
Versatile Systems Inc.
Management Discussion and Analysis
Six months ended December 31, 2009

The following management discussion and analysis of the consolidated results of operations and financial condition of Versatile Systems Inc. (the “Company” or “Versatile”) is made as of January 22, 2010 on the consolidated financial statements and notes for the six months ended December 31, 2009.

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) and are stated in United States dollars unless otherwise specified. The consolidated financial statements and management discussion and analysis have been reviewed and approved by the Company’s Audit Committee as directed by the Company’s Board of Directors.

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions, which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

Forward-Looking Statements

This document may contain forward-looking statements relating to Versatile’s operations or to the environment in which it operates, which are based on Versatile’s operations, estimates, forecasts and projections. These statements are not guarantees of future performance and involve risks and uncertainties that are difficult to predict or are beyond Versatile's control. A number of important factors including those set forth in other public filings could cause actual outcomes and results to differ materially from those expressed in these forward looking statements. Consequently readers should not place any undue reliance on such forward-looking statements. In addition, these forward looking statements relate to the date on which they are made. Versatile disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

Non-GAAP Disclosure

EBITDA is defined by the Company as net earnings before interest, income taxes, depreciation and amortization. The Company has included information concerning EBITDA because it believes that it may be used by certain investors as one measure of the Company's financial performance. EBITDA is not a measure of financial performance under Canadian GAAP and is not necessarily comparable to similarly titled measures used by other companies. EBITDA should not be construed as an alternative to operating income or to cash flows from operating activities (as determined in accordance with Canadian GAAP) as a measure of liquidity.

In addition, the Company has included information concerning its cash flow from operations before the net change in non-cash working capital items as it may be used by certain investors as a measure of the Company's financial performance.

Overview

The Company's core business is developing solutions that solve customers' problems in the storage, security, transmission and collection of mission critical data. The Company's proprietary software applications, the *Mobiquity*TM Solution Suite, are a key component of this solution. This enables companies to improve the sales, marketing and distribution of their products. The Company delivers wireless/wired solutions to the consumer packaged goods, retail, financial, pharmaceutical, healthcare, and logistics verticals through an integrated combination of licensed software, professional services, and the re-sale of mobile-computing devices and related hardware. The Company also offers maintenance and support via a 24 hour call centre.

Highlights of the Second quarter

Highlights of the Company's operations for the quarter included:

- Cash and cash equivalents and short term investments at December 31, 2009 was \$6,096,258 compared to \$2,002,530 at June 30, 2009, an increase of \$4,093,728. The short term investments consists of 696,869 shares of Equus Total Return, Inc. which is a public company trading on the NYSE under the symbol EQS;
- Revenue for the three months ended December 31, 2009 was \$11,259,292 compared to \$12,327,064 for the same quarter last year, a decrease of \$1,067,772;
- Deferred revenue at December 31, 2009 was \$7,512,605 (of which \$6,641,170 is expected to be recognized in the next four quarters) compared to \$7,986,465 for the same quarter last year;
- EBITDA loss for the quarter was \$268,531 compared to an EBITDA loss of \$645,947 for the same quarter last year;
- Net Loss for the quarter amounted to \$80,661 (\$0.00 per share) compared to a Net Loss of \$533,171 (\$0.00 per share) for the same period last year, an improvement of \$452,510;
- Research and development expense for the quarter amounted to \$247,084 compared to \$391,088 for the same quarter last year;
- Non-brokered private placement with the issuance of 39,000,000 shares for gross proceeds of \$3,876,257;
- The Company generated revenue of \$1,804,020 from Comcast, \$672,579 from Tyco, \$491,783 from Hershey, \$463,343 from Urban Outfitters and \$347,057 from Motorola; and
- The Company increased its position to 696,869 shares of Equus Total Return, Inc. (NYSE: EQS).

Review of the Second quarter

Revenue for the three months ended December 31, 2009 was \$11,259,292 compared to \$12,327,064 for the same quarter last year, a decrease of \$1,067,772. During the current quarter the Company generated revenue of \$1,804,020 from Comcast, \$672,579 from Tyco, \$491,783 from Hershey, \$463,343 from Urban Outfitters and \$347,057 from Motorola. While the Company had repeat business from its existing customer base including Comcast, Tyco, Motorola, PASAP Software, Hershey, Thermo Fisher, and various retailers, universities and government organizations, the Company has been impacted by the overall macro-economic environment and continued to experience a slowdown in orders from customers for routine expenditures on infrastructure.

The EBITDA loss for the quarter was \$268,531 compared to an EBITDA loss of \$645,947 for the same quarter last year.

During the current quarter the Company recorded a Non-recurring expense consisting of an additional provision of \$28,219 (2008 – \$372,177) primarily for legal costs, for transactions occurring in prior periods.

