



First Quarter Report | January 31, 2011

March 9, 2011

To our Shareholders,

First quarter revenue was \$28.6 million, compared to \$19.5 million reported in the same period last year, an increase of 46%. Operating income for the quarter was \$6.9 million compared to \$3.7 million in the prior year's first quarter, an increase of 85%. Net income for the first quarter was \$3.1 million or \$0.12 per share on a diluted basis compared to the prior year's first quarter net income of \$1.9 million or \$0.08 per share. The increase in revenue was primarily a result of increased license sales in the quarter and contributions from acquisitions. As has become the norm, revenue and operating costs are impacted by the volatility of foreign exchange as outlined in the MD&A.

Operating expenses increased to \$13.2 million from \$9.5 million in the prior year's first quarter and include incremental operating costs related to the Mettoni and Telrex acquisitions, not included in the prior year's first quarter results. Non-cash amortization charges were \$2.4 million compared to \$1.8 million in the prior year's first quarter and include amortization charges for acquired software and other intangibles from acquired operations, including Mettoni and Telrex.

The Company generated cash flows from operations of \$9.5 million in the first quarter compared to \$2.1 million in the prior year's first quarter. Enghouse closed the quarter with \$83.4 million in cash and short-term investments, after payment of approximately \$2.5 million related to the final holdbacks on the Mettoni and Telrex acquisitions, compared to \$78.3 million at October 31, 2010. The Company continues to have no long-term debt and did not repurchase any shares in the quarter.

The Board of Directors today authorized a 25% increase to the eligible quarterly dividend to \$0.05 per common share, payable on May 31, 2011 to shareholders of record at the close of business on May 17, 2011. 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 March 9, 2011 and should be read in conjunction with the Company's unaudited interim consolidated financial statements and the notes thereto for the periods ended January 31, 2011 and 2010, 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, 2010, contained in the Company's 2010 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 subsidiaries, all wholly owned, for the first quarter ended January 31, 2011. 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 Interaction Management Group and the Asset Management Group. The Interaction Management Group 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 Group 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 January 31, 2011). 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.

	Q1/11	Q4/10	Q3/10	Q2/10	Q1/10	Q4/09	Q3/09	Q2/09
Revenue	\$ 28,569	\$ 27,378	\$ 26,031	\$21,263	\$19,536	\$20,003	\$23,353	\$16,834
Net Income	3,112	3,426	3,202	1,707	1,903	2,571	2,431	938
Basic income per share	0.12	0.14	0.13	0.07	0.08	0.10	0.10	0.04
Diluted income per share	0.12	0.13	0.13	0.07	0.08	0.10	0.10	0.04
Cash and short-term investments	83,443	78,267	77,140	72,619	89,819	93,152	91,767	88,628
Total assets	185,586	181,427	184,032	179,808	162,933	161,234	162,048	165,437

### 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, 2010, contained in the Company’s 2010 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, 2010.

### Changes in accounting policy

#### **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 3R, *Business Combinations*. The Section applies prospectively to business combinations for which the acquisition date is on or after November 1, 2011 and allows for earlier application. The standard also requires that acquisition-related costs be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. These costs are presently capitalized.

CICA Section 1601, *Consolidated Financial Statements* and Section 1602, *Non-Controlling Interests* were also 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 November 1, 2011 and allow for earlier adoption. Early adoption may reduce the amount of

restatement required upon conversion to IFRS. The Company is currently assessing what 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.

Under EIC 175, allocation of revenue to separate elements in a multiple element transaction will be based on their relative selling prices, as indicated by VSOE or third-party evidence of selling prices, or if both are not available, on estimated selling prices. The allocated portion of the arrangement not delivered would then be deferred. The Company is currently assessing what impact these amendments would have 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 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 of all relevant IFRS standards to identify key areas that are expected to be impacted.
- *Impact analysis, evaluation and design phase* – each area identified will be addressed to specify, quantify and design changes to existing accounting policies, information systems and business processes, consider optional IFRS 1 exemptions and develop 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; and preparing detailed reconciliations of Canadian GAAP to IFRS financial statements.

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

The Company has developed a detailed conversion plan, established an IFRS implementation team and engaged external advisors to consult on its IFRS project. The Company's Audit Committee is updated on the progress of the conversion plan on at least a quarterly basis. To date the Company has completed its phase I review and has identified and reviewed the key areas in Phase II where changes to current accounting policies may be required. Based on our review, we have determined that in many respects the Company's accounting policies are aligned with IFRS requirements. 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, other than those noted below. However, the Company does anticipate a significant increase in disclosure resulting from the adoption of IFRS.

