



# ENGHOUSE SYSTEMS LIMITED

Third Quarter Report  
July 31, 2010



September 2, 2010

To our Shareholders,

Third quarter revenue was \$26.0 million, compared to \$23.4 million reported in the same period last year, an increase of approximately 11%. Net income for the third quarter was \$3.2 million or \$0.13 per share on a diluted basis compared to the prior year's third quarter net income of \$2.4 million or \$0.10 per share. The increase in revenue was the result of increased license and services revenue attributable to recent acquisitions, Pulse Voice Inc. ("Pulse") acquired November 1, 2009, Mettoni Ltd. ("Mettoni") acquired on April 6, 2010 and Telrex LLC ("Telrex") acquired on June 1, 2010. As has become the norm, revenue and operating costs are impacted by the continued volatility of foreign exchange as outlined in the MD&A.

Operating expenses increased to \$12.5 million from \$10.6 million in the prior year's third quarter and include incremental operating costs related to acquisitions and the impact of foreign exchange on U.S. dollar denominated operating expenses converted to Canadian dollars. Non-cash amortization charges were \$2.4 million compared to \$1.8 million in the prior year's third quarter and include amortization charges for acquired software and other intangibles from recently acquired operations which added \$0.8 million to amortization expense in the quarter.

The Company generated cash flows from operations of \$9.1 million in the third quarter compared to \$7.2 million in the prior year's third quarter, closing the quarter with \$77.1 million in cash and short-term investments compared to \$93.2 million at October 31, 2009, which is after payment of Mettoni acquisition costs of approximately \$22.3 million, \$4.6 million for Pulse and \$3.5 million for the Telrex acquisition. The Company continues to have no long-term debt.

The Board of Directors today authorized an eligible quarterly dividend of \$0.04 per common share, payable on November 30, 2010 to shareholders of record at the close of business on November 16, 2010. The Company remains committed to its strategy of seeking further acquisitions to continue to diversify its revenue stream and expand its market presence.



Stephen J. Sadler  
Chairman of the Board and Chief Executive Officer

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following discussion and analysis has been prepared as of September 2, 2010 and should be read in conjunction with the Company's unaudited interim consolidated financial statements and the notes thereto for the periods ended July 31, 2010 and 2009, as well as the Company's audited Consolidated Financial Statements and Management's Discussion and Analysis ("MD&A") for the fiscal year ended October 31, 2009, contained in the Company's 2009 Annual Report to Shareholders. This MD&A covers the results of operations, financial condition and cash flows of Enghouse Systems Limited (the "Company" or "Enghouse") and its wholly owned subsidiaries for the third quarter ended July 31, 2010. This document is intended to assist the reader in better understanding operations and key financial results as of the date of this report. The consolidated financial statements and the MD&A have been reviewed by the Company's Audit Committee and approved by its Board of Directors.

### **Forward-looking Statements**

Certain statements made or incorporated by reference in this MD&A are forward-looking and relate to, among other things, anticipated financial performance, business prospects, strategies, regulatory developments, new services, market forces, commitments and technological developments. By its nature, such forward-looking information is subject to various risks and uncertainties, including those discussed in this MD&A or in documents incorporated by reference in this MD&A, such as Enghouse's Annual Information Form, which could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed herein. Readers are cautioned not to place undue reliance on this forward-looking information, and the Company shall have no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except in accordance with applicable securities laws.

### **Non-GAAP Measures**

The Company uses non-GAAP measures to assess its operating performance. Securities regulations require that companies caution readers that earnings and other measures adjusted to a basis other than GAAP do not have standardized meanings and are unlikely to be comparable to similar measures used by other companies. Accordingly, they should not be considered in isolation. The Company uses operating income as a measure of performance. Therefore, operating income may not be comparable to similar measures presented by other issuers. Operating income is calculated as net income before amortization of acquired software and other intangibles, net interest income, other income, foreign exchange gains and losses and the provision for income taxes. This is denoted as "Income before the undernoted" on the Consolidated Statements of Operations and Retained Earnings of the Company. Management uses operating income to evaluate performance as it excludes amortization of software and intangibles and foreign exchange gains and losses.

### **Corporate Overview**

Enghouse is a Canadian publicly traded company (TSX:ESL) that develops enterprise software solutions for a variety of vertical markets. The Company is organized around two business segments: the Syntellect Division and the Asset Management Division. The Syntellect Division serves the customer service market segment through the provision of Interactive Voice Response ("IVR") systems and speech and voice recognition solutions as well as an advanced contact center platform that manages multi-channel customer interactions. Its customers include insurance companies, banks, utilities as well as high technology, health care and hospitality companies. The Asset Management Division provides visual-based software solutions for the design and management of complex network infrastructures to telecommunications, utilities, public and private transportation and oil and gas companies.

### **Quarterly Results of Operations**

The following table sets forth certain unaudited information for each of the eight most recent quarters (the last of which ended July 31, 2010). Historically, the Company's operating results have fluctuated on a quarterly basis, which the Company expects will continue in the future. Fluctuations in results continue to relate to the timing of software license and hardware sales, which may result in large sales orders in any one quarter, movements in foreign currency exchange rates and to the timing of acquisitions, staffing and

infrastructure changes. See “Risks And Uncertainties” for more details. All financial results are in thousands of Canadian dollars, unless otherwise stated, with the exception of per share amounts.

	Q3/10	Q2/10	Q1/10	Q4/09	Q3/09	Q2/09	Q1/09	Q4/08
Revenue	\$ 26,031	\$21,263	\$19,536	\$20,003	\$23,353	\$16,834	\$18,228	\$14,648
Net Income	3,202	1,707	1,903	2,571	2,431	938	794	2,333
Basic income per share	0.13	0.07	0.08	0.10	0.10	0.04	0.03	0.09
Diluted income per share	0.13	0.07	0.08	0.10	0.10	0.04	0.03	0.09

**Accounting Policies, Accounting Standards and Estimates**

The Company’s unaudited consolidated interim financial statements are prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”). The preparation of the Company’s unaudited consolidated interim financial statements is based on the selection and application of significant accounting policies, some of which require management to make significant estimates that affect the reported amounts of assets, liabilities, revenue and expenses and the related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to revenue recognition, allowance for doubtful accounts, the useful lives and recoverability of long-term assets, recoverability of goodwill and the valuation allowance on future income tax assets. The Company bases its estimates on historical experience as well as on various other assumptions that are believed to be reasonable under the circumstances at the time. Under different assumptions or conditions, the actual results would differ, potentially materially, from those previously estimated. Many of the conditions impacting these assumptions and estimates are beyond the Company’s control.

The Company believes that these accounting policies affect its more significant judgments and estimates used in the preparation of its unaudited consolidated interim financial statements. These policies remain substantially unchanged from those discussed in the Company’s latest Management’s Discussion and Analysis for the year ended October 31, 2009, contained in the Company’s 2009 Annual Report to Shareholders, with the exception of new accounting standards issued by The Canadian Institute of Chartered Accountants (“CICA”) Accounting Standards Board and adopted by the Company on November 1, 2009.

