The loan was made for the following purposes:

- Acquisition of Premier and certain lands related to Premier's auction business
- Acquisition of Santiago Custom and Classic Car Auctions Inc.
- Fees and ancillary costs of raising the financing
- Working capital

A \$60,000 fee is payable to Corporate Mentors Inc. for management of the funds. The fee is to be paid at \$3,000 per month for 20 months, without interest.

The minimum return to the participants will be accrued at a rate of 3% per month commencing the date funds were advanced by the participants and became due and payable commencing November 15, 2003 and thereafter. At December 31, 2003, charges in the amount of \$250,555 have been accrued. No payment has been paid as at December 31, 2003.

The financing is documented by a promissory note and secured by proceeds of any warrants exercised by financial participants, a guarantee of and postponements of claims from Icoworks Holdings from its subsidiaries, pledge of shares of any corporation acquired and a mortgage on certain lands held by Premier.

In addition, advances made by participants under the arrangement may be converted to common shares by exercise of 5,714,282 warrants at \$0.35 any time up until June 30, 2004. The fair value of the warrants calculated using the Black-Scholes option pricing model is \$543,000. At December 31, 2003, the Company has amortized \$181,000 and the balance of \$362,000 will be amortized over the remaining life of the warrants, which is six months. The total amortization charge for the six-month period ended December 31, 2003,

relating to these warrants is \$181,000.

The bridge loan is repayable on or before February 28, 2004. Subsequent to December 31, 2003, the Company extended the maturity date to June 30, 2004 by agreement. The Company intends to seek additional financing to retire this loan.

F-15

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

12. FINANCIAL ARRANGEMENTS AND GUARANTEES USED TO ACQUIRE INVENTORY (continued)**b) Guarantees used to acquire inventory**

Guarantees arise when the Company provides a consignor with assurance as to the amount they will receive for consigned goods from the net auction proceeds. This amount is recorded as a liability and a corresponding amount is recorded as inventory held for resale. Similarly, when funds are advanced from the participants, a liability is recorded in the amount of the funds advanced and a corresponding entry is made to increase the inventory value of goods held for sale.

13. DUE TO RELATED PARTIES

| | December 31, 2003 | June 30, 2003 |
|---|----------------------|------------------|
| Advances due to directors, unsecured, non-interest bearing, no fixed terms of repayment. | \$ 368,561 | \$ 195,274 |
| Management fees due to a company related by common ownership and a common director, unsecured, non-interest bearing, no fixed terms of repayment. | 413,086 | 362,087 |
| Advances due to a company controlled by common management, unsecured, non-interest bearing, no fixed terms of repayment | 141,648 | 111,378 |
| Payment due to the former shareholders of Icoworks Services, unsecured, non-interest bearing, no fixed terms of repayment. | 61,704 | 132,404 |
| Due to shareholders | 260,564 | 173,499 |
| Advances due to a company related by common ownership and a common director, unsecured, bearing interest at prime plus 1%, due on demand. | 76,984 | 75,813 |
| | \$ 1,472,547 | \$ 1,050,455 |

14. PREFERRED SHARES TO BE ISSUED

During the year ended June 30, 2003, the Company entered into an agreement to issue 30,000 Series A preferred shares as part of an offering of 300,000 shares. Each Series A preferred share has a face value of \$10.00 per share, and;

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

14. PREFERRED SHARES TO BE ISSUED (continued)

- a) Is convertible into shares of the Company's common stock on the basis of one share of common stock for each \$0.75 of Series A preferred shares at the option of the holder. The minimum amount of Series A preferred shares that may be converted by a holder is \$10,000.
- b) Accrue dividends at the rate of 10% per annum. Dividends will be paid quarterly at the end of each calendar quarter, commencing June 30, 2003.
- c) The Company has the right to redeem the Series A preferred shares at any time after eighteen months from the date of issuance in the event that the closing price of the Company's common stock is equal to or greater than \$1.50 per share for at least twenty consecutive trading days during the three month period prior to the date of notice of redemption.
- d) Each holder will have the right to redeem the Series A preferred shares at any time subsequent to three years from the date of closing of the purchase of the Series A preferred shares.
- e) Does not have voting rights, other than on matters affecting the Series A preferred shares, as prescribed by Nevada law.
- f) Does not have dividend rights, other than to receive the annual 10% dividend rate.

The Series A preferred shares result in a quarterly obligation to pay dividends of \$7,500 (\$30,000 annually). If converted, the Series A preferred shares, which are yet to be issued, would have resulted in the issue of 40,000 shares of common stock. At December 31, 2003 \$22,500 has been accrued as dividends payable and no dividends have been paid to date.

The obligation to issue these shares is shown as a liability on the consolidated balance sheet at December 31, 2003 (Note 22).

15. COMMON STOCK

On August 6, 2003, 142,500 common shares of Icoworks Holdings at a price of \$0.75 for each common share, were issued to Panther Industries as compensation for services rendered in the amount of \$107,000 in relation to assistance in establishing the financial arrangements.

On September 10, 2003, 22,000 common shares of Icoworks Holdings at a price of \$0.50 for each common share were issued to Canberra Financial Services, Inc. as a bonus in the amount of \$11,000 pursuant to an October 31, 2000 financial services agreement.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

15. COMMON STOCK (continued)

On December 3, 2003 and December 11, 2003, 600,000 and 300,000 common shares of the Company, respectively, were issued upon the exercise of 900,000 stock options at a price of \$0.35 for each common share.

Warrants

At December 31, 2003, the Company had warrants that were outstanding enabling holders to acquire the following shares of common stock:

| Number of Shares | Exercise Price | Expiry Date |
|------------------|----------------|---------------|
| 4,018,518 | \$0.54 | June 30, 2004 |
| 5,714,282 | \$0.35 | June 30, 2004 |

At December 31, 2003, Icoworks Holdings had warrants that were outstanding enabling holders to acquire the following shares of common stock:

| Number of Shares | Exercise Price | Expiry Date |
|------------------|----------------|-------------------|
| 21,000 | \$1.50 | December 27, 2004 |
| 1,500,000 | \$1.50 | January 8, 2005 |

Stock options

At December 31, 2003, Icoworks Holdings had options that were outstanding enabling holders to acquire the following shares of common stock:

| Number of Shares | Exercise Price | Expiry Date |
|------------------|----------------|-------------------|
| 200,000 | \$1.00 | November 12, 2007 |

Generally, the stock options have a life of five years and vest equally on each anniversary date over a three year period.

At December 31, 2003, 66,667 stock options had vested, none had expired and 900,000 options were exercised. During the period ended December 31, 2003, the Company also cancelled 150,000 options.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

15. COMMON STOCK (continued)

The Company used the Black-Scholes option pricing model to compute estimated fair value, based on the following assumptions:

| | |
|---|--------|
| Risk free interest rate | 3.0% |
| Dividend yield rate | 0.0% |
| Volatility | 66.3% |
| Weighted average expected life of options | 1 year |

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation.

| | December 31, 2003 | December 31, 2002 |
|---|----------------------|----------------------|
| Net loss, as reported | \$ (1,023,807) | \$ (455,176) |
| Add: Total stock-based employee compensation expense included in loss, as reported determined under APB 25, net of related tax effects | - | - |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (9,348) | - |
| Pro-forma net loss | \$ (1,033,155) | \$ (455,176) |
| Basic and diluted net loss per share, as reported | \$ (0.08) | \$ (0.09) |
| Basic and diluted net loss per share, pro-forma | \$ (0.08) | \$ (0.09) |

16. RELATED PARTY TRANSACTIONS

Unless disclosed elsewhere in these consolidated financial statements, the Company entered into the following transactions with related parties during the period ended December 31, 2003:

- a) Paid or accrued management fees of \$51,000 (2002 \$102,000) to a company related by common ownership and a common director.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

16. RELATED PARTY TRANSACTIONS (continued)

- b) Paid or accrued rent of \$92,602 (2002 \$103,109) to a company controlled by employees who were previously directors of Icoworks Services.
- c) Paid or accrued financing fees of \$Nil (2002 \$21,359) to a company related by common ownership and a common director.
- d) Paid or accrued consulting expenses of \$Nil (2002 \$46,350) to companies related by common ownership and directors.