The Company continues to prepare detailed component evaluation analyses of these key areas, including analysis of the potential impact on IT systems, business processes, internal controls over financial reporting and disclosure controls. The Company has also begun to draft preliminary IFRS consolidated financial statements and notes for the first IFRS financial statements issued for quarter ended January 31, 2012 to better evaluate the impact that the conversion will have on its initial financial statements.

The following table summarizes the key elements of the transition plan and the expected timing of future activities:

<b>IFRS Conversion Plan Task</b>	<b>Expected Timing</b>
Identification of key areas likely to be impacted by IFRS (Phase I)	Complete
Detailed component evaluations of all relevant IFRS requirements and identification of areas requiring change in accounting policies and alternatives (Phase II)	In progress – continuing through Q2/11
Final determination of expected changes to accounting policies and alternatives under IFRS 1 (Phase II)	In progress – continuing through Q4/11
Resolution of expected accounting policy change implications on internal controls, IT systems and business processes (Phase III)	In progress – continuing through Q4/11
Quantification of expected financial statement impact of changes in accounting policies (Phase III)	In progress – continuing through Q4/11
Preparation of pro forma Q1/12 financial statements consistent with IFRS presentation and disclosure requirements (Phase II and III)	In progress – continuing through Q1/12
Management and employee education and training	On-going throughout the transition plan

Enghouse has identified the following areas that have the greatest potential impact to the Company's accounting policies, based on existing IFRS as at January 31, 2011:

- Presentation of Financial Statements (IAS 1)
- First-time Adoption of IFRS (IFRS 1)
- Business Combinations (IFRS 3R)
- Revenue Recognition (IAS 11 and 18)
- Provisions and Contingent Liabilities (IAS 37)
- Impairment of Assets (IAS 36)
- Income Taxes (IAS 12)
- Foreign exchange (IAS 21)

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. The International Accounting Standards Board ("IASB") continues 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.

The following are the Company's preliminary IFRS policy decisions, IFRS 1 optional exemptions and expected accounting differences identified in the preparation of the IFRS statement of financial position in the opening comparative balance sheet at November 1, 2010, (the "Transition Date"):

**Optional IFRS 1 exemptions:**

<b>Exemption</b>	<b>Application of Exemption</b>
Cumulative translation differences	The Company has chosen to deem the cumulative translation differences for all foreign operations to be zero as of the Transition Date. Enghouse had cumulative translation losses of \$12.4 million at October 31, 2010. This will be adjusted against retained earnings on the transition balance sheet.
Share based payments	The Company has elected to apply IFRS 2 <i>Share-based Payments</i> only to equity instruments issued after November 7, 2002 and not vested by the Transition Date. The Company has not yet quantified the impact of this transition but does not expect this to have a material impact on the financial statements.
Net book value as deemed cost available for property plant and equipment and intangible assets	The Company has chosen to elect to use historical cost accounting at the Transition Date to value its property and equipment. This is consistent with the Company's current accounting policy, and will be used rather than using fair value accounting. The Company will use depreciated cost to value property and equipment subsequent to the transition date.
Business combinations	Management continues to evaluate whether the Company will elect under IFRS 1 to apply the rules of IFRS 3R - <i>Business Combinations</i> prospectively from the Transition Date or as of some other prior date.
Other exemptions	Management is also evaluating other optional exemptions under IFRS 1 as part of our Phase II analysis. The evaluation also includes 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.

**IFRS transition effects:**

<b>Key Accounting Area</b>	<b>Differences with potential impact to Company</b>
Presentation of Financial Statements (IAS1)	Additional disclosures and detail will be required in the notes to the financial statements. The format for the actual financial statements will also change. Work is underway to draft the first interim IFRS financial statements to identify format requirements, data gaps and presentation requirements.
Business Combinations (IFRS 3R)	Acquisition transaction costs as well as restructuring costs related to acquisitions must be expensed under IFRS, which will reduce the amount of residual goodwill booked on acquisitions. This may also increase the volatility of net income on the Company's income statement.
Goodwill Impairment (IAS 16)	Goodwill must be tested at the cash generating unit level of the Company, which could be lower than the reporting unit level at which goodwill is presently being evaluated. Goodwill is tested for impairment using discounted cash-flow method in a single-step approach. We do not anticipate that this accounting policy difference will have a significant impact on our consolidated financial statements.
Share-based payments (IAS 2)	Forfeiture estimates will be recognized in the period in which they are estimated, and will be revised for actual forfeitures in subsequent periods, whereas under current accounting policies, forfeitures are only recognized as they occur. In addition, each tranche of graded option vesting is treated as a separate option grant, which will accelerate the recognition of option expense. The impact is not expected to be material to the Company.