**Changes in accounting policy**

***Changes in accounting policy adopted in fiscal 2010***

CICA Handbook section 1506, *Accounting Changes*, was amended to exclude from its scope changes in accounting policies upon the complete replacement of an entity’s primary basis of accounting. The amendments apply to interim and annual financial statements for years beginning on or after July 1, 2009. This amendment did not have an impact on the unaudited consolidated interim financial statements presented herein.

***Recent accounting pronouncements issued and not yet applied***

In January 2009, CICA Section 1582, *Business Combinations* was issued replacing Section 1581 *Business Combinations*. The Section establishes standards for the accounting for business combinations and provides the Canadian equivalent to the International Financial Reporting Standards (“IFRS”) standard, IFRS 3 (revised), *Business Combinations*. The Section applies prospectively to business combinations for which the acquisition date is on or after October 1, 2011 and allows for earlier application. CICA Section 1601, *Consolidated Financial Statements* and Section 1602, *Non-Controlling Interests* were issued replacing Section 1600, *Consolidated Financial Statements*. These sections establish standards for the preparation of consolidated financial statements and accounting for non-controlling interests in a subsidiary subsequent to a business combination. The sections are equivalent to the corresponding provisions of the IFRS standard, IAS 27 (revised), *Consolidated and Separate Financial Statements*. The Sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after October 1,

2011 and allow for earlier adoption. The Company is currently assessing the impact the adoption of these new Standards may have on the Company's results of operations and consolidated financial position.

In December 2009, the CICA issued EIC 175, Multiple Deliverable Revenue Arrangements, replacing EIC 142, Revenue Arrangements with Multiple Deliverables. This EIC (a) provides updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated; (b) requires, in situations where the vendor does not have vendor-specific objective evidence ("VSOE") or third-party evidence of selling prices, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (c) eliminates the use of the residual method and requires an entity to allocate revenue using the relative selling price method and (d) requires expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. The accounting changes required under EIC 175 are effective for fiscal years beginning on or after January 1, 2011, with earlier adoption permitted. Adoption may either be on a prospective basis or by retrospective application. If EIC 175 is adopted early, in a reporting period that is not the first reporting period in the entity's fiscal year, it must be applied retroactively from the beginning of the Company's fiscal year. The Company is currently assessing the impact of these amendments on its financial statements and has not yet determined either the timing or method of its adoption.

#### ***Harmonization of Canadian and International Accounting Standards***

In February 2008 the CICA Accounting Standards Board ("AcSB") confirmed that International Financial Reporting Standards ("IFRS") will replace Canadian GAAP effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company's first unaudited consolidated interim financial statements presented in accordance with IFRS will be for the three month period ending January 31, 2012, and its first audited consolidated annual financial statements presented in accordance with IFRS will be for the year ending October 31, 2012 and will include comparative results for fiscal 2011.

The Company's conversion project consists of three phases:

- *Scoping and diagnostic phase* – this phase involves performing a high-level impact assessment to identify key areas that are expected to be impacted by the transition to IFRS. The objective of this phase is to perform a detailed review of all relevant IFRS standards to identify differences with our current policies and practices, consider one-time accounting policy alternatives available on the adoption of IFRS and to prioritize those differences that could have a material impact on the financial statements, business processes and IT systems.
- *Impact analysis, evaluation and design phase* – each area identified from the scoping and diagnostic phase will be addressed. The objective of this phase will be to specify, quantify and design changes to existing accounting policies, information systems and business processes, together with a detailed analysis of policy choices under IFRS, including optional IFRS 1 exemptions and the development of draft IFRS consolidated financial statements.
- *Implementation and review phase* – this phase involves the implementation of changes to affected accounting policies and practices, business processes and systems and internal controls and training programs across the organization, as necessary. It will culminate in the collection of the financial information necessary to compile IFRS-compliant financial statements.

#### ***Progress towards completion of our IFRS Changeover Plan***

The Company's Audit Committee is updated on the progress of the conversion plan on at least a quarterly basis. As at July 31, 2010, the following progress has been made relating to the Company's IFRS conversion plan:

In its scoping and diagnostic phase the Company identified the following areas that have the greatest potential impact to the Company's accounting policies, based on existing IFRS as at July 31, 2010:

- Presentation of Financial Statements (IAS 1)
- First-time Adoption of IFRS (IFRS 1)
- Business Combinations (IAS 3)
- Revenue Recognition (IAS 11 and 18)
- Provisions and Contingent Liabilities (IAS 37)
- Impairment of Assets (IAS 36)
- Income Taxes (IAS 12)

The list should not be regarded as an exhaustive list of the changes that may result from the adoption of IFRS. It is intended to highlight those areas we believe to be of the most significant impact to the Company. In the period leading up to the changeover, the AcSB will continue to issue accounting standards that are converged with IFRS, thus mitigating the impact of adopting IFRS at the changeover date. The International Accounting Standards Board (“IASB”) will also continue to issue new accounting standards during the conversion period and is presently in the process of amending standards on areas such as revenue recognition, lease accounting, financial statement presentation and income taxes. As a result, the final impact of IFRS on the Company’s consolidated financial statements can only be measured once all applicable standards at the conversion date are known.

During the third quarter the Company commenced its Phase II review of the key areas identified in the diagnostic phase. The Company commenced a more detailed analysis and component evaluation of each area identified, an assessment and evaluation of whether changes to accounting policies may be required, the potential impact on IT systems and business processes and the impact on internal controls over financial reporting and disclosure controls. The Company has also started drafting preliminary IFRS consolidated financial statements and notes to be issued for the quarter ended January 31, 2012 to better evaluate the impact that the conversion will have on its initial financial statements. The Company has also engaged external advisors to consult on its IFRS project.

This phase also includes analysis of the IFRS 1 optional exemptions and mandatory exceptions to the general requirement for full retroactive application of IFRS on adoption. We are considering the possibility of electing the following IFRS 1 optional exemptions in the preparation of the IFRS statement of financial position in our opening comparative balance sheet at November 1, 2010, (the “Transition Date”):

- To deem the cumulative translation differences for all foreign operations to be zero as of the Transition Date.
- To apply IFRS 2 Share-based Payments only to equity instruments issued after November 7, 2002 and not vested by the Transition Date.
- To apply IFRS 3 Business Combinations prospectively from the Transition Date and therefore not restate acquisitions that took place prior to this date.

We continue to evaluate whether we may elect to apply these, and other optional exemptions under IFRS 1 as part of our Phase II analysis. The evaluation will also include an assessment of the potential impact on the Company’s financial reporting, accounting policies, internal systems, internal control over financial reporting, disclosure controls and business activities. We expect the evaluations of this phase to continue through the first quarter of fiscal 2011.

We have determined that in many respects the Company’s accounting policies are aligned with IFRS requirements and that there are likely to be no material differences in the majority of line items in the Company’s balance sheet and income statement from that reported under Canadian GAAP. However, the Company does anticipate a significant increase in disclosure resulting from the adoption of IFRS and has begun to identify and assess the extent of these additional disclosure requirements in its draft IFRS interim financial statements for the quarter ended January 31, 2012.

IFRS training is ongoing for project team members related to relevant aspects of IFRS which are expected to impact the Company and will be rolled out as the project progresses to include all project team members, the Audit Committee and other stakeholders.