These transactions were in the normal course of operations and were measured at the exchange value, which represented the amount of consideration established and agreed to by the related parties.

17. SUPPLEMENTAL DISCLOSURES WITH RESPECT TO CASH FLOWS

The significant non-cash transactions during the six-month period ended December 31, 2003, consisted of the following:

- a) The Company acquired inventory of \$126,029 through the assumption of guarantees used to acquire inventory of the same amount.
- b) The Company issued 142,500 common shares of its subsidiary Icoworks Holdings for settlement of accounts payable of \$107,000.
- c) The Company received a promissory note of \$315,000 for the exercise of 900,000 share purchase options.

18. CONTINGENT LIABILITIES

Icoworks Services was named as a defendant in a statement of claim relating to the purchase of certain equipment Icoworks Services considered to be in poor condition. Consequently, Icoworks Services accrued a liability of \$63,530 relating to this claim in a prior year's financial statements. During the year ended June 30, 2002, the claim was settled in favor of Icoworks Services, however the plaintiff appealed the ruling. Management believes the appeal has no merit and, as a result, the \$63,530 contingent liability previously recorded was reversed during the year ended June 30, 2002. As at December 31, 2003, the appeal has not been resolved.

Icoworks Services has been named as a defendant in a statement of claim relating to the termination of two employees in the amount of \$80,987 and \$50,906 respectively plus related expenses, subsequent to December 31, 2003. Further the Company was named as a defendant in a counter claim related to the acquisition of Premier subsequent to December 31, 2003. No provision has been made in the books of Icoworks as management believes the claims have no merit and intends to defend them vigorously.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

19. COMMITMENTS

Unless disclosed elsewhere in these consolidated financial statements, the Company has the following commitments at December 31, 2003:

- a) Pay management fees of \$17,000 per month, plus all reasonable out-of-pocket disbursements, to a company related by common ownership and a common director.
- b) Pay consulting fees relating to assistance with investor relation services to a company related by common ownership. The agreement required a payment of \$25,000 upon signing (paid) and a payment of \$125,000 upon completion of all services. At December 31, 2003, \$100,000 of the \$125,000 of services remained to be performed.
- c) Issue 79,780 shares of common stock to various brokers as compensation for arranging private placements during the year ended June 30, 2002.
- d) Pay minimum lease payments for premises of approximately \$99,000 per annum, including common area costs, under an operating lease expiring February 2008.
- e) Pay future annual operating lease payments for equipment and other office premises as follows:

| | |
|---------|--------|
| 2004 \$ | 67,499 |
| 2005 \$ | 64,842 |
| 2006 \$ | 47,919 |
| 2007 \$ | 22,716 |
| 2008 \$ | 11,259 |

- f) Concurrent with the acquisition of Premier, the Company agreed to issue a total of 2,700,000 common shares of the Company to three key employees of Premier (Note 4).

20. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, income taxes recoverable, promissory notes, other assets, bank overdraft, accounts payable and accrued liabilities, advances payable, financial arrangements and guarantees issued to acquire inventory and due to related parties. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximates their carrying values unless otherwise noted.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

20. FINANCIAL INSTRUMENTS (continued)**Concentrations of credit risk**

The Company is exposed to credit risk only with respect to cash and cash equivalents and uncertainties as to the timing and amount of the collectibility of accounts receivable. The Company mitigates cash and cash equivalents credit risk by maintaining the majority of its cash balances in reputable financial institutions in Canada. The Company mitigates accounts receivable credit risk through standard credit and reference checks and monitoring the financial condition of its customers to reduce risk of loss. The Company provides an allowance for doubtful accounts when, in their judgment, future collection is considered doubtful.

21. SEGMENT INFORMATION

Notwithstanding that the Company may operate certain assets it acquires while it holds the goods for resale, the Company conducts operations in one reportable segment, being the conduct of customized auctions, in Canada and the USA. Prior to August 29, 2003, the Company operated in one geographical segment that being Canada. During the six-month period ended December 31, 2003, the Company's breakdown by geographical segment was as follows:

| | Geographic Information | | |
|-------------------|------------------------|------------|---------------|
| | Canada | USA | Totals |
| Revenues | \$ 10,385,287 | \$ 828,361 | \$ 11,213,648 |
| Long lived assets | \$ 110,795 | \$ 387,123 | \$ 494,918 |

22. SUBSEQUENT EVENTS

Subsequent to December 31, 2003, the Company entered into the following transactions:

- a) On January 2, 2004 the board of directors was changed and as consideration for undertaking these positions the Company has agreed to issue 800,000 common shares of the Company, being 200,000 common shares to each of the new directors. The share grant has a vesting schedule of 50,000 common shares upon signing and the balance vest on the anniversary date equally over the next three years.

F-22

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

22. SUBSEQUENT EVENTS (continued)

- b) On January 2, 2004, a subsidiary of the Company, Icoworks Holdings, executed a promissory note in exchange for cash received of \$500,000 whereby the holder is entitled to convert the promissory note to approximately 40% of the total common shares of Icoworks Holdings. This conversion would further reduce the Company's ownership of Icoworks Holdings from approximately 53% as at December 31, 2003 to approximately 32%. Concurrent with the execution of this promissory note, the holder postponed a prior security interest on certain property held by the Company to allow the Company to mortgage the property for proceeds of \$250,000.
- c) On January 9, 2004, the Company executed promissory notes to settle certain of its debts with related parties totalling \$139,000. The promissory notes are due on or before June 30, 2006 and bear interest at a rate of 4% per annum.
- d) On January 16, 2004 the Company issued 437,773 common shares of Icoworks Holdings to Panther Industries as finders fees.
- e) On January 21, 2004, the Company completed the purchase of the business of Santiago Custom and Classic Car Auctions Inc. for \$250,000 of which 225,000 was paid in cash and \$25,000 will be paid by the delivery of 100,000 common shares of the Company.
- f) On January 26, 2004, the Company cancelled the agreement to pay management fees of \$17,000 per month, plus all reasonable out-of-pocket disbursements, to a company related by common ownership and a common director effective September 30, 2003. No management fees were accrued in respect of this agreement during the three-month period ended December 31, 2003. The management fees owing of \$413,086 plus other related party amounts advanced of \$222,882 owing by the Company at December 31, 2003 will be settled for a total consideration of 1,817,052 common shares of the Company at \$0.35 per share.
- g) On February 4, 2004, the Company agreed to issue 610,000 common shares in exchange for the 25% of the total common shares of Icoworks Eastern not already held by Icoworks Holdings. This share exchange agreement remains subject to the completion of certain conditions.
- h) On February 11, 2004, the Company entered into agreements to settle certain of its debts with related parties totalling \$500,912 through the issuance of 1,431,179 common shares of the Company at \$0.35 per common share.
- i) On February 13, 2004, the Company sold promissory notes totalling \$315,000 received by the Company prior to December 31, 2003 (Note 8) to related parties to settle certain of its debts with these related parties.