During the quarter the Company recorded a future income tax benefit of \$347,566 compared to \$307,255 for the same quarter last year.

The Net Loss for the quarter amounted to \$80,661 (\$0.00 per share) compared to a Net Loss of \$533,171 (\$0.00 per share) for the same period last year, an improvement of \$452,510.

Cost of sales

Cost of sales for the quarter amounted to \$8,599,212 resulting in a gross profit of \$2,660,080 or 23.6% of sales as compared to \$9,287,669 resulting in a gross profit of \$3,039,395 or 24.7% of sales for the same quarter last year.

The Company determines its provision for inventory obsolescence based upon historical experience, expected inventory turnover, inventory aging and current condition, and current and future expectations with respect to product offerings. Assumptions underlying the provision for inventory obsolescence include future sales trends and product offerings, and the expected inventory requirements and inventory composition necessary to support these future sales and offerings. The estimate of the Company's provision for inventory obsolescence could materially change from period to period due to changes in product offerings and consumer acceptance of those products. At December 31, 2009 the Company had an inventory provision of \$169,817 (June 30, 2009 - \$172,569).

General and administrative

General and administrative expenses for the quarter amounted to \$1,100,145 compared to \$1,278,420 for the same quarter last year, a decrease of \$178,275. As a percentage of sales the

general and administrative expenses were 9.8% in the quarter compared to 10.4% in the same quarter last year.

Technology Investment

Over the past ten years the Company has made a significant investment in the form of expenses to advance the abilities of its technology and resulting service offering. This investment does not contribute directly to revenues during the period that the research and development expenses are incurred.

Research and development expense for the quarter amounted to \$247,084 compared to \$391,088 for the same quarter last year. The significant expense item in this category is salary and benefit costs. As a percentage of sales the research and development expenses are 2.2% in the quarter compared to 3.2% in the same quarter last year. The decrease in the overall expenditures on research and development expense can be attributed to the reduction in the number of research and development projects.

During the current quarter the Company's technology investment related to enhanced product functionality and requirements from various partners:

For the *Mobiquity Route*TM these included the following:

- Researching iPhone development tools for *Mobiquity Route*TM; and
- Researching SQL Reporting to enhance future development of *Mobiquity Route*TM

For the *Mobiquity Transaction Engine 3.0*TM these included the following:

- Completing the design and implementation of adaptors to support the latest wi-fi temperature monitors;
- Enhancing the functionality and accuracy of wi-fi real time location services data processing;
- Enhancing the functionality available through the Motorola UCA server and CA50 device; and
- Implementing object-level security throughout the system.

For the *Mobiquity Kiosk*TM, these included the following:

- Enhancing the printing capabilities for the *Mobiquity Kiosk*TM, including PDF printing, barcode printing, and multi printer support for thin client environments;
- Completing the initial platform and application designs to support multi-seated *Mobiquity Kiosk*TM environments. A multi-seated environment will allow two independent self-service applications (with interfaces on separate touch displays) to run simultaneously off of a single *Mobiquity Kiosk*TM computing device;
- Improving the content management delivery system to provide enhanced capabilities allowing customers to self-manage application images, screen text, coupons and receipts;
- Researching integration with a mail marketing company to deliver instant marketing capabilities with the *Mobiquity Kiosk*TM. This functionality benefits the *Mobiquity*

- KioskTM* owner by driving traffic to their location through registration code and bar code marketing delivered to customers via direct mailers;
- Enhancing the *Mobiquity KioskTM* administration engine, allowing for the streamlining and consolidation of health reporting in conjunction with bank related transaction reporting; and
 - Improving the audio subsystem on the *Mobiquity KioskTM*, allowing for quicker response times between touch screen interaction and audio output.

During the current period, the Company incurred \$104,619 for research and development activities related to *Mobiquity RouteTM* and related mobile software products.

During the current period, the Company incurred \$109,717 for research and development activities related to *Mobiquity Transaction Engine 3.0TM*, *Mobiquity KioskTM* and research on Virtualization.

Selling and marketing expenses

Selling and marketing expense for the quarter amounted to \$1,619,075 compared to \$1,717,311 for the same quarter last year, a decrease of \$98,236. Selling and marketing expenses includes salaries, commissions, advertising, trade shows and promotion costs to support the various sales initiatives. As a percentage of sales the selling and marketing expenses are 14.4% in the quarter compared to 13.9% in the same quarter last year. As a percentage of gross profit the selling and marketing expenses were 60.9% in the quarter compared to 56.9% in the same quarter last year. There were no significant changes in the selling and marketing activities during the quarter.

Future Income Tax Benefits

Canadian GAAP requires a valuation allowance to be recorded against any future tax asset to the extent that it is *more likely than not* that the future income tax asset will not be realized.

Prior to the 2006 fiscal year, the Company determined that it had not met this test so the Company recorded a full valuation allowance against the potential value of all of its tax losses and deductions available to be taken against future years' taxable income. As a result, future income tax assets were fully provided for.

