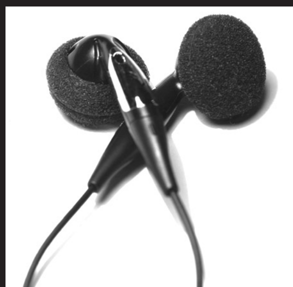

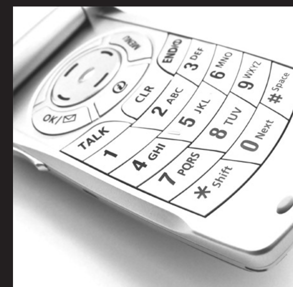

QSOUND

QSoundLabs

First Quarter Report 2004

President's Message

We made excellent progress with our business development efforts in the first quarter. The main focus of these efforts was the Company's soft audio solutions for the mobile & PC markets. The Company saw its first returns for the investments made last year in developing microQ for the mobile market. Specifically, the Company began recognizing revenues for microQ in this quarter and continued to develop new relationships, which should lead to long term growth situations. Among those is the recently announced availability of microQ on LSI Logic's DSP hardware platform for mobile products. Even more importantly, the Company is experiencing increased demand for microQ, particularly from Europe & Asia.

The Company is also making progress in the PC marketplace. This has been caused by the elimination of our only standalone independent software competitor through acquisition.

The Philips SoundAgent 2 ("PSA2") audio software solution developed by the Company for Philips began shipping in the first quarter with several of Philips mini component systems in Europe and Latin America. This distribution of the PSA2 is in addition to the USB powered speakers and soundcards which were previously announced as shipping with the PSA2.

In the VoIP market, the Company continues to market its existing product line, while at the same time gathering feedback from our dealer channel on market requirements. The Company has plans for new product introduction later this year, but in the meantime has cut its cost structure to better match existing cash flow from this business unit.

David Gallagher
President and Chief Executive Officer

Forward-looking statements concerning expectation of revenues from existing and new licensees, product distribution through Philips, and sales of existing and new IP telephony products involve risk and uncertainties including loss of relationships with companies that do business with QSound, continued growth of mobile devices and Internet telephony products, successful product development, introduction and acceptance, QSound's ability to carry out its business strategy and marketing plans, dependence on intellectual property, rapid technological change,competition, general economic and business conditions, and other risks detailed from time to time in QSound's periodic reports filed with the Securities and Exchange Commission.

Management's Discussion and Analysis

First Quarter ended March 31, 2004

This Management Discussion and Analysis ("MD&A") of the results of operations of QSound Labs, Inc. (the company) for the quarter ended March 31, 2004 should be read in conjunction with the interim unaudited consolidated financial statements of the company for the quarter ended March 31, 2004, and the annual audited financial statements of the company for the fiscal year ended December 31, 2003. Management has prepared these notes with the understanding that readers are already familiar with the MD&A for the fiscal year ended December 31, 2003.

The company reports its unaudited consolidated financial statements in United States dollars and in accordance with Canadian Generally Accepted Accounting Principles (GAAP).

Operations

Revenues for the three months ended March 31, 2004 were $510,248 as compared to $830,850 for the same period in 2003. The audio segment had revenues of $369,669 for the quarter as compared to $728,933 for the same period in 2003. The decrease was due primarily to the reduction in royalties received from the hearing aid license, the North American portion of which expired in February 2003. The e-commerce segment had revenues of $68,845 as compared to $101,917 for 2003. The decrease was due to a decrease in the number of subscribers for the e-commerce services. The telephony segment had revenues of $71,734 for the quarter. There are no comparative figures for the telephony segment.

The operating loss for three months ended March 31, 2004 was $530,561 as compared to an operating profit of $178,380 for the same period last year. The audio segment had an operating loss of $206,054 for the quarter as compared to an operating profit of $132,890 for the same period in 2003. The reason for the decrease in profit was due to the decrease in royalties from the hearing aid license and increased engineering and marketing costs. The e-commerce segment had an operating loss of $17,275 for the quarter as compared to an operating profit of $45,490 for the same period in 2003. The reason for the decrease was due to the decrease in revenue being larger than the decrease in operating costs. The telephony segment had an operating loss of $307,233 for the quarter. This loss was due mainly to the expenses incurred in marketing and engineering. Subsequent to the quarter end management has taken steps to reduce operating expenses in the telephony segment by one third.
Net loss for the quarter ended March 31, 2004 was $642,578 or $0.09 per share as compared to net income of $88,441 or $0.01 per share for the same period in 2003. The audio segment had profits of $54,695 in 2003 as compared to $103,438 in 2002.

