

new horizons  
for growth

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JUN 10 2003  
MCGILL UNIVERSITY



Coreco Inc. designs, develops, manufactures and markets machine vision hardware and software that help enhance the productivity, quality and cost-competitiveness of manufacturing processes.

The Company serves two target markets, Original Equipment Manufacturers (OEMs) and End-users.

The OEM group provides a full range of frame grabbers, embedded products and accompanying software for integration in high-performance machine vision applications in the industrial vision, medical imaging, multimedia and surveillance markets.

The Intelligent Products group (IPD) specializes in providing user-friendly, cost-effective vision appliances for task-specific factory floor applications, such as gauging, high-precision alignment, inspection, assembly verification and machine guidance.

Coreco employs a staff of 135 people and has operations in Montreal (QC), Vancouver (BC) and Boston (MA), with additional sales offices in Cleveland (OH) and San Juan Capistrano (CA).

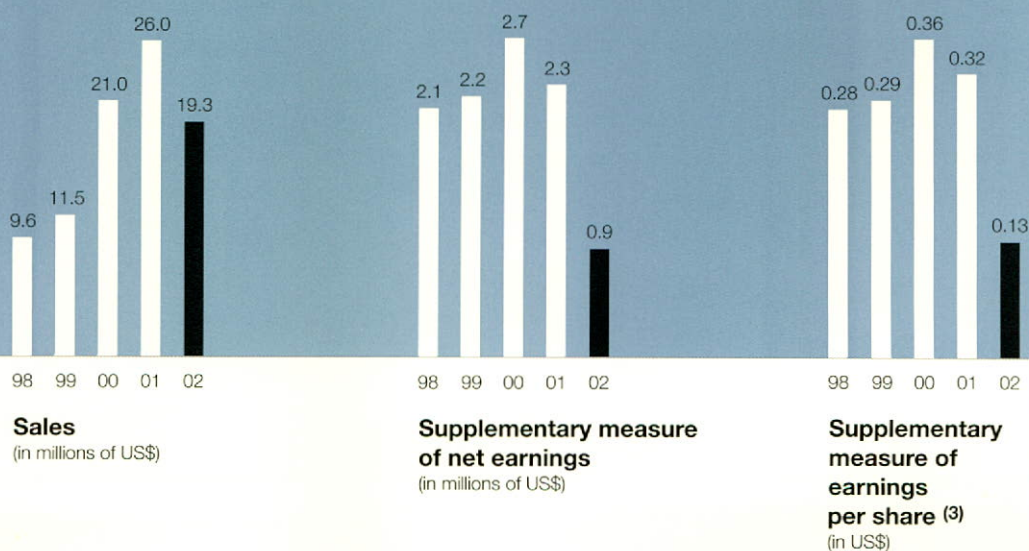


	years ended December 31, (in thousands of US dollars, except share data <sup>(1)</sup> )	2002	2001 \$	% Change \$
<b>Operating results</b>				
Sales		19,273	26,009	-26%
Gross profit		10,832	14,614	-26%
Gross margin		56.2%	56.2%	—
Research and development expenditures (gross)		3,873	4,448	-13%
Selling and marketing expenses		3,777	4,400	-14%
Acquisition-related charges <sup>(2)</sup>		—	6,452	—
Earnings (loss) before income taxes		1,234	(3,036)	-141%
Supplementary measure of net earnings <sup>(3)</sup>		940	2,326	-60%
Net earnings (loss)		940	(3,872)	-124%
Supplementary measure of earnings per share (basic and diluted) <sup>(3)</sup>		0.13	0.32	-59%
Earnings (loss) per share (basic and diluted)		0.13	(0.53)	-125%
<b>Number of shares outstanding</b>				
Weighted average number of shares outstanding (basic)		7,170,438	7,247,426	—
Weighted average number of shares outstanding (diluted)		7,230,248	7,312,132	—
Total number of shares outstanding		7,108,872	7,234,472	—
<b>Financial position</b>				
Total assets		16,578	19,248	-14%
Working capital		8,658	9,143	-5%
Net cash position		2,383	330	+623%
Shareholders' equity		12,408	11,955	+4%

<sup>(1)</sup> Effective January 1, 2001, the Corporation adopted the US dollar as its measurement currency as a result of the significance of business activities conducted in the United States and the increasing proportion of operating, financing and investing transactions in the Canadian operations that are denominated in US dollars.

<sup>(2)</sup> In 2001, represents the amortization of intangible assets related to business acquisitions. In 2002, as a result of new accounting rules, no amortization is required.

<sup>(3)</sup> In 2001, excludes the after-tax amortization of intangible assets related to business acquisitions. In 2002, as a result of new accounting rules, no amortization is required.





Despite a tough operating environment for most of 2002, Coreco maintained its strong financial position, introduced new products and won a host of design competitions. We begin 2003 leaner, and poised to profit from a rebound in business investment.

**Weathering the downturn** Our strategy for dealing with a second straight year of slack demand was simple. We decided to weather the downturn by continuing to streamline operations across the organization. Most importantly, we consolidated OEM manufacturing facilities in Montreal so as to improve inventory control and reduce cost of goods. Only our research and new product development budgets were left untouched during this streamlining exercise.

Net earnings for the year ended December 31, 2002 were US\$940,000 (US\$0.13 per share), compared with a loss of US\$3.9 million the previous year. The positive earnings results were particularly impressive in light of the fact that revenues for the year dropped to US\$19.3 million compared with US\$26.0 million during 2001.

At year-end, Coreco was in an enviable financial position. Cash and cash equivalents were US\$4.2 million at December 31, 2002, up US\$678,000 from the same period last year. Inventories were lower by US\$1.2 million and the Company had paid down US\$1.4 million of long-term debt. As a result, Coreco heads into 2003 with a strong cash position and close to debt-free.

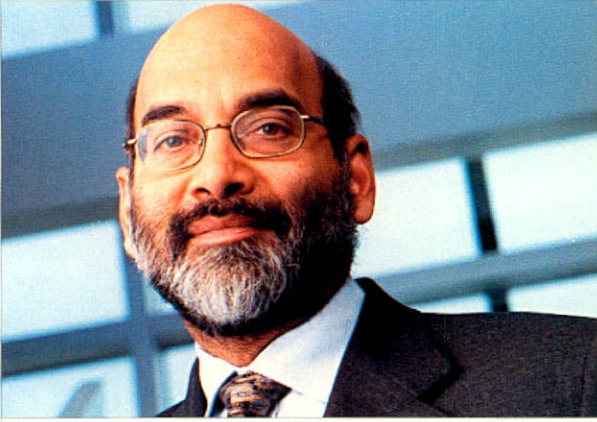
During the past year, our broad geographic and sector diversification continued to pay off. Because we are active in so many markets and industries, our results were less affected by the downturn in capital spending. In 2002, a new market for Coreco was China, where we have begun to establish our sales network with success.

**A continued R & D focus** During 2002 we maintained our focus on providing integrated application specific solutions to international machine vision markets. The key, as always, was ongoing research and development, which led to significant upgrades in our product line.

**New OEM products** On the OEM side of our business, we launched the X64, a new, high-efficiency frame grabber that quadruples performance compared with earlier versions and has generated significant market interest.

In 2002, the Company's products were selected for design into 46 OEM applications, including several wins for the X64, which could result in volume orders during the next two years. One key win was from the world's largest Liquid Crystal Display (LCD) manufacturer, a sector that is seeing increasing consumer acceptance. The X64 was also designed into an inspection system for consumer products in the automotive industry.





**IPD is an investment in our future** Coreco's new Intelligent Products group (IPD), set up at the end of 2001 to address the growing market for end-user applications, also made great strides. During the fourth quarter of 2002 we launched *iGauge*, a smart, highly precise measuring appliance, and we will soon introduce a label reading device called *iLabel*. Our significant investment in end-user applications, a new market segment for Coreco, will begin to make a contribution to our results in 2003 and form an important part of our revenues beginning in 2004.

**Well-positioned for a recovery in capital spending** Analysts have been predicting a pick-up in business investment for some time. That would mean a return to traditional 10% to 15% annual industry growth rates, in the OEM markets. Although economists have been somewhat optimistic in the past, we believe a turnaround in business investment is due. When that rebound comes — likely by the second half of 2003 — there will be considerable pent up demand in the market.

With Coreco's lean management structure, low-cost base and strong product range, the Company will be in an ideal position to take advantage of those trends. Already we are seeing some volume orders from OEM clients in the pipeline. By 2004, sales to the end-user market should start to take on growing importance.

Two-thousand-and-two was a tough year. To accomplish what we have, we needed a team commitment from employees, directors and shareholders. To them, our customers, suppliers and other stakeholders, we offer our heartfelt thanks.

On behalf of the Board,

A handwritten signature in black ink that reads "Keith A. Reuben".

**Keith A. Reuben**  
President and Chief Executive Officer

A handwritten signature in black ink that reads "Robert Mee".

**Robert Mee**  
Chairman of the Board

# Vision solutions for high-performance manufacturing needs

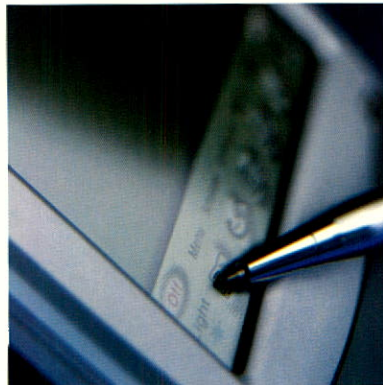
**Coreco's OEM group provides a full range of frame grabbers, embedded products and accompanying software for integration in high-performance machine vision applications in the industrial vision, medical imaging, multimedia and surveillance markets.**



**New products** The X64 frame grabber, which increases performance by four times, was selected for design into several OEM applications in 2002 and has significant potential for volume orders over the next two years.