ICOWORKS, INC. AND SUBSIDIARIES

(formerly Paragon Polaris Strategies.com, Inc)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in U.S. Dollars)

December 31, 2003

(unaudited)

22. SUBSEQUENT EVENTS (continued)

The Company has also agreed in principle to issue 600,000 common shares and 600,000 options, exercisable at \$0.35 per share, to the Company's president and chief operating officer. These common shares will be released and the options will vest at various stages over a three year period from the date an employment agreement is signed. No definitive agreement has been executed to date.

Further, the Company intends to enter into a new merger agreement to complete the acquisition of the minority interest of Icoworks Holdings as the terms of the original merger agreement expired (Note 4). Based on preliminary negotiations relating to the proposed merger agreement, the Company intends to issue common shares of the Company to the shareholders of Icoworks Holdings, who would own approximately 66.6% of the total outstanding shares of Icoworks Holdings at the proposed date of the merger, provided that immediately prior to the consummation of the merger, certain events are completed including, but not limited to, the following:

- The holder of a promissory note converts the promissory note into approximately 40% of the total common shares of Icoworks Holdings (see a) above).
- The share exchange agreement relating to the acquisition of the minority interest of Icoworks Eastern is completed (see f) above).
- The preferred shares to be issued in the amount of \$300,000 plus accrued but unpaid dividends in the amount of \$15,000 as December 31, 2003 are converted into common shares of the Company.

F-24

Item 2. Management's Discussion and Analysis or Plan of Operation.

FORWARD LOOKING STATEMENTS

The information in this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties, including statements regarding our capital needs, business strategy and expectations. Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "expect", "plan", "intend", "anticipate", "believe", "estimate", "predict", "potential" or "continue", the negative of such terms or other comparable terminology. Actual events or results may differ materially. In evaluating these statements, you should consider various factors, including the risks outlined below, and, from time to time, in other reports we file with the SEC including our Annual Report on Form 10-KSB for the year ended June 30, 2003. These factors may cause our actual results to differ materially from any forward-looking statement. We disclaim any obligation to publicly update these statements, or disclose any difference between our actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

OVERVIEW

Icoworks Inc. (formerly Paragon Polaris Strategies.com Inc.) (We , Icoworks or the Company) is engaged in the auction and asset realization business through our investment in 50.5% of the outstanding stock of Icoworks Holdings, Inc., a Nevada corporation (Icoworks Holdings).

Icoworks Holdings is engaged in the asset realization business and is a provider of a full and comprehensive range of auction, liquidation and appraisal services to the industrial, oilfield, commercial and office markets. Icoworks Holdings' business operations have historically been based in Calgary, Alberta, Canada and have recently been expanded to include a subsidiary operation in Oakville, Ontario, Canada and, subsequent to the end of our fiscal year, Premier Auctions based in Texas and Oklahoma. Icoworks Holdings plans to expand its business, both through the expansion of its traditional auction, liquidation and appraisal services and through the acquisition of other businesses engaged in the asset realization business that complement Icoworks Holdings' growth strategy. Icoworks Holdings also plans to enhance its traditional services by the use of technology, including the use of live internet auctions, online internet auctions and technology-assisted auctions, in order to expand the scope of potential purchasers for its asset realization business and to facilitate auction transactions.

Icoworks Holdings completed the acquisition of Premier Auctions, a Texas and Oklahoma based auction business specializing in the oil and gas equipment industry on August 29, 2003. Icoworks Holdings completed the acquisition of Santiago Classic Car Auctions, a New Mexico based auction business specializing in classic automobiles, in January 2004.

We do not have any business or subsidiaries other than our 50.5% interest in Icoworks Holdings.

PRESENTATION OF FINANCIAL INFORMATION

We completed the acquisition of a 56% interest in Icoworks Holdings effective February 20, 2003. Our interest in Icoworks Holdings has subsequently been diluted to a 50.5% interest. Under United States generally accepted accounting principles, our financial statements have been prepared using reverse-acquisition accounting principles, which result in Icoworks Holdings acquiring Icoworks for accounting purposes. Accordingly, Icoworks Holdings is treated as the acquirer for accounting purposes, even though Icoworks is the legal acquirer. Under United States generally accepted accounting principles, comparative figures for prior periods are based on the operating results of Icoworks Holdings, but the type of share capital and number of issued and outstanding shares continue to reflect those

of Icoworks. Therefore, our consolidated financial statements include the accounts of Icoworks Holdings and its legal subsidiaries. All significant inter-company accounts and transactions have been

eliminated on consolidation. Comparative figures reported in our financial statements for the six months ended December 31, 2002 are for Icoworks Holdings only. Further adjustments were also required as outlined in the notes to the financial statements. We have adopted the June 30 year end of Icoworks Holdings to reflect the accounting treatment of the acquisition, rather than proceeding with our previous December 31 year end. Due to the fact that we own less than 100% of Icoworks Holdings, our financial statements account for the minority interest in Icoworks Holdings that we do not own.

We acquired the business of Premier Auctions effective August 29, 2003. The results of operations of Premier Auctions for the period from August 29, 2003 to December 31, 2003 are included in our statements of operations and our statement of cash flows for the periods ended December 31, 2003. Our balance sheet at December 31, 2003 accounts for the acquisition of Premier Auctions.

RECENT CORPORATE DEVELOPMENTS

We have recently taken a number of steps in connection with the reorganization of our business and our corporate structure. These material corporate developments are summarized as follows:

1. Changes To Our Officers And Directors

Mr. Ian Brodie, our former president and sole director, resigned as a director and officer on January 2, 2004. Concurrently with his resignation, Mr. J. Graham Douglas was appointed as a director and as our chief executive officer and chief financial officer. Mr. Douglas has been the president and a director of Icoworks Holdings for several years. In addition, Mr. Michiel Dening was appointed to our board of directors and has been appointed as our president and chief operating officer. In addition, Mr. Dening has been appointed as president and chief operating officer of Icoworks Holdings. Mr. Dening is a professional engineer and has directed and managed international business units of several multi-national corporations.

Subsequent to the appointment of Mr. Douglas and Mr. Dening to the board of directors, Mr. Thomas Butt, Mr. Crawford Shaw, Mr. B.B. Tuley and Mr. Gerry Lindberg were appointed to the board of directors. Mr. Butt is a health care management consultant with substantial experience in design, building and processing management practices. Mr. Shaw is an attorney and a member of the firm of Sonfield and Sonfield, a law firm based in Houston, Texas, with extensive experience in commercial law, corporate finance and litigation. Mr. Tuley is a certified public accountant with experience in managing and consulting with companies in a wide range of industries. Mr. Lindberg is a seasoned sales executive with experience in a number of successful start up businesses.