The company used $690,003 of cash in operations in the quarter as compared to a generation of $284,663 in cash for the same period in 2003.

Financial Condition

The company had a working capital surplus of $1,703,741 at March 31, 2004 as compared to $2,142,840 as at December 31, 2003.

Cash resources at the end of the first quarter of 2004 were $1,358,633 as compared to $2,061.93 at December 31, 2003. Liabilities at the end of the first quarter of 2004 were $364,179, which consisted of $280,210 in accounts payable and accrued liabilities and $83,969 in deferred revenue. Liabilities at December 31, 2003 were $329,745 which consisted of $2,33,198 in accounts payable and accrued liabilities and $96,547 in deferred revenue. Management feels that with our current cash on hand and cash flows from operations the company has sufficient capital to carry out its business plan for the remainder of 2004.

Capital Expenditures

The company continues to take steps to ensure that its technology is current and up to date. To facilitate that goal and ongoing research and development, as well as protecting its technology through the registration of trademarks and patents, the company invested $47,527 in the quarter in new computer equipment and software, trademarks and patents.

Consolidated

Balance Sheets

As at March 31, 2004 and December 31, 2003
(Expressed in United States dollars)

	March 31, 2004 (unaudited)	December 31,2003
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,358,633	$ 2,061,093
Accounts receivable	406,997	221,194
Inventory	154,707	107,377
Deposits and prepaid expenses	147,583	82,921
	2,067,920	2,472,585
Capital assets (note 2)	1,065,918	1,114,992
Other intangible assets (note 3)	177,974	189,002
	$ 3,311,812	$ 3,776,579
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	$ 280,210	$ 233,198
Deferred revenue	83,969	96,547
	364,179	329,745
Shareholders' equity		
Share capital (note 4)	44,251,517	44,108,140
Contributed surplus	1,114,316	1,114,316
Deficit	(42,418,200)	(41,775,622)
	2,947,633	3,446,834
	$ 3,311,812	$ 3,776,579

See accompanying notes to consolidated financial statements.

Consolidated
Statements of Operations and Deficit

For the three month periods ended March 31, 2004 and 2003
(Expressed in United States dollars under Canadian GAAP)

	2004	2003
	(unaudited)	(unaudited)
REVENUE		
Royalties and license fees	$ 205,467	$ 480,655
Product sales	304,781	350,195
	510,248	830,850
Cost of product sales	138,663	82,737
	371,585	748,113
EXPENSES		
Marketing	350,476	256,798
Operations	71,536	36,069
Product engineering	224,517	151,654
Administration	255,617	125,212
	902,146	569,733
Operating (loss) profit	(530,561)	178,380
OTHER ITEMS		
Depreciation and amortization	(107,629)	(80,265)
Interest and other income	1,139	5,931
Other	(5,527)	(15,605)
	(112,017)	(89,939)
Net (loss) income for period	(642,578)	88,441
Deficit, beginning of period	(41,775,622)	(38,069,991)
Deficit, end of period	$ (42,418,200)	$ (37,981,550)
Income (loss) per common share	$ (0.09)	$ 0.01

See accompanying notes to consolidated financial statements.

Consolidated
Statements of Cash Flows

For the three month periods ended March 31, 2004 and 2003
(Expressed in United States dollars under Canadian GAAP)

	2004	2003
	(unaudited)	(unaudited)
Cash provided by (used in)		
Operations		
Income for the period	$ (642,578)	$ 88,441
Items not requiring (providing) cash:		
Depreciation and amortization	107,629	80,265
Compensation cost of options issued	108,307	5,864
Changes in working capital balances (note 6)	(263,361)	110,093
	(690,003)	284,663
Financing		
Issuance of common shares, net	35,070	1,410
	35,070	1,410
Investments		
Purchase of capital assets	(31,666)	(844)
Purchase of intangible assets	(15,861)	(11,480)
	(47,527)	(12,324)
Increase (decrease) in cash	(702,460)	273,749
Cash and cash equivalents, beginning of period	2,061,093	2,621,205
Cash and cash equivalents, end of period	$ 1,358,633	$ 2,894,954

See accompanying notes to consolidated financial statements.

