## Management's Discussion and Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") comments on the consolidated operations, performance and financial condition of MKS Inc. ("MKS" or the "Company") for the three and nine month periods ended January 31, 2007 and 2006.

This MD&A should be read in conjunction with the unaudited consolidated financial statements of the Company and the related notes for the three and nine month periods ending January 31, 2007 and 2006. All currency amounts in this MD&A are stated in US dollars, unless otherwise indicated.

The financial information set forth in this MD&A has been derived from the unaudited consolidated financial statements of MKS prepared in accordance with United States generally accepted accounting principles ("US GAAP"). The date of this MD&A is February 27, 2007.

Additional information relating to the Company, including the Company's Annual Information Form, is available on SEDAR at www.sedar.com.

### Forward Looking Statements

Except for the historical information contained herein, the discussion in this MD&A contains certain forward-looking statements that involve risks and uncertainties, such as statements of the Company's plans, objectives, strategies, expectations and intentions. The words "may", "would", "could", "will", "intend", "plan", "anticipate", "believe", "estimate", "expect" and similar expressions, as they relate to the Company or its management, are intended to identify such forward-looking statements. Such statements reflect the Company's views as at the date of this MD&A with respect to future events and are subject to certain risks, uncertainties and assumptions.

Many factors could cause the Company's actual results, performance or achievements to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements. These factors include, but are not limited to, development of the ALM market, fluctuation in quarterly results, intense competition, management of growth, rapid technological change, dependence on and retention of management and key employees, currency exchange rate fluctuations, international sales, importance of maintenance contracts, economic uncertainty, dependence on a limited number of products, acquisitions, distribution channels in the interoperability market, potential for undetected errors in software, protection of intellectual property, reliance on third party relationships, limited financial resources, litigation, concentration of ownership and market maturity in the Interoperability market. See the "Risk Factors" section of this MD&A for more detailed information regarding these risks and uncertainties. Although the Company believes the expectations represented by such forward looking statements are reasonable, there can be no assurance that those expectations will prove to be correct. Should one or more of these risks or uncertainties materialize, or should assumptions underlying the forward-looking statements prove incorrect, actual results may vary materially from those described herein as intended, planned, anticipated, believed, estimated or expected. The Company does not intend, and does not assume any obligation, to update these forward-looking statements.

## About the Company

MKS evaluates operational performance based on two operating segments: software application lifecycle management ("ALM") and systems administration ("Interoperability" or "IO"). The segments are managed separately because each requires unique selling and marketing strategies and is exposed to different economic environments.

The Company's primary focus is the ALM segment. Application lifecycle management describes a set of capabilities used to manage all activities surrounding the delivery of software applications within large enterprises, from requirements management through to final deployment. Within this market, the Company provides products and services that facilitate collaboration between large multi-site development teams, control the creation and ongoing maintenance of software, and manage business processes utilized by information technology ("IT") departments of Global 1000 companies. MKS's solution for the ALM market, MKS Integrity, is a highly integrated ALM platform, spanning all major operating environments and all aspects of the software development lifecycle and supporting critical business transformations, including service-oriented architecture, application rationalization and outsourcing. MKS Integrity's single architecture drives high levels of user productivity and facilitates rapid deployment and process standardization while delivering a complete view of application development activity through real time metrics, trends and reporting. MKS Integrity also provides essential support for IT operations through software deployment and issue management.

MKS has focused its marketing and sales efforts on enterprises with large software development organizations. The Company primarily targets companies with more than 10,000 employees and more than 1,000 IT staff. These large organizations rely on the internal development of software systems to facilitate critical business operations. Examples of corporate software systems include customer billing systems, inventory management and warehousing systems and online banking systems. Additionally, many organizations have large engineering departments, where embedded software is a key component of the organization's product offerings, such as automotive braking systems, banking automated teller machines, wireless communications and semiconductors.

The MKS Interoperability segment encompasses products, namely MKS Toolkit®, that addresses the issues surrounding UNIX-Windows operating system co-existence, cross-platform development, application migration, systems administration and network management.

## Performance Highlights

Overall, for the three months ended January 31, 2007 ("Q307") revenue declined 14% to $11.6 million, down from $13.4 million for the three months ended January 31, 2006 ("Q306"). This was driven by a decline in new licensing revenue of 43% compared to Q306 when the Company recorded its largest transaction to date. Growth in both maintenance revenue and service revenue in Q307 of 18% and 37%, respectively, compared to Q306 partially offset the decline in license revenue. For the nine months ended January 31, 2007 and 2006, revenue remained constant at approximately $35.7 million as increased maintenance and services revenue was offset by the decline in new licensing revenue.

Revenue in Q307 was generated primarily from the North American and European markets, the Company's principal geographic segments. The volume of transactions over $100,000 increased this quarter as the Company completed 23 transactions over $100,000 in Q307 compared with 17 in Q306. Of the transactions over $100,000 completed during Q307, 15 were related to maintenance renewal contracts compared to 5 such contracts during Q306. There were no transactions in excess of $500,000 in Q307 compared to 2 during Q306.

The longer sales cycles of large transactions have been the primary cause of lower license revenue. Some lengthening of sales cycles is the result of devoting a larger proportion of the sales force to larger and more complex transactions. MKS expects that the investments in these larger sales initiatives will result in commensurate revenue growth and that the company's experience in these initiatives will increase over time. Additionally, the attributes of the MKS Integrity product platform are best suited to these large and complex implementations and offer the strongest prospects for continued license revenue growth over the long term. These initiatives require a larger investment in sales resources to overcome MKS's small size and lesser known brand to new customers relative to MKS's competitors. The Company's execution on mid-range deals remains consistent with prior quarters.

Over the past few quarters, MKS has released technology upgrades that extend the applicability of its platform across a significantly broader user base within its target enterprise customers. These upgrades include functionality beyond core version and development task management and into requirements, testing, server deployment and portfolio management. While this has generated significant interest among large enterprise customers and increased the value of the Company's solution it has added to the complexity of sales initiatives and lengthened sales cycles.