It is anticipated that the adoption of IFRS will impact the Company's information system requirements. The areas where information systems will be most impacted are those related to the ability to track IFRS adjustments in the accounting system, particularly during the fiscal 2011 transition year where the Company is required to retroactively report on an IFRS basis in addition to Canadian GAAP. In addition, we are reviewing how the accounting system and general ledger structure will need to be modified to address increased financial statement and note disclosure, including nature and function income statement reporting, tracking of the continuity of fixed assets and reserves and functional currency accounting. The Company will continue to assess the impact on information systems as Phase II efforts continue.

The Company continues to assess the impact of adopting IFRS on its business activities, processes and policies. It is expected that employee incentive plans that are based on Canadian GAAP financial measures may have different values under IFRS and that the Company's budgeting and forecasting processes and procedures may need to be amended to consider the impact of IFRS on its results.

The Company's certification of disclosure controls and internal controls over financial reporting under NI 52-109 requires that all entity level, financial reporting, IT and disclosure controls will be required to be updated and tested consistent with any changes resulting from the Company's conversion to IFRS. As the majority of change is anticipated to be related to the disclosure requirements in the financial statements, it is anticipated that disclosure controls will be the most impacted. To the extent that material changes are identified, these changes will be mapped and tested to ensure that no material deficiencies exist as a result of the conversion to IFRS.

The Company will continue to provide quarterly updates on the progress towards the Company's conversion plan throughout the conversion process to allow stakeholders to assess the potential impact of the IFRS conversion on the Company's financial performance, and to assess the Company's ability to meet the transition date. At July 31, 2010, the Company cannot reasonably determine the full impact that adopting IFRS would have on its financial statements as changes in circumstances such as changes in existing IFRS, regulatory and economic conditions could alter the Company's assumptions regarding its conversion plan.

**Liquidity and Capital Resources:**

The Company closed the quarter with cash reserves of \$77.1 million, compared to the October 31, 2009 balance of \$93.2 million, which is after payment of approximately \$3.5 million related to the acquisition of Telrex on June 1, 2010, \$22.3 million related to the acquisition of Mettoni Ltd. completed on April 6, 2010 and \$4.6 million related to the acquisition of Pulse Voice Inc, completed on November 1, 2009. The Company also paid \$1.3 million as part of the final holdback on the Envovx acquisition earlier in the fiscal year. The Company continues to have no long-term debt and has sufficient cash resources to fund both its current and future financial operating commitments as well as its dividend obligations.

During the quarter the Company generated cash flow from operations of \$9.1 million compared to \$7.2 million in the third quarter of 2009. The Company had 25,167,662 Common Shares issued and outstanding as at September 2, 2010. During the third quarter no stock options were exercised compared to 2,000 options exercised for nominal proceeds in the third quarter of fiscal 2009. The Company granted 15,000 options in the current year's third quarter. Enghouse did not repurchase any shares of its common stock in the third quarter under its Normal Course Issuer Bid. In comparison, in the prior year's third quarter, the Company repurchased 44,100 shares at a cost of \$0.3 million representing an average price of approximately \$5.89 per common share. On June 2, 2010 the Company declared an eligible dividend of \$0.04 per common share which was paid on August 31, 2010 to shareholders of record as of August 17, 2010. As of July 31, 2010 the Company has paid \$2.5 million in dividends compared to \$2.0 million in the first three quarters of fiscal 2009.

**Off-Balance Sheet Arrangements**

The Company has not entered into off-balance sheet financing arrangements. Except for operating leases and other low probability and/or immeasurable contingent liabilities (not accrued in accordance with Canadian GAAP), all commitments are reflected on the Company's balance sheet.

### **Transactions with Related Parties**

The Company has not entered into any transactions with related parties during the year, other than transactions between wholly owned subsidiaries and the Company in the normal course of business, which are eliminated on consolidation.

### **Results of Operations:**

#### **Revenue**

Total revenue for the quarter was \$26.0 million compared to \$23.4 million in the prior year's third quarter and includes license revenue of \$8.4 million compared to \$7.9 million in the prior year's third quarter. Services revenue was \$16.9 million compared to \$13.7 million in the prior year's third quarter. The increase in revenue is attributable to contributions from the acquisitions of Pulse Voice Inc., Mettoni Ltd. and Telrex LLC, acquired November 1, 2009, April 6, 2010 and June 1, 2010 respectively. This mitigates the unfavourable impact of foreign exchange on the conversion of U.S. dollar revenue into Canadian dollars compared to the prior year's third quarter. During the third quarter the average foreign exchange rate used to convert U.S. dollars to Canadian dollars was \$1.04 compared to \$1.15 in the prior year's third quarter. On a year to date basis, revenue was \$66.8 million compared to \$58.4 million in the prior year and reflects incremental revenue from acquisitions. Revenue on a comparative year to date basis has also been adversely impacted by foreign exchange when translating U.S. dollars to Canadian dollars, which averaged \$1.05 for the current year compared to \$1.21 for the prior year. As the majority of the Company's revenue is denominated in U.S. dollars, this has had a negative impact on revenue.

The Syntellect Division contributed \$22.4 million in revenue in the quarter, compared to \$20.9 million reported in the third quarter of fiscal 2009. The increase is attributable to incremental revenue contributions from Mettoni and Telrex, which was mitigated by the impact of foreign exchange. The Asset Management Division contributed revenue of \$3.6 million in the third quarter, compared to \$2.5 million reported in the third quarter of fiscal 2009 as a result of stronger license and services revenue in the Division's transit operations and the inclusion of the Pulse Network operations in the Division's results.

#### **Cost of Sales**

Cost of sales for the quarter was \$7.8 million or 30.0% of revenue compared to \$7.6 million or 32.7% of revenue in the prior year's third quarter. The improvement in gross margins is attributable to the smaller proportionate contribution from lower margin hardware and third party software license revenue in the quarter. On a year to date basis cost of sales was \$20.8 million or 31.1% compared to \$20.3 million or 34.7% which represents a proportionate increase in gross margins for the same reason.

#### **Operating Expenses**

Operating expenses for the quarter were \$12.5 million, compared to \$10.6 million reported in the third quarter of last year and include the operating costs of Mettoni, Telrex and Pulse which were not included in the prior year's third quarter results. The majority of operating expenses continue to be denominated in U.S. dollars and reflect the cost of translating these expenses into Canadian dollars at lower exchange rates than in the third quarter of 2009, which mitigated the operating cost increases related to acquired operations. Also included in the quarter were \$0.5 million in investment tax credits netted against research and development expenses. On a year to date basis, operating expenses were \$32.3 million compared to \$27.7 million, and include increased operating costs related to acquired operations.

Non-cash charges for amortization of acquired software and other intangibles related to acquisitions were \$2.4 million, an increase from \$1.8 million in the prior year's third quarter. On a year to date basis, amortization was \$6.0 million compared to \$5.5 million in the prior year and reflects incremental amortization charges related to acquisitions completed in the year. The Company recorded foreign exchange gains in the current quarter of \$0.2 million compared to \$0.1 million in the prior year's third quarter.