Our board of directors is now comprised of the following individuals:

- J. Graham Douglas
- Michiel Dening
- Thomas Butt
- Crawford Shaw
- B.B. Tuley
- Gerry Lindberg

Our executive officers are now comprised of the following individuals:

- J. Graham Douglas, Chief Executive Officer and Chief Financial Officer
- Michiel Diening, President and Chief Operating Officer

2. Termination of Antares Investment Management Contract

We entered into an agreement dated January 26, 2004 with Mr. J. Graham Douglas and Antares Investments Inc., a company controlled by Mr. Douglas, and several additional parties. Pursuant to this agreement, Antares has agreed that its management agreement that provides for payment of \$17,000 per

month in consideration for the provision of the services of Mr. Douglas has been terminated. In addition, Antares agreed to settle any and all outstanding debts owed to it by us and Icoworks Holdings in consideration for the issuance by us of shares of our common stock based on a price of \$0.35 per share. Based on this agreement, Antares agreed to assign to us indebtedness of \$413,086 owed to Antares by Icoworks Holdings in consideration of the issuance by us of 1,180,200 shares of our common stock. In addition, Antares assigned an additional \$222,282 of indebtedness to us in consideration of our agreement to issue an additional 636,852 shares of our common stock to Antares. We have not issued these shares as of this date.

Mr. Douglas has agreed to continue to act as our chief executive officer until the completion of our contemplated merger with Icoworks Holdings, at a total compensation of \$5,000 per month, plus reasonable expenses. Mr. Douglas has also agreed during this time to act as our chief executive officer for nominal additional consideration.

3. Series A Preferred Stock

In our fourth quarter ended June 30, 2003, we completed a financing with a non-U.S. investor for proceeds of \$300,000 pursuant to which we agreed to issue 30,000 shares of our preferred stock, which was to be designated as Series A Preferred Shares. Each Series A Preferred Share was to be issued for each \$10.00 advanced and was to be convertible into shares of our common stock at a rate of one share for each \$0.75 of preferred shares converted. We have entered into negotiations with the investor who has indicated to us his agreement to exchange the \$300,000 of Series A Preferred Shares to be issued, plus accrued and unpaid dividends in the amount of \$22,500, in consideration of the issuance by us to the investor of 1,290,000 shares of our common stock. This settlement is based on an agreed price of \$0.25 per share of common stock. To date, no formal agreement has been executed with the investor and the 1,290,000 shares have not been issued.

4. Panther Industries

Icoworks Holdings entered into a financing agreement with Panther Industries whereby it agreed to pay a fee equal to 10% of any monies raised by Panther, which would be available to Icoworks Holdings for a period of one year or more. This agreement was entered into in April 2003. The fee is payable in shares of Icoworks Holdings common stock. Pursuant to this agreement, Icoworks Holdings has issued an aggregate of 665,773 shares in respect of financings obtained by Icoworks Holdings which has resulted in dilution of our interest in Icoworks Holdings to 50.5%. Of these shares, 285,714 and 152,059 shares were issued subsequent to December 31, 2003 in connection with the \$2,000,000 bridge loan financing and the \$500,000 Ian de Bie financing, discussed below in Paragraph 6.

5. Acquisition of Santiago Sports and Classics Collector Car Auctions

Icoworks Holdings completed the acquisition of 100% of Santiago Sports and Classics Collector Car Auctions in January 2004. The total purchase price paid \$250,000, of which \$225,000 was paid in cash and \$25,000 will be paid by delivery of 100,000 shares of our common stock to Mr. Rocky Santiago, the former owner of Santiago Sports and Classics Collector Car Auctions. These shares have not been issued to date. The \$100,000 necessary to enable Icoworks Holdings to complete this acquisition was advanced to us as part of the Ian de Bie financing, as described below. The closing of the acquisition was effective January 5, 2004.

We have agreed to issue 100,000 shares of our common stock to Icoworks Holdings in consideration of the issuance of 50,000 shares of Icoworks Holdings common stock to us. Icoworks Holdings will deliver the 100,000 shares of our common stock to Mr. Santiago as completion of payment of the purchase price.

6. Icoworks Holdings Convertible Note Financing

Icoworks Holdings entered into a financing arrangement with Mr. Ian de Bie on January 6, 2004. Under the terms of this agreement, Mr. Ian de Bie has advanced \$500,000 to Icoworks Holdings as a convertible

loan. The loan is evidenced by a promissory note in the principal amount of \$500,000. The note is repayable by Icoworks Holdings on demand of Mr. de Bie. In addition, Mr. de Bie has the right before demand at any time to convert the principal amount of the indebtedness into shares of Icoworks Holdings, representing 40% of the outstanding shares of Icoworks Holdings at the time of conversion. In addition, Mr. de Bie has agreed to convert the indebtedness under the promissory note into shares of Icoworks Holdings immediately prior to the contemplated merger of Icoworks Inc. and Icoworks Holdings, such that Mr. de Bie will receive shares of our common stock upon completion of the merger.

The financing arrangement between Icoworks Holdings and Mr. de Bie has the potential to substantially dilute our ownership interest in Icoworks Holdings. Based on our current ownership of Icoworks Holdings, our interest in Icoworks Holdings will be diluted to approximately 32% in the event that Mr. de Bie converts his promissory note.

The financing with Mr. de Bie was arranged by us to address a shortfall of operating cash in Icoworks Holdings. Icoworks Holdings was unable to meet its short term obligations, including payment of interest on the \$2,000,000 bridge loan financing obtained by Icoworks Holdings to enable it to acquire Premier Auctions in August 2003. The lenders under this bridge loan financing include private companies controlled by Mr. de Bie and Mr. Butt, one of our directors. This accrued interest was outstanding in the amount of \$250,555 as at December 31, 2003. As a result of the completion of this financing, Icoworks Holdings has completed payments of accrued interest under the \$2,000,000 bridge loan facility. The maturity date of the bridge loan has been extended from February 28, 2004 to June 30, 2004 by agreement.

7. Agreement to Acquire Minority Interest of Icoworks Eastern

We have entered into an agreement with Mel Blackburn, the current owner of 25% of Icoworks Eastern to acquire Mr. Blackburn's interest in Icoworks Eastern in exchange for 610,000 shares of our common stock. It is a condition of the closing of this acquisition that Mr. Blackburn will have entered into an employment agreement with Icoworks Holdings, which is on acceptable terms to us and Mr. Blackburn. This acquisition has not completed and no shares of our common stock have been issued to Mr. Blackburn to date.

We have agreed with Icoworks Holdings to exchange the 25% interest in Icoworks Eastern upon completion of this acquisition from Mr. Blackburn in exchange for 305,000 shares of Icoworks Holdings. This exchange is contingent upon the completion of the acquisition of the 25% interest in Icoworks Eastern from Mr. Blackburn.

8. Issuance of Shares to Premier Auctions Management

In connection with our acquisition of Premier Auctions, we have agreed to issue an aggregate of 2,700,000 shares of our common stock to the principal managers of our Premier Auctions business, Mr. Richie, Mr. Long and Mr.

Felker, as part of their management compensation arrangements, and to other employees of Premier Auctions. With regards to the compensation arrangements for Mr. Richie, Mr. Long and Mr. Felker, it is contemplated that an aggregate of 610,000 shares will be issued to each of Mr. Richie, Mr. Long and Mr. Felker, of which 25% of the shares will vest up front and the remaining 75% will vest annually over a three-year period. We are currently in the process of preparing drafts of employment agreements to be entered into with each of Mr. Richie, Mr. Long and Mr. Felker, which will be required to give effect to this stock compensation arrangement. No compensation shares have been issued to any of Mr. Richie, Mr. Long or Mr. Felker to date.