Additional lengthening in sales cycle has been the result of lower levels of process maturity and methodology expertise within its customer base. MKS has been building its services practice both internally and through third party services providers to assist customers with deployment and to help alleviate the lack of methodology and experience in these extended areas of functionality.

ALM services revenue grew 38% to $1.6 million in revenue in Q307 from $1.2 million in Q306 with a margin on services of 22% in Q307 compared to a margin of 6% in Q306. For the nine months ended January 31, 2007, ALM services revenue grew 22% to $4.6 million compared to $3.7 million in the same period in fiscal 2006, with margins of 24% and 18%, respectively.

The Company continues to focus on developing its sales and product development capabilities, resulting in an increase in operating costs in Q307 from Q306. Operating costs increased to $12.7 million for the current quarter compared to operating costs of $11.8 million in Q306. On a year to date basis, operating costs increased from $32.8 million for the nine months ended January 31, 2006 to $38.6 million for the nine months ended January 31, 2007. The increase was primarily attributable to investments made in the Company's field sales forces and the continued expansion of its product development capabilities. Increases to field personnel and related costs accounted for $0.5 million of additional operating costs from Q306 to Q307 and $3.3 million on a year to date basis. Product development costs increased $0.3 million and $1.5 million, respectively, over the same periods. As at January 31, 2007, the Company's headcount rose to 320 compared to 297 as at January 31, 2006, an increase of 23 employees or 8%. In Q307, the Company continued to be subject to fluctuations in the exchange rates among the main currencies in which the Company operates, namely the Canadian dollar, Pound Sterling and Euro. These fluctuations had the effect of increasing costs in the current quarter, compared with Q306, by $0.3 million ($1.1 million on a year to date basis) as each of those currencies strengthened against the US dollar during the period.

Revenue for the Interoperability segment has remained flat for Q307 compared with Q306 and on a year to date basis. The Company has successfully maintained the profitability relative to its revenues in that segment. In Q307, operating margin was 17%, down from 18% in Q306, but increased on a year to date basis to 25% in fiscal 2007 compared with 23% for the same period in fiscal 2006. In the Interoperability segment, the Company utilizes both direct and indirect channels of distribution to reach a diverse customer base ranging from large multinational companies to individual developers. The Company continues to conduct research and development in the IO segment to provide its large customer base with up to date features and functionality and from time to time may release new products that will appeal to customers that can be reached through existing sales channels. The markets for the Company's Interoperability products are mature and well developed and the Company believes that opportunities to develop new customers for this product line are limited.

**Supplementary Financial Information**
*(tabular amounts in thousands, except per share amounts)*

**Select Unaudited Consolidated Quarterly Financial Information**

The following table presents certain unaudited consolidated quarterly financial information of the Company for each of the past eight quarters ended January 31, 2007. The Company's quarterly operating results have historically fluctuated significantly and may continue to fluctuate significantly in the future as a result of a variety of factors. Therefore, the Company believes that the past operating results and period-to-period comparisons should not be relied upon as an indication of the Company's future performance. See "Risk Factors" below.

| | Three months ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Apr 30 2005 | Jul 31 2005 | Oct 31 2005 | Jan 31 2006 | Apr 30 2006 | Jul 31 2006 | Oct 31 2006 | Jan 31 2007 |
| License revenue | $ 7,311 | $ 5,245 | $ 5,431 | $ 7,399 | $ 6,585 | $ 6,014 | $ 4,425 | $ 4,229 |
| Maintenance revenue | 4,099 | 4,355 | 4,704 | 4,853 | 4,887 | 5,205 | 5,491 | 5,727 |
| Service revenue | 1,047 | 1,205 | 1,401 | 1,161 | 1,096 | 1,400 | 1,593 | 1,594 |
| Total revenue | $ 12,457 | $ 10,805 | $ 11,536 | $ 13,413 | $ 12,568 | $ 12,619 | $ 11,509 | $ 11,550 |
| Income (loss) from operations | $ 1,507 | $ 516 | $ 900 | $ 1,575 | $ 699 | $ (618) | $ (1,158) | $ (1,122) |
| per share, basic | $ 0.04 | $ 0.01 | $ 0.02 | $ 0.04 | $ 0.02 | $ (0.01) | $ (0.02) | $ (0.02) |
| per share, diluted | $ 0.03 | $ 0.01 | $ 0.02 | $ 0.03 | $ 0.01 | $ (0.01) | $ (0.02) | $ (0.02) |
| Net income (loss) | $ 1,519 | $ 536 | $ 939 | $ 1,629 | $ 6,009 | $ (488) | $ (690) | $ (1,207) |
| per share, basic | $ 0.04 | $ 0.01 | $ 0.02 | $ 0.04 | $ 0.13 | $ (0.01) | $ (0.01) | $ (0.02) |
| per share, diluted | $ 0.03 | $ 0.01 | $ 0.02 | $ 0.03 | $ 0.12 | $ (0.01) | $ (0.01) | $ (0.02) |
| Total assets | $ 24,035 | $ 23,603 | $ 26,017 | $ 32,583 | $ 39,689 | $ 38,083 | $ 35,811 | $ 36,218 |
| Cash dividends per share | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.02 | $ 0.02 | $ 0.02 |

As at January 31, 2007, 50,562,000 common shares of the Company and options to purchase 7,678,000 common shares of the Company were outstanding.

## Financial Results Analysis

This section discusses the consolidated financial results of the Company and each of its operating segments for the fiscal 2007 third quarter and year to date periods. Revenue and operating income from operations are analyzed on a segmented basis.