#### **Interest and Other Income**

During the third quarter the Company recognized net interest income of \$0.1 million compared to \$0.2 million in the third quarter of fiscal 2009, consistent with the significant decline in interest rates and

returns available in the market. The Company reported \$0.4 million in other income from the sale of equities in the quarter, compared to nominal gains reported from the sale of equities in the prior year.

### **Income Tax Expense**

During the quarter, the Company established a tax provision of \$0.8 million or a 19.9% effective tax rate as compared to a provision of \$1.2 million or 33.3% in the prior year's third quarter. The decrease in the effective tax rate relates to the reversal of tax provisions previously set up, but no longer required. The Company paid \$0.3 million in tax installments in the third quarter (\$2.4 million year to date), compared to \$0.3 million in the third quarter of fiscal 2009 (\$1.7 million year to date in 2009).

### **Net Income**

Net income was \$3.2 million or \$0.13 per share on a diluted basis in the third quarter compared to \$2.4 million and \$0.10 per share respectively in the third quarter of fiscal 2009 as a result of increased license and services revenue. On a year to date basis, net income was \$6.8 million or \$0.27 per diluted share compared to \$4.2 million or \$0.17 per share in the prior year.

### **Risks and Uncertainties:**

The primary risks and uncertainties that affect or may affect the Company and its business, financial condition, and results of operations are substantially unchanged from those discussed in the Company's latest Annual Information Form and its Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended October 31, 2009, contained in the Company's 2009 Annual Report to Shareholders and all such risks and uncertainties are incorporated herein by reference.

### **Controls and Procedures**

In compliance with the Canadian Securities Administrators' National Instrument 52-109 ("NI 52-109"), the Company has filed with applicable Canadian securities regulatory authorities, certificates signed by its Chief Executive Officer ("CEO") and Vice President Finance that, among other things, report on the design and effectiveness of disclosure controls and procedures and the design of internal controls over financial reporting.

### **Disclosure Controls and Procedures**

Disclosure controls and procedures have been designed under the supervision of the CEO and Vice President Finance, with the participation of other management, to provide reasonable assurance that all relevant information required to be disclosed by the Company is recorded, processed, summarized and reported on a timely basis to senior management, as appropriate, to allow timely decisions regarding required public disclosure. Pursuant to NI 52-109, as of October 31, 2009, an evaluation of the effectiveness of the Company's disclosure controls and procedures was carried out under the supervision of the CEO and Vice President Finance. Based on this evaluation, the CEO and the Vice President Finance concluded that the design and operation of these disclosure controls and procedures were effective. This evaluation considered the Company's disclosure policy, a sub-certification process and the functioning of the Company's Disclosure Committee.

### **Internal Controls over Financial Reporting**

The Company's CEO and Vice President Finance are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements in accordance with Canadian GAAP.

At October 31, 2009, an evaluation was carried out of the effectiveness of the design and operation of internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting. Based on that evaluation, the Company's CEO and Vice President Finance have concluded that, as at October 31, 2009, the design and operation of controls over financial reporting was effective. These evaluations were conducted in accordance with the standards established in "Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission", and the requirements of NI 52-109.

There were no changes to the Company's internal control over financial reporting during the quarter ended July 31, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Additional Information:**

Additional information relating to the Company including our most recently completed Annual Information Form ("AIF") is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.enghouse.com](http://www.enghouse.com).

**Notice of No Auditor Review of Interim Financial Statements**

The accompanying unaudited consolidated interim financial statements of the Company for the three and nine months ended July 31, 2010 have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of the interim financial statements by an entity's auditor.

**Consolidated Balance Sheets**  
*(in thousands of Canadian dollars)*  
*(Unaudited)*

	July 31, 2010	October 31, 2009
<b>Assets</b>		
<b>Current</b>		
Cash (Note 2)	\$ 47,459	\$ 39,276
Short-term investments (Note 2)	29,681	53,876
Accounts receivable, net	23,293	17,017
Future income taxes	1,245	973
Prepaid expenses and other assets	4,022	2,434
	<u>105,700</u>	<u>113,576</u>
Property and equipment, net	2,006	1,576
Acquired software and other intangibles, net	36,550	22,934
Goodwill (Note 3)	36,051	19,965
Future income taxes	3,725	3,183
	<u>\$ 184,032</u>	<u>\$ 161,234</u>
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	19,777	17,107
Income taxes payable	1,540	1,473
Dividends payable (Note 4)	1,007	746
Deferred revenue	28,771	15,765
	<u>51,095</u>	<u>35,091</u>
Future income taxes	12,528	8,693
Long-term income taxes payable	588	1,043
Deferred revenue	616	197
	<u>64,827</u>	<u>45,024</u>
<b>Shareholders' Equity</b>		
Share capital (Note 5)	50,685	49,780
Contributed surplus (Note 5)	2,318	2,047
Retained earnings	77,186	73,142
Accumulated other comprehensive loss	(10,984)	(8,759)
	<u>119,205</u>	<u>116,210</u>
	<u>\$ 184,032</u>	<u>\$ 161,234</u>

*The accompanying notes form an integral part of these consolidated interim financial statements.*

**Consolidated Statements of Operations and Retained Earnings**  
*(in thousands of Canadian dollars except per share amounts)*  
*(Unaudited)*

	Three months ended July 31		Nine months ended July 31	
	2010	2009	2010	2009
<b>Revenue</b>				
Software licenses	\$ 8,387	\$ 7,889	\$ 21,404	\$ 17,450
Services	16,929	13,747	43,401	37,810
Hardware	715	1,717	2,025	3,155
	<b>26,031</b>	<b>23,353</b>	<b>66,830</b>	<b>58,415</b>
<b>Cost of sales</b>				
Software licenses	1,272	1,517	3,443	3,029
Services	5,992	4,883	15,937	14,751
Hardware	542	1,238	1,386	2,518
	7,806	7,638	20,766	20,298
<b>Gross margin</b>	<b>18,225</b>	<b>15,715</b>	<b>46,064</b>	<b>38,117</b>
<b>Operating expenses</b>				
Selling, general and administrative	9,173	7,118	22,365	17,649
Research and development	2,922	3,152	8,990	9,117
Amortization of property and equipment	369	320	975	979
	12,464	10,590	32,330	27,745
<b>Income before the undernoted</b>	<b>5,761</b>	<b>5,125</b>	<b>13,734</b>	<b>10,372</b>
Amortization of acquired software and other intangibles	(2,417)	(1,840)	(5,983)	(5,505)
Foreign exchange gain	207	107	148	182
Interest income, net	68	228	295	1,175
Other income	378	24	942	24
<b>Income before income taxes</b>	<b>3,997</b>	<b>3,644</b>	<b>9,136</b>	<b>6,248</b>
Provision for income taxes				
Current	1,057	373	2,139	1,419
Future	(262)	840	185	666
<b>Net income for the period</b>	<b>\$ 3,202</b>	<b>\$ 2,431</b>	<b>\$ 6,812</b>	<b>\$ 4,163</b>
<b>Retained earnings, beginning of period</b>	<b>\$ 74,991</b>	<b>\$ 69,865</b>	<b>\$ 73,142</b>	<b>\$ 72,015</b>
Dividends	(1,007)	(746)	(2,768)	(2,115)
Purchase and cancellation of common shares	-	(175)	-	(2,688)
<b>Retained earnings, end of period</b>	<b>\$ 77,186</b>	<b>\$ 71,375</b>	<b>\$ 77,186</b>	<b>\$ 71,375</b>
<b>Earnings per share</b>				
Basic	\$ 0.13	\$ 0.10	\$ 0.27	\$ 0.17
Diluted	\$ 0.13	\$ 0.10	\$ 0.27	\$ 0.17
Weighted average shares outstanding during period (millions)				
- basic	25.2	24.9	25.1	25.0
- diluted	25.4	25.2	25.3	25.1