**Industrial vision for flat panel displays** One of Coreco's notable design-wins in 2002 was from one of the world's largest manufacturers of inspection systems for flat panel displays.

Our vision technology is being designed into an OEM machine vision product that will be used to inspect and control the quality of flat panel displays during the manufacturing process.



**Superior Colour Reproduction and Resolution Drive Flat Panel Sales** Flat panel display technology is being used in a number of consumer products including television, hand-held computing devices, cellular telephones and computer screens.





resolution

accuracy

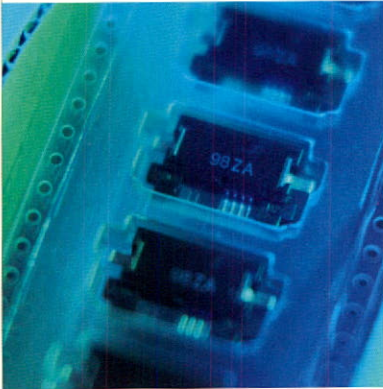
speed

According to leading market researchers, sales of flat panel computer screens will surpass those of traditional picture-tube models in 2003 for the first time as prices fall. Global flat panel display sales will rise to more than \$20 billion as total shipments of monitors increase almost 5% this year, and are expected to reach \$31.55 billion in 2006.



# Simple imaging solutions for everyday manufacturing problems

Coreco's **Intelligent Products group (IPD)** specializes in providing user-friendly, cost-effective vision appliances for task-specific factory floor applications like gauging, high-precision alignment, inspection, assembly verification and machine guidance.



**New products** The *iGauge* and *iLabel* products are the first in Coreco's family of smart appliances. These appliances are designed to solve specific and common vision tasks, that is, gauging or label inspection. Because they provide robust solutions to common manufacturing problems, they are applicable across multiple industries.



**Packaging inspection** *iLabel* is an easily deployed solution for manufacturers of packaged goods. It verifies that the correct label is present and properly placed on the package. It then detects flags, tears and damage to the label, and inspects each one for significant defects such as smears, splatter and contamination.

**Serving a Multitude of End-user Needs** End-user vision products target everyday, factory-floor applications. Consequently, they must be simple to use and have price points that make them attractive to a wide variety of manufacturers.





easy and fast to implement

robust

no expensive customization required

cost-effective

The end-user segment of the machine vision market is in the early stages of its development. The decision to purchase end-user vision products is independent of the spending cycles associated with investments in capital equipment.



*The following discussion and analysis of financial condition, results of operations and cash flows should be read in conjunction with the audited Consolidated Financial Statements and related Notes for the year ended December 31, 2002.*

*All amounts are expressed in US dollars unless otherwise stated. Effective January 1, 2001, the Company adopted the US dollar as its measurement currency as a result of the significance of business activities conducted in the United States and the increasing proportion of US-denominated operating, financing and investing transactions in the Canadian operations.*

**Forward-looking statements** Statements in this report, or any document filed by Coreco Inc. (the "Company") with the different governing authorities, or in any other written or oral communication by or on behalf of the Company, to the extent not directly and exclusively based on historical events, constitute forward-looking statements. These statements represent the Company's intentions, plans, expectations, and beliefs, and no assurance can be given that the results described in such statements will be achieved.

Forward-looking statements include, without limitation, statements evaluating market and general economic conditions in the following sections, and statements regarding future-oriented costs and expenditures. Investors are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date thereof. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially. Such risks and uncertainties with respect to the Company include the effects of general economic conditions, changing foreign exchange rates and actions by government authorities, uncertainties associated with legal proceedings and negotiations, industry supply levels, competitive pricing pressures and misjudgments in the course of preparing forward-looking statements. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## Vision, Core Business and Strategy

**Vision** Coreco Inc. is a leader in the design, development, manufacturing and marketing of hardware and software for high-performance computer vision applications, primarily in the medical imaging and industrial vision markets. Simply put, Coreco's products provide computers with the eyes (hardware) and the brains (software) to see and analyze images. Coreco's products are used in a wide variety of applications where the required performance surpasses the capabilities of the human eye in terms of speed, precision, fatigue and repetitiveness. Coreco products add value to the manufacturing processes of customers by improving speed and reliability as well as reducing costs.

**Core business** The present customer base is composed primarily of Original Equipment Manufacturers (OEMs). These customers build products for mainly the industrial and medical vision markets. An example of an OEM application for the industrial vision market is an inspection system to monitor an assembly line to build flat panel display monitors. Typical medical vision applications would be ultrasound and MRI equipment where the objective is to deliver an improved image to facilitate diagnosis.

**Operations** The Company employs 135 people and has operations in Montreal (QC), Vancouver (BC) and Boston (MA), with additional sales offices in Cleveland (OH) and San Juan Capistrano (CA). Founded in 1979, Coreco's success is driven by sound financial management combined with its commitment to the research and development of value-added products to serve the evolving needs of the computer vision market.

During the economic slowdown of 2002, Coreco examined its corporate structure so as to maintain and further improve its profitability, and to position itself to take full advantage of market opportunities when economic activities returned to normal levels. The Company has delivered consistent profitability from its operations since 1993 and this objective will continue to guide its management in the future.



**OEM strategy** For the past fifteen years, the Company has focused on targeting OEM customers. This market is well defined and the players are well known. Economic indicators predict that the current slowdown, which has affected this market over the last two years, will ease in the second half of 2003. Because of the diversification of Coreco's customer base both in terms of applications and geographic distribution, the Company has been less affected by the slowdown than other industry players. Both profitability and strong cash generation have been maintained during this period. Coreco is one of the top players in this market and works to maintain its leadership position by continuously developing new OEM products.

**End-user strategy** In order to generate more revenue growth, the Company made a strategic decision in 2001 to enter the end-user market for vision applications. Whereas OEM products are oriented toward complex vision applications that require engineered customization and applications support thus commanding a higher price, end-user products are cost-effective and easy to use and target everyday machine vision applications. The most recent market studies estimate the size of the end-user market to be approximately equivalent to that of the OEM machine vision market. The end-user market is not yet well developed and, in the opinion of management, there is room for significant and rapid growth for Coreco.

To be successful, an end-user product must be simple to use with a price point that makes it attractive to a wide variety of manufacturers. A typical example is Coreco's *iGauge* smart appliance, used to take measurements, that was launched in the fourth quarter of 2002. This user-friendly product is housed in a small box consisting of a computer, vision processor and software. A second end-user product, *iLabel* used to read labels, will be launched in the first half of 2003.

**Growth and shareholder value creation** Since the Company's initial public offering in 1996, management has always focused on generating profits. With the prudent investment of its IPO proceeds and three successful acquisitions, sales have grown from \$8.144 million in 1996 to \$19.273 million in 2002.

In order to continue to generate significant revenue growth, the Company must address new markets that demonstrate a large potential for growth and profit. In fiscal 2002, the Company invested over \$1.4 million in research and development to develop a completely new line of products to address the end-user market, and expects to maintain the same level of investment in fiscal 2003. The first revenue contribution from this new market will begin in the first quarter of fiscal 2003. In 2004 and beyond, the contribution of end-user products is forecasted to be approximately 25% of sales.

The OEM market is still growing and Coreco is committing significant effort in research and development to support the development of new products to address this core business. The Company still considers that this market has exciting potential and fully intends to maintain its leadership position.

## Key Performance Drivers

The Company's success is driven by the following factors:

- Technology;
- Significant investment in the research and development of new products;
- Unique value-added approach with OEM customers;
- Lean structure;
- Sound management of resources;
- Solid balance sheet;
- Well-diversified customer base.

The principal indicators to measure the performance of the Company are:

- Net earnings from operations;
- Cash flow generation;
- Research and development expenditures;
- Gross margin;
- Design-wins.

**Net earnings from operations** In light of the acquisitions made by the Company since 1997, management decided to use a supplementary measure of net earnings and earnings per share ("net earnings from operations") to help investors monitor its performance. This method excludes the after-tax effect of acquisition-related charges (refer to Note 12 of the Consolidated Financial Statements).

At the beginning of 2002, new CICA accounting recommendations came into effect regarding "Business Combinations" and "Goodwill and Other intangible assets" (refer to Note 2 of the Consolidated Financial Statements for a complete explanation of significant accounting policies). Under these new recommendations, goodwill and intangible assets with an indefinite life are no longer amortized to earnings, and management is required to perform an annual assessment of goodwill for impairment based on fair value. The Company has completed the transitional impairment test and concluded that no goodwill impairment charge needs to be recorded.

With the implementation of these new recommendations, the profitability of the Company can be measured more simply in future years by tracking the GAAP net earnings.

**Cash flow generation** Because of the Company's lean structure, net earnings convert easily into cash. The Company's operations are not capital-intensive and it is therefore not required to make significant investments in capital assets. All capital-intensive functions are outsourced. Over the years, the Company has allied itself with good partners for these tasks at a very reasonable cost. It is not the intention of the Company to invest in these sectors.

**Research and development expenditures** To ensure sales growth in a challenging high technology environment, management has invested between 18-22% of sales over the last five years in research and development. This ensures a steady flow of new products to address the evolving needs of its market. This rationale is being validated in today's market. With the slowdown that has affected the global economy in the last two years, analysts have confirmed that customers building new-generation applications are mainly seeking new-technology products. Companies with old-technology products, or without any new product offerings, are facing tremendous competitive pressure. In fiscal 2002, Coreco's new generation of high-performance vision products represented 64% of total sales.