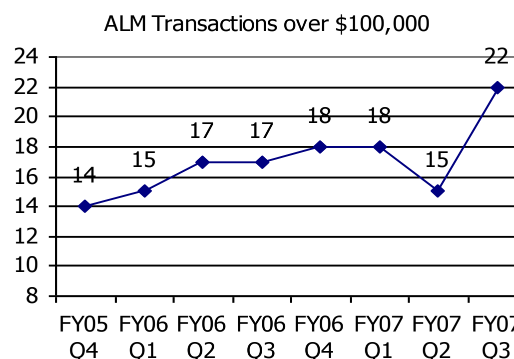
**Revenue**
*(tabular amounts in thousands)*

| | **Three Months Ended Jan 31** | | | **Nine Months Ended Jan 31** | | |
|---|---|---|---|---|---|---|
| | **2007** | 2006 | % Change | **2007** | 2006 | % Change |
| ALM segment: | | | | | | |
| License revenue | **$ 3,237** | $ 6,481 | -50.1% | **$ 11,312** | $ 14,892 | -24.0% |
| Maintenance revenue | **4,931** | 4,001 | 23.2% | **14,028** | 11,408 | 23.0% |
| Service revenue | **1,594** | 1,152 | 38.4% | **4,577** | 3,746 | 22.2% |
| | **9,762** | 11,634 | -16.1% | **29,917** | 30,046 | -0.4% |
| Interoperability segment: | | | | | | |
| License revenue | **992** | 918 | 8.1% | **3,356** | 3,183 | 5.4% |
| Maintenance revenue | **796** | 852 | -6.6% | **2,395** | 2,504 | -4.4% |
| Service revenue | **-** | 9 | -100.0% | **10** | 21 | -52.4% |
| | **1,788** | 1,779 | 0.5% | **5,761** | 5,708 | 0.9% |
| Total revenue | **$ 11,550** | $ 13,413 | -13.9% | **$ 35,678** | $ 35,754 | -0.2% |

**ALM Segment**

License revenue in the ALM segment declined by 50% in Q307 compared to Q306 and declined by 24% for the nine months ended January 31, 2007 compared to the same period in the prior fiscal year. Revenue from non-North American markets increased to 35% of total ALM revenue in Q307 from 34% in Q306.

License revenue is derived from three primary sources: new customers, large follow-on transactions with existing customers who are rolling out new projects, and smaller incremental licensing transactions with existing customers with expanding operations. In Q307 licensing revenue was driven by several mid-size deals with new customers. The number of large licensing transactions from existing customers was lower than in previous quarters.




There were no license transactions greater than $500,000 during the quarter and 22 transactions greater than $100,000. The increase of the transactions greater than $100,000 was related to the Company's strong customer base and the renewal of annual maintenance contracts during the quarter. Smaller incremental transactions were close to normal levels. The company did not record any large new transactions as it experienced longer sales cycles across all jurisdictions**.**

Over the past few quarters, MKS has released technology upgrades that extend the applicability of its platform across a significantly broader user base within its target enterprise customers. While this has generated significant interest among new large enterprise customers, increasing the value of the Company's solution and promising to establish much deeper adoption of the platform by them, it has added to the complexity of sales initiatives and lengthened sales cycles.

In the case of existing customers, the deployment of functionality beyond core version and development task management and into requirement, testing, server deployment and portfolio management requires more expertise and methodology development than many customers have in-house. This expertise must be supplied by MKS services personnel or by third party services organizations. MKS has experienced rapid growth in its service bookings and in deliveries, and has established relationships with third party services organizations who perform services under MKS subcontract. MKS is moving quickly to improve its ability to sell and deliver the services required to speed deployments of MKS Integrity to its existing customer base, which is expected in turn to have a significant influence on new license transactions.

In the case of new customers, MKS has traditionally targeted divisions of large companies where initial successful deployments can act as a beachhead to subsequent sales once customers become familiar with MKS Integrity and once its capabilities and scalability are proven in live customer implementations. This continues to be the core strategy of the sales organization. Recently MKS has been engaged in sales opportunities that are larger in scope and size than has traditionally been the case. These initiatives have commensurately longer sales cycles and have had the effect of delaying license revenue.

As MKS has long expected, the importance of software development task and process management continues to increase in the minds of CIO's and CTO's of major organizations. MKS believes that they are steadily coming to the conclusion that the implementation of enterprise wide ALM systems is the only way to achieve the productivity and compliance objectives that are among their most important objectives. As a result, some of the Company's divisional sales initiatives are being transformed into enterprise wide CIO initiatives prior to initial implementations being completed. While the Company believes that MKS Integrity is best suited from a technical perspective to enterprise scale mandates, and while its attributes are most compelling in those situations requiring the large scale integration of processes across many departments, such transactions require a larger investment in sales resources to overcome MKS's small size and lesser known brand to new customers relative to MKS's competitors. MKS believes that as its field organization adjusts to large scale enterprise selling, and as more reference customers are established and deployed, it will be successful in more of these sales situations.

Service revenue is generated by providing process consulting, installation services, user training, conversion services and other product feature/configuration consulting to ensure successful deployment of the Company's products to meet its customers' needs. Services are delivered on a regional basis by the Company's employees and services partners, priced on a daily rate. Service revenue grew 38% to $1.6 million in Q307 compared to $1.2 million during Q306 due to the strong backlog of services sold in licensing transactions, in addition to the recent trend of stand-alone services engagements. Services margins increased to 22% in Q307 compared to 6% in Q306. The Company continues to grow its service revenue through key engagements with customers in all geographic segments and increasing its penetration into key accounts and expects that services revenue as a percentage of license revenue will continue to grow for the foreseeable future.

Maintenance revenue growth in Q307 was primarily attributable to the maintenance component of new transactions and the extension of maintenance contracts by existing customers to additional maintenance periods in order to gain access to product upgrades and MKS support services. In Q307, the Company continued to experience a high maintenance contract renewal rate, with over 90% of the total value of expiring annual enterprise ALM customer maintenance contracts being renewed. In addition, the Company completed 14 maintenance contract renewals of over $100,000 during Q307, compared to 5 in Q306. The Company experiences a higher renewal rate on installations of its products with its Global 1000 accounts compared to smaller accounts.