*The accompanying notes form an integral part of these consolidated interim financial statements.*

**Consolidated Statements of Comprehensive Income and Accumulated Other Comprehensive Loss**

*(in thousands of Canadian dollars)*  
*(Unaudited)*

	Three months ended July 31		Nine months ended July 31	
	2010	2009	2010	2009
Net income for the period	\$ 3,202	\$ 2,431	\$ 6,812	\$ 4,163
<b>Other comprehensive income (loss):</b>				
Unrealized gain (loss) on translating financial statements of self-sustaining foreign operations	1,747	(2,891)	(2,873)	(3,839)
Transfer to net income of realized gains on available for sale investments, net of tax of (\$114) (nine months – (\$284))	(263)	(16)	(657)	(172)
Unrealized gain (loss) on available for sale investments, net of tax of \$195 (nine months – \$613)	451	429	1,416	(505)
Unrealized foreign currency translation gain (loss) on available for sale investments, net of tax of \$18 (nine months – (\$48))	41	71	(111)	731
<b>Other comprehensive income (loss)</b>	<b>\$ 1,976</b>	<b>\$ (2,407)</b>	<b>\$ (2,225)</b>	<b>\$ (3,785)</b>
<b>Comprehensive income</b>	<b>\$ 5,178</b>	<b>\$ 24</b>	<b>\$ 4,587</b>	<b>\$ 378</b>
<b>Accumulated other comprehensive loss, beginning of period</b>	<b>\$ (12,960)</b>	<b>\$ (4,597)</b>	<b>\$ (8,759)</b>	<b>\$ (3,219)</b>
Other comprehensive income (loss)	1,976	(2,407)	(2,225)	(3,785)
<b>Accumulated other comprehensive loss, end of period</b>	<b>\$ (10,984)</b>	<b>\$ (7,004)</b>	<b>\$ (10,984)</b>	<b>\$ (7,004)</b>

*The accompanying notes form an integral part of these consolidated interim financial statements.*

**Consolidated Statements of Cash Flows**  
*(in thousands of Canadian dollars)*  
*(Unaudited)*

	For the three months ended July 31		For the nine months ended July 31	
	2010	2009	2010	2009
<b>Cash flows from operating activities</b>				
Net income for the period	\$ 3,202	\$ 2,431	\$ 6,812	\$ 4,163
<b>Add (deduct) items not involving cash</b>				
Amortization of property and equipment	369	320	975	979
Amortization of acquired software and other intangibles	2,417	1,840	5,983	5,505
Stock-based compensation expense	111	88	271	169
Gain on sale of short-term investments	(378)	(24)	(942)	(24)
Future income taxes	(262)	840	185	666
<b>Cash flows before changes in operating assets and liabilities</b>	<b>5,459</b>	<b>5,495</b>	<b>13,284</b>	<b>11,458</b>
<b>Changes in operating assets and liabilities</b>				
Decrease (increase) in accounts receivable, net	1,894	(1,144)	1,594	3,126
Decrease (increase) in prepaid expenses and other assets	589	353	(446)	269
Increase (decrease) in accounts payable and accrued liabilities	1,281	4,103	(4,564)	1,622
Increase (decrease) in current income taxes payable	537	133	(861)	(2,377)
Increase (decrease) in deferred revenue	1,041	(1,932)	8,679	(60)
Unrealized foreign exchange (gain) loss	(1,691)	164	(1,428)	(144)
<b>Cash flows from operating activities</b>	<b>9,110</b>	<b>7,172</b>	<b>16,258</b>	<b>13,894</b>
<b>Cash flows from investing activities</b>				
Purchase of property and equipment, net	(51)	(98)	(609)	(354)
Acquisitions, net of cash acquired (Note 6)	(4,804)	(75)	(30,131)	(6,935)
Proceeds from sale of short-term investments	2,583	888	25,287	21,168
	<b>(2,272)</b>	<b>715</b>	<b>(5,453)</b>	<b>13,879</b>
<b>Cash flows from financing activities</b>				
Issuance of share capital	-	5	905	955
Payment of cash dividend	(1,007)	(748)	(2,507)	(2,005)
Purchase and cancellation of common shares	-	(259)	-	(4,477)
	<b>(1,007)</b>	<b>(1,002)</b>	<b>(1,602)</b>	<b>(5,527)</b>
Effect of foreign exchange rate changes on cash	602	(1,952)	(1,020)	(2,342)
<b>Net increase in cash during the period</b>	<b>6,433</b>	<b>4,933</b>	<b>8,183</b>	<b>19,904</b>
Cash – beginning of period	41,026	27,302	39,276	12,331
<b>Cash – end of period</b>	<b>\$ 47,459</b>	<b>\$ 32,235</b>	<b>\$ 47,459</b>	<b>\$ 32,235</b>
<b>Supplementary cash flow information:</b>				
Cash paid during the period for income taxes	\$ 333	\$ 289	\$ 2,418	\$ 1,665

**Note: Cash excludes short-term investments (Note 2)**

*The accompanying notes form an integral part of these consolidated interim financial statements.*

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**July 31, 2010 and 2009**

**(in thousands of Canadian dollars)**

**1. Significant Accounting Policies**

These unaudited consolidated interim financial statements have been prepared in Canadian dollars in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and follow the same accounting policies and methods of application as the October 31, 2009 annual audited consolidated financial statements, with the exception of accounting for certain disclosures related to new accounting policies. These unaudited consolidated interim financial statements do not conform in all respects with disclosures required for annual financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis contained in the Company's Annual Report for the fiscal year ended October 31, 2009.

(a) Changes in accounting policy:

CICA Handbook section 1506, *Accounting Changes*, was amended to exclude from its scope changes in accounting policies upon the complete replacement of an entity's primary basis of accounting. The amendments apply to interim and annual financial statements for years beginning on or after July 1, 2009. This amendment did not have an impact on the unaudited consolidated interim financial statements.

(b) Recent accounting pronouncements issued and not yet applied:

In January 2009, CICA Section 1582, *Business Combinations* was issued replacing Section 1581 *Business Combinations*. The Section establishes standards for the accounting for business combinations and provides the Canadian equivalent to the International Financial Reporting Standards ("IFRS") standard, IFRS 3 (revised), *Business Combinations*. The Section applies prospectively to business combinations for which the acquisition date is on or after October 1, 2011 and allows for earlier application. CICA Section 1601, *Consolidated Financial Statements* and Section 1602, *Non-Controlling Interests* were issued replacing Section 1600, *Consolidated Financial Statements*. These sections establish standards for the preparation of consolidated financial statements and accounting for non-controlling interests in a subsidiary subsequent to a business combination. The sections are equivalent to the corresponding provisions of the IFRS standard, IAS 27 (revised), *Consolidated and Separate Financial Statements*. The Sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after October 1, 2011 and allows for earlier adoption. The Company is currently assessing the impact the adoption of these new Standards may have on the Company's results of operations and consolidated financial position.