9. Solara Ventures Inc.

We entered into an assignment of indebtedness agreement with Solara Ventures Inc. on February 11, 2004. Solara Ventures is one of our 10% shareholders. Mr. Ian Brodie, our former president and director, is deemed to control Solara Ventures. Under the terms of the assignment of indebtedness agreement, Solara Ventures has agreed to assign to us indebtedness owed by Icoworks Holdings to Solara Ventures in the amount of \$39,860.91 in consideration of the issuance by us of 113,888 shares of our common stock to Solara Ventures.

10. Westin Capital Inc.

We entered into an assignment of indebtedness agreement with Westin Capital Inc. on February 11, 2004. Westin Capital is a company controlled by Mr. Ian Brodie, our former president and director. Under the terms of the assignment of indebtedness agreement, Westin Capital has agreed to assign to us indebtedness of \$461,051.73 owed by Icoworks Holdings to Westin Capital in consideration of the issuance by us of 1,317,291 shares of our common stock to Westin Capital.

11. Texas Land Loan

Icoworks Holdings has arranged for a loan in the principal amount of \$275,000 which will be secured by land in Odessa, Texas, which was acquired as part of the Premier Auctions acquisition. The proceeds of this loan will be held in trust upon advance and are intended to be applied to repayment of interest to be accrued on the \$2,000,000 bridge loan financing arranged for the Premier Auctions acquisition. The lender under the bridge loan financing has agreed to a postponement of its security against the land in order to enable this financing to be completed.

12. Directors Shares and Options

We have agreed to issue 200,000 shares to each of Mr. Thomas Butt, Mr. Crawford Shaw, Mr. B.B. Tuley and Mr. Gerry Lindberg in consideration for their acting as our directors. These shares are to be subject to vesting provisions such that 25% will be issued up-front and 75% will vest annually over a three year period. No shares have been issued to date.

We have agreed to issue 600,000 shares and 600,000 options to Michiel Dening, our president and chief operating officer. Of the shares, 300,000 shares are to vest upon commencement of his engagement agreement and 300,000 shares are to vest upon the first anniversary of his engagement agreement. Of the options, 300,000 options are to vest upon the second anniversary of his engagement agreement and 300,000 options are to vest upon the third anniversary of his engagement agreement. The options are to be exercisable at a price of \$0.35 per share. We have agreed upon these terms with Mr. Dening, but no definitive agreement has been executed to date.

13. Principal Executive Offices

We have made a determination to move our corporate offices to Dallas, Texas. We have not yet located premises for our new principal executive offices or completed this move.

14. Minority Interest in Icoworks Holdings

We continue to own the 3,593,199 shares of Icoworks Holdings that we acquired on February 20, 2003. The total number of issued and outstanding shares of Icoworks Holdings has increased to 7,118,448 shares. Accordingly, we now own a 50.5% interest in Icoworks Holdings. Icoworks Holdings has agreed to issue to us an additional 305,000 shares in consideration for the 25% interest in Icoworks Eastern if this acquisition is completed. Icoworks Holdings has also agreed to issue to us an additional 50,000 shares of its common stock in consideration of us issuing the 100,000 shares of our common stock as part of the Santiago acquisition. In addition, Icoworks Holdings has agreed to issue additional shares of its common stock to Mr. Ian de Bie representing 40% of the post-conversion shares of Icoworks Holdings in the event of the conversion of the promissory note in the amount of \$500,000 issued by Icoworks Holdings to Mr. de Bie. Mr. de Bie has agreed that this dilution will be exclusive of the 305,000 shares to be issued to us in respect of Icoworks Eastern and the 50,000 shares to be issued to us in respect of Santiago. Upon this issuance, and presuming the issuance of the

additional 305,000 shares in respect of Icoworks Eastern and the 50,000 shares in respect of Santiago, we would own 3,948,199 shares of Icoworks Holdings, out of a

7

total of 11,864,080 shares of Icoworks Holdings outstanding. Accordingly, our ownership interest would be diluted to 33.3%.

15. Debt Settlement

We settled an aggregate of \$315,000 owed to certain creditors, including Westin Capital, in the amount of \$315,000 by the transfer to the creditors of promissory notes totaling \$315,000 that had been issued to us.

RESULTS OF OPERATIONS

Revenues

We earn revenues from two principal activities, namely auction revenues and held for sale revenues. Auction revenues are comprised of buyers' premiums, being premiums over and above the purchase prices of items sold, and commissions paid by consigners of items for auctions. Held-for-sale revenues are comprised of revenues from items purchased and held for sale and/or liquidation. Revenue is recognized once the auction or sales are completed and collections reasonably assured. Other commissions are earned by us when we provide guarantees on the gross proceeds to be received from sale to a consigner. We conduct our sales where we temporarily acquire title to goods pending sale. We also enter into joint venture agreements through our subsidiary, Icoworks Joint Ventures, whereby goods are purchased for resale on a joint venture basis. When these activities are conducted on a joint venture basis, the profits are divided between us and the joint venture party on a negotiated basis. If the actual proceeds are less than cost, or less than the guaranteed price, then we may be required to fund any shortfall. The structure of sales varies from sector to sector as do the amounts of commissions and buyer's premiums and accordingly, the nature of our revenues in any period will depend on the mix of sales which are conducted during the period.

We also earn fees charged for appraisals. Revenue from appraisals is recognized when work is completed and collection is reasonably assured.

Our sales revenues increased to \$11,213,648 for the six months ended December 31, 2003, compared to \$623,383 for the six months ended December 31, 2002. Our sales revenues increased to \$7,966,775 for the quarter ended December 31, 2003, compared to \$42,941 for the quarter ended December 31, 2002. Our increase in revenues is attributable to the following factors:

1. We have expanded the operations of Icoworks Holdings through the establishment of Icoworks Eastern in the Province of Ontario and the opening of a branch office in Surrey, British Columbia in our fiscal year ended June 30, 2003 and the acquisition of Premier Auctions in our fiscal quarter ended September 30, 2003. Our results of operations for the six months ended December 31, 2002 included only the results of operations of Icoworks Services, whereas results of operations for the six months ended December 31, 2003 include the results of operations of Icoworks Services, Icoworks Eastern (a 75% subsidiary of Icoworks Holdings) and Premier Auctions (for the period from August 29, 2003 to December 31, 2003).
2. We have expanded the revenue generating operations carried out by Icoworks Holdings. Our revenues for the six months ended December 31, 2002 were comprised primarily of auction revenues attributable to the operations of Icoworks Services, whereas revenues for the six months ended December 31, 2003 include auction revenues attributable to the operations of Icoworks Services and Premier Auctions (for the period from August 29, 2003 to December 31, 2003) and held-for-sale revenues attributable to bought-deal sales

conducted by Icoworks Eastern.

3. The held-for-sale revenues attributable to bought-deal sales conducted by Icoworks Eastern increased substantially in our first two quarters due to ongoing auctions, including auctions of wood products and associated equipment and books, that had been acquired as inventory in our fiscal year ended June 30, 2002. Revenues from Icoworks Eastern comprised approximately 86% of our revenues for the six months ended December 31, 2003 compared to nil for the six months ended December 31, 2002.
4. The acquisition of Premier Auctions contributed revenue of \$828,361 for the six months ended December 31, 2003.

We experienced a decline in revenues from Icoworks Services for the six months ended December 31, 2003 from for the six months ended December 31, 2002.