Income Taxes (IAS 12)	Under Canadian GAAP, if additional deferred tax assets that were not recognized at the acquisition date are subsequently realized, the adjustment is recognized first against goodwill, and then against intangible assets, before any adjustment is recognized as a tax recovery on the income statement. Under IFRS, such adjustment is recognized directly in the income statement. The Company is still evaluating the impact of this standard.
Provisions and contingencies (IAS 37)	Under IFRS a provision is recognized in the financial statements if it is probable, which is defined as “more likely than not”. This is a lower threshold than “likely” under Canadian GAAP, which could have an impact on the timing of when a provision may be recorded. On the Transition Date, any provisions and contingent liabilities that qualify for recognition will be recognized as a liability with a resulting decrease in retained earnings. The Company is still evaluating the impact this standard will have on the Company.

This is not an exhaustive list of all the potential impacts that could occur during the conversion to IFRS.

**Training:**

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.

**Information Systems:**

It is anticipated that the adoption of IFRS will not significantly impact the Company’s information system requirements. The Company’s accounting processes are not heavily dependent on the Company’s information systems. The areas where information systems will be most impacted are those related to the ability to track parallel 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, in our detailed component evaluations for each area potentially impacted by IFRS, 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 provisions, acquisition and restructuring costs and functional currency accounting differences. To date, the changes to the systems and processes that have been identified are minimal and the Company believes that the systems and processes can accommodate the necessary changes. The Company will continue to assess the impact on information systems as Phase II efforts continue.

**Business Processes:**

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.

**Internal Controls:**

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 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. It is also noted that certain adjustments will be required in the transition year that will require calculation, monitoring and disclosure outside of the Company’s accounting system, which increases the inherent risk of misstatement. It is anticipated that these adjustments will be managed at the corporate level as part of the Company’s disclosure and financial reporting processes. These adjustments will also be tested as part of the Company certification of controls. To the extent that any material changes are identified, these changes will also be mapped and

tested to ensure that no material deficiencies exist as a result of the conversion to IFRS. The Company is still evaluating the impact of the change to IFRS on its certification process.

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 January 31, 2011, 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 \$83.4 million, compared to the October 31, 2010 balance of \$78.3 million. 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 \$9.5 million compared to \$2.1 million in the first quarter of 2010, and paid approximately \$2.0 million as payment of the final holdback on the Mettoni acquisition and \$0.5 million as payment of the final holdback on the Telrex acquisition. The Company had 25,171,662 Common Shares issued and outstanding as at March 9, 2011. During the first quarter, no stock options were exercised, compared to 252,000 options exercised at a value of \$0.7 million in the first quarter of fiscal 2010. The Company did not grant any options in the first quarter, compared to 60,000 options granted in the prior year's first quarter at an exercise price of \$8.60. Enghouse did not repurchase any shares of its common stock in either first quarter under its Normal Course Issuer Bid.

**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 \$28.6 million compared to \$19.5 million in the prior year's first quarter, a 46% increase over the prior year. The overall increase in revenue is largely attributable to contributions from the acquisitions of the Mettoni Group and Telrex, LLC, acquired April 6, 2010 and June 1, 2010 respectively, which were not included in the comparative quarter's results. Revenue includes license sales of \$10.6 million compared to \$6.0 million in the prior year's first quarter and reflects strong license sales in the traditional Syntellec operations. Services revenue was \$17.2 million compared to \$12.8 million in the prior year's first quarter and includes recurring maintenance revenue of \$12.6 million compared to \$9.7 million in the prior year's first quarter. This recurring revenue is important to the Company as it increases the predictability of future cash flows.

The Interaction Management Group contributed \$25.5 million in revenue in the quarter, compared to \$16.7 million reported in the first quarter of fiscal 2010. The increase is attributable to incremental revenue contributions of \$7.4 million and \$0.8 million from Mettoni and Telrex, respectively, as well as a large third party license sale in the traditional Syntellec operations. The Asset Management Group contributed revenue of \$3.1 million in the quarter, compared to \$2.9 million reported in the first quarter of fiscal 2010, as a result of stronger services revenue in the Group's transit operations.