**Gross margin** The gross margin is the key driver of profitability. Product costing is an integral part of the product design stage, which is Coreco's core expertise, to ensure that the final product generates the required margins. Final assembly of components is outsourced; the Company may manage the procurement of assembly components or, depending on cost, work with turnkey suppliers. This approach eliminates the need for significant capital expenditures and ensures available capacity. Over the last five-year period, the gross margin represented approximately 56% to 66% of sales.

**Design-wins** It can be difficult to monitor customer acceptance of products because of the length of the selling cycle. Therefore, the Company discloses the number of design-wins as an additional measurement of performance.

The design-win process involves a number of steps. First, a customer orders a product for evaluation in the design of a new product. This step may also be carried out concurrently with a competitor's product. During this period, lasting from 30-60 days, the customer will evaluate the product on the basis of performance, price and compatibility. The Company's OEM application group will assist the customer during this phase in evaluating the feasibility of the application and how to rapidly achieve his goals. Following this analysis, the customer will decide which product best meets the needs of his project. If he opts for a Coreco product, this is considered a design-win. In the next step, the customer finalizes the machine vision application with the help of Coreco's OEM application group. Finally, the customer will place a volume order for the product within three to nine months depending on the complexity of the application.

## Capabilities to Achieve Desired Results

**Capital resources** At December 31, 2002, the Company held \$4.164 million in cash offset by total long-term debt of \$1.781 million, resulting in a net cash position of \$2.383 million.

Coreco has an operating credit facility of CAN\$7.0 million, or the equivalent thereof in US dollars, that was unused as at December 31, 2002. In addition, Coreco has a \$1.781 million revolving term loan outstanding. Under the terms of the agreement for the long-term debt, the Company may borrow, prepay the loan in whole or in part, and re-borrow under this facility. This loan is denominated in US dollars and was for an original amount of \$5.5 million (currently \$2.406 million). Under these credit facilities, the Company is required to maintain a number of financial ratios.

Coreco believes that existing cash and credit facilities, as well as cash flows from operations, will be sufficient to meet all the Company's planned expenditures and debt service requirements for the remainder of this year. The Company regularly reviews acquisition opportunities, for which it may require additional debt or equity financing.

**Human resources** At the end of fiscal 2002, the Company employed 135 people. All functions considered non-essential or not related to its core technology functions are outsourced. Over the past 2 years, the organizational size was reduced from 165 to 135 employees, thus improving efficiency and reducing the cost structure.

The Company has been successful in attracting and retaining skilled human resources. Management is of the opinion that a competitive compensation package is necessary to attract and retain the best employees in its sector.

**Manufacturing capacity** Since the Company outsources all manufacturing functions, it has never experienced problems with capacity. Over the years, Coreco has developed a network of turnkey manufacturers able to provide high quality service with competitive pricing.

## Operating Results

In fiscal 2002, the Company has:

- Maintained profitability with earnings of \$0.13 per share and cash flows from operating activities of \$2.736 million;
- Invested \$1.4 million in the development of new end-user products;
- Finalized the consolidation of all OEM manufacturing in Montreal resulting in a gross margin of 56%;
- Reduced inventories by \$1.202 million;
- Increased contribution of new products to 64% of sales;
- Reimbursed \$1.375 million of long-term debt;
- Ended fiscal 2002 with a streamlined structure and well positioned for growth.

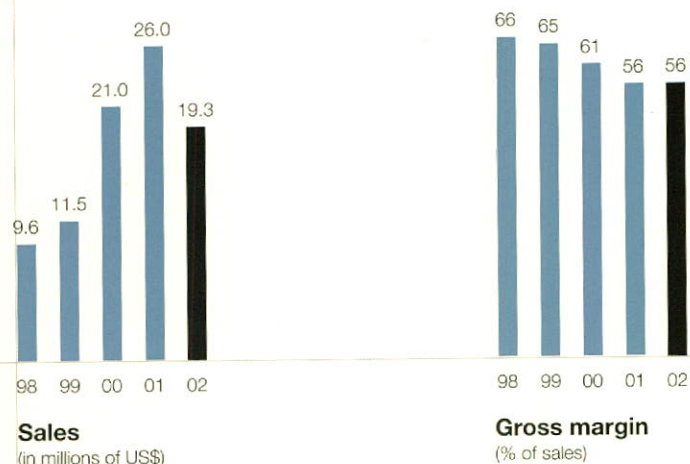
The following table presents certain items in the Consolidated Financial Statements of the Company as a percentage of sales.

	2002	2001
Sales	100%	100%
Cost of goods sold	44%	44%
Gross margin	56%	56%
Expenses		
Research and development expenditures	20%	17%
Less research tax credits	(5%)	(4%)
	15%	13%
Selling and marketing	20%	17%
General and administrative	11%	10%
Depreciation and amortization of capital assets	3%	2%
Financial, net	1%	1%
Earnings before undernoted items	6%	13%
Acquisition-related charges <sup>(1)</sup>	—	25%
Earnings (loss) before income taxes	6%	(12%)
Income taxes	1%	3%
Net earnings (loss)	5%	(15%)
Supplementary measure of net earnings <sup>(2)</sup>	5%	9%
Earnings before interest, income taxes, depreciation and amortization (EBITDA) <sup>(3)</sup>	10%	17%

<sup>(1)</sup> In 2001, represents the amortization of intangible assets related to business acquisitions. In 2002, as a result of new accounting rules, no amortization is required.

<sup>(2)</sup> In 2001, excludes the after-tax effect of amortization of intangible assets related to business acquisitions. In 2002, as a result of new accounting rules, no amortization is required.

<sup>(3)</sup> EBITDA is a widely used measure of cash operating earnings before financing charges, depreciation and amortization of capital assets, acquisition-related charges and income taxes. EBITDA does not have any standardized meaning prescribed by generally accepted accounting principles.



In fiscal 2002, the gross margin remained stable despite a drop in sales. This was achieved by consolidating OEM manufacturing and generally streamlining operations across the organization.



**Revenues** Sales for the year ended December 31, 2002 were \$19.273 million, compared with \$26.009 million for the same period in 2001, representing a decrease of 26% due to the imaging market that continued to be flat in 2002 following a drop in the second half of 2001. In 2002, quarter-over-quarter sales demonstrated little fluctuation with average sales of approximately \$4.800 million per quarter for the last five quarters.

In 2001, the slowdown in the imaging market occurred in the second half of the year. Company sales decreased 29% to \$10.799 million in the second half of 2001 from \$15.209 million in the first half.

The breakdown of sales by geographic region and product category was comparable with the previous year. Asia, Europe and the U.S. accounted for 17%, 28% and 50% of total sales, respectively, with Canada making up the remainder. By product category, frame grabbers, embedded products and software made up 56%, 36% and 8% of sales, respectively.

**Sales by region**

	2002		2001	
	\$	%	\$	%
Asia-Pacific	3,363,000	17%	3,929,000	15%
Canada	1,050,000	5%	1,139,000	4%
Europe	5,318,000	28%	7,764,000	30%
USA	9,542,000	50%	13,177,000	51%
<b>Total</b>	<b>19,273,000</b>	<b>100%</b>	<b>26,009,000</b>	<b>100%</b>

**Sales by product category**

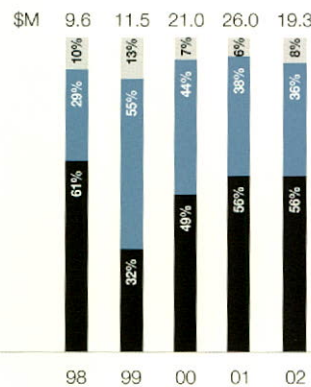
	2002		2001	
	\$	%	\$	%
Frame grabbers	10,717,000	56%	14,625,000	56%
Embedded products	7,031,000	36%	9,757,000	38%
Software	1,525,000	8%	1,627,000	6%
<b>Total</b>	<b>19,273,000</b>	<b>100%</b>	<b>26,009,000</b>	<b>100%</b>

**New OEM products** The Company's new high-performance vision products continue to command a steadily increasing percentage of the Company's sales. In 2002, they represented 64% of total sales, compared with 53% in 2001, 37% in 2000 and 18% in 1999. In fiscal 2002, Coreco products were selected for design into 46 OEM applications including several for its new X64 product, which increases performance by four times and has significant potential for volume orders over the next two years.

**End-user products** The Intelligent Products group (IPD) began shipping the *iGauge* smart appliance to certain key accounts in the fourth quarter of 2002, after a delay in product launch to incorporate changes recommended by some end-user customers. Distribution channels have been appointed both in the U.S. and Europe with Asia to follow in 2003. Work also began during the quarter on the *iLabel* smart appliance scheduled for release in the first quarter of 2003. Overall, the product has been well received by the market and production is expected to ramp up in the second half of 2003.



Coreco's machine vision technology is used by a wide range of industries around the world, which reduces our exposure to fluctuations in the capital spending cycle.



**Sales by region**  
(% of total sales)

- Europe
- Asia/Pacific
- Canada
- USA

**Sales by product category**  
(% of total sales)

- Software
- Embedded products
- Frame grabbers

**Gross profit** In fiscal 2002, the gross profit remained stable at 56% of sales, amounting to \$10.832 million, compared with 56% of sales or \$14.614 million for the same period in 2001. To maintain the same gross margin on lower sales in 2002, the Company took several measures including the consolidation of OEM product manufacturing in Montreal, Canada. These measures, combined with the overall year-over-year reduction in inventory of 25%, should have a positive effect on the gross margin in fiscal 2003. The objective for 2003 and beyond is to bring the gross margin progressively back to historic levels of 60%-63% of sales.