MKS had 25 Regional Sales Managers at the end of Q307 and 25 as of the date of this MD&A, down from 29 at the beginning of fiscal 2007. The Company added significantly to its sales force during fiscal 2006, and has experienced an expected amount of attrition from both its newly hired sales personnel as well as its existing representatives to date in fiscal 2007. Productivity growth of the remaining Regional Sales Managers has been growing steadily each quarter.

**Interoperability Segment**

The Interoperability segment is in decline due to a continuing shift by the market to port UNIX applications to the Linux operating system instead of Windows NT, thus not utilizing the Company's MKS Toolkit products to port from UNIX to Windows NT, to increased levels of competition in this segment from both freeware and other low-cost alternatives which remain prevalent in the UNIX to Windows interoperability market. The markets for the Company's Interoperability products are mature and well developed and the Company believes that opportunities to develop new customers for this product line are limited. The Interoperability segment experienced consistent revenues of $1.8 million in both Q307 and Q306 and approximately $5.8 million in the nine months ended January 31, 2007 and 2006.

License revenue increased 8% in Q307 compared to Q306, and increased 5% for the nine months ended January 31, 2007. The general maturity of the segment has resulted in stability of licensing fees, with competitive and market conditions contributing small period-to-period variations in license revenue. Over the long term and consistent with the maturing of the technology and the market, the Company expects to experience a decline in license revenue from its Interoperability segment in future periods.

Maintenance revenue declined 7% to $0.8 million in Q307 compared to $0.9 million in Q306 and declined 4% from $2.5 million in the nine months ended January 31, 2007 compared to $2.4 million in the same period in fiscal 2006. This is attributable to reduction in maintenance renewals over the past fiscal year as many customers continue to rely on having access to the latest versions and updates to the Company's IO products to remain current with the changes to existing operating system environments. Maintenance revenue is expected to decline in the future in correlation with the anticipated decline in licensing revenue referred to above.

There was minimal service revenue in both Q307 and Q306. The Interoperability products generally do not require consulting on implementation, and the Company does not expect to generate service revenue on a quarter-by-quarter basis.

**Operating Income**

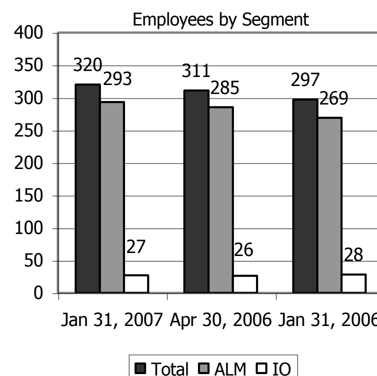
*(tabular amounts in thousands)*

| | Three Months Ended Jan 31 | | | Nine Months Ended Jan 31 | | |
|---|---|---|---|---|---|---|
| | **2007** | 2006 | % Change | **2007** | 2006 | % Change |
| Revenue | | | | | | |
| ALM segment | **$ 9,762** | $ 11,634 | -16.1% | **$ 29,917** | $ 30,046 | -0.4% |
| Interoperability segment | **1,788** | 1,779 | 0.5% | **5,761** | 5,708 | 0.9% |
| | **11,550** | 13,413 | -13.9% | **35,678** | 35,754 | -0.2% |
| Operating costs | | | | | | |
| ALM segment | **11,184** | 10,387 | 7.7% | **34,266** | 28,373 | 20.8% |
| Interoperability segment | **1,488** | 1,451 | 2.5% | **4,310** | 4,390 | -1.8% |
| | **12,672** | 11,838 | 7.0% | **38,576** | 32,763 | 17.7% |
| Operating income (loss) | | | | | | |
| ALM segment | **(1,422)** | 1,247 | -214.0% | **(4,349)** | 1,673 | -360.0% |
| Interoperability segment | **300** | 328 | -8.5% | **1,451** | 1,318 | 10.1% |
| | **$ (1,122)** | $ 1,575 | -171.2% | **$ (2,898)** | $ 2,991 | -196.9% |

Consolidated income (loss) from operations was (10%) of total revenue in Q307 compared with 12% in Q306. Operating expenses were $12.7 million in Q307, up from $11.8 million in Q306, a 7% increase. For the nine months ended January 31, 2007, the operating margin was (8%) compared with 8% in the same period in fiscal 2007, with operating costs increasing 18% during that period. Costs increased in the ALM segment as resources have been invested throughout the fiscal year to generate sales, develop the market and further develop the Company's ALM products. The emphasis of ALM spending increases continues to be on sales and market development and research and development activities as the Company executes its strategy of building a market leading enterprise ALM business. The increase includes ramp up costs associated with the Company's expansion into the Asia Pacific market of approximately $0.5 million during the quarter and $1.4 million on a year to date basis. Additionally, increased costs that affected the ALM segment this quarter included: stock compensation charges relating to the adoption of SFAS123R of approximately $0.3 million for the quarter ($0.8 million year to date) (See "Changes in Accounting Policy") and the impact of the strengthening Canadian dollar, Pound Sterling and Euro against the US dollar during Q307 versus Q306, which accounted for approximately $0.3 million ($1.1 million year to date) of the cost increase. This latter increase affected the areas containing a significant number of the Company's Canadian employees, namely research and development and general and administrative costs.