Variations in our operating results on a quarter by quarter basis may in part be explained due to the nature of the auction business. Our auction business involves large sales of items through auctions. The scheduling of these large auction sales will impact on the timing of revenues earned and will result in quarter by quarter variations in revenues and consequent operating results.

Cost of Sales

Our cost of sales increased to \$9,365,898 for the six months ended December 31, 2003 from \$369,224 for the six months ended December 31, 2002. Our cost of sales increased to \$6,571,765 for the quarter ended December 31, 2003 from \$239,017 for the quarter ended December 31, 2002. The increases in our costs of sales were primarily attributable to increased costs of sales attributable to bought deal sales conducted by Icoworks Eastern during the first half of our fiscal year.

Net Auction Revenue

Our net auction revenue was \$1,847,750 for the six months ended December 31, 2003, compared to \$254,159 for the six months ended December 31, 2002. Our net auction revenue was \$1,395,010 for the quarter ended December 31, 2003, compared to (\$196,076) for the quarter ended December 31, 2002. Net auction revenue as a percentage of sales decreased to 16.5% for the six months ended December 31, 2003, compared to 40.8% for the six months ended December 31, 2002. The decrease in net auction revenue as a percentage of sales was in part attributable to the shift in our revenues from auction revenues to held for sale revenues. We experienced lower net auction revenues with respect to held for sale revenues due to the cost of acquisition of the inventory that is sold in held for sale revenues.

Other Revenue

Other revenue is comprised of revenues earned from appraisal services. Other revenues increased to \$69,336 for the six months ended December 31, 2003 from \$51,750 for the six months ended December 31, 2002. Other revenues increased to \$21,627 for the quarter ended December 31, 2003 from \$15,337 for the quarter ended December 31, 2002. Other revenues for the six months ended December 31, 2003 were primarily attributable to Premier Auctions. Other revenues attributable to DM International Appraisals, a wholly-owned subsidiary of Icoworks Holdings were minimal for the six months ended December 31, 2003. We expect that Premier Auctions will continue to contribute to increased appraisal revenue in the future as our previous appraisal revenues were limited to our Alberta operations.

Expenses

Our operating expenses increased to \$3,164,238 for the six months ended December 31, 2003, compared to \$777,748 for the six months ended December 31, 2002. Our operating expenses increased to \$1,919,161 for the quarter ended December 31, 2003, compared to \$113,678 for the quarter ended December 31, 2002. The large increase in operating expenses is attributable to the following factors:

1. The expansion of our operations into Ontario, Canada and British Columbia, Canada, from our initial base in Calgary, Alberta during our fiscal year ended June 30, 2003;
2. Our acquisition of Premier Auctions during our fiscal quarter ended September 30, 2003. Accordingly, our expenses for the six months ended December 31, 2003 include expenses attributable to the operations of Premier Auctions from August 29, 2003 to December 31, 2003;

As a result of our expansion and acquisitions:

1. Our office and miscellaneous expenses increased to \$433,954 for the six months ended December 31, 2003 from \$229,443 for the six months ended December 31, 2002. Increased costs are also a result of our becoming a reporting company under the Securities Exchange Act of 1934;
2. Our general and administrative expenses increased to \$1,186,521 for the six months ended December 31, 2003 from \$354,337 for the six months ended December 31, 2002; and
3. Our rent increased to \$288,574 for the six months ended December 31, 2003 from \$nil for the six months ended December 31, 2002.

We incurred financing fees in the amount of \$605,648 during the six months ended December 31, 2003, compared to nil for the six months ended December 31, 2002. These financing fees were attributable to our arranging financing for the acquisition of Premier Auctions.

We anticipate that our operating expenses will continue to increase as the operations of Premier Auctions are fully incorporated into our operating results and as we continue our expansion strategy.

Net Loss

Our net loss increased to \$1,023,807 for the six months ended December 31, 2003, compared to \$455,176 for the six months ended December 31, 2002. Our net loss decreased to \$345,901 for the quarter ended December 31, 2003, compared to \$355,820 for the quarter ended December 31, 2002. Our increased loss is primarily attributable to the increases to our operating expenses that were not off-set by increases in net revenues.

LIQUIDITY AND FINANCIAL CONDITION

Cash and Working Capital

We had cash of \$904,787 at December 31, 2003 compared to cash of \$448,404 at June 30, 2003. We had a working capital deficiency of \$3,427,946 at December 31, 2003, compared to a working capital deficiency of \$1,562,863 at June 30, 2003. Our working capital deficiency is the result of a number of factors including the expansion of operations and continuing losses. We anticipate that we will require additional funding in order to achieve profitable operations and to implement our plan of operations.

Financial Arrangements and Guarantees Used to Acquire Inventory

The amount of financial arrangements and guarantees used to acquire inventory outstanding was \$3,480,176 at December 31, 2003, compared to \$2,449,626 at June 30, 2003. This amount at December 31, 2003 included a liability to the participants in the Icoworks Joint Venture bought deal fund, as discussed below, that was outstanding in the amount of \$1,480,176 at December 31, 2003 and a liability in the amount of \$2,000,000, plus accrued interest and guaranteed return fees of \$250,255, which is included in accounts payable and accrued liabilities, owed in respect of the Icoworks US JV bridge loan facility that was obtained to enable Icoworks Holdings to acquire Premier Auctions. The balance of \$1,353,147 was comprised of amounts that we had guaranteed to receivers and consignors with respect to goods to be auctioned by us where we have guaranteed a minimum sales price to the receivers and consignors. In these arrangements, we are at risk as to the ultimate sales price of the goods to be sold. Accordingly, the goods that are the subject of these arrangements are recorded by us as inventory.

Cash From Operating Activities

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Cash provided by operating activities was \$1,961,170 during the six months ended December 31, 2003, compared to cash used in operating activities in the amount of \$233,773 during the six months ended December 31, 2002. We experienced a decrease in inventory in the amount of \$1,204,779 during our first half of our fiscal year.

Financing Activities

Cash provided by financing activities was \$965,154 for the six months ended December 31, 2003 compared to cash provided by financing activities in the amount of \$234,530 for the six months ended December 31, 2002. Cash provided by financing activities included proceeds of \$4,846,745 from financial arrangements, which included proceeds of \$2,000,000 from the Icoworks US JV bridge loan facility. Cash provided by financing activities included an offset in respect of the repayment of guarantees in the amount of \$1,552,282 and an offset in respect of repayments to the Icoworks Joint Venture financial arrangement in the amount of \$2,700,401.

We have access to a fund of capital in the amount of \$2,398,638 through the Icoworks Joint Venture financial arrangement which we anticipate will be used to finance the acquisition of inventory and assets for resale on a project by project basis. These joint ventures financial arrangements and our obligations thereunder are described below under Icoworks Joint Ventures .

We anticipate that we will require additional financing in the amount of \$500,000 over the next twelve months in order to fund our shortfall in cash used in operating activities. See discussion below under Financing Requirements .