**Expense control** In recognition of the economic downturn in 2001, the Company increasingly implemented measures to reduce the level of expenses within the organization in order to maintain profitability. These measures included a reduction in staff, a freeze on salary increases, a restricted hiring plan, and the elimination of all bonuses.

As a result of these measures, all departments showed sequential reductions in expenses in 2001. The same measures remained in effect in fiscal 2002. In fiscal 2003, management will continue to be prudent and the emphasis will remain on maintaining profitability.

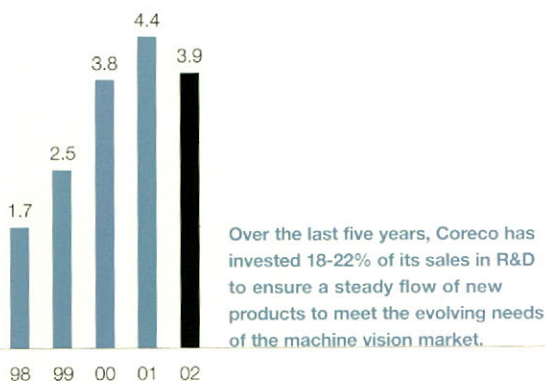
**Research and development** In fiscal 2002, R&D expenditures amounted to \$3.873 million, or 20% of sales, compared with \$4.448 million, or 17% of sales, for the same period in 2001. The decrease in dollar terms is mainly due to the expense control program progressively put in place in 2001, including the closure of the Company's Ottawa facility, finalized in the first quarter of 2002.

The current level of R&D expenditures reflects the Company's ongoing commitment to make significant investments in research and development. As part of the amount expensed in 2002, approximately \$1.4 million was invested in the development of its new end-user products. Management considers that this market holds substantial potential for growth. The significant investment made in R&D in 2002, which will be maintained in 2003, will ensure that the Company has a full spectrum of products to address both OEM and end-user markets.

Investment tax credits for research and development totaled \$910,000 in fiscal 2002 compared with \$1.035 million in 2001. This reduction of approximately 12% is related to the closing of the Ottawa facility, where activities were focused mainly on research and development.

**Selling and marketing** Selling and marketing expenses amounted to \$3.777 million, or 20% of sales, for fiscal 2002 compared with \$4.400 million, or 17% of sales, for the same period in 2001. The decrease in dollar terms is mainly due to the expense control program put in place to mitigate the impact of the economic slowdown.

**General and administrative** For fiscal 2002, general and administrative expenses amounted to \$2.147 million, or 11% of sales, compared with \$2.492 million, or 10% of sales, for the same period in 2001.



Over the last five years, Coreco has invested 18-22% of its sales in R&D to ensure a steady flow of new products to meet the evolving needs of the machine vision market.

**Research & development expenditures**  
(in millions of US\$)



**Financial expense** For fiscal 2002, net financial expense amounted to \$225,623 compared with \$253,647 in fiscal 2001. The Company made debt repayments of \$343,750 in each of the quarters of 2002, using cash flows generated from operating activities. As a result, long-term debt at the end of the fourth quarter amounted to \$1.781 million.

**Acquisition-related charges** In accordance with new CICA accounting recommendations, acquisition-related charges of \$2.694 million presented as goodwill in the balance sheet at the end of 2002 were not amortized during 2002. The new recommendations provide for management to perform an annual assessment of goodwill for impairment based on fair value.

During the second quarter ended June 30, 2002, the Corporation completed the transitional impairment test and concluded that no goodwill impairment charge was required. The Corporation intends to perform its annual review of goodwill as of December 31 of each year. Based on the impairment test performed as of December 31, 2002, the Corporation concluded that no goodwill impairment charge was required.

Acquisition-related charges amounted to \$6.452 million in fiscal 2001.

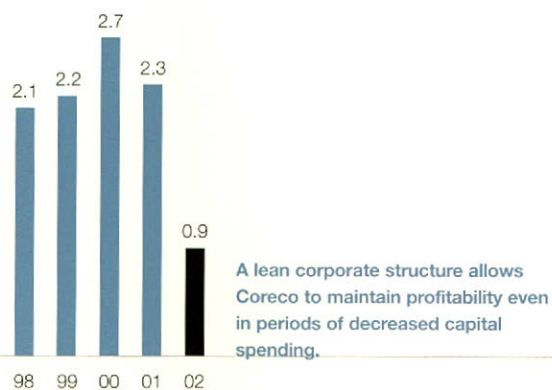
**Income taxes** The effective tax rate for fiscal 2002 was 24% compared with 32% for the same period in 2001. The tax rate of the Company is affected by the amount of net income earned in

its various jurisdictions. In fiscal 2001, the amortization of the intangible assets associated with the acquisition of ITI was not deductible for income tax purposes (refer to Note 11 of the Consolidated Financial Statements for complete explanation on tax provision and rate).

**Supplementary measure of net earnings** As a measure of the financial performance of the Company, management utilized during 2001 a supplementary measure of net earnings and earnings per share ("net earnings from operations"). This method excludes the after-tax effect of acquisition-related charges (refer to Note 12 of the Consolidated Financial Statements).

Net earnings from operations for fiscal 2002 were \$939,526 compared with \$2.326 million for fiscal 2001. On a per-share basis, net earnings from operations amounted to \$0.13 (basic and diluted) in 2002, compared with \$0.32 (basic and diluted) for the same period in 2001.

**Net earnings** For fiscal 2002, net earnings amounted to \$939,526 compared with a net loss of \$3.872 million in fiscal 2001. On a per-share basis, net earnings amounted to \$0.13 (basic and diluted) in 2002, compared with a net loss of \$0.53 (basic and diluted) for the same period in 2001.



**Supplementary measure of net earnings**  
(in millions of US\$)

## Liquidity and Capital Resources

In fiscal 2002, the Company set a priority to reduce the inventory level and to raise or maintain the gross margin in view of the lingering downturn in the world economy. Both of these objectives were achieved. Gross margin was 56% in fiscal 2002, which was equivalent to that reported in 2001. As described earlier, measures have been put in place to achieve historical gross margin levels of 60%-63% in the future. Inventories decreased by \$1.202 million, or 25%, in fiscal 2002. This inventory reduction is in direct contrast with 2001 when inventories increased by \$1.000 million during the year.

During fiscal 2002, through its normal course issuer bid program, the Company repurchased 127,100 common shares for cancellation, at an average price of CAN\$6.02 for a total consideration of US\$490,234. In March 2003, the Company renewed its normal course issuer bid program, entitling the Company to repurchase for cancellation a maximum of 200,000 shares over the twelve-month period ending March 13, 2004 through the facilities of the Toronto Stock Exchange.

During fiscal 2002, the Company made debt repayments of \$1.375 million to reduce long-term debt to \$1.781 million. Because of the prepayments made since 2000, the Company is ahead of the original schedule of reimbursement. One of the Company's objectives in 2003 will be to continue the prepayment of debt from the funds generated from operations.

During fiscal 2002, investments in capital assets amounted to \$212,456 compared with \$361,422 during the same period in 2001, reflecting continued prudent control over capital spending.

The Company reported a total increase in cash of \$678,003 in fiscal 2002. This is lower than the \$1.848 million increase in cash recorded in 2001 due to additional long-term debt repayments of \$1.031 million and the increase of \$351,144 for the repurchase of common shares in 2002.

At December 31, 2002, the Company held \$4.164 million in cash offset by total long-term debt of \$1.781 million, resulting in a net cash position of \$2.383 million. This represents an improvement of \$2.053 million over the situation at the beginning of this year.

Coreco has an operating credit facility of CAN\$7.0 million, or the equivalent thereof in US dollars, that was unused as at December 31, 2002. In addition, Coreco has a \$1.781 million revolving term loan outstanding. Under the terms of the agreement for the long-term debt, the Company may borrow, prepay the loan in whole or in part, and re-borrow under this facility. This loan is denominated in US dollars and was for an original amount of \$5.5 million (current \$2.406 million). Under these credit facilities, the Company is required to maintain a number of financial ratios.

Coreco believes that existing cash and credit facilities, as well as cash flows from operations, will be sufficient to meet all the Company's planned expenditures and debt service requirements for the remainder of this year. The Company regularly reviews acquisition opportunities, for which it may require additional debt or equity financing.



## Risks

**Business outlook** The Company has limited visibility as to when the slowdown in the OEM market will end. Industry forecasts are showing indications of renewed strength in the second half of 2003. Hence the Company continues to maintain a cautious stance with respect to spending across the organization in order to maintain profitability. Despite the current slowdown, new machine vision markets are emerging which Coreco is positioned to address as a result of its ongoing investment in the research and development of new products for both its OEM and end-user markets. The Company's Intelligent Products group is currently in the initial phase of marketing its smart appliance for factory floor applications and its OEM group will be launching new high-performance vision products. With its healthy balance sheet, strong cash flow from operations and new products entering the market, Coreco is positioned to take advantage of any upswing in demand in the machine vision market.

**Seasonality** Historically, the Company's operating results have fluctuated on a quarterly basis as a result of the timing of standard sales to OEM customers. The Company expects that quarterly financial results may continue to fluctuate in the future. In the opinion of management, a more appropriate approach to assess the performance of the Company would be to monitor its growth on a year-over-year rather than on a quarterly basis.

### **Risk of servicing the high technology and electronics sectors**

The Company's customers are largely associated with the high technology and electronic sectors, which are subject to fluctuations in demand from time to time. Coreco believes that its exposure to risk in any specific sector is naturally mitigated by its large customer base operating across numerous sectors of activity in geographic markets around the world.