**Cost of Sales**

Cost of sales for the quarter was \$8.4 million or 29.5% of revenue compared to \$6.3 million or 32.2% of revenue in the prior year’s first quarter. The improvement in gross margins is attributable to improved services margins due to the increase in higher margin maintenance contributions and to the smaller proportionate contribution from lower margin third party software and hardware revenue in the quarter as a percentage of overall revenue.

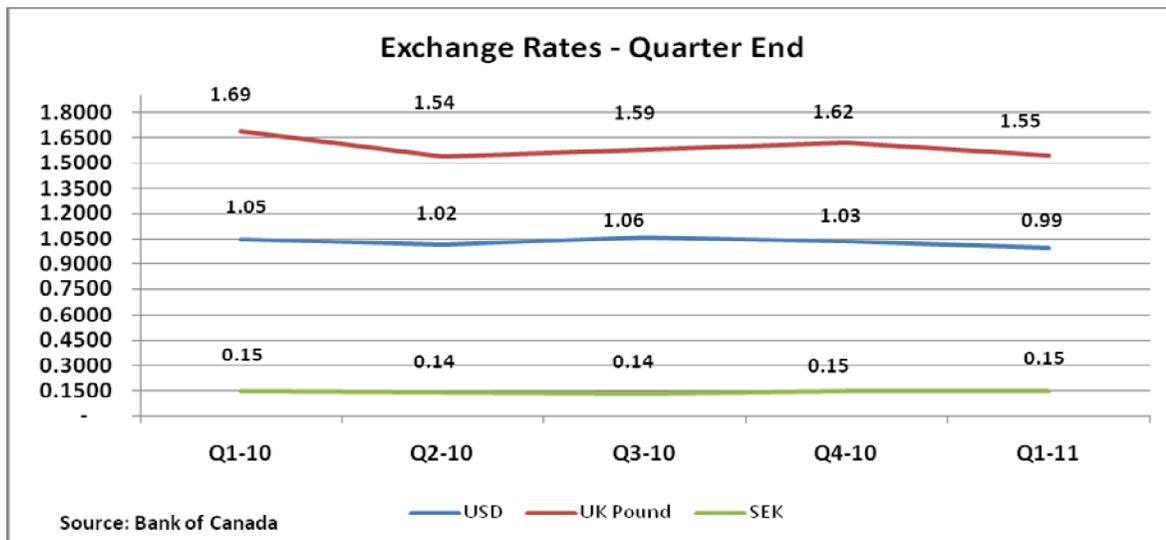
**Operating Expenses**

Operating expenses for the quarter were \$13.2 million, compared to \$9.5 million reported in the first quarter of last year and include the operating costs of Mettoni and Telrex, which were not included in the prior year’s first quarter results. Operating costs as a percentage of total revenue declined from 48.7% to 46.2% in the quarter as a result of operating cost synergies realized from acquired operations. 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 first quarter of 2010, which partially mitigates the operating cost increases 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 first quarter as a result of incremental charges related to the Mettoni and Telrex acquisitions.

**Foreign Exchange**

The Company transacts a significant portion of its business activities in foreign currencies including U.S. Dollars, Pounds Sterling and Swedish Kronor. The Company has both revenue and operating expenses denominated in these currencies, which act as a natural hedge. However, the fluctuation in these currencies against the Canadian dollar impacts the amount of recorded revenue and expenses for the Company. In addition, net monetary assets and liabilities denominated in these foreign currencies in fully integrated foreign operations will generate a foreign exchange gain or loss on translation when the Canadian dollar fluctuates compared to these currencies. The Company recorded foreign exchange losses in the current quarter of \$0.3 million compared to gains of \$0.1 million in the prior year’s first quarter as the Canadian dollar continues to strengthen against other major currencies in which its revenue and expenses are denominated. The table below outlines the movement in foreign exchange rates relative to the Canadian dollar.



### **Interest and Other Income**

During the quarter the Company recognized net interest income of \$0.1 million compared to \$0.2 million in the first quarter of fiscal 2010, consistent with the returns available in the market. The Company reported nominal other income, compared to gains of \$0.6 million from the sale of equities in the prior year.

### **Income Tax Expense**

During the quarter, the Company established a tax provision of \$1.2 million or a 27.5% effective tax rate as compared to a provision of \$0.8 million or 30.2% in the prior year's first 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 quarter, compared to \$1.6 million in the first quarter of fiscal 2010.

### **Net Income**

Net income was \$3.1 million or \$0.12 per share on a diluted basis in the quarter compared to \$1.9 million and \$0.08 per share respectively in the first quarter of fiscal 2010 as a result of increased license and services revenue.