During the 2006 fiscal year, the Company determined that the U.S. subsidiaries were generating sufficient profits such that they were *more likely than not* to utilize the losses and deductions attributable to these U.S. subsidiaries. Consequently, the Company concluded that the valuation allowance be reduced accordingly. The difference between the total value of these tax benefits less the valuation allowance is the amount of the future income tax asset that is recorded by the Company.

For the three months ended December 31, 2009 the Company recorded a future income tax benefit of \$347,566 compared to \$307,255 for the same quarter last year.

To the extent that the Company expects to generate sufficient profits in the following fiscal period, that portion of the Future income tax benefits have been classified as current.

Amortization

The amortization of capital assets and intangible assets for the quarter amounted to \$170,862 (December 31, 2008 - \$178,081) including amortization of \$17,900 included in cost of sales for Kiosks deployed pursuant to various subscription agreements.

Foreign Exchange Gain

The foreign exchange gain for the quarter amounted to \$89,154 compared to a foreign exchange gain of \$76,407 for the same quarter last year. The gain was primarily due to the fluctuation in the U.S. dollar against the Canadian dollar in the quarter.

Review of the operations for the six months ended December 31, 2009

Revenue for the six months ended December 31, 2009 was \$22,875,517 generating a gross profit of \$5,315,384 or 23.2% of sales compared to \$26,630,915 generating a gross profit of \$6,792,495 or 25.5% of sales for the same period last year. The EBITDA loss for the period was \$152,736 compared to \$393,375 for the same period last year. The Net Loss for the period amounted to \$127,436 (\$0.00 per share) compared to \$476,556 (\$0.00 per share) for the same period last year.

Cost of sales

Cost of sales for the six months ended December 31, 2009 amounted to \$17,560,133 resulting in a gross profit of \$5,315,384 or 23.2% of sales as compared to \$19,838,420 resulting in a gross profit of \$6,792,495 or 25.5% of sales for the same period last year.

General and administrative

General and administrative expenses for the six months ended December 31, 2009 amounted to \$1,974,493 compared to \$2,601,480 for the same period last year.

Technology Investment

Research and development expense for the six months ended December 31, 2009 amounted to \$493,754 compared to \$815,840 for the same period last year. The significant expense item in this category is salary and benefit costs. As a percentage of sales the research and development expenses are 2.2% compared to 3.1% in the same period last year.

Selling and marketing expenses

Selling and marketing expense for the six months ended December 31, 2009 amounted to \$2,980,776 compared to \$3,487,136 for the same period last year.

Amortization

The amortization of capital assets and intangible assets for the six months ended December 31, 2009 amounted to \$348,987 (December 31, 2008 - \$344,983).

Foreign exchange gain

The foreign exchange gain for the six months ended December 31, 2009 was \$74,612 compared to \$96,759 for the same period last year.

Summary of Quarterly Results

The table below provides a summary of certain selected unaudited financial information from the Consolidated Statements of Operations for the most recent eight fiscal quarters comprising the Company's preceding two years:

	Q3 2008 Mar 08	Q4 2008 Jun 08	Q1 2009 Sept 08	Q2 2009 Dec 08	Q3 2009 Mar 09	Q4 2009 Jun 09	Q1 2010 Sept 09	Q2 2010 Dec 09
Revenue	14,519,869	13,721,812	14,303,851	12,327,064	10,877,354	11,609,822	11,616,225	11,259,292
Cost of Sales	11,094,832	10,180,648	10,550,751	9,287,669	8,553,367	8,614,785	8,960,921	8,599,212
Gross Profit	3,425,037	3,541,164	3,753,100	3,039,395	2,323,987	2,995,037	2,655,304	2,660,080
Expenses:								
General and administrative (including foreign exchange)	1,219,904	1,530,733	1,302,708	1,202,013	898,936	987,696	888,890	1,010,991
Non recurring expenses	-	-	-	372,177	160,158	(110,823)	19,860	28,219
Research and Development	397,591	448,260	424,752	391,088	278,701	186,568	246,670	247,084
Selling and Marketing	1,746,710	1,470,184	1,769,825	1,717,311	1,515,711	1,685,829	1,361,701	1,619,075
Stock-based compensation	56,587	(63,219)	3,243	2,753	2,696	12,719	22,388	23,242
	3,420,792	3,385,958	3,500,528	3,685,342	2,856,202	2,761,989	2,539,509	2,928,611
Earnings (loss) before interest taxes and amortization	4,245	155,206	252,572	(645,947)	(532,215)	233,048	115,795	(268,531)
Amortization	(261,951)	(193,655)	(160,574)	(178,081)	(182,273)	(124,066)	(157,298)	(152,962)
Interest	90,375	(167)	(29,088)	(354)	1,648	(5,520)	(3,769)	(10,441)
Gain on sale of investments								4,952
Income taxes	99,709	(323,427)	(6,295)	291,211	139,885	279,930	(1,503)	346,321
Net Earnings (loss)	(67,622)	(362,043)	56,615	(533,171)	(572,955)	383,392	(46,775)	(80,661)
Per share, basic and diluted	(0.00)	(0.00)	0.00	(0.00)	(0.00)	0.00	(0.00)	(0.00)