**Cost of Product and Support**

Cost of product and support consists of costs incurred to deliver the Company's product to customers, including royalty costs paid to third parties for technology embedded in the product, and to provide telephone support for customers under maintenance contracts. On a consolidated basis, cost of product and support decreased 24% to $0.8 million in Q307 compared to $1.0 million in Q306, primarily related to the decreased license revenue over the same periods. However, cost of product and support increased as a percentage of license revenue to 19% in Q307 compared to 14% in Q306. For the nine months ended January 31, 2007 and 2006, the cost of product and support remained consistent at $2.8 million, yet increased as a percentage of license revenue to 19% in the nine months ended January 31, 2007 compared to 15% in the same period in fiscal 2006. The increases in percentage of product and support costs was primarily driven by the Company's fixed base of costs, which did not decrease with the lower license revenue sales volume in the ALM segment in fiscal 2007.




**Cost of Service**

Cost of service for Q307 increased 13% from Q306. The Company achieved a 22% margin on service revenue in Q307 compared with a 6% margin in Q306. Cost of service for the nine months ended January 31, 2007 increased 13% from the same period in fiscal 2007 with a margin on service revenue of 24% in the nine months ended January 31, 2007 compared with a margin of 18% in the same period in fiscal 2006. Costs increased in fiscal 2007 due to an investment in resources by the Company to increase its ability to deliver its future services in the ALM segment both through employees (an increase in average headcount of 2 compared to Q306) as well as external contractors. These additional employees were hired to address the trend of increasing demand for services.

**Sales and Marketing**

Sales and marketing expenses in Q307 rose 7%, or $0.4 million, compared to Q306. For the nine months ended January 31, 2007, sales and marketing expenses increased by 20% or $2.9 million compared to the same period in fiscal 2006. Cost increases in fiscal 2007 were primarily attributable to the expansion of the ALM sales force. Most notably, the Company's investment in the expansion into the Asia-Pacific market represented approximately $0.5 million during Q307 ($1.4 million on a year to date basis). Those costs were partially offset by lower overall sales commissions in Q307, due to the lower license revenue sales volume in the ALM segment compared to Q306. Average headcount increased by 16 positions from Q306 to Q307 with a corresponding increase in compensation costs of $0.5 million. These direct costs were incurred to build a larger sales organization and to generate higher revenue in the ALM segment in the current and future quarters. As a percentage of license revenue, sales and marketing expenses increased from 72% in Q306 to 135% in Q307. For the nine months ended January 31, 2007, sales and marketing expenses represented 120% of license revenue compared to 81% in the same period in fiscal 2006.

**Research and Development**

Research and development expenses for Q307 increased 13%, or $0.3 million, compared with Q306. For the nine months ended January 31, 2007 research and development expenses increased 21%, or $1.5 million compared with the same period in fiscal 2006. The Company continues to invest in the development of its core ALM products to expand the features and functionality needed to remain competitive in the marketplace. Average headcount for the quarter increased by 10 from Q306 to Q307, increasing the cost base by $0.4 million. Since the majority of the Company's development takes place in Canada, the effect of the strengthening Canadian dollar accounted for $0.2 million of the increase in research and development expenses in the nine months ended January 31, 2007. As the Company continues to expand its customer base, increased spending in the ALM segment on research and development will be essential to maintain and further expand on its products. As a percentage of total revenue, research and development costs rose from 19% in Q206 to 25% in Q207. For the nine months ended January 31, 2007, research and development expenses increased to 24% of total revenue, from 20% in the same period in fiscal 2006. Research and development costs for the IO segment remained constant in both Q307 and Q306 at approximately $0.2 million and for the nine months ended January 31, 2007 and 2006 at approximately $0.7 million.

**General and Administrative**

General and administrative expenses decreased 3% to $1.8 million in Q307 compared to $1.9 million in Q306. For the nine months ended January 31, 2007 general and administrative expenses increased 3% to $5.3 million from $5.1 million in the same period in fiscal 2006. During the nine months ended January 31, 2007, the higher Canadian dollar versus the US dollar increased costs by $0.3 million, which was offset by cost reductions. Headcount for the Company's general and administrative structure remained relatively consistent in Q307 compared with Q306, with an average headcount increase of one. General and administrative expenses increased to 16% of total revenue in Q307 compared to 14% in Q306. For the nine months ended January 31 ,2007 and 2006, general and administrative expenses remained consistent at approximately 15% of total revenue for each period. The Company gained efficiencies in its general and administrative structure, which were offset by the lower license revenue volume in the ALM segment in fiscal 2007.

### Interest Income

Interest income was generated from short-term investment grade interest-bearing securities. Low short-term interest rates in Q307 and the nine months ended January 31, 2007 minimized available returns.

### Income Taxes

In Q307 and the nine months ended January 31, 2007, a non-cash deferred income tax expense or recovery was recorded in jurisdictions where the income was generated to the extent a deferred tax asset has been recorded in that jurisdiction. The Company has reviewed the valuation allowance on the deferred tax asset and has determined that it is appropriate. The Company's deferred tax assets will be utilized to offset taxable income, mainly in Canada and the United States in the future. Realization of the net deferred tax asset is dependent on generating sufficient future taxable income on a jurisdiction by jurisdiction basis. Although realization is not assured, the Company believes it is more likely than not that the deferred tax asset recorded in the financial statements will be realized. As factors change in the future, this estimate could change in the near term as estimated future taxable income in each legal entity changes. Refer to note 3 in the audited consolidated financial statements of the Company for the year ended April 30, 2006 for a summary of tax losses available and a summary of the deferred tax asset to which a valuation allowance still applies.

In addition, the Company recorded the benefit of a refundable Investment Tax Credit during the nine months ended January 31, 2007 in the amount of $0.3 million ($nil for Q307). This amount reduced the Company's current tax expense and is reflected as a reduction of the income tax provision.

## Liquidity and Capital Resources

The Company's cash balance as at January 31, 2007 decreased by $0.6 million to $15.1 million compared to $15.7 million at April 30, 2006 due primarily to cash expenditures for investing and financing activities exceeding cash generated from operations.