### **Dependence on new products and risk of product development delays**

The Company's success depends upon continuing market acceptance of its existing products, as well as its ability to enhance existing products and introduce new products and features to meet changing customer requirements. There can be no assurance that Coreco will be successful in identifying, developing, manufacturing and marketing new products, or enhancing its existing products, which could have a material adverse effect on the Company's business, operations and prospects. In order to reduce its exposure to this risk, the Company continues to invest a significant amount in research and development to ensure that it is in line with the latest machine vision technology available. The Company also has a dedicated group of engineers working closely with customers to ensure alignment with their needs and to understand the requirements of the evolving market for machine vision products and services.

**Outlook** Coreco intends to pursue its strategy to provide integrated, application-specific solutions to the international machine vision market. Within this perspective, the Company will continue to develop new products and to examine acquisition opportunities relating to complementary technologies and businesses.

FIVE-YEAR FINANCIAL REVIEW

years ended December 31, (in thousands of US dollars, except share data <sup>(1)</sup> )	2002 \$	2001 \$	2000 \$	1999 \$	1998 \$
<b>Operating results</b>					
Sales	19,273	26,009	21,010	11,538	9,565
Gross profit	10,832	14,614	12,702	7,501	6,287
Gross margin	56.2%	56.2%	60.5%	65.0%	65.7%
Research and development expenditures (gross)	3,873	4,448	3,799	2,532	1,688
Selling and marketing expenses	3,777	4,400	3,470	1,693	1,487
Acquisition-related charges and other charges <sup>(2)</sup>	—	6,452	2,887	2,604	370
Earnings (loss) before income taxes	1,234	(3,036)	1,271	825	2,818
Supplementary measure of net earnings <sup>(3)</sup>	940	2,326	2,659	2,150	2,094
Net earnings (loss)	940	(3,872)	(201)	519	1,852
<b>Financial position</b>					
Total assets	16,578	19,248	25,671	18,449	19,076
Shareholders' equity	12,408	11,955	15,956	16,460	16,523
Working capital	8,658	9,143	7,715	13,875	14,548
Current ratio	3.8:1	2.9:1	2.3:1	8.4:1	9.5:1
Cash position	4,164	3,486	1,638	9,947	11,683
Long-term debt	1,781	3,156	3,500	—	—
Net cash position	2,383	330	(1,862)	9,947	11,683
Cash flows from operating activities	2,736	2,682	3,966	2,192	2,549
Cash flows from financing activities	(1,861)	(472)	2,775	(502)	(704)
Cash flows from investing activities	(197)	(361)	(5,179)	(5,022)	737
<b>Per share data</b>					
Supplementary measure of earnings per share (basic and diluted) <sup>(3)</sup>	0.13	0.32	0.36	0.29	0.28
Earnings (loss) per share	0.13	(0.53)	(0.03)	0.07	0.25
Book value per share	1.75	1.65	2.19	2.25	2.25
Cash per share (including short-term investments)	0.59	0.48	0.23	1.36	1.59
Dividend	—	—	0.03	0.07	—
<b>Shareholder data</b>					
Weighted average number of shares outstanding (basic)	7,170,438	7,247,426	7,286,121	7,345,452	7,506,927
Weighted average number of shares outstanding (diluted)	7,230,248	7,312,132	7,389,795	7,549,243	7,569,886
Total number of shares outstanding	7,108,872	7,234,472	7,276,622	7,333,322	7,364,416
Market price range (CAN\$ per share)					
High	8.10	6.75	8.50	7.00	11.80
Low	3.80	4.50	4.25	4.35	3.40

<sup>(1)</sup> Effective January 1, 2001, the Corporation adopted the US dollar as its measurement currency as a result of the significance of business activities conducted in the United States and the increasing proportion of operating, financing and investing transactions in the Canadian operations that are denominated in US dollars.

<sup>(2)</sup> In 2001, represents the amortization of intangible assets related to business acquisitions. In 2002, as a result of new accounting rules, no amortization is required.

<sup>(3)</sup> In 2001, excludes the after-tax amortization of intangible assets related to business acquisitions. In 2002, as a result of new accounting rules, no amortization is required.



(unaudited) (in thousands of US dollars, except share data <sup>(1)</sup> )		Year \$	Q4 \$	Q3 \$	Q2 \$	Q1 \$
Sales	<b>2002</b>	<b>19,273</b>	<b>4,785</b>	<b>4,738</b>	<b>4,913</b>	<b>4,837</b>
	2001	26,009	4,739	6,060	7,626	7,584
Gross profit	<b>2002</b>	<b>10,832</b>	<b>2,706</b>	<b>2,748</b>	<b>2,725</b>	<b>2,653</b>
	2001	14,614	2,680	3,374	4,301	4,259
Research and development expenditures (gross)	<b>2002</b>	<b>3,873</b>	<b>995</b>	<b>984</b>	<b>932</b>	<b>962</b>
	2001	4,448	921	1,077	1,218	1,232
Selling and marketing expenses	<b>2002</b>	<b>3,777</b>	<b>966</b>	<b>936</b>	<b>930</b>	<b>945</b>
	2001	4,400	899	1,088	1,151	1,262
Acquisition-related charges <sup>(2)</sup>	<b>2002</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>
	2001	6,452	2,101	1,435	1,458	1,458
Earnings (loss) before income taxes	<b>2002</b>	<b>1,234</b>	<b>323</b>	<b>307</b>	<b>381</b>	<b>223</b>
	2001	(3,036)	(1,771)	(761)	(161)	(343)
Supplementary measure of net earnings <sup>(3)</sup>	<b>2002</b>	<b>940</b>	<b>267</b>	<b>233</b>	<b>276</b>	<b>164</b>
	2001	2,326	272	505	833	716
Net earnings (loss)	<b>2002</b>	<b>940</b>	<b>267</b>	<b>233</b>	<b>276</b>	<b>164</b>
	2001	(3,872)	(1,623)	(915)	(609)	(725)
Supplementary measure of earnings per share (basic) <sup>(3)</sup>	<b>2002</b>	<b>0.13</b>	<b>0.04</b>	<b>0.03</b>	<b>0.04</b>	<b>0.02</b>
	2001	0.32	0.04	0.07	0.11	0.10
Supplementary measure of earnings per share (diluted) <sup>(3)</sup>	<b>2002</b>	<b>0.13</b>	<b>0.04</b>	<b>0.03</b>	<b>0.04</b>	<b>0.02</b>
	2001	0.32	0.04	0.07	0.11	0.10
Earnings (loss) per share (basic and diluted)	<b>2002</b>	<b>0.13</b>	<b>0.04</b>	<b>0.03</b>	<b>0.04</b>	<b>0.02</b>
	2001	(0.53)	(0.22)	(0.13)	(0.08)	(0.10)

<sup>(1)</sup> Effective January 1, 2001, the Corporation adopted the US dollar as its measurement currency as a result of the significance of business activities conducted in the United States and the increasing proportion of operating, financing and investing transactions in the Canadian operations that are denominated in US dollars.

<sup>(2)</sup> In 2001, represents the amortization of intangible assets related to business acquisitions. In 2002, as a result of new accounting rules, no amortization is required.

<sup>(3)</sup> In 2001, excludes the after-tax amortization of intangible assets related to business acquisitions. In 2002, as a result of new accounting rules, no amortization is required.

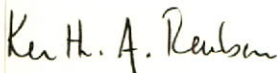
The financial statements of Coreco Inc. and the other financial information included in this annual report are the responsibility of the Company's management and have been examined and approved by its Board of Directors. These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include some amounts that are based on management's best estimates using careful judgment. The selection of accounting principles and methods is management's responsibility.

The Company maintains internal control systems designed to ensure that financial information is relevant and accurate and that assets are safeguarded. Management recognizes its responsibility for conducting the Company's affairs to comply with the requirements of applicable laws and established financial standards of conduct in its activities.

The Board of Directors supervises the financial statements and other financial information through its Audit Committee, which consists solely of outside directors.

This committee's role is to examine the financial statements and recommend that the Board of Directors approve them, to examine the internal control and information protection systems and all other matters relating to the Company's accounting and finances. In order to do so, the Audit Committee meets periodically with the external auditors, either with or without the Company's management, to review their audit plan and discuss the results of their examinations.

The financial statements have been audited by Deloitte & Touche LLP, the external auditors, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders. The external auditors have full and free access to the Audit Committee.



**Keith A. Reuben**  
President and Chief Executive Officer



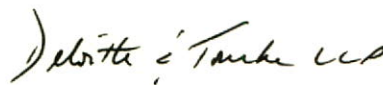
**Louis Daigneault**  
Vice-President, Finance and Administration,  
Secretary and Chief Financial Officer

To the Shareholders of  
Coreco Inc.

We have audited the consolidated balance sheets of Coreco Inc. as at December 31, 2002 and 2001 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

Montréal, Canada  
February 21, 2003



as at December 31, (in US dollars)	2002 \$	2001 \$
<b>Assets</b>		
Current assets		
Cash and cash equivalents	4,163,706	3,485,703
Accounts receivable (Note 3)	2,715,699	3,521,909
Research tax credits receivable	861,084	1,712,802
Inventories (Note 4)	3,515,916	4,717,602
Prepaid expenses	315,492	321,984
Future income taxes (Note 11)	224,160	266,199
	<b>11,796,057</b>	14,026,199
Capital assets (Note 5)		
Investment, at cost (Note 6)	791,376	1,096,509
Goodwill (Note 7)	987,888	987,888
Deferred financing fees	2,694,122	2,789,881
Future income taxes (Note 11)	268,292	286,678
	<b>40,491</b>	60,737
	<b>16,578,226</b>	19,247,892
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	2,124,605	2,593,272
Income taxes payable	93,905	1,341,503
Current portion of long-term debt (Note 8)	750,000	750,000
Future income taxes (Note 11)	170,000	197,938
	<b>3,138,510</b>	4,882,713
Long-term debt (Note 8)		
Future income taxes (Note 11)	1,031,250	2,406,250
	—	4,183
	<b>4,169,760</b>	7,293,146
Commitments (Note 14)		
<b>Shareholders' equity</b>		
Share capital (Note 9)	10,637,702	10,815,730
Cumulative translation adjustment	115,663	115,663
Retained earnings	1,655,101	1,023,353
	<b>12,408,466</b>	11,954,746
	<b>16,578,226</b>	19,247,892

See notes to consolidated financial statements.