The Company's revenues and earnings fluctuate from quarter to quarter. A number of factors can cause such fluctuations, including the timing of substantial orders, the timing of releases of new products, timing of the deployment of solutions and delays by customers. Because the Company's operating expenses are determined based on anticipated sales, are generally fixed and are incurred throughout each fiscal quarter, any of the factors listed above can cause significant variations in the Company's revenues and earnings in any given quarter. Thus, the Company's quarterly results are not necessarily indicative of the Company's overall business, results of operations and financial condition.

Over the past three years the Company has improved its financial position while maintaining selling, marketing, general and administration expenses at relatively the same level as revenue.

On January 22, 2009 the Company announced that it had reduced its workforce, focused research and development activities on core products, and redeployed research and development staff to the professional services group resulting in estimated annual savings of approximately \$1,670,000. Since that time the Company has made further reductions in its workforce and other cost reductions bringing the total estimated annual savings to approximately \$2.5 million.

Financial position

The working capital as of December 31, 2009 was \$6,148,754, an increase of \$3,578,333 compared to the working capital of \$2,570,421 at June 30, 2009.

Cash and cash equivalents and short term investments at December 31, 2009 was \$6,096,258 compared to \$2,002,530 at June 30, 2009, an increase of \$4,093,728.

The cash flow used in operations, before non-cash working capital items amounted to \$277,284 for the three months ended December 31, 2009 compared to cash flow used in operations of \$631,679 for the same period last year, an improvement of \$354,395.

The Company has a credit line facility of \$5,800,000, which is limited to 70% of eligible accounts receivable of certain U.S. subsidiaries from a U.S. based financial institution. The line of credit bears interest at the prime rate of lending as published in the Wall Street Journal and is secured with a first charge on the assets of VAC, VSI and POI. At December 31, 2009 the line of credit was \$2,558,445 (June 30, 2009 - Nil).

The amount that may be advanced under the credit line is limited to 70% of eligible accounts receivable of VAC, POI and VSI less than 90 days from the invoice date. At December 31, 2009 this amounted to \$4,415,003. At December 31, 2009 the financial covenants for these companies include the requirement of a minimum Tangible Net worth of \$4,800,000. The companies met this test.

Included in accounts payable and accrued liabilities is \$2,866,659 owing to a major supplier.

Investment in Equus

The short term investments consists of 696,869 shares of Equus Total Return, Inc. which is a public company trading on the NYSE under the symbol EQS.

On October 5, 2009 the Company filed a Schedule 13D with the U.S. Securities and Exchange Commission.

Versatile purchased the shares of Common Stock of EQS based on Versatile's belief that the Common Stock at current market prices are undervalued and represent an attractive investment opportunity. Depending upon overall market and general economic conditions, other investment opportunities available to Versatile, the market prices of the shares of EQS, the business affairs and financial condition of EQS, Versatile may endeavor to increase or decrease their position in EQS through, among other things, the purchase or sale of shares of EQS in the open market or in

private transactions, including the purchase of shares through a tender offer or otherwise, on such terms and at such times as Versatile may deem advisable.

Capital Expenditures

During the three months ended December 31, 2009 the majority of the capital expenditures of \$21,414 relate to the costs of Kiosks that have been deployed under various subscription agreements.

Share Capital

As of January 22, 2010 the Company had 157,285,643 common shares issued and outstanding.

Stock Options

The Company can grant up to 10% of the issued shares pursuant to its stock option plan.

	Number of shares	Weighted average exercise price CDN\$
Outstanding – June 30, 2009	9,160,000	0.42
Granted	-	
Forfeited	-	
Expired	(1,179,000)	0.28
Exercised	-	-
Outstanding – December 31, 2009	<u>7,981,000</u>	<u>0.44</u>

For the three months ended December 31, 2009, the Company recognized \$23,242 (2008 - \$2,753) in stock-based compensation, a non-cash item, for vesting of stock options granted to employees, consultants, directors and officers of the Company in prior years.

Warrants

The details of the outstanding warrants at December 31, 2009 are as follows:

Expiry date	Exercise Price CDN\$	Number of Warrants	Cost
March 31, 2011	\$ 0.569	1,411,808	63,309
April 16, 2011	\$ 0.6636	583,770	81,058
January 22, 2012	\$ 0.30	<u>600,000</u>	<u>42,000</u>
Balance		<u>2,595,578</u>	<u>186,367</u>

Related Party Transactions

During the current quarter, the Company paid consulting fees and salaries, which are included in the general and administration expense, of \$178,753 (2008 - \$163,970) to Directors and Officers of the Company.