Icoworks Joint Ventures

Icoworks Holdings has incorporated a subsidiary, Icoworks Joint Ventures Inc. (Icoworks Joint Ventures), for the purpose of acting as a bare trustee for participants who advance funds for the purpose of financing and selling bought deals. The shares of this subsidiary were transferred to Ian de Bie and Paul McAteer, as trustees, in January 2004. Icoworks Holdings and Icoworks Joint Ventures have entered into joint venture agreements with several initial participants. The purpose of the joint venture formed pursuant to the joint venture agreement is to provide a financing arrangement that will provide funding to enable us to purchase and resell various types of assets being liquidated in receiverships and bankruptcy on a bought deal basis. Assets purchased will be resold using the services of Icoworks Holdings. The joint venture will plan to generate profit by selling these assets at a higher price than the original purchase cost plus costs of sale. Under the joint venture agreements, Icoworks Holdings will carry out the purchase and sale of assets for each bought deal. Icoworks Joint Ventures has agreed to advance to Icoworks Holdings 3.5% of the gross sale price of the assets to fund the sale costs relating to the marketing, promotion and resale of the purchased assets. The gross profit, being the sale price of each completed sale, less acquisition costs, sale costs and any additional costs, will be distributed as follows:

- (1) 65% to Icoworks Holdings, and
- (2) 35% to be divided proportionately to each of the joint venture participants.

Icoworks Holdings has guaranteed a return to each joint venture investor of 15% per annum. The terms of the joint venture agreements are for a minimum of one year and a maximum of three years. Icoworks Holdings will report quarterly to the joint venture participants and distributions will be made on a quarterly basis of cash available for distribution. The joint venture participants will have the option to convert their investments in Icoworks Joint Ventures into shares of our common stock at any time within one year of their initial investment by the exercise of warrants granted to the participants at an amended exercise price of \$0.54 per share. To date, a total of \$2,398,638 has been made available by participants of which \$1,480,776 was outstanding as of December 31, 2003. As at December 31, 2003, we would be liable for \$359,796 in each of the twelve month periods ended June 30, 2004 and 2005 if we are required to pay the participants based on our guarantee obligation.

Icoworks Joint Ventures was formed during the fourth quarter of fiscal 2003 and participated in four bought deals during the fourth quarter. Funds advanced by the joint venture participants are held in trust by Icoworks Joint Ventures for the joint venture participants until such time as funds are advanced to fund a bought-deal acquisition.

Bridge Loan Facility - Icoworks US JV Inc.

Icoworks Holdings incorporated Icoworks US JV Inc. in the United States for the purpose of arranging for bridge loan financing to enable it to acquire the assets of Premier Auctions and Santiago Classic Car Sales. Icoworks US

JV Inc. was incorporated for the purpose of acting as a bare trustee for the investors who advanced the bridge loan. The borrower under the bridge loan was Icoworks Services US and the bridge loan has been guaranteed by Icoworks Holdings. The bridge loan facility is for a principal amount of \$2,000,000. Advances under the bridge loan facility accrue interest at the rate of 1.5% per month from the date of advance plus a guaranteed return fee of 1.5% per month. Interest accrued on the bridge loan is repayable on November 15, 2003 or thereafter at the demand of the lender. The principal amount of the bridge loan and accrued interest was originally repayable on or before February 28, 2004. The maturity date of the bridge loan has been extended to June 30, 2004 by agreement. The bridge loan facility is secured by a promissory note, an assignment of proceeds from the exercise of warrants issued to the participants in the Icoworks Joint Venture, a guarantee and postponement of claims by Icoworks Holdings, a pledge of the shares of any corporation acquired and, at the request of the lender, a mortgage of any lands acquired. The full amount of the principal advanced under the bridge loan facility is convertible into shares of Icoworks at a price of \$0.35 per share of common stock.

A total of \$2,000,000 was advanced under the bridge loan facility during the six months ended December 31, 2003. Of the amount advanced, \$1,500,000 was used to acquire the assets of Premier Auctions and the balance was applied to the acquisition of Santiago Classic Car Sales and to working capital.

Completion of Merger with Icoworks Holdings

We plan to complete the merger with Icoworks Holdings. We anticipate that the completion of this acquisition will take approximately six months and will cost approximately \$100,000 due to the fact that we must file a registration statement with the United States Securities and Exchange Commission to register the shares to be issued to the remaining shareholders of Icoworks Holdings.

Financing Requirements

We will require additional financing over the next twelve months. We anticipate that we will require financing in the amount of approximately \$500,000 to fund the shortfall in cash used in operating activities. In addition, we will require financing in the amount of \$2,000,000 plus accrued interest in order to repay the bridge loan facility obtained through Icoworks US JV. This loan must be repaid on or before June 30, 2004. We also plan to pursue our acquisition strategy and anticipate that any future acquisitions will be completed using new financings that will have to be negotiated and obtained on a transactional basis.

Our financing requirements are in excess of our current financial resources. We plan to pursue equity financings involving sales of our common stock or convertible preferred stock in order to raise financing to fund our ongoing capital requirements. It is contemplated that funds we raise would be advanced by us to Icoworks Holdings as a loan pending the completion of the merger with Icoworks Holdings. We do not have any arrangements for financing currently in place. There is no assurance that we will be successful in raising the necessary financing to meet our financing requirements.

We previously announced a private placement of up to 2,000,000 units at a price of \$0.35 per unit. Each unit was to be comprised of one share of our common stock and one share purchase warrant. No sales of these units were completed.

In the event that we are successful in achieving financing, we anticipate advancing funds to Icoworks Holdings to fund bought deals and the acquisition strategy of Icoworks Holdings as a loan pending the completion of the merger of Icoworks Holdings. These loans may be advanced as secured or unsecured loans. In the event that we advance funds to Icoworks Holdings, there will be no assurance that these funds will be repaid by Icoworks Holdings. If the business of Icoworks Holdings is not successful in generating sufficient funds to repay these loans, then our financial condition will be adversely affected. In addition, there is a risk that we will advance substantial funds to Icoworks Holdings and the merger of Icoworks Holdings will not proceed. In the event that we are unable to raise additional financing under acceptable terms, then we may not be able to proceed with our plan of operations or we may be required to scale back

our plan of operations. We also anticipate that we will continue to incur losses until such time as we are able to generate profits from the business of Icoworks Holdings and its expansion strategy.

CRITICAL ACCOUNTING POLICIES

Revenue Recognition

Revenues mainly consist of auction revenues and held-for-sale revenues. Auction revenues are comprised of buyers premiums, being premiums over and above the purchase prices of items sold, and commissions paid by consignors of items for auction. Held for sale revenues are comprised of revenues from items purchased and held-for-sale and or liquidation. Revenue is recognized once the auction or sales are completed and collection is reasonably assured. Other commissions are earned when we provide guarantees on the gross proceeds to be received from sale to the consignor.

We conduct these sales where we, or in joint venture with others, temporarily acquire title to the goods. When these activities are conducted, the profits are divided between us and the joint venture partners on a negotiated basis. If the actual proceeds are less than cost, or less than the guaranteed price, we may be required to fund the shortfall, as discussed above.

Revenue is also earned from fees charged for appraisals and is recognized when the work is completed and collection is reasonably assured.

Foreign Currency Translation

We have determined that the functional currency of certain of our wholly-owned and partially-owned Canadian subsidiaries is the local currency, the Canadian dollar. Assets and liabilities denominated in foreign currency are translated into U.S. dollars at the period end exchange rates. Revenue and expenses are translated at the rates of exchange prevailing on the dates such items are recognized in earnings. Related exchange gains and losses are included in a separate component of shareholders' equity under other comprehensive income. Exchange gains and losses resulting from foreign currency transactions are included in income for the period.

Inventory

Inventory is stated at the lower of cost or market. Cost is generally determined on the first-in, first-out basis.