Approved by the Board



**Robert Mee**  
Director



**Jacques E. Lefebvre, C.M.**  
Director

CONSOLIDATED STATEMENTS OF EARNINGS

years ended December 31, (in US dollars)	2002 \$	2001 \$
<b>Sales</b>	<b>19,272,638</b>	26,008,794
Cost of goods sold	<b>8,440,741</b>	11,394,574
Gross profit	<b>10,831,897</b>	14,614,220
Expenses		
Research and development expenditures	<b>3,873,371</b>	4,448,005
Less research tax credits	<b>(910,000)</b>	(1,034,786)
	<b>2,963,371</b>	3,413,219
Selling and marketing	<b>3,776,880</b>	4,399,670
General and administrative	<b>2,146,507</b>	2,492,248
Depreciation and amortization of capital assets	<b>485,331</b>	639,340
Financial, net	<b>225,623</b>	253,647
	<b>9,597,712</b>	11,198,124
Earnings before the undernoted items	<b>1,234,185</b>	3,416,096
Acquisition-related charges (Note 10)	—	6,452,063
Earnings (loss) before income taxes	<b>1,234,185</b>	(3,035,967)
Income taxes (Note 11)		
Current	<b>266,355</b>	976,663
Future	<b>28,304</b>	(140,368)
	<b>294,659</b>	836,295
<b>Net earnings (loss)</b>	<b>939,526</b>	(3,872,262)
Earnings (loss) per share – basic and diluted (Note 12)	<b>0.13</b>	(0.53)

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

years ended December 31, (in US dollars)	2002 \$	2001 \$
<b>Balance, beginning of year</b>	<b>1,023,353</b>	4,964,450
Net earnings (loss)	<b>939,526</b>	(3,872,262)
Excess of purchase price over book value of common shares (Note 9 (a))	<b>(307,778)</b>	(68,835)
<b>Balance, end of year</b>	<b>1,655,101</b>	1,023,353

See notes to consolidated financial statements.



years ended December 31, (in US dollars)	2002 \$	2001 \$
<b>Cash flows from operating activities</b>		
Net earnings (loss)	939,526	(3,872,262)
Adjustments for:		
Depreciation and amortization of capital assets	485,331	639,340
Amortization of goodwill	—	5,691,056
Amortization of acquired software	—	95,225
Amortization of deferred financing fees	20,246	20,244
Write-off of goodwill and acquired software	—	643,118
Loss on disposal of capital assets	16,736	—
Future income taxes	28,304	(140,368)
Changes in working capital items		
Accounts receivable	806,210	1,907,627
Research tax credits receivable	851,718	477,468
Inventories	1,201,686	(1,000,100)
Prepaid expenses	6,492	4,299
Accounts payable and accrued liabilities	(372,908)	(1,377,425)
Income taxes payable	(1,247,598)	(406,423)
	<b>2,735,743</b>	<b>2,681,799</b>
<b>Cash flows used for financing activities</b>		
Repurchase of shares	(490,234)	(131,180)
Proceeds from issue of common shares	4,428	2,298
Repayment of long-term debt	(1,375,000)	(343,750)
	<b>(1,860,806)</b>	<b>(472,632)</b>
<b>Cash flows used for investing activities</b>		
Purchase of capital assets	(212,456)	(361,422)
Proceeds from disposal of capital assets	15,522	—
	<b>(196,934)</b>	<b>(361,422)</b>
Increase in cash and cash equivalents	678,003	1,847,745
Cash and cash equivalents, beginning of year	3,485,703	1,637,958
<b>Cash and cash equivalents, end of year</b>	<b>4,163,706</b>	<b>3,485,703</b>
Supplemental information		
Cash paid during the year for		
Income taxes	118,035	561,564
Interest	94,999	360,780
Portion of purchase price related to business acquisition not settled in cash and reversed from accrued liabilities (Note 7)	95,759	91,676

See notes to consolidated financial statements

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

years ended December 31, 2002 and 2001  
(in US dollars)

## 1. Description of the business

Coreco Inc. (the "Corporation"), incorporated under the Canada Business Corporations Act, develops, manufactures, markets and sells computer vision products.

## 2. Significant accounting policies

### Use of estimates

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

### Consolidation and change in measurement currency

The consolidated financial statements include the accounts of its wholly owned subsidiary, Coreco Imaging, Inc. Intercompany balances transactions have been eliminated on consolidation.

Effective January 1, 2001, the Corporation adopted the US dollar as its measurement and reporting currency as a result of the significance of business activities conducted in the United States and the increasing proportion of operating, financing and investing transactions in the Canadian operations that are denominated in US dollars.

### Cash and cash equivalents

Cash and cash equivalents represent unrestricted cash and highly liquid investments with a maturity of three months or less at the date of acquisition.

### Inventories

Raw materials are carried at the lower of cost and replacement cost, while goods in process and finished goods are carried at the lower of cost and net realizable value. The cost of raw materials is determined on a first-in, first-out basis, whereas the cost of goods in process and finished goods is determined using the full cost accounting method.

### Capital assets

Capital assets are recorded at cost and are depreciated and amortized over their estimated useful lives. Depreciation and amortization are calculated using the following methods and annual rates:

Equipment	Declining balance	20% and 30%
Computer equipment	Straight line	2 years
Furniture and fixtures	Declining balance	20% and 30%
Leasehold improvements	Straight line	Over lease term

### Goodwill

The Corporation adopted prospectively the recommendations of Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1581 "Business Combinations," and 3062, "Goodwill and Other Intangible Assets," effective January 1, 2002. These recommendations require that all business combinations be accounted for using the purchase method. In addition, goodwill and intangible assets with an indefinite life are no longer amortized to earnings and are subject to an annual impairment test including a transitional test whereby any resulting impairment would be charged to opening retained earnings. During the second quarter ended June 30, 2002, the Corporation completed the transitional impairment test and concluded that no goodwill impairment charge was required. The Corporation intends to perform its annual review of goodwill as of December 31 of each year. Based on the impairment test performed as of December 31, 2002, the Corporation concluded that no goodwill impairment charge was required.

Net earnings and earnings per share data below are presented to show net earnings as adjusted for the impact of the goodwill amortization charges on an after-tax basis.



**2. Significant accounting policies (cont.)**

	2002 \$	2001 \$
Net earnings (loss)	939,526	(3,872,262)
Add back of goodwill amortization (Note 10)	—	5,691,056
Adjusted net earnings	939,526	1,818,794
Basic and diluted earnings per share		
Earnings (loss)	0.13	(0.53)
Goodwill amortization, net of tax	—	0.78
Adjusted earnings per share	0.13	0.25

**Deferred financing fees**

Deferred financing fees relate to costs incurred in securing the long-term debt and are being amortized over the term of the debt.

**Revenue recognition**

Revenue from product sales is recognized at the point in time when persuasive evidence of an arrangement exists, the price is fixed and final delivery has occurred, and there is reasonable assurance of collection of the sale proceeds. The Corporation generally obtains oral or written purchase authorizations from its customers for a specified amount of product at a specified price and considers delivery to have occurred at the point of shipment.

**Government assistance**

Government assistance, comprised of grants and research tax credits, is recorded as a reduction of the related expense or the cost of the capital assets acquired.

**Research and development expenditures**

Research and development expenses are charged to operations in the year in which they are incurred, unless certain criteria for deferral are met. The expenses are not considered deferrable at the present time.

**Foreign currency translation**

Revenue and expenses denominated in foreign currencies are recorded at the rate of exchange prevailing at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates prevailing at the balance sheet dates. Other balance sheet items denominated in foreign currencies are translated at the rates of exchange at the transaction date. Translation gains and losses are included in net earnings.

The Corporation adopted the recommendations of CICA Handbook Section 1650 "Foreign Currency Translation," effective January 1, 2002. The amended recommendations require that all unrealized translation gains and losses on assets and liabilities denominated in foreign currencies be included in earnings for the year, including gains and losses on long-term monetary assets and liabilities, such as long-term debt, which were previously deferred and amortized on a straight-line basis over the remaining lives of the related items. The adoption of this new recommendation had no impact on the results of operations and financial position for all periods presented.

**2. Significant accounting policies (cont.)***Stock-based compensation and other stock-based payment plans*

The Corporation adopted the recommendations of CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments," effective January 1, 2002. These recommendations establish standards for the recognition, measurement and disclosure of stock-based compensation made in exchange for goods and services. The standard requires that compensation for all awards made to non-employees and certain awards made to employees, including stock appreciation rights, direct awards of stock and awards that call for settlement in cash or other assets, be measured and recorded in the financial statements at fair value, and encourages, but does not require, the use of the fair value method for all types of stock-based compensation plans. This Section applies to awards granted by the Corporation on or after January 1, 2002.

The Corporation, as permitted by Handbook Section 3870, has chosen to continue its existing policy of recording no compensation cost on the grant of stock options to employees. No restatement of prior periods was required as a result of the adoption of this recommendation. The required *pro forma* disclosure is found in Note 9 (c).