### **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, 2010, contained in the Company's 2010 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, 2010, 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, 2010, 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, 2010, 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 January 31, 2011 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 months ended January 31, 2011 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)*

	January 31, 2011	October 31, 2010
<b>Assets</b>		
<b>Current</b>		
Cash	\$ 64,247	\$ 46,640
Short-term investments (Note 2)	19,196	31,627
Accounts receivable, net	27,956	24,500
Income tax receivable	-	591
Future income taxes	438	447
Prepaid expenses and other assets	3,531	3,360
	<u>115,368</u>	<u>107,165</u>
Property and equipment, net	1,740	1,844
Acquired software and other intangibles, net	31,630	34,330
Goodwill (Note 3)	34,168	35,137
Future income taxes	2,680	2,951
	<u>\$ 185,586</u>	<u>\$ 181,427</u>
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	17,429	20,115
Income taxes payable	508	-
Dividend payable (Note 4)	1,007	1,007
Deferred revenue	31,591	26,040
	<u>50,535</u>	<u>47,162</u>
Future income taxes	11,910	12,571
Long-term income taxes payable	522	522
Deferred revenue	674	790
	<u>63,641</u>	<u>61,045</u>
<b>Shareholders' Equity</b>		
Share capital (Note 5)	50,705	50,705
Contributed surplus (Note 5)	2,540	2,429
Retained earnings	81,711	79,606
Accumulated other comprehensive loss	(13,011)	(12,358)
	<u>121,945</u>	<u>120,382</u>
	<u>\$ 185,586</u>	<u>\$ 181,427</u>

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

**Consolidated Statements of Operations and Retained Earnings**  
**For the three months ended January 31**

*(in thousands of Canadian dollars except per share amounts)*  
*(Unaudited)*

	2011	2010
<b>Revenue</b>		
Software licenses	\$ 10,623	\$ 5,989
Services	17,224	12,778
Hardware	722	769
	<b>28,569</b>	<b>19,536</b>
<b>Cost of sales</b>		
Software licenses	1,557	936
Services	6,314	4,887
Hardware	560	466
	8,431	6,289
<b>Gross margin</b>	<b>20,138</b>	<b>13,247</b>
<b>Operating expenses</b>		
Selling, general and administrative	9,071	6,249
Research and development	3,863	2,969
Amortization of property and equipment	275	300
	13,209	9,518
<b>Income before the undernoted</b>	<b>6,929</b>	<b>3,729</b>
Amortization of acquired software and other intangibles	(2,440)	(1,801)
Foreign exchange (loss) gain	(329)	82
Other income	3	564
Interest income, net	129	151
<b>Income before income taxes</b>	<b>\$ 4,292</b>	<b>\$ 2,725</b>
Provision for income taxes		
Current	1,305	797
Future	(125)	25
<b>Net income for the period</b>	<b>\$ 3,112</b>	<b>\$ 1,903</b>
<b>Retained earnings, beginning of period</b>	79,606	73,142
Dividends	(1,007)	(754)
<b>Retained earnings, end of period</b>	<b>\$ 81,711</b>	<b>\$ 74,291</b>
<b>Earnings per share</b>		
Basic	\$ 0.12	\$ 0.08
Diluted	\$ 0.12	\$ 0.08
Weighted average shares outstanding during period (millions)		
- basic	25.2	24.9
- diluted	25.5	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**  
**For the three months ended January 31**

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

	2011	2010
Net income for the period	\$ 3,112	\$ 1,903
<b>Other comprehensive income:</b>		
Unrealized loss on translating financial statements of self-sustaining foreign operations	(650)	(1,364)
Transfer to net income of realized gains on available for sale investments, net of tax of (\$1) (Q1/10 (\$170))	(2)	(394)
Unrealized gain on available for sale investments, net of tax of \$4 (Q1/10 – \$290)	20	670
Unrealized foreign currency translation loss on available for sale investments, net of tax of (\$4) (Q1/10 – (\$21))	(21)	(49)
<b>Other comprehensive loss</b>	<b>\$ (653)</b>	<b>\$ (1,137)</b>
<b>Comprehensive income</b>	<b>\$ 2,459</b>	<b>\$ 766</b>
<b>Accumulated other comprehensive loss, beginning of period</b>	<b>\$(12,358)</b>	<b>\$ (8,759)</b>
Other comprehensive loss	(653)	(1,137)
<b>Accumulated other comprehensive loss, end of period</b>	<b>\$(13,011)</b>	<b>\$ (9,896)</b>