In December 2009, the CICA issued EIC 175, *Multiple Deliverable Revenue Arrangements*, replacing EIC 142, *Revenue Arrangements with Multiple Deliverables*. This EIC (a) provides updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated; (b) requires, in situations where the vendor does not have vendor-specific objective evidence ("VSOE") or third-party evidence of selling prices, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (c) eliminates the use of the residual method and requires an entity to allocate revenue using the relative selling price method and (d) requires expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. The accounting changes required under EIC 175 are effective for fiscal years beginning on or after January 1, 2011, with earlier adoption permitted. Adoption may either be on a prospective basis or by retrospective application. If EIC 175 is adopted early, in a reporting period that is not the first reporting period in the entity's fiscal year, it must be applied retroactively from the beginning of the Company's fiscal year. The Company is currently assessing the

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

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(in thousands of Canadian dollars)

impact of these amendments on its financial statements and has not yet determined either the timing or method of its adoption.

**Harmonization of Canadian and International Accounting Standards**

In February 2008, the CICA Accounting Standards Board (“AcSB”) confirmed that International Financial Reporting Standards (“IFRS”) will replace Canadian GAAP effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company’s first unaudited consolidated interim financial statements presented in accordance with IFRS will be for the three month period ending January 31, 2012, and its first audited consolidated annual financial statements presented in accordance with IFRS will be for the year ending October 31, 2012 and will include comparative results for fiscal 2011.

Based on our preliminary scoping analysis we cannot yet quantify the impact that the future adoption of IFRS will have on our financial statements and operating performance measures; however, such impact could be material. Additional information will be provided on a quarterly basis as we progress towards implementation.

**2. Cash and Short-term investments**

Short-term investments consist of the following:

	<b>July 31, 2010</b>		<b>October 31, 2009</b>	
	Carrying Value	Market Value	Carrying Value	Market Value
Mutual funds	\$ 14,556	\$ 14,556	\$ 28,897	\$ 28,897
Banker’s acceptances	8,757	8,757	18,341	18,345
Corporate bonds	4,035	4,031	3,526	3,546
Equities	2,333	2,333	3,112	3,112
<b>Total</b>	<b>\$ 29,681</b>	<b>\$ 29,677</b>	<b>\$ 53,876</b>	<b>\$ 53,900</b>

Cash as at July 31, 2010 includes £1.5 million in restricted cash balances held in escrow as part of the Mettoni acquisition and is payable on January 6, 2011, subject to adjustment. Payment of £0.8 million was released from escrow on July 6, 2010.

**3. Goodwill**

The Continuity of goodwill by reportable segment is as follows:

	<b>July 31, 2010</b>			<b>October 31, 2009</b>		
	Syntellect Division	Management Division	Asset Total	Syntellect Division	Management Division	Asset Total
Opening Balance	\$ 16,877	\$ 3,088	\$ 19,965	\$ 18,919	\$ 3,034	\$ 21,953
Additions, Net	16,316	1,400	17,716	2,174	-	2,174
Acquired tax benefit adjustment	(1,397)	-	(1,397)	(2,587)	-	(2,587)
Purchase price adjustments	(13)	(127)	(140)	431	-	431
Foreign exchange	(76)	(17)	(93)	(2,060)	54	(2,006)
<b>Ending balance</b>	<b>\$ 31,707</b>	<b>\$ 4,344</b>	<b>\$ 36,051</b>	<b>\$ 16,877</b>	<b>\$ 3,088</b>	<b>\$ 19,965</b>

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**July 31, 2010 and 2009**

(in thousands of Canadian dollars)

During each of the quarter ended July 31, 2010 and the year ended October 31, 2009, adjustments for previously unrecognized tax benefits from earlier acquisitions were accounted for as a credit to goodwill. Certain adjustments to the preliminary purchase price allocation related to the acquisitions of Gamma, Trio and Transched were booked in the year resulting in a decrease to goodwill of \$140, while adjustments to Envov were booked in the prior year and resulted in a \$431 increase to goodwill and offsetting reduction to acquired software and other intangibles.

**4. Dividends**

The Company's policy is to pay quarterly dividends subject to Board approval, based on the Company's financial results, since the policy's inception in 2007. The Company has paid regular quarterly dividends since May 31, 2007. The Board of Directors determines if and when dividends should be declared and paid based on all relevant circumstances at the time. The Company increased its quarterly dividend from \$0.025 to \$0.03 per common share outstanding effective for its May 29, 2009 dividend payment and again to \$0.04 per common share outstanding effective for its May 31, 2010 dividend payment. On June 2, 2010 the Company declared an eligible dividend, which was paid on August 31, 2010 to shareholders of record as of August 17, 2010 of \$1.0 million, which is reflected as a liability of the Company on the balance sheet as at July 31, 2010.

**5. Share capital**

**(A) Authorized**

Unlimited common shares

Unlimited Class A, redeemable, retractable, non-voting, non-cumulative, preference shares

Unlimited Class B, redeemable, retractable, non-voting, preference shares

**(B) Issued and outstanding**

	Number of Common Shares	Share Capital Amount	Contributed Surplus Amount
<b>Balance – October 31, 2008</b>	<b>25,492,724</b>	<b>\$ 50,568</b>	<b>\$ 1,827</b>
Stock options exercised (C)	332,500	1,006	-
Stock options expensed (D)	-	20	220
Shares repurchased and cancelled under common share re-purchase plan (E)	(949,562)	(1,814)	-
<b>Balance – October 31, 2009</b>	<b>24,875,662</b>	<b>\$ 49,780</b>	<b>\$ 2,047</b>
Stock options exercised (C)	292,000	905	-
Stock options expensed (D)	-	-	271
Shares repurchased and cancelled under common share re-purchase plan (E)	-	-	-
<b>Balance – July 31, 2010</b>	<b>25,167,662</b>	<b>\$ 50,685</b>	<b>\$ 2,318</b>

There were no Class A and no Class B preference shares issued and outstanding as at July 31, 2010 or October 31, 2009.

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**July 31, 2010 and 2009**

(in thousands of Canadian dollars)

**(C) Common share purchase options**

The Company has granted options to purchase common shares to certain directors, officers and employees of the Company, pursuant to the terms of the Company's stock option plan (the "Plan"). The Plan provides that a total of 1,818,800 (October 31, 2009 – 2,110,800) common shares are reserved for options and that the shares reserved for options, which could become exercisable in any one year, will not exceed more than 10% of the issued and outstanding common shares of the Company at the time such options may be exercisable. These options vest at various times over four years and expire seven to ten years after the grant date. The exercise price of each option equals the market price of the Company's stock on the date the options are granted.