Risk Factors

The securities of the Company should be considered a highly speculative investment and investors should carefully consider all of the information disclosed in this Management Discussion & Analysis prior to making an investment in the Company. In addition to the other information presented in this Management Discussion & Analysis, the following risk factors should be given special consideration when evaluating an investment in the Company's securities.

Operating History

The Company's predecessor company commenced operations in March 1987 to distribute and sell Maximizer products in European countries, as well as provide consulting services and Customer Relationship Management (“CRM”) solutions to companies. In January 1997, the Company changed its focus to research and development of CRM software. The Company purchased Versatile Mobile Systems on September 19, 2000, Perfect Order, Inc. and Versatile Systems, Inc. on April 26, 2005 and Sagent Solutions on December 28, 2007. The Company may face many of the risks and uncertainties encountered by early-stage companies in rapidly evolving markets.

History of Losses

The Company had a history of losses up to September 30, 2005 and has an accumulated deficit of \$35.9 million to December 31, 2009. Although the Company has decreased its operating expenses and increased its revenues over the past three years the Company cannot be assured that it can consistently maintain profitable operations.

No Certainty of Future Profitability

The Company's product revenues are not predictable with any significant degree of certainty and future product revenues may differ from historical patterns. If customers cancel or delay orders, it can have a material adverse impact on the Company's revenues and results of operations from quarter to quarter. Because the Company's results of operations may fluctuate from quarter to quarter, investors should not assume that results of operations in future periods can be predicted based on results of operations in past periods.

Even though the Company's revenues are difficult to predict, the Company's expense levels are based in part on future revenue projections. Many of the Company's expenses are fixed and, accordingly, the Company cannot quickly reduce spending if revenues are lower than expected.

Competitive Market

The market for the Company's software is intensely competitive, fragmented and rapidly changing. Some of the Company's actual and potential competitors are larger, established companies that have greater technical, financial and marketing resources. In addition, as the Company develops new products, particularly applications focused on electronic commerce or specific industries, it may begin competing with companies with whom it has not previously competed. It is also possible that new competitors will enter the market or that the Company's competitors will form alliances that may enable them to rapidly increase market share.

Increased competition may result in price reductions, lower gross margins or loss of the Company's market share, any of which could materially adversely affect its business, financial condition and operating results.

Technological Change

The market for the Company's solutions is characterized by rapidly changing technology and evolving industry standards. The market is affected by changes in end user requirements and frequent new product introductions and enhancements. The Company's products embody complex technology and may not always be compatible with current and evolving technical standards and products, developed by others. Failure or delays by the Company to meet or comply with the requisite and evolving industry or user standards could have a material adverse effect on the Company's business, results of operations and financial condition. The Company's ability to anticipate changes in technology, technical standards and product offerings will be a significant factor in the Company's ability to compete. There can be no assurance that the Company will be successful in identifying, developing, manufacturing and marketing products that will respond to technological change, evolving standards or individual wireless communications service provider standards or requirements. The Company's business will be adversely affected if the Company incurs delays in developing new products or enhancements or if such products or enhancements do not gain market acceptance. In addition, there can be no assurance that products or technologies developed by others will not render the Company's products or technologies non-competitive or obsolete.

Limited Sales and Support Infrastructure

The Company's future revenue growth will depend in large part on its ability to successfully expand its direct sales force and its customer support capability. The Company may not be able to successfully manage the expansion of these functions or to recruit and train additional direct sales, consulting and customer support personnel.

If the Company is unable to hire and retain additional highly skilled direct sales personnel, it may not be able to increase its license revenue to the extent necessary to achieve profitability. If the Company is unable to hire highly trained consulting and customer support personnel, it may be unable to meet customer demands. The Company is unlikely to be able to increase its revenues as planned if it fails to expand its direct sales force or its consulting and customer

support staff. Even if the Company is successful in expanding its direct sales force and customer support capability, the expansion may not result in revenue growth.

Dependence on Business Alliances

A key element of the Company's business strategy is the formation of corporate alliances with leading companies. The Company is currently investing and plans to continue to invest significant resources to develop these relationships. The Company believes that its success in penetrating new markets for its products will depend in part on its ability to maintain these relationships and to cultivate additional or alternative relationships. There can be no assurance that the Company will be able to develop additional corporate alliances with such companies, that existing relationships will continue or be successful in achieving their purposes or that such companies will not form competing arrangements.

Dependence on Key Personnel

The Company's success depends largely upon the continued service of its executive officers and other key management, sales and marketing and technical personnel. The loss of the services of one or more of the Company's executive officers or other key employees could have a material adverse effect on its business, results of operations or financial condition.