*Income taxes*

Future income tax assets and liabilities are determined based on differences between the accounting basis and tax basis of the assets and liabilities, and are measured using the substantively enacted tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized. Income tax expense or benefit is the sum of the Corporation's provision for current income taxes and the change in future income tax assets and liabilities.

*Future accounting changes*

The CICA has issued the following new Handbook Sections:

- a) Handbook Section 3063, "Impairment of Long-lived Assets": effective April 1, 2003, this Section provides guidance on the recognition, measurement and disclosure of the impairment of long-lived assets. It replaces the write-down provisions in Section 3061 "Property, Plant and Equipment." The provisions of the Section require an impairment loss for a long-lived asset to be held and used to be recognized when its carrying amount exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition. Impairment loss is measured as the amount by which its carrying amount exceeds its fair value.

The Corporation does not believe that the adoption of this new Section will have a material impact on its consolidated financial statements.

- b) Handbook Section 3475, "Disposal of Long-lived Assets and Discontinued Operations": effective for disposal activities initiated by an enterprise's commitment to a plan on or after May 1, 2003, this Section provides guidance on the recognition measurement, presentation and disclosure of long-lived assets to be disposed of. It replaces the disposal provisions of Property, Plant and Equipment, Section 3061, as well as Discontinued Operations, Section 3475. The Section:

- Provides criteria for classifying assets as held for sale;
- Requires an asset classified as held for sale to be measured at fair value less cost to sell;
- Provides criteria for classifying a disposal as a discontinued operation; and,
- Specifies presentation and disclosure for discontinued operations and other disposals of long-lived assets.

The Corporation does not believe that the adoption of this new Section will have a material impact on its consolidated financial statements.



**3. Accounts receivable**

	2002 \$	2001 \$
Trade receivables	2,588,091	3,457,817
Sales tax and other receivables	127,608	64,092
	<b>2,715,699</b>	<b>3,521,909</b>

**4. Inventories**

	2002 \$	2001 \$
Raw materials	1,298,961	1,740,212
Goods in process	1,637,668	1,620,063
Finished goods	579,287	1,357,327
	<b>3,515,916</b>	<b>4,717,602</b>

**5. Capital assets**

	2002			2001		
	Cost	Accumulated depreciation and amortization	Net book value	Cost	Accumulated depreciation and amortization	Net book value
	\$	\$	\$	\$	\$	\$
Equipment, including computer equipment	6,353,762	5,732,889	620,873	6,132,373	5,290,602	841,771
Furniture and fixtures	727,932	595,030	132,902	780,241	585,910	194,331
Leasehold improvements	212,037	147,246	64,791	221,638	121,389	100,249
	<b>7,293,731</b>	<b>6,475,165</b>	<b>818,566</b>	<b>7,134,252</b>	<b>5,997,901</b>	<b>1,136,351</b>
Investment tax credits	(76,978)	(49,788)	(27,190)	(69,709)	(29,867)	(39,842)
	<b>7,216,753</b>	<b>6,425,377</b>	<b>791,376</b>	<b>7,064,543</b>	<b>5,968,034</b>	<b>1,096,509</b>

**6. Investment, at cost**

During 1999, the Company acquired a 16.4% voting ownership interest in Dipix Technology Inc. ("Dipix"). The investment is in the form of 950,993 Class A common shares, 10,000 Class B common shares and 500,000 First Preferred shares. The Company's investment in Dipix is as follows:

	Number of shares	Book value
	\$	\$
Class A common (voting)	950,993	650,163
Class B common (voting)	10,000	4,436
First Preferred (non-voting)	500,000	333,289
	<b>1,460,993</b>	<b>987,888</b>

The principal business activities of Dipix involve the design, manufacture and sale of computer hardware and the development and licensing of software intended for use in computerized product-inspection systems having high-speed two-dimensional and three-dimensional image-processing capabilities. At December 31, 2002, cumulative dividends on First Preferred shares in arrears amounted to approximately CAN\$82,500 (2001 - CAN\$55,000).

**7. Goodwill**

	2002 \$	2001 \$
Goodwill, beginning of year	<b>2,789,881</b>	8,834,629
Write-off of goodwill (Note 10)	—	(262,016)
Change in estimated integration costs	<b>(95,759)</b>	(91,676)
Goodwill amortization (Note 10)	—	(5,691,056)
Goodwill, end of year	<b>2,694,122</b>	2,789,881

During 2002, certain integration costs accrued in connection with the June 30, 2000 acquisition of Coreco Imaging Inc. (formerly Imaging Technology, Inc.) were found not to be required. As a result, goodwill and accrued liabilities have both been reduced accordingly, in an amount of \$95,759. In 2001, an initial reduction of both goodwill and accrued liabilities in the amount of \$91,676 had been recorded based on management's best estimate at that time.

**8. Long-term debt**

	2002 \$	2001 \$
\$5,500,000 revolving term loan, bearing interest at LIBOR plus 2.5%, secured by a deed of movable hypothec over the universality of the Corporation's assets. Effective interest rate at December 31, 2002 was 4.275% (2001 - 4.40%). The authorized limit of the revolving term loan decreases quarterly by \$343,750, with the first quarterly reduction having occurred on December 31, 2000. Any outstanding loan amounts are repayable in full on December 31, 2004. Interest is payable monthly.	<b>1,781,250</b>	3,156,250
Less current portion	<b>750,000</b>	750,000
	<b>1,031,250</b>	2,406,250



## 8. Long-term debt (cont.)

Minimum repayments of principal revolving term loan amounts outstanding over the next years are as follows:

	\$
2003	750,000
2004	1,031,250

## 9. Share capital

Authorized

An unlimited number of common shares, without nominal or par value

An unlimited number of preferred shares, without nominal or par value, issuable in series with such rights and conditions as may be determined by the Board of Directors

	2002		2001	
	Number of shares	Book value	Number of shares	Book value
		\$		\$
Issued and outstanding:				
Common shares				
Balance, beginning of year	7,234,472	10,815,730	7,276,622	10,875,779
Repurchased under normal course issuer bid (a)	(127,100)	(182,456)	(42,900)	(62,347)
Issued for cash on exercise of options	1,500	4,428	750	2,298
<b>Balance, end of year</b>	<b>7,108,872</b>	<b>10,637,702</b>	<b>7,234,472</b>	<b>10,815,730</b>

### (a) Normal course issuer bid

In 2002, the Corporation repurchased 127,100 common shares (2001 – 42,900 common shares) under a normal course issuer bid for a total consideration of \$490,234 (2001 – \$131,180). The excess of the purchase price over book value of common shares in the amount of \$307,778 (2001 – \$68,835) was charged to retained earnings.

### (b) Stock option plans

The Corporation may grant options to purchase common shares to key employees, directors, officers and service-providers. The terms, number of common shares covered by each option, as well as the permitted frequency of the exercise of such options are determined by the Board of Directors. The subscription price for each share covered by an option is established by the Board of Directors, but such price shall not be lower than the fair market value at the date of grant. Options vest ratably over a period of four years and are exercisable for a maximum period of ten years after date of grant. As at December 31, 2002, 588,012 common shares have been reserved for issuance under the stock option plan.

**9. Share capital (cont.)**

## (b) Stock option plans (cont.)

The following table presents information concerning all stock options granted to the Corporation's key employees, directors, officers and service-providers:

	2002		2001	
	Number of options	Weighted average exercise price per share	Number of options	Weighted average exercise price per share
		CAN\$		CAN\$
Outstanding, beginning of period	452,500	5.55	510,500	5.51
Granted	35,000	6.19	—	—
Cancelled	(11,500)	4.70	(57,250)	5.18
Exercised	(1,500)	4.70	(750)	4.70
Outstanding, end of period	474,500	5.62	452,500	5.55
Exercisable, end of period	302,250	5.79	199,250	5.88

The following table summarizes information about the Corporation's outstanding stock options at December 31, 2002.

Range of exercise price	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
CAN\$			CAN\$		CAN\$
\$4.50 to \$5.35	404,500	7	5.01	252,250	4.99
\$7.30 to \$10.11	70,000	7	9.14	50,000	9.85
	474,500	7	5.62	302,250	5.79

## (c) Stock-based compensation

For stock options granted to employees during 2002, had the Corporation determined compensation cost based on the fair values of the stock options at grant dates, consistent with the method recommended under CICA Handbook Section 3870, the Corporation's earnings would have been reported at the *pro forma* amounts indicated below:

	\$
Net earnings, as reported	939,526
<i>Pro forma</i> net earnings	919,419
<i>Pro forma</i> basic and diluted earnings per share	0.13

The Corporation granted a total of 35,000 stock options during 2002, of which 15,000 were granted during the three months ended March 31, 2002, and 20,000 during the three months ended September 30, 2002.



## 9. Share capital (cont.)

### (c) Stock-based compensation (cont.)

The weighted-average fair value at grant date for stock options issued during 2002 was \$2.53 per share. The fair value of options granted was estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions:

Risk-free interest rates	3.91%
Dividend yield	nil
Expected volatility	51%
Weighted-average expected life	3.5 years

### (d) Rights plan

Under a Rights Agreement approved by Shareholders in 1997, rights were issued to purchase common shares from the Corporation; each right is exercisable at a price of \$75.00 for each outstanding share, subject to adjustments. The rights will separate and trade apart from the common shares and become exercisable in the event that 20% or more of the common shares of the Corporation have been acquired or in the event of a public announcement of a takeover bid. Each right will entitle the holder to receive, upon payment of the exercise price, that number of common shares that have a market value equal to twice the exercise price. The plan is in effect until the end of the Annual Meeting of Shareholders of the Corporation to be held in 2005 or at such later date as will be determined by means of a resolution reconfirming the plan at that meeting. As at December 31, 2002 and 2001, no rights were issued and outstanding under this plan.