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

## Consolidated Statements of Cash Flows

### For the three months ended January 31

(in thousands of Canadian dollars)  
(Unaudited)

	2011	2010
<b>Cash flows from operating activities</b>		
Net income for the period	\$ 3,112	\$ 1,903
<b>Add (deduct) items not involving cash</b>		
Amortization of property and equipment	275	300
Amortization of acquired software and other intangibles	2,440	1,801
Gain on sale of short-term investments	(3)	(564)
Stock-based compensation expense	111	50
Future income taxes	(125)	25
<b>Cash flows before changes in operating assets and liabilities</b>	<b>5,810</b>	<b>3,515</b>
<b>Changes in operating assets and liabilities</b>		
Increase in accounts receivable, net	(3,830)	(927)
Increase in prepaid expenses and other assets	(217)	(306)
Increase (decrease) in accounts payable and accrued liabilities	788	(3,712)
Increase (decrease) in current income taxes payable	1,105	(732)
Increase in deferred revenue	5,860	4,165
Unrealized foreign exchange loss	18	87
<b>Cash flows from operating activities</b>	<b>9,534</b>	<b>2,090</b>
<b>Cash flows from investing activities</b>		
Purchase of property and equipment, net	(176)	(224)
Acquisitions, net of cash acquired (Note 6)	(2,450)	(5,529)
Proceeds from sale (purchase) of short-term investments	12,443	(1,014)
	<b>9,817</b>	<b>(6,767)</b>
<b>Cash flows from financing activities</b>		
Issuance of share capital	-	737
Payment of cash dividend	(1,007)	(746)
	<b>(1,007)</b>	<b>(9)</b>
Effect of foreign exchange rate changes on cash	(737)	(297)
Net increase (decrease) in cash during the period	<b>17,607</b>	<b>(4,983)</b>
Cash – beginning of period	46,640	39,276
<b>Cash – end of period</b>	<b>\$ 64,247</b>	<b>\$ 34,293</b>
<b>Supplementary cash flow information:</b>		
Cash paid during the period for income taxes	\$ 326	\$ 1,580

**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)

**January 31, 2011 and 2010****(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, 2010 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, 2010.

***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, *Business Combinations*. The Section applies prospectively to business combinations for which the acquisition date is on or after November 1, 2011 and allows for earlier application. The standard also requires that acquisition-related costs be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. These costs are presently capitalized.

CICA Section 1601, *Consolidated Financial Statements* and Section 1602, *Non-Controlling Interests* were also 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 November 1, 2011 and allow for earlier adoption. Early adoption may reduce the amount of restatement required upon conversion to IFRS. The Company is currently assessing what 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.

Under EIC 175, allocation of revenue to separate elements in a multiple element transaction will be based on their relative selling prices, as indicated by VSOE or third-party evidence of selling prices, or if both are not available, on estimated selling prices. The allocated portion of the arrangement not delivered would then be deferred. The Company is currently assessing what impact these amendments may have on its financial statements and has not yet determined either the timing or method of its adoption.

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**January 31, 2011 and 2010**

(in thousands of Canadian dollars)

**Harmonization of Canadian and International Accounting Standards**

In February 2008, the CICA Accounting Standards Board confirmed that 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 the preliminary scoping and phase II diagnostic analysis, the Company 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. Short-term investments**

Short-term investments consist of the following:

	<b>January 31, 2011</b>		<b>October 31, 2010</b>	
	Carrying Value	Market Value	Carrying Value	Market Value
Mutual funds	\$ 5,228	\$ 5,228	\$ 17,677	\$ 17,684
Banker's acceptances	8,810	8,810	8,780	8,779
Corporate bonds	4,036	4,040	4,037	4,041
Equities	1,122	1,122	1,133	1,133
<b>Total</b>	<b>\$ 19,196</b>	<b>\$ 19,200</b>	<b>\$ 31,627</b>	<b>\$ 31,637</b>

Cash previously disclosed as restricted cash held in escrow was paid in the amount of approximately \$2.0 million in January, 2011 as the final payment on the Mettoni acquisition.