The Company's future success also depends on its ability to attract and retain highly qualified personnel. The competition for qualified personnel in the computer software and Internet markets is intense, and the Company may be unable to attract or retain highly qualified personnel in the future. In addition, due to intense competition for qualified employees, it may be necessary for the Company to increase the level of compensation paid to existing and new employees to the degree that operating expenses could be materially increased.

Management of Growth

The Company expects to experience a period of significant growth in the number of personnel that will place a strain upon its management systems and resources. The Company's future will depend in part on the ability of its officers and other key employees to implement and improve its financial and management controls, reporting systems and procedures on a timely basis and to expand, train and manage its employee workforce. There can be no assurance that the Company will be able to effectively manage such growth. The Company's failure to do so could have a material adverse effect upon the Company's business, prospects, results of operation and financial condition.

Integration of Newly Acquired Businesses or Technology

The Company may expand its operations through acquisitions of additional businesses or technology. There can be no assurance that the Company will be able to identify, acquire or profitably manage additional businesses or technology or successfully integrate acquired businesses or technology into the Company without substantial expense, delay or other operational or financial problems. Further, acquisitions may involve a number of additional

risks, including diversion of management's attention, failure to retain key acquired personnel, unanticipated events or circumstances, legal liabilities and amortization of acquired intangible assets, some or all of which could have a material adverse effect on the Company's business, financial condition and results of operation. In addition, there can be no assurance that acquired businesses, if any, will achieve anticipated revenues and earnings. The failure of the Company to manage its acquisition strategy successfully could have a material adverse effect on the Company's business, financial condition and results of operation.

Potential Fluctuations in Quarterly Financial Results

The Company's quarterly financial results may be affected by the timing of new releases of its products and/or substantial customer orders. The Company's operating expenses are based on anticipated revenue levels in the short term, are relatively fixed, and are incurred throughout the quarter. As a result, if expected revenues are not realized on a timely basis as anticipated, the Company's financial results could be materially and adversely affected. These or other factors, including possible delays in the shipment of new products, may influence quarterly financial results in the future. Accordingly, there may be significant variation in the Company's quarterly financial results.

International Sales

Sales outside of the United States currently represent less than 10% of the Company's total gross revenues. The Company believes that its continued growth and profitability will require additional expansion of its sales in international markets. To the extent that the Company is unable to expand international sales in a timely and cost effective manner, the Company's business, results of operations and financial condition could be materially and adversely affected. In addition, even with the successful recruitment of additional personnel and international resellers, there can be no assurance that the Company will be successful in maintaining or increasing international market demand for the Company's products.

Currency Exchange Rate Risk

The Company's results have been stated into U.S. dollars as a substantial portion of the Company's revenues and a material portion of its expenses are denominated in US dollars.

Dependence on Proprietary Technology and Limited Patent and Trademark Protection

The Company relies on a combination of copyright and trademark laws, trade secret, confidentiality procedures and contractual provisions to protect its proprietary rights. Unauthorized parties may attempt to copy aspects of the Company's products or obtain and use information that the Company regards as proprietary. Policing unauthorized use of the Company's product is difficult, time-consuming and costly as is the pursuing of patents in each jurisdiction in which the Company carries on business. Although the Company is unable to determine the extent to which piracy of its software product exists, software piracy is a possibility. In addition, the laws of certain countries in which the Company's products may be licensed do not protect its product and intellectual property rights to the same extent as the laws

do in Canada or the United States. There is no assurance that the Company's means of protecting its proprietary rights will be adequate or the Company's competitors will not independently develop similar technology, the effect of either of which may be materially adverse to the Company's business, results of operations and financial condition.

Risk of Third Party Claims for Infringement

The Company is not aware that its product infringes the proprietary rights of third parties. There can be no assurance, however, that third parties will not claim such infringement by the Company or its licensees with respect to current or future products. The Company expects that software product developers will increasingly be subject to such claims as the number of products and competitors in the Company's industry segment grows and the functionality of products in different industry segments overlaps. Any such claims, with or without merit, could be time-consuming, result in costly litigation, cause product shipment delays or require the Company to enter into royalty or licensing agreements which, if required, may not be available on terms acceptable to the Company. Any of the foregoing could have a materially adverse effect on the Company's business, results of operations and financial condition.

Lengthy Sales and Implementation Cycle

The adoption of the Company's product generally involves a significant commitment of resources by potential customers. As a result, the Company's sales process is often subject to delays associated with lengthy approval processes by potential customers. For these and other reasons, the sales cycle associated with the license of the Company's product varies substantially from customer to customer and typically lasts between 6 to 12 months during which time the Company may devote significant time and resources to a prospective customer, including costs associated with multiple site visits, product demonstrations and feasibility studies, and experience a number of significant delays over which the Company has no control. Any significant or ongoing failure by the Company to ultimately achieve such sales could have a material adverse effect on the Company's business, results of operations and financial condition. In addition, following license sales, the implementation period is expected to involve a time period for customer training and integration with the customer's existing systems. A successful implementation program requires a close working relationship between the Company, the customer and, generally, third party consultants and system integrators who assist in the process. There can be no assurance that delays or difficulties in the implementation process for any given customer will not have a material adverse effect on the Company's business, results of operations and financial condition.