## 10. Acquisition-related charges

	2002 \$	2001 \$
Amortization of goodwill	—	5,691,056
Amortization of acquired software	—	95,225
Write-off of goodwill and acquired software	—	643,118
Other expense	—	22,664
	—	6,452,063

During the fourth quarter of 2001, as a result of its review of the carrying value of acquired software and goodwill related to the Dipix Technologies Inc. acquisition in 1999, the Corporation determined that the acquired software and goodwill were permanently impaired. This determination was based on the Corporation's assessment of the recoverability of these balances.

Significant changes during 2001 reduced the value of these assets. Specifically, the Corporation developed new products, which substantially reduced the application and marketability of the acquired software.

In view of those changes, and based upon the revised estimates of undiscounted future cash flows, the values were written down to their estimated net realizable value of nil.

**11. Income taxes**

The income tax provision reported differs from the amount computed by applying the Canadian federal and provincial rates to earnings before income taxes. The principal reasons for the difference and the related tax effects are as follows:

	2002 \$	2001 \$
Earnings (loss) before income taxes	1,234,185	(3,035,967)
Expected rate	36%	37%
Expected income taxes (recovery)	444,307	(1,123,308)
Adjustments		
Effect of different tax rates on earnings (losses) of foreign subsidiary	29,375	(137,346)
Effect of permanent and other differences	(179,023)	(153,473)
Effect of non-deductible goodwill	—	2,250,422
	<b>294,659</b>	<b>836,295</b>

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities as at December 31 are presented below:

	2002 \$	2001 \$
Future tax assets		
Accounting reserves and accruals deductible in different periods	372,576	321,824
Book depreciation in excess of tax depreciation (subsidiary)	119,876	231,053
	<b>492,452</b>	<b>552,877</b>
Future tax liabilities		
Federal research tax credits	170,000	197,938
Tax depreciation in excess of book depreciation and amortization (Canada)	—	4,183
	<b>170,000</b>	<b>202,121</b>

**12. Earnings (loss) per share and acquisition-related charges**

Earnings (loss) per share have been calculated based on the weighted average number of outstanding shares during the year.

	2002 \$	2001 \$
Basic and diluted earnings (loss) per share	0.13	(0.53)
Weighted average number of common shares outstanding		
Basic	7,170,438	7,247,426
Diluted	7,230,248	7,312,132



**12. Earnings (loss) per share and acquisition-related charges (cont.)**

The denominator for diluted earnings (loss) per share is as follows:

	2002 \$	2001 \$
Denominator for basic earnings (loss) per share—weighted average number of shares	7,170,438	7,247,426
Effect of dilutive securities:		
Employee stock options	59,810	64,706
<b>Denominator for diluted earnings (loss) per share—weighted average number of shares</b>	<b>7,230,248</b>	<b>7,312,132</b>

Supplementary measure of net earnings and earnings per share data are presented to show net earnings as adjusted for the impact of the acquisition-related charges described in Note 10 on an after-tax basis.

	2002 \$	2001 \$
Net earnings (loss)	939,526	(3,872,262)
Add back of acquisition-related charges, net of tax	—	6,198,650
<b>Supplementary measure of net earnings</b>	<b>939,526</b>	<b>2,326,388</b>
Supplementary measure of earnings per share:		
Basic and diluted	0.13	0.32

**13. Segment disclosure****(a) Geographic information**

The Corporation operates in one business segment, namely computer vision products. Sales by geographical area, based on the location of customers, are approximately as follows:

	2002 \$	2001 \$
Canada	1,050,000	1,139,000
United States	9,542,000	13,177,000
Europe	5,318,000	7,764,000
Asia/Pacific	3,363,000	3,929,000
	<b>19,273,000</b>	<b>26,009,000</b>

**13. Segment disclosure (cont.)**

(a) Geographic information (cont.)

Capital assets and goodwill by geographic area are as follows:

	2002 \$	2001 \$
Canada	486,026	552,032
United States	2,999,472	3,334,358

(b) Information about major customers

One customer represents approximately 11% of total sales in 2002 (2001 - there was no single customer above 10% of total sales). Accounts receivable from this customer represent approximately 11% of total accounts receivable (approximately 9% in 2001).

**14. Commitments**

(a) Operating lease commitments

Minimum lease payments under operating leases relating to premises are approximately as follows:

	\$
2003	901,621
2004	750,161
2005	763,745
2006	483,056
2007	835
	2,8N99,418

(b) Operating credit facility

The Corporation has an operating credit facility with its bankers to a maximum of CAN\$7,000,000 (\$4,432,000), none of which was used as at December 31, 2002. This facility, which is based on eligible accounts receivable and inventories, bears interest at the prime rate of the financial institution, and is secured by a deed of movable hypothec over the universality of the assets of the Corporation.

(c) Letter of guarantee

The Corporation has an outstanding letter of guarantee for a total amount of \$400,000 maturing on August 29, 2003. This letter of guarantee was obtained for an operating lease relating to premises.



## 15. Financial instruments

### (a) Concentration of credit risk

Credit risk results from the possibility that a loss may occur from the failure of another party to perform according to the terms of the contract. The Corporation regularly monitors credit risk exposure and takes steps to mitigate the likelihood of such exposure resulting in actual loss.

Financial instruments that potentially subject the Corporation to significant concentrations of credit risk consist principally of short-term investments and accounts receivable.

The Corporation has investment policies that require placement of short-term investments in financial institutions evaluated as highly creditworthy.

Concentration of credit risk with respect to accounts receivable is limited due to the Corporation's credit evaluation process, reasonably short collection terms, the large number of customers comprising the Corporation's customer base and their dispersion among different industries and geographical locations around the world. In the normal course of business, the Corporation evaluates the financial condition of its customers on a continuing basis and reviews the creditworthiness of all new customers. The Corporation determines an allowance for doubtful accounts to reflect specific customer risks.

### (b) Foreign currency risk management

A significant portion of the Corporation's expenses are denominated in Canadian dollars. This results in financial risk due to fluctuations in the value of the US dollar relative to the Canadian dollar. From time to time, the Corporation uses forward foreign exchange contracts to reduce its foreign exchange exposure on its Canadian-denominated expenses. Fluctuations in payments made for the Corporation's products could cause unanticipated fluctuations in the Corporation's operating results. There were no forward foreign exchange contracts outstanding as at December 31, 2002 and 2001.

### (c) Fair value risk

Fair value estimates are made as at a specific point in time using available information about the financial instrument. These estimates are subjective in nature and often cannot be determined with precision.

The Corporation has determined that the carrying values of the Corporation's short-term financial assets and liabilities approximate their fair values due to the relatively short periods to maturity of these instruments. The carrying values of the Corporation's short-term investments are not significantly different from their fair values. The fair values of short-term investments are determined based on published market prices or quotes as of December 31, 2002. The carrying value of the Corporation's long-term debt also approximates fair value because interest is based on market-related variable rates.

### (d) Interest rate risk

The Corporation's principal exposure to interest rate fluctuations is with respect to its long-term financing which bears interest at floating rates.

## BOARD OF DIRECTORS

**Robert Mee**, B.Sc. Eng.\*  
Vice-President,  
Altacap Investors Inc.  
Chairman of the Board,  
Coreco Inc.

**Keith A. Reuben**, B.Sc., M.Eng.  
President  
and Chief Executive Officer,  
Coreco Inc.

**Jacques E. Lefebvre**, C.M.\*  
President,  
Lefebvre, Démosthène  
et les autres inc.

**Pierre Fleurent**, B. Eng., MBA, CFA\*  
Managing Director,  
Global Banking  
RBC Dominion Securities Inc.

**Daniel Crevier**, Ph.D.\*  
Professional Engineer

\* Member of Audit Committee

## MANAGEMENT TEAM

**Keith A. Reuben**, B.Sc., M.Eng.\*  
President  
and Chief Executive Officer

**Ghislain Beaupré**, B.Eng., P.Eng.\*  
Vice-President, Operations,  
Research and Development,  
Canadian Operations

**Steven Geraghty**, Bs.EE  
Vice-President, Operations,  
Research and Development,  
U.S. Operations

**Philip N. Colet**, B.Eng.  
Vice-President,  
Sales and Marketing

**Louis Daigneault**, B.A.A., CA\*  
Vice-President, Finance and  
Administration, Secretary and  
Chief Financial Officer

**Brad Finney**, B.Sc.  
Vice-President, U.S. Sales

\* Officers

### Stock Information

At December 31, 2002

Stock exchange – TSX  
Stock symbol – CRC  
Common shares outstanding  
Basic – 7,108,872  
Diluted – 7,583,372

Trading volume in 2002:  
331,167 shares  
Public float: 5,253,232 shares  
52-week high/low (CAN\$):  
\$8.10/\$3.80



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**Transfer Agent and Registrar**

Computershare Trust Company of Canada  
Montreal, Quebec, Canada

**Bankers**

Canadian Imperial Bank of Commerce  
Montreal, Quebec, Canada

**Legal Counsel**

Heenan Blaikie  
Montreal, Quebec, Canada

**Auditors**

Deloitte & Touche LLP  
Montreal, Quebec, Canada

*Ce rapport est aussi disponible en français.*

**Annual Meeting**

Shareholders are invited to attend the Annual Meeting of Coreco Inc. on Wednesday, May 21, 2003 at 8:30 a.m.  
Omni Mont-Royal Hotel, Salon Été  
1050 Sherbrooke Street West, Montreal, Quebec Canada  
A continental breakfast will be served starting at 8:00 a.m.

[www.coreco.com](http://www.coreco.com)