A summary of the status of the Company's Plan as at July 31, 2010 and October 31, 2009, and changes during the nine and twelve months ended respectively on those dates is presented as follows:

	<b>July 31, 2010</b>		<b>October 31, 2009</b>	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding at beginning of period	1,329,100	\$ 5.82	1,575,600	\$ 5.54
Granted	545,000	8.10	260,000	5.00
Exercised	(292,000)	3.10	(332,500)	3.02
Forfeited	(10,000)	8.60	(174,000)	7.37
Outstanding at end of period	<b>1,572,100</b>	<b>\$ 7.10</b>	<b>1,329,100</b>	<b>\$ 5.82</b>
Options exercisable at end of period	<b>875,600</b>	<b>\$ 6.93</b>	<b>1,035,100</b>	<b>\$ 5.96</b>

**(D) Stock-based compensation**

The Company uses the fair value method for recording compensation expense related to equity instruments awarded to employees, officers and directors in accordance with CICA 3870. For the purposes of expensing stock options, the estimated fair value of the options is amortized to expense over the vesting period of the options on a straight-line basis with a corresponding credit to contributed surplus. During the third quarter of 2010, the Company recorded a non-cash charge of \$111 (Fiscal 2009 - \$240). For options granted, the fair value of each stock option on the date of the grant was estimated using the Black-Scholes option pricing model as follows:

	<b>June 2010</b>	<b>April 2010</b>	<b>December 2009</b>	<b>March 2009</b>
Risk-free interest rate	2.28%	2.59%	2.12%	1.85%
Estimated volatility	35%	34%	35%	33%
Dividend yield	\$ 0.16	\$ 0.16	\$ 0.12	\$ 0.12
Expected life in years	5	5	5	5
Weighted average fair value (in dollars)	\$ 2.60	\$ 2.25	\$ 2.53	\$ 1.23

**(E) Common share repurchase plan**

On April 14, 2010, the Company renewed its common share repurchase plan, whereby it may repurchase up to a maximum of 1,641,376 common shares of the Company, expiring on April 13, 2011. During the first three quarters of fiscal 2010, the Company did not repurchase any shares for cancellation (YTD July 31/2009 – 936,924 shares for proceeds of \$4,477 at an average cost of \$4.78). In the first three quarters of 2009, \$1,789 was allocated to share capital and the remainder offset against retained earnings.

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**July 31, 2010 and 2009**

**(in thousands of Canadian dollars)**

**6. Acquisitions**

*Telrex LLC*

Effective June 1, 2010, Enghouse completed the acquisition of the intellectual property of Telrex LLC, and Mettoni, Inc., a wholly owned subsidiary of Enghouse, acquired the Telrex operations for a total purchase price of approximately \$4.1 million plus the assumption of maintenance obligations and including transaction costs of approximately \$0.1 million. Of this total, approximately \$0.5 million remains subject to holdback and adjustment, payable on October 1, 2010. Telrex is a leading provider of IP call recording and contact center optimization software solutions with operations in North America and EMEA. The transaction was accounted for as a purchase and was included in the operations of the Company from June 1, 2010.

*Mettoni Group*

On April 6, 2010 the Company acquired 100% of the issued and outstanding common shares of Mettoni Limited ("Mettoni") for a cash purchase price of approximately \$24.6 million which includes estimated transaction costs of approximately \$0.4 million. Of this total, approximately \$2.3 million remains subject to holdback and adjustment, payable on January 6, 2011. The first holdback was subject to adjustment and was paid on July 6, 2010 in the amount of \$1.3 million. The acquisition of Mettoni also includes its wholly owned subsidiaries, Arc Solutions (International) Limited, Datapulse Limited, Excomm Limited, Mettoni Inc., Arc Solutions (International) Inc. and Datapulse Inc. Mettoni provides unified communications software solutions and has operations in North America, Europe, Middle East and Africa and Asia Pacific. The transaction was accounted for as a purchase and was included in the operations of the Company from April 6, 2010.

*Pulse Voice Inc.*

On November 1, 2009 the Company acquired 100% of the issued and outstanding common shares of Pulse Voice Inc. for a cash purchase price of approximately \$4.6 million, including transaction costs. Pulse is a leading provider of communications solutions with a contact center division providing solutions to over 200 customers (reported as part of the Syntellect Division) and a network division providing cost control and intelligent network solutions to the telecom industry (reported as part of the Asset Management Division). The transaction will be accounted for as a purchase and was included in the operations of the Company from November 1, 2009.

*Trio Enterprise AB*

On April 1, 2009, Enghouse acquired the business and outstanding common shares of Trio Enterprise AB ("Trio") for a cash purchase price of \$7.4 million, which includes transaction costs of \$0.3 million. Trio provides Enterprise Communication, presence, call and message management solutions in Northern Europe.

These acquisitions have been recorded under the purchase method of accounting and results have been included in the consolidated statements of operations from the acquisition dates. Accordingly, the allocations of the purchase price to assets and liabilities are based on their fair value, with the excess of the purchase price over the fair value of the assets acquired being allocated to goodwill. Management has established the preliminary purchase price allocations taking into account all relevant information at the time of preparing the notes to the unaudited consolidated interim financial statements. However, the preliminary purchase price allocations are subject to further refinements.

Goodwill is not amortized but is assessed annually for any potential impairment in value. Other intangibles representing acquired software and customer relationships are being amortized over a period of three and six years, respectively for Trio and four and six years respectively for Pulse. Acquired software in the Mettoni acquisition is being amortized over five years while customer intangibles are being amortized over seven years. Acquired software in the Telrex acquisition is being amortized over four years while customer intangibles are being amortized over three years.

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**July 31, 2010 and 2009**

(in thousands of Canadian dollars)

The Company's purchase price allocations are as follows:

	FY 10 Telrex (preliminary)	FY 10 Mettoni (preliminary)	FY 10 Pulse (final)	FY 09 Trio (final)
Cash	\$ -	\$ 1,456	\$ 216	\$ 780
Accounts receivable, net	159	6,428	1,990	3,279
Prepays and other current assets	9	1,161	69	528
Property and equipment	14	383	440	86
Future income tax assets	146	1,116	122	1,374
Acquired software	2,616	7,440	760	1,680
Other intangibles	377	7,650	490	2,498
Goodwill	1,566	13,350	2,800	2,186
Total assets acquired	<u>\$ 4,887</u>	<u>\$ 38,984</u>	<u>\$ 6,887</u>	<u>\$12,411</u>
Less: Current liabilities assumed	\$ 830	\$ 10,144	\$ 1,869	\$ 5,054
Less: Future income tax liabilities	-	4,225	400	-
Total liabilities assumed	<u>\$ 830</u>	<u>\$ 14,369</u>	<u>\$ 2,269</u>	<u>\$ 5,054</u>
Net assets acquired for cash consideration	<u>\$ 4,057</u>	<u>\$ 24,615</u>	<u>\$ 4,618</u>	<u>\$ 7,357</u>

**7. Segmented Information**

The Company has two reportable segments, the Syntellect Division and Asset Management Division, based on the nature of the operations and markets that each of these segments serves. The accounting policies followed by these segments are the same as those described in the summary of significant accounting policies.

The Company's reportable segments each develop and market software products and provide services for their respective markets. The Syntellect Division also includes the operations of Telrex (June 1, 2010), Mettoni (April 6, 2010), the Pulse Voice IVR operations (November 1, 2009) and Trio Enterprises AB (April 1, 2009) since their respective dates of acquisition in parenthesis. The division develops, markets and integrates self-service software solutions including voice and speech based applications as well as traditional Interactive Voice Response (IVR) systems, with a vertical market focus on the financial services, media, telecommunications, public utility and healthcare industries.