Risk of System Defects

System development involves the integration of the Company's proprietary software and software of others into the customer's operating systems. There can be no assurance that defects and errors will not be found in the Company's product when integrated with other products or systems. Any such defects and errors could result in adverse customer reactions, negative publicity regarding the Company and its product or damages. Consequently, there could be a material adverse effect on the Company's business, results of operations and financial condition.

Requirements for New Capital

As a growing business, the Company typically needs more capital than it has available to it or can expect to generate through the sale of its products. In the past, the Company has had to raise, by way of debt and equity financing, considerable funds to meet its capital needs. There is no guarantee that the Company will be able to continue to raise funds needed for its business. Failure to raise the necessary funds in a timely fashion will limit the Company's growth.

Critical Accounting Estimates

General

Unless otherwise specified in the discussion of the specific critical accounting estimates, the Company is not aware of trends, commitments, events, or uncertainties that it reasonably expects to materially affect the methodology or assumptions associated with the critical accounting estimates, subject to the circumstances identified above.

Changes are made to assumptions underlying all critical accounting estimates to reflect current economic conditions and updating of historical information used to develop the assumptions, where applicable. Unless otherwise specified in the discussion of the specific critical accounting estimates, it is expected that no material changes in overall financial performance and financial statement line items would arise either from reasonably likely changes in material assumptions underlying the estimate or within a valid range of estimates, from which the recorded estimate was selected.

All critical accounting estimates are uncertain at the time of making the estimate.

Accounts Receivable

Allowance for doubtful accounts

The Company considers the business area that gives rise to the accounts receivable, maintains procedures for granting credit terms on sales transactions and performs specific account identification when determining its allowance for doubtful accounts. This accounting estimate is in respect of the accounts receivable line item on the Company's consolidated balance sheet comprising approximately 20% of total assets as at December 31, 2009. In the event the future results were to adversely differ from management's best estimate of the allowance for doubtful accounts, the Company could experience a bad debt charge in the future. Such a bad debt charge would not result in a cash outflow.

The estimate of the Company's allowance for doubtful accounts could materially change from period to period due to the allowance being a function of the balance and composition of accounts receivable, which can vary on a month-to-month basis. The variance in the balance of accounts receivable can arise from a variance in the amount and composition of operating revenues and from variances in accounts receivable collection performance.

Inventories

Provision for inventory obsolescence

The Company determines its provision for inventory obsolescence based upon historical experience, expected inventory turnover, inventory aging and current condition, and current and future expectations with respect to product offerings.

Assumptions underlying the provision for inventory obsolescence include the activity levels over previous fiscal years, and the expected inventory requirements and inventory composition necessary to support these future sales and offerings. The estimate of the Company's provision for inventory obsolescence could materially change from period to period due to changes in product offerings and consumer acceptance of those products.

This accounting estimate is in respect of the inventory line item on the Company's consolidated balance sheet comprising approximately 4% of total assets as at December 31, 2009. If the provision for inventory obsolescence was inadequate, the Company could experience a charge to direct cost of sales in the future. Such an inventory obsolescence charge would not result in a cash outflow.

Long-Lived Assets

The accounting estimates for long-lived assets that include capital assets, purchased technology, intellectual property, customer contracts and licenses, in aggregate, represent approximately 2% of the Company's total assets as at December 31, 2009, presented in its consolidated balance sheet. If the Company's estimated useful lives of assets were different as a result of changes in facts and circumstances, the Company could experience increased or decreased charges for amortization and the Company could potentially experience future material impairment charges in respect of its recovery of long-lived assets.

The estimated useful lives of capital assets are determined by a continuing program of asset life studies. The recoverability of capital assets is significantly impacted by the estimated useful lives. Assumptions underlying the estimated useful lives of capital assets include timing of technological obsolescence, competitive pressures and future infrastructure utilization plans. In the event management's best estimate of the useful lives of capital assets was adversely affected, the Company could potentially experience a charge to amortization expense in the future. Such a charge to amortization would not result in a cash outflow.

Purchased Technology

The recoverability of the Company's investment in purchased technology is determined by an ongoing analysis of the economic benefits attributed to the purchased technology. The Company estimates the future economic benefits attributed to the purchased technology and compares the results with the net book value of the asset. Assumptions underlying the estimated future economic benefits of purchased technology costs include future sales trends, product offerings, timing of technological obsolescence, competitive pressures and consumer acceptance of product

offerings. If management's best estimate of the future economic benefits of purchased technology costs was adversely affected, the Company could potentially experience a charge to amortization expense in the future. Such a charge to amortization would not result in a cash outflow.