**3. Goodwill**

The Continuity of goodwill by reportable segment is as follows:

	<b>January 31, 2011</b>			<b>October 31, 2010</b>		
	Interaction Management Group	Asset Management Group	Total	Interaction Management Group	Asset Management Group	Total
Opening Balance	\$ 30,722	\$ 4,415	\$ 35,137	\$ 16,877	\$ 3,088	\$ 19,965
Additions, Net	-	-	-	17,027	1,400	18,427
Acquired tax benefit adjustment	(466)	-	(466)	(2,972)	-	(2,972)
Purchase price adjustments	-	-	-	(158)	(55)	(213)
Foreign exchange	(503)	-	(503)	(52)	(18)	(70)
<b>Ending balance</b>	<b>\$ 29,753</b>	<b>\$ 4,415</b>	<b>\$ 34,168</b>	<b>\$ 30,722</b>	<b>\$ 4,415</b>	<b>\$ 35,137</b>

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**January 31, 2011 and 2010**

**(in thousands of Canadian dollars)**

During each of the first quarter ended January 31, 2011 and the year ended October 31, 2010, adjustments for previously unrecognized tax benefits from earlier acquisitions were accounted for as a credit to goodwill.

**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. On December 15, 2010 the Company declared an eligible dividend of \$0.04 per common share, which was paid on February 28, 2011 to shareholders of record as of February 14, 2011 of \$1.0 million. This is reflected as a liability of the Company on the balance sheet as at January 31, 2011.

**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, 2009</b>	<b>24,875,662</b>	<b>\$ 49,780</b>	<b>\$ 2,047</b>
Stock options exercised (C)	296,000	925	-
Stock options expensed (D)	-	-	382
Shares repurchased and cancelled under common share re-purchase plan (E)	-	-	-
<b>Balance – October 31, 2010</b>	<b>25,171,662</b>	<b>\$ 50,705</b>	<b>\$ 2,429</b>
Stock options exercised (C)	-	-	-
Stock options expensed (D)	-	-	111
Shares repurchased and cancelled under common share re-purchase plan (E)	-	-	-
<b>Balance – January 31, 2011</b>	<b>25,171,662</b>	<b>\$ 50,705</b>	<b>\$ 2,540</b>

There were no Class A and no Class B preference shares issued and outstanding as at January 31, 2011 or October 31, 2010.

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**January 31, 2011 and 2010**

(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 1,814,800 (October 31, 2010 – 1,814,800) 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 January 31, 2011 and October 31, 2010, and changes during the three and twelve months ended respectively on those dates is presented as follows:

	<b>January 31, 2011</b>		<b>October 31, 2010</b>	
	Number of	Weighted	Number of	Weighted
	Options	Average	Options	Average
		Exercise Price		Exercise Price
		in \$		in \$
Outstanding at beginning of period	1,563,100	7.10	1,329,100	5.82
Granted	-	-	545,000	8.10
Exercised	-	-	(296,000)	3.12
Forfeited	-	-	(15,000)	8.70
Outstanding at end of period	<b>1,563,100</b>	<b>7.10</b>	<b>1,563,100</b>	<b>7.10</b>
Options exercisable at end of period	<b>874,600</b>	<b>6.94</b>	<b>866,600</b>	<b>6.92</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 first quarter of 2011, the Company recorded a non-cash charge of \$111 (Fiscal 2010 - \$382). For options granted in the period, 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>Options Granted</b>	<b>Options Granted</b>	<b>Options Granted</b>
	<b>June 2010</b>	<b>April 2010</b>	<b>December 2009</b>
Risk-free interest rate	2.28%	2.59%	2.12%
Estimated volatility	35%	34%	35%
Dividend yield	\$ 0.16	\$ 0.16	\$ 0.12
Expected life in years	5	5	5
Weighted average fair value (in dollars)	\$ 2.60	\$ 2.24	\$ 2.53

**(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 quarter of each of fiscal 2011 and 2010, the Company did not repurchase any shares for cancellation.

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**January 31, 2011 and 2010**

**(in thousands of Canadian dollars)**

**6. Acquisitions**

**2010 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, including transaction costs of approximately \$0.1 million. Of this total, \$0.5 million was subject to hold back and adjustment and was paid on November 1, 2010. Telrex is a leading provider of IP call recording and contact center optimization software solutions with operations in North America and EMEA.

***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 \$2.4 million was subject to hold back and adjustment. Approximately \$2.0 million was paid on January 6, 2011 as full payment of the obligation. The acquisition of Mettoni also includes its wholly owned subsidiaries, Arc Solutions (International) Limited, Datapulse Limited, Excomm Limited, Mettoni Inc., Arc Solutions (International) Inc., Datapulse Inc. and Mettoni FZE. Mettoni provides unified communications software solutions and has operations in North America, Europe, Middle East and Africa and Asia Pacific.