### Operating Activities

The Company generated $2.0 million of cash from operating activities in Q307 compared with cash used in operations of ($0.4) million in Q306. Days sales outstanding in accounts receivable at January 31, 2007 were 61 days compared to 76 and 79 days at January 31, 2006 and April 30, 2006, respectively. The decrease in days sales outstanding from April 30, 2006 is attributable to the cycle of the Company's maintenance renewals, the timing of deals completed in the quarter, and the extension of payment terms to customers throughout the last half of fiscal 2006 which was not as prevalent during the first nine months of fiscal 2007, and to an update to the Company's maintenance renewal billing system that allows for earlier invoicing of renewals. As the Company renews the majority of its maintenance contracts in the last two quarters of each fiscal year, the Company expects the trend of accounts receivable and deferred revenue balances to be higher in Q3 and Q4 during each fiscal year. Accordingly, deferred revenue increased by $2.5 million due to the timing of maintenance renewals and the maintenance relating to the new licensing transactions in the quarter.

### Investing Activities

Purchases of fixed assets and intangibles amounted to $0.6 million in Q307 compared with $0.2 million in Q306. Capital spending consists primarily of computer hardware and software acquisitions in order to replace aging equipment, to provide enhanced security and productivity and to support growth in operations.

### Financing Activities

On June 7, 2006, the Company announced that its Board of Directors had adopted a dividend policy and had declared an initial quarterly dividend on its common shares of $0.02 per share, or an aggregate dividend of $1.0 million. The initial dividend was paid on July 17, 2006 with subsequent second and third quarter dividends paid on October 16, 2006 and January 15, 2007. The Company's policy is to pay a quarterly dividend, so long as the payment of the dividend does not impair the Company's financial position.

The Company received $0.8 million during the nine months ended January 31, 2007 from the issuance of common shares upon the exercise of stock options under the Company's employee stock option plans.

### Capital Resources

The Company's primary sources of liquidity are its cash balances generated by operations and working capital. An additional source of liquidity over the next three years is anticipated to come from the Company's employee stock option plans. Due to the maturity of these plans and the pending expiry over the next three years of a significant number of options having exercise prices below the current market price for the Company's common shares, the Company believes that stock option exercises should provide additional cash from financing activities to the Company during this period. The Company had cash and cash equivalents totaling $15.1 million at January 31, 2007, compared with $13.2 million at January 31, 2006.

The Company believes that, based on current estimates, its current cash balances will be sufficient to meet its working capital and capital expenditure requirements for the next twelve month period. If the Company's spending plans change, and/or cash generated from the Company's operations during that period is below the Company's expectations, the Company may find it necessary to seek additional sources of equity or debt financing and/or reduce or eliminate its quarterly dividend to support its capital needs. If the Company does need to seek additional financing, there is no assurance that this additional financing will be available in amounts or on terms favourable to the Company and not dilutive to the Company's shareholders.

The Company may make strategic investments in related products or acquire customer bases. The Company may utilize a portion of its cash balances or issue additional share capital or debt to finance such investments.

**Contractual Obligations**

The following table provides a summary of the Company's contractual obligations for the periods indicated.

| | Fiscal year ended April 30 | | | | | | |
|---|---|---|---|---|---|---|---|
| *(tabular amounts in thousands)* | 2007 | 2008 | 2009 | 2010 | 2011 | Thereafter | Total |
| Operating lease obligations | $ 485 | $ 1,835 | $ 1,492 | $ 1,368 | $ 525 | $ - | $ 5,705 |
| Purchase obligations | 1,167 | 129 | - | - | - | - | 1,296 |
| **Total** | **$ 1,652** | **$ 1,964** | **$ 1,492** | **$ 1,368** | **$ 525** | **$ -** | **$ 7,001** |

Represents commitments under certain contractual arrangements to make future payments for goods and services to be used in the normal course of business.

## Outlook for Fiscal 2007

The Company believes that annual fiscal 2007 revenue will be in the range of $50 to $52 million and income before tax will be in the range of ($1) to $1 million, revised down from the guidance given last quarter. The material factors and assumptions applied by the Company in arriving at these ranges and that could materially affect the Company's liquidity are: the ability of the Company to successfully expand its ALM sales, services and research and development staff and to generate higher revenue in the ALM segment; the ability of the Company to make increased marketing expenditures in the ALM segment; increased ALM research and development expenditures to ensure the Company maintains its technical leadership in the ALM market; the Company will incur increased costs relating to stock compensation charges; and the expectation that the Company's Interoperability business will decline on an annual basis of approximately 10 percent over the course of the year. See "Risk Factors" below.

Income tax expense is recorded in the Company's financial statements at the prevailing tax rate in the jurisdiction where the income was generated, to the extent a deferred tax asset has been recorded in that jurisdiction. Such rate may be higher than the average rate the Company expects to pay in the future across all jurisdictions. The Company expects the long term tax rate to be approximately 35% to 36%. This will be subject to an ongoing quarterly assessment of the valuation allowance by jurisdiction which may give rise to further increases or decreases to the existing tax asset.

## Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements such as special purpose or variable interest entities.

## Changes in Accounting Policy

In December 2004, the FASB issued SFAS 123R, Share-Based Payment, ("SFAS 123R"). This revised standard addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for either equity instruments of the company or liabilities that are based on the fair value of the company's equity instruments or that may be settled by the issuance of such equity instruments. Under the new standard, companies will no longer be able to account for share-based compensation transactions using the intrinsic method in accordance with APB 25. Instead, companies will be required to account for such transactions using a fair-value method and recognize the expense in the consolidated statement of income. For the Company, SFAS 123R has been adopted for May 1, 2006 and reflects the impact of expensing share-based payments using the modified prospective method. This resulted in a compensation charge of $0.3 million in Q307, $0.8 million year to date. The impact on the Company's financial statements is disclosed in note 1 of the Notes to the Consolidated Financial Statements for the three and nine months ended January 31, 2007.

Please see note 1 to the consolidated financial statements of the Company for the fiscal year ended April 30, 2006 for more information about the accounting policies of the Company.