(Expressed in United States dollars under Canadian GAAP)

1. Basis of presentation:

These consolidated financial statements include the accounts of QSound Labs, Inc., a public company organized under the laws of the Province of Alberta, Canada and its wholly-owned subsidiaries. All significant inter-company transactions and balances have been eliminated.

The statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles for interim financial statements. These financial statements follow the same accounting policies and methods of applications as the most recent annual financial statements dated December 31, 2003. These interim financial statements should be read in conjunction with the Company's December 31, 2003 audited annual financial statements. The disclosures provided below are incremental to those included in the annual financial statements.

2. Capital assets:

March 31, 2004	Cost	Accumulated depreciation	Net book value
Sound source and control equipment	$ 556,695	$ 523,854	$ 32,841
Real time systems	905,534	897,644	7,890
Furniture and fixtures	359,638	321,324	38,314
Computer equipment	908,731	679,730	229,001
Software and production tooling	1,969,789	1,211,917	757,872
	$ 4,700,387	$ 3,634,469	$ 1,065,918

3. Other intangible assets:

March 31, 2004	Cost	Accumulated amortization	Net book value
Patents and trademarks	$ 836,539	$ 679,216	$ 157,323
Purchased customer list	34,418	13,767	20,651
	$ 870,957	$ 692,983	$ 177,974

4. Share capital:

	Number of Shares	Consideration
Balance at December 31, 2003	7,199,244	$ 44,108,140
Issued for cash on exercise of options	36,880	35,071
Additional paid-in capital stock options	—	108,306
Balance at March 31, 2004	7,236,124	$ 44,251,517

5. Stock option plan:

	Number of Shares	Exercise price per share	Weighted average exercise price
Balance at December 31, 2003	1,738,765	$ 0.47 – 1.75	$ 0.87
Granted	240,720	1.65 – 1.88	1.77
Exercised	(36,880)	0.47 – 1.00	0.95
Cancelled or expired	(225,000)	1.21	1.21
Balance at March 31, 2004	1,717,605	$ 0.47 – 1.75	$ 0.95

5. Stock option plan (continued):

The following table summarizes the information about stock options outstanding at March 31, 2004:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at March 31, 2004	Weighted-Average Remaining Term (Years)	Weighted-Average Exercise Price	Number Exercisable at March 31, 2004	Weighted-Average Exercise Price
$ 0.47	500,997	2.6	$ 0.47	500,997	$ 0.47
0.57 - 0.62	275,000	4.0	0.61	136,106	0.61
1.04 - 1.21	526,638	2.3	1.05	435,203	1.04
1.32 - 1.88	414,970	4.4	1.65	273,302	1.63
	1,717,605			1,345,608	

6. Changes in non-cash working capital balances:

	March 31, 2004	March 31, 2003
Accounts receivable	$ (185,803)	$ 219,893
Inventory	(47,330)	(16,310)
Deposits and prepaid expenses	(64,662)	(3,317)
Accounts payable and accrued liabilities	47,012	(82,939)
Deferred revenue	(12,578)	(7,234)
	$ (263,361)	$ 110,093

7. Segmented information:

For the three month period ended March 31, 2004	Audio	E-Commerce	Telephony	Total
Revenues	$ 369,669	$ 68,845	$ 71,734	$ 510,248
Interest revenue	1,098	—	41	1,139
Amortization of capital assets	41,245	7,060	42,732	91,037
Segment operating (loss) income	(206,054)	(17,275)	(307,233)	(530,562)
Segment assets	2,300,751	118,030	893,031	3,311,812
Expenditures for segment capital assets	37,883	—	5,000	42,883

For the three month period ended March 31, 2003	Audio	E-Commerce	Telephony	Total
Revenues	$ 728,933	$ 101,917	$ —	$ 830,850
Interest revenue	5,931	—	—	5,931
Amortization of capital assets	50,552	9,992	—	60,544
Segment operating income	132,890	45,490	—	178,380
Segment assets	4,994,457	2,391,575	—	7,386,032
Goodwill	—	2,184,589	—	2,184,589
Expenditures for segment capital assets	109,569	—	—	109,569

Geographic Information	2004 Revenue	2003 Revenue
Canada	$ 8,935	$ 1,315
United States	294,176	688,078
Asia	140,470	141,457
Europe	66,667	—
	$ 510,248	$ 830,850

QSOUND LABS, INC.

400, 3115 - 12th Street NE
Calgary, Alberta
Canada T2E 7J2

www.qsound.com

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