Customer Contracts

The recoverability of the Company's investment in customer contracts is determined by an ongoing analysis of the economic benefits attributed to the customer contracts in place at the date of the acquisition. The Company estimates the future economic benefits attributed to the customer contracts and compares the results with the net book value of the asset. Assumptions underlying the estimated future economic benefits of customer contracts include future sales trends, product offerings, timing of technological obsolescence, competitive pressures and consumer acceptance of product offerings. If management's best estimate of the future economic benefits of customer contracts was adversely affected, the Company could potentially experience a charge to amortization expense in the future. Such a charge to amortization would not result in a cash outflow.

Future Income Tax Benefits

The amount recorded for Future Income Tax Benefits represents approximately 17% of the Company's assets as at December 31, 2009, presented in its consolidated balance sheet. If the Company determines that the valuation allowances relating to the loss carry forwards and tax deductions should be increased, the Company could experience a reduction in the recorded future income tax benefits.

Goodwill

The accounting estimates for goodwill represents approximately 26% of the Company's total assets as at December 31, 2009, presented in its consolidated balance sheet. If the Company's estimated fair value were incorrect, the Company could experience increased or decreased charges for changes to the estimated fair value in the future. If the future were to adversely differ from management's best estimate to recover the Company's investments in its goodwill, the Company could potentially experience future material impairment losses in respect of its goodwill. The impairment losses would be recognized and presented as a separate line item in the consolidated statements of loss and deficit. Impairment losses to goodwill would not result in a cash outflow.

Changes in accounting policies

The Company retroactively adopted, on July 1, 2008, the following new Handbook sections issued by the CICA:

- (i) General standards on financial statement presentation

In June 2007, the CICA amended Section 1400, *General Standards on Financial Statement Presentation*. The new section is applicable to financial statements relating to

fiscal years beginning on or after January 1, 2008. The amended section includes requirements to assess and disclose a company's ability to continue as a going concern.

(ii) Inventories

The Company adopted the recommendations of CICA Handbook Section 3031 on inventories which provides guidance on the determination of cost of inventories and its subsequent recognition as an expense, and includes additional disclosure requirements. The new section also requires the Company to account for the reversal of write-downs previously recognized when there is a subsequent increase in the value of inventories. This accounting policy was applied retroactively; the retroactive application did not have an impact on the comparative financial statements presented. There was no effect as of September 30, 2009 or for the year then ended.

(iii) Financial instrument disclosures

On July 1, 2008, the Company adopted three new CICA Handbook sections: Section 1535, *Capital Disclosures*; Section 3862, *Financial Instruments - Disclosures*; and Section 3863, *Financial Instruments - Presentation*. Prior year financial statements have not been restated. These sections relate to disclosure and presentation only and have no impact on the consolidated financial results.

Section 1535 requires disclosure of an entity's objectives, policies, and processes for managing capital; information about what the entity regards as capital; whether the Company has complied with any external capital requirements; and the consequences of not complying with these capital requirements.

Sections 3862 and 3863 replace Handbook Section 3861, *Financial Instruments - Disclosure and Presentation*. Section 3863 carries forward unchanged the presentation requirements of Section 3861 while Section 3862 requires enhanced financial instrument disclosures focusing on disclosures related to the nature and extent of risks arising from financial instruments and how the entity manages those risks.

The following is an overview of accounting standard changes that the Company will be required to adopt in future periods:

(i) Goodwill and intangible assets

In February 2008, the CICA issued Section 3064, *Goodwill and Intangible Assets*, replacing Section 3062, *Goodwill and Other Intangible Assets*, and Section 3450, *Research and Development Costs*. The new section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning July 1, 2009. This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. In February 2007, the CICA amended Section 1000,

Financial Statement Concepts, to clarify the criteria for the recognition of an asset. The amended section is applicable to all entities and is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning July 1, 2009.

Key International Financial Reporting Standards (IFRS) conversion dates

According to dates set out by the AcSB, the Company will be required to changeover to IFRS on July 1, 2010 and begin publicly reporting under IFRS in the fiscal year ending June 30, 2012. Because of the need to present comparative financial information, the Company will need to create its first IFRS compliant balance sheet as at July 1, 2010. For the fiscal year ending June 30, 2011, the Company will need to prepare information for financial statements and note disclosures under both Canadian GAAP and IFRS in order to meet Canadian GAAP reporting requirements that year and to allow for comparative information to be presented in 2012.

Additional information relating to the Company can be found on the Canadian Securities Administrators System for Electronic Document Analysis and Retrieval (SEDAR), located at www.sedar.com