Intangible Assets

The carrying value of intangible assets is re-evaluated for potential permanent impairment on an ongoing basis at the reporting unit level. In order to determine whether permanent impairment exists, management considers the Company's and its subsidiaries' financial condition as well as expected pre-tax earnings, discounted cash flows or market related values. If the carrying value of intangible assets of a reporting unit exceeds the fair value of the reporting unit, the carrying value of intangible assets must be written down to fair value in the year the impairment is recognized.

ITEM 3. CONTROLS AND PROCEDURES.

As required by Rule 13a-15 under the Securities Exchange Act of 1934 (the Exchange Act), we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2003, being the date of our most recently completed fiscal quarter. This evaluation was carried out under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, Mr. J. Graham Douglas. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting management to material information relating to us required to be included in our periodic SEC filings. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out our evaluation.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

During our most recently completed fiscal six months ended December 31, 2003, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

The term internal control over financial reporting is defined as a process designed by, or under the supervision of, the registrant's principal executive and principal financial officers, or persons performing similar functions, and effected by the registrant's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the registrant;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant; and
- (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the registrant's assets that could have a material effect on the financial statements.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

We, and our consolidated subsidiaries, are presently party to the following legal proceedings:

1. Mr. Michael Hunt has commenced action against Icoworks Services, a wholly owned subsidiary of Icoworks Holdings, in the Supreme Court of British Columbia on February 10, 2004. Mr. Hunt claims that Icoworks Services wrongfully terminated a consultant agreement between Mr. Hunt and Icoworks Services on December 24, 2003. Mr. Hunt has claimed for judgment in the amount of \$105,000 in respect of breach of contract, unpaid expenses in the approximate amount of \$1,000, and the full amount of any bonuses and share options payable and due under his contract. Icoworks Services filed an Appearance in the Supreme Court of British Columbia. Icoworks Services maintains that it is not liable to Mr. Hunt for any breach of contract or otherwise intends to file a Statement of Defence with the Supreme Court of British Columbia in order to defend this action.
2. Mr. Guy Gauthier has commenced action against Icoworks Services in the Supreme Court of British Columbia on February 10, 2004. Mr. Gauthier claims that Icoworks Services wrongfully terminated a consultant agreement between Mr. Gauthier and Icoworks Services on December 24, 2003. Mr. Gauthier has claimed for judgment in the amount of \$66,000 in respect of breach of contract, unpaid expenses in the approximate amount of \$1,000, and the full amount of any bonuses and share options payable and due under his contract. Icoworks Services filed an Appearance in the Supreme Court of British Columbia. Icoworks Services maintains that it is not liable to Mr. Gauthier for any breach of contract or otherwise intends to file a Statement of Defence with the Supreme Court of British Columbia in order to defend this action.
3. Icoworks Services is also party to the litigation referred to in Note 18 to the December 31, 2003 financial statements which is believed not to be material. This litigation was resolved in favour of Icoworks Services, but the ruling of the court has been appealed.
4. Craig Cannon has filed a counterclaim on February 2, 2004 in respect of the litigation originally commenced by Icoworks Holdings against Network International Inc., Premier Auctioneers International Inc. and Craig Cannon in the District Court of Harris County, Texas. The litigation between Icoworks Holdings and Network International Inc. and Premier Auctioneers International Inc. was settled in August 2003 and resulted in the transfer of the Premier Auctions business to Icoworks Holdings. Mr. Cannon has counterclaimed against Icoworks Holdings and has named James Richie, David Long and Scott Felker as defendants. Mr. Cannon has alleged tortious interference with a contract alleged to be between Mr. Cannon and Network International for the sale of Premier Auctions and has also alleged tortious interference with prospective business relations. Mr. Cannon has claimed unspecified damages arising from these alleged tortious acts. Icoworks Holdings intends to file a defence denying any wrongdoing in this matter and will vigorously defend the action.

Item 2. Changes in Securities.

We did not complete any sales of our common stock without registration pursuant to the Securities Act of 1933 (the 1933 Act) during our fiscal quarter ended December 31, 2003, except as described below:

1. We issued warrants to purchase 5,714,280 shares of our common stock at an exercise price of \$0.35 per share to the lenders who advanced to Icoworks Holdings the \$2,000,000 bridge loan that enabled Icoworks Holdings to acquire the Premier Auctions business. The warrants were issued pursuant to Regulation S of the 1933 Act based on the representations of each of the investors that they are not U.S. Persons , as defined under Regulation S of the 1933 Act.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to our security holders for a vote during our fiscal quarter ended December 31, 2003.

Item 5. Other Information.

None.

Item 6. Exhibits and Reports on Form 8-K.

EXHIBITS REQUIRED BY ITEM 601 OF REGULATION S-B

| <u>Exhibit Number</u> | <u>Description of Exhibit</u> |
|------------------------------|---|
| 3.1 | Articles of Incorporation ⁽¹⁾ |
| 3.2 | Bylaws ⁽¹⁾ |
| 3.3 | Certificate of Amendment to Articles of Incorporation ⁽³⁾ |
| 10.1 | Form of share purchase agreement entered into between the registrant and the individual non-US shareholders of Icoworks, Inc. to acquire the majority interest. ⁽²⁾ |
| 10.2 | Management Services Agreement between Icoworks Holdings Inc. and Antares Investments Ltd. ⁽⁴⁾ |
| 10.3 | Release and Settlement Agreement between Icoworks Holdings Inc. and Network International ⁽⁴⁾ |
| 10.4 | Form of Joint Venture Agreement for Icoworks Joint Ventures ⁽⁴⁾ |
| <u>10.5</u> | <u>Promissory Note executed by Icoworks Holdings Inc. in favour of Ian de Bie</u> ⁽⁵⁾ |
| <u>10.6</u> | <u>Agreement dated January 26, 2004 between Icoworks Inc., Icoworks Holdings, Icoworks Services, J. Graham Douglas, Antares Investments and Paul McAteer</u> ⁽⁵⁾ |
| <u>31.1</u> | <u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> ⁽⁵⁾ |
| <u>32.1</u> | <u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> ⁽⁵⁾ |

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- (1) Filed as an Exhibit to our Form SB-2 Registration Statement originally filed on March 16, 2000, as amended.
 (2) Filed as an Exhibit to our Current Report on Form 8-K filed on March 6, 2003.
 (3) Filed as an Exhibit to our Quarterly Report on Form 10-QSB on June 20, 2003.
 (4) Filed as an Exhibit to our Annual Report on Form 10-KSB for the year ended June 30, 2003 filed with the SEC on October 23, 2003.
 (5) Filed as an Exhibit to this Quarterly Report on Form 10-QSB.
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CURRENT REPORTS ON FORM 8-K

We filed the following Current Reports on Form 8-K during our fiscal quarter ended December 31, 2003:

- We filed an Amendment No. 1 to Current Report on Form 8-K on November 13, 2003 to amend our Current Report on Form 8-K originally filed on March 6, 2003 to include the financial statements of Icoworks Holdings required by Item 7(a) and (b) of Form 8-K.

2. We filed a Current Report on Form 8-K on November 13, 2003 to disclose our acquisition of the Premier Auctions business.

SIGNATURES

In accordance with the requirements of the Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ICOWORKS INC.

Date: February 25, 2004

By: /s/ J. Graham Douglas

J. Graham Douglas, President
Chief Executive Officer
Chief Financial Officer and
Principal Accounting Officer