The Asset Management Division, which includes the results of the Network operations of Pulse Voice Inc. since the date of acquisition, November 1, 2009, develops, markets and provides services related to visual based network management software solutions to customers in the telecommunications, cable, electric, gas and public and private transit markets. The Company evaluates segment performance based on revenue and profit or loss before investment income and income taxes.

**Notes to Interim Consolidated Financial Statements**  
(Unaudited)  
**July 31, 2010 and 2009**  
(in thousands of Canadian dollars)

	Syntellect Division	Asset Management Division	Total
<b>Three months ended July 31, 2010</b>			
Revenue	\$ 22,402	\$ 3,629	\$ 26,031
Operating expenses, excluding non-cash charges	(17,120)	(2,207)	(19,327)
Amortization of property and equipment	(326)	(43)	(369)
Amortization of acquired software and intangibles	(2,306)	(111)	(2,417)
<b>Segmented profit</b>	<b>\$ 2,650</b>	<b>\$ 1,268</b>	<b>\$ 3,918</b>
Corporate expenses			(574)
Foreign exchange			207
Interest income			68
Other income			378
Income before income taxes			<b>\$ 3,997</b>
Goodwill	\$ 31,707	\$ 4,344	\$ 36,051
Other assets	92,626	25,674	118,300
Short-term investments			29,681
<b>Total assets</b>			<b>\$184,032</b>
<b>Three months ended July 31, 2009</b>			
Revenue	\$ 20,872	\$ 2,481	\$ 23,353
Operating expenses, excluding non-cash charges	(14,848)	(2,364)	(17,212)
Amortization of property and equipment	(293)	(27)	(320)
Amortization of acquired software and intangibles	(1,661)	(179)	(1,840)
<b>Segmented profit</b>	<b>\$ 4,070</b>	<b>\$ (89)</b>	<b>\$ 3,981</b>
Corporate expenses			(696)
Foreign exchange			107
Interest income			228
Other income			24
Income before income taxes			<b>\$ 3,644</b>
Goodwill	\$ 17,272	\$ 3,088	\$ 20,360
Other assets	62,614	19,542	82,156
Short-term investments			59,532
<b>Total assets</b>			<b>\$ 162,048</b>

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**July 31, 2009 and 2008**

(in thousands of Canadian dollars)

	<b>Syntellec Division</b>	<b>Asset Management Division</b>	<b>Total</b>
<b>Nine months ended July 31, 2010</b>			
Revenue	\$ 56,826	\$ 10,004	\$ 66,830
Operating expenses, excluding non-cash charges	(42,894)	(7,362)	(50,256)
Amortization of property and equipment	(842)	(133)	(975)
Amortization of acquired software and intangibles	(5,541)	(442)	(5,983)
<b>Segmented profit</b>	<b>\$ 7,549</b>	<b>\$ 2,067</b>	<b>\$ 9,616</b>
Corporate expenses			(1,865)
Foreign exchange			148
Interest income			295
Other income			942
Income before income taxes			<b>\$ 9,136</b>
<b>Nine months ended July 31, 2009</b>			
Revenue	\$ 51,194	\$ 7,221	\$ 58,415
Operating expenses, excluding non-cash charges	(38,181)	(7,059)	(45,240)
Amortization of property and equipment	(914)	(65)	(979)
Amortization of acquired software and intangibles	(4,968)	(537)	(5,505)
<b>Segmented profit</b>	<b>\$ 7,131</b>	<b>\$ (440)</b>	<b>\$ 6,691</b>
Corporate expenses			(1,824)
Foreign exchange			182
Interest income			1,175
Other income			24
Income before income taxes			<b>\$ 6,248</b>

**8. Litigation and Contingencies**

Apropos Technology, Inc. ("Apropos"), an indirect wholly owned subsidiary of the Company, was named as a defendant in a shareholder class action litigation suit filed in federal court in New York City in November 2001 against Apropos and certain of its former directors and officers and the underwriters of Apropos' initial public offering ("IPO"). This lawsuit alleges that the prospectus and registration statement for the IPO failed to disclose that the underwriters allegedly solicited and received excessive commissions from investors and that some of the investors in the IPO allegedly agreed with the underwriters to buy additional shares in the aftermarket in order to inflate the price of Apropos' stock. The Company understands that approximately 300 other publicly traded companies and their public offering underwriters have had similar suits filed against them.

In June 2003, Apropos and certain issuer defendants entered into a proposed settlement which will be funded from participating issuers' directors and officers insurance proceeds, less any settlement amounts by the underwriter defendants.

Prior to consummation of the proposed settlement on December 5, 2006, the Third Circuit Court of Appeals issued a ruling concerning class certification, in which it concluded that the proposed class of IPO purchasers could not be certified, as the issues were not common among all class members. A petition seeking a rehearing of this December 5, 2006 ruling was denied by the Court on April 6, 2007. In light of this Court of

**Notes to Interim Consolidated Financial Statements**

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**July 31, 2010 and 2009**

**(in thousands of Canadian dollars)**

Appeals ruling, the District Court entered an order of June 25, 2007 terminating the proposed settlement between the plaintiffs and the issuers, including Apropos.

In February 2009, an agreement to settle the litigation in its entirety was reached and definitive settlement documents filed with the District Court. Final court approval of the settlement was received in October, 2009. Several appeals have been filed objecting to the definition of the settlement class and fairness of the settlement, and those appeals remain pending. If the final order relating to the settlement is not granted, and litigation against the Company continues, Apropos will continue to defend the action vigorously. Apropos expects that its insurance proceeds will be sufficient to cover any outcome of this litigation, including its allocable share of any settlement.

**General**

The Company provides its customers a qualified indemnity against the infringement of third party intellectual property rights. From time to time, various owners of patents and copyrighted works send the Company or its customers letters alleging that the Company's products do or might infringe upon the owner's intellectual property rights, and/or suggesting that the Company or its customers should negotiate a license agreement with the owner. The Company's policy is to never knowingly infringe upon any third party's intellectual property rights. Accordingly, where appropriate, the Company forwards any such allegation or licensing request to its outside legal counsel for review. The Company generally attempts to resolve any such matter by informing the owner of the Company's position concerning non-infringement or invalidity. Even though the Company attempts to resolve these matters without litigation, it is always possible that the owner of a patent or copyrighted work will sue the Company.

In response to correspondence from and, in a few instances, litigation instigated by, third party patent holders, a few of the Company's customers have attempted to tender to the Company the defense of its products under contractual indemnity provisions. The Company does not believe that it currently has any obligation to provide such a defense or that the Company's products infringe any third party patent. However, the Company is currently subject to two actions on the suggested basis of contractual indemnity. With respect to this litigation, and any other litigation the Company becomes involved with, under a contractual indemnity or any other legal theory, the Company has and will continue to vigorously assert all appropriate defenses.

**9. Comparative consolidated financial statements**

Certain comparative figures have been reclassified to conform to the current period's consolidated financial statement presentation.