***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 Interaction Management Group) and a network division providing cost control and intelligent network solutions to the telecom industry (reported as part of the Asset Management Group).

These acquisitions have been recorded under the purchase method of accounting and results have been included in the consolidated statements of operations from their respective acquisition dates. Accordingly, the allocation of the purchase price to assets and liabilities is 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 these notes to consolidated financial statements. The Pulse purchase equation has been finalized, whereas the Telrex and Mettoni purchase price allocations have not been finalized subject to receipt of additional information related to transaction costs and settlement of holdbacks.

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 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.

The Company's purchase price allocations are as follows:

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**January 31, 2011 and 2010**

(in thousands of Canadian dollars)

	FY 10 Telrex	FY 10 Mettoni	FY 10 Pulse
Cash	\$ -	\$ 1,456	\$ 216
Accounts receivable, net	159	6,428	1,990
Prepays and other current assets	9	1,161	69
Property and equipment	14	383	440
Future income tax assets	-	1,116	122
Acquired software	2,616	7,440	760
Other intangibles	377	7,650	490
Goodwill	1,712	13,918	2,800
Total assets acquired	<u>\$ 4,887</u>	<u>\$ 39,552</u>	<u>\$ 6,887</u>
Less: Current liabilities assumed	\$ 830	\$ 10,712	\$ 1,869
Less: Future income tax liabilities	-	4,225	400
Total liabilities assumed	<u>\$ 830</u>	<u>\$ 14,937</u>	<u>\$ 2,269</u>
Net assets acquired for cash consideration	<u>\$ 4,057</u>	<u>\$ 24,615</u>	<u>\$ 4,618</u>

**7. Segmented Information**

The Company has two reportable segments, the Interaction Management Group and the Asset Management Group, 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 Interaction Management Group, which includes the operations of Telrex, Mettoni and the Pulse Voice IVR operations since their respective dates of acquisition, serves the customer service market segment through the provision of IVR systems and speech and voice recognition solutions. The Asset Management Group, which also includes the results of the Network operations of Pulse Voice Inc. since the date of acquisition, develops, markets and provides services related to visual-based network management software solutions to customers in the telecommunications, transit, cable, electric and gas markets.

The Company evaluates segment performance based on revenue and profit or loss before corporate expenses, foreign exchange, interest and other income and income taxes.

**Notes to Interim Consolidated Financial Statements**  
(Unaudited)  
**January 31, 2011 and 2010**  
(in thousands of Canadian dollars)

	<b>Interaction Management Group</b>	<b>Asset Management Group</b>	<b>Total</b>
<b>Three months ended January 31, 2011</b>			
Revenue	\$ 25,500	\$ 3,069	\$ 28,569
Operating expenses, excluding non-cash charges	(18,273)	(2,242)	(20,515)
Amortization of property and equipment	(238)	(37)	(275)
Amortization of acquired software and intangibles	(2,293)	(147)	(2,440)
<b>Segmented profit</b>	<b>\$ 4,696</b>	<b>\$ 643</b>	<b>\$ 5,339</b>
Corporate expenses			(850)
Foreign exchange			(329)
Other income			3
Interest income			129
Income before income taxes			<b>\$ 4,292</b>
Goodwill	\$ 29,753	\$ 4,415	\$ 34,168
Other assets	109,023	23,199	132,222
Short-term investments			19,196
<b>Total assets</b>			<b>\$185,586</b>

	<b>Interaction Management Group</b>	<b>Asset Management Group</b>	<b>Total</b>
<b>Three months ended January 31, 2010</b>			
Revenue	\$ 16,674	\$ 2,862	\$ 19,536
Operating expenses, excluding non-cash charges	(12,387)	(2,581)	(14,968)
Amortization of property and equipment	(256)	(44)	(300)
Amortization of acquired software and intangibles	(1,590)	(211)	(1,801)
<b>Segmented profit</b>	<b>\$ 2,441</b>	<b>\$ 26</b>	<b>\$ 2,467</b>
Corporate expenses			(539)
Foreign exchange			82
Other income			564
Interest income			151
Income before income taxes			<b>\$ 2,725</b>
Goodwill	\$ 16,238	\$ 6,170	\$ 22,408
Other assets	60,854	24,145	84,999
Short-term investments			55,526
<b>Total assets</b>			<b>\$162,933</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

**Notes to Interim Consolidated Financial Statements**

(Unaudited)

**January 31, 2011 and 2010**

**(in thousands of Canadian dollars)**

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 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 one action 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 consider all its options for resolution and vigorously assert all appropriate defenses.