## Related Party Transactions

During the first three quarters of fiscal 2007, the Company did not engage in any transactions involving related parties.

## Disclosure Controls and Procedures

As of the end of the period covered by this MD&A, the Chief Executive Officer and the Chief Financial Officer of the Company reviewed and evaluated the Company's disclosure controls and procedures (as that term is defined in Multilateral Instrument 52-109) and, based upon that review and evaluation, concluded that those disclosure controls and procedures were effective and met the requirements thereof.

## Critical Accounting Policies and Estimates

The consolidated interim financial statements of the Company for the three and nine months ended January 31, 2007 have been prepared in accordance with US GAAP. Refer to note 1 in the annual consolidated financial statements for more information about the accounting policies applied in the preparation of the financial statements.

The preparation of the financial statements in accordance with US GAAP requires management to make certain estimates, judgments and assumptions. Management continually evaluates these estimates, judgments and assumptions based on past experience and other relevant factors and believe them to be reasonable based upon information available to management at the time. Because this involves varying degrees of judgment and uncertainty, the amounts currently reported in the financial statements could, in the future, prove to be inaccurate. The accounting policies that reflect management's more significant estimates, judgments and assumptions and which management believes are the most critical to aid in fully understanding and evaluating the reported financial results include the following:

#### Revenue Recognition

The Company follows the provisions of Statement of Position (SOP) 97-2, "Software Revenue Recognition" and Staff Accounting Bulletin (SAB) 104, "Revenue Recognition in Financial Statements". Revenue is recognized from the sale of product and software licenses when delivery has occurred based on purchase orders, contracts or other documentary evidence, provided that collection of the resulting receivable is deemed probable by management. A provision is made for estimated sales returns and other insignificant vendor obligations. Revenue from post contract customer support is recognized ratably over the period that the customer support services are provided, which is generally one year. The amount of revenue allocated to this undelivered service is based on the vendor-specific objective evidence, is recorded as unearned, and the difference between the total contract fee and the amount recorded as unearned for the undelivered service is recognized as revenue related to delivered elements of the contract. Revenue from consulting, training and other services are recognized as services are performed. Deferred revenue represents unearned income associated with support agreements, software license revenue where significant vendor obligations remain and any other situations where payments are received in advance of revenue recognition.

#### Allowance for Doubtful Accounts

The Company maintains allowances for losses that could result from customers who do not make the required payments. The allowance is estimated based on the likelihood of recovering the accounts receivable. This is based on past experience, taking into account current and expected collection trends.

If economic conditions worsen and customer losses increase, the allowance for doubtful accounts will increase by recording an additional expense to the statement of operations.

#### Impairment of Long-Lived Assets

Impairment of long-lived assets is assessed when events or changes in circumstances indicate that the carrying value of the asset may not be recovered.

In the case of goodwill, the Company no longer amortizes these assets as a result of an accounting change in fiscal 2002. However, goodwill impairment is assessed annually and when events or changes in circumstances indicate that goodwill might be impaired. This involves forecasting cash flows and market multiples used to value the assets. There is uncertainty in these estimates as the related cash flows are projected for future years based on underlying assumptions such as volume growth, inflation factors, and industry trends which may or may not materialize. Management uses its best efforts to forecast these amounts, but the actual amounts may vary from the estimated numbers. The impairment test is based on a projected discounted cash flow method. The Company believes that the estimate of future cash flows and fair value are reasonable. The assumptions used are consistent with internal budgets and reflect best estimates, but they have inherent uncertainties that management may not be able to control. As a result, the amounts reported for these items could be different if different assumptions were used, or if conditions change in the future.

### Income Taxes

The Company believes that it has adequately provided for income taxes based on all of the information that is currently available. Tax filings are subject to audits, which could materially change the amount of current and deferred income tax assets and liabilities. As outlined in note 3 in the audited annual financial statements of the Company for the year ended April 30, 2006, a valuation reserve has been taken against a portion of the deferred tax assets of the Company, impacting the deferred tax assets recorded in the Company's financial statements. Any future change to the valuation allowance of the deferred tax asset would result in an income tax expense or recovery on the income statement in that future period. Realization of the net deferred tax assets is dependent on generating sufficient taxable income in certain legal entities. Although realization is not assured, the Company believes it is more likely than not that the net amount of the deferred tax asset will be realized. However, this estimate could change in the near term as estimated future taxable income in these certain legal entities changes. If the Company achieves a consistent and substantial level of profitability the likelihood of the Company recording a future tax asset for some portion of the losses incurred in prior periods in one of its business jurisdictions will increase.

## Risk Factors

An investment in the securities of the Company involves risks. In addition to the other information contained in this MD&A, investors should carefully consider the risks described below before investing in the Company's securities. The risks described below are not the only ones facing the Company. Additional risks not currently known to the Company or that the Company currently believes are immaterial may also impair the business, results of operations, financial condition and liquidity of the Company.

### Development of the ALM Market

The Company's strategy is to focus its sales and marketing efforts on the enterprise segment of the ALM market, a segment that the Company believes is comprised of large corporations that have a need to improve the productivity, processes and governance over internally developed software in large, dispersed IT departments. This segment of the market is currently estimated to be 10% of the total ALM market of approximately $1 billion annually. The Company believes that the enterprise segment of the ALM market will grow faster than the traditional desktop segment that has been in decline in recent years due to high levels of competition.

As part of its strategy, over the past few quarters, MKS has released technology upgrades that extend the applicability of its platform across a significantly broader user base within its target enterprise customers. While this has generated significant interest among new large enterprise customers, increasing the value of the Company's solution and promising to establish much deeper adoption of the platform by them, it has added to the complexity of sales initiatives and lengthened sales cycles.

The Company has focused its ALM strategy on penetrating Global 1000 companies. This strategy has had, and may continue to have, an effect on the size and timing of license transactions and has increased and may continue to increase the Company's operating expenses (which may adversely affect the Company's operating income and net income if revenues do not increase proportionately) and the variability of the length of the sales cycle for the Company's enterprise ALM products.

There is no assurance that the Company's strategy will be successful or that the Company will develop a profitable business from selling its products and services into this segment of the market. The Company's future financial performance will depend in large part on the continued growth in the number of businesses adopting ALM products and the expansion of the products use on a company-wide basis.

### Fluctuation in Quarterly Results

The Company's quarterly revenues and operating results have fluctuated significantly in the past and are likely to fluctuate substantially from quarter to quarter in the future. Such fluctuations may result in volatility in the price of the Company's common shares ("Common Shares"). Quarterly revenues and operating results may fluctuate as a result of a variety of factors, including demand for the Company's products, the proportion of revenues attributable to license versus service revenues, the introduction of new products and product enhancements by the Company or its competitors, changes in the Company's pricing policies or those of its competitors, the geographical mix of the Company's sales and currency exchange rate fluctuations, unanticipated product discontinuation or deferrals by the Company's OEM customers, the fixed nature of a significant portion of the Company's operating expenses, particularly personnel, research and development and leases, general economic conditions, and competitive conditions in the ALM and Interoperability markets. In the ALM segment of its business, the Company has focused its strategy on penetrating Global 1000 companies. This strategy has had, and may continue to have, an effect on the size and timing of license transactions and has increased and may continue to increase the Company's operating expenses (which may adversely affect the Company's operating income and net income if revenues do not increase proportionately) and the variability of the length of the sales cycle for the Company's enterprise ALM products.

The Company has historically operated with little backlog because its software products are generally shipped as orders are received. In addition, the Company has often recognized a substantial portion of its revenues in the last month of a quarter and often in the last week or days of that month. As a result, license fees in any quarter are substantially dependent on orders booked and shipped in the last month or last week of that quarter. Accordingly, a small variation in the timing of recognition of revenues for specific transactions can adversely and disproportionately affect the Company's business, results of operations, liquidity and financial condition because the Company establishes its expenditure levels on the basis of its expected future revenues and only a small portion of the Company's expenses varies with its revenues in the short term.

Due to all of the foregoing factors, the Company’s revenues and operating results are difficult to predict and may not meet the expectations of market analysts and investors. In such an event, the trading price of the Common Shares would likely be materially adversely affected. Accordingly, the Company believes that period to period comparisons of results of operations are not necessarily meaningful and should not be relied upon as indicative of future performance.

**Intense Competition**

The markets for the Company's products and services are intensely competitive and rapidly changing and a number of companies offer products and services similar to the Company's products and services and target the same customers as the Company. The Company believes its ability to compete depends upon many factors within and outside its control, including the timely development and introduction of new products and product enhancements, product functionality, performance, price, reliability, customer service and support, sales and marketing efforts, product distribution, and product releases by competitors.

Many of the Company's competitors and potential competitors are substantially larger than the Company and have greater name recognition, larger customer bases and significantly greater financial, technical, marketing, public relations, sales, distribution and other resources than the Company. As a result, they may be able to respond more quickly to new or emerging technologies and changes in customer requirements, or to devote greater resources to the development, promotion and sale of their products than the Company.

In addition, the Company anticipates that the quality, functionality and breadth of the Company’s competitors’ product offerings will improve, and there can be no assurance that the Company will be able to compete effectively with such product offerings. The Company expects that additional competition will develop, both from existing businesses in the ALM and Interoperability markets and from new entrants. Moreover, as competition increases, the prices that the Company charges for its products may decline. In addition, the Company could be materially adversely affected if there were a significant movement towards the acceptance of open source solutions or other alternative technologies that compete with the Company's products. If the Company is not able to compete successfully, the Company's business, financial condition and operating results could be materially adversely affected. The Company's most significant direct competitors in the ALM market include IBM Corporation, Serena Software Inc., Telelogic North America, Inc., Computer Associates International, Inc. and Borland Software Corporation, and in the Interoperability market include Microsoft Corporation and Red Hat, Inc.

**Management of Growth**

The Company has in the past experienced significant growth in its business, including an expansion in the Company's staff and customer base, the establishment of new distribution channels and the expansion of its product lines. Such growth placed, and may continue to place, a significant strain on the Company's management and operations. The Company’s ability to manage growth effectively in the future will require it to further develop and improve its operational, financial and other internal systems, and to hire, train and manage employees. If the Company is unable to manage its growth effectively, the Company's business, results of operations, liquidity and financial condition could be materially and adversely affected.

**Rapid Technological Change**

The markets for the Company's products are characterized by rapid technological advances, evolving industry standards, changes in end-user requirements and frequent new product introductions and enhancements. The introduction of products embodying new technologies and the emergence of new industry standards could render the Company's existing products, and products currently under development, obsolete and unmarketable. The Company's future success will depend upon its ability to enhance its current products, and to develop and introduce new products that keep pace with technological developments, respond to evolving end-user requirements and achieve market acceptance. The development of such new products or enhanced versions of existing products entails significant technological risks. There can be no assurance that the Company will be successful in marketing its existing products or be successful in developing or marketing new products or product enhancements on a timely basis, or that the Company will not experience significant delays in development in the future, any of which could have a material adverse effect on the Company's business, results of operations and financial condition.

**Dependence on and Retention of Management and Key Employees**

The Company’s success will depend to a very significant extent on the performance and continued services of its senior management and certain other key employees, the loss of any of whom could have a material adverse effect upon the Company. In addition, the Company has hired a number of key managers within the past three years and may continue to expand its management team in the future.

The Company believes that its future success will also depend in large part upon its ability to attract and retain highly skilled technical, managerial and marketing personnel. Competition for such personnel is intense and the Company has experienced difficulties in recruiting qualified personnel and may continue to experience such difficulties in the future. There can be no assurance that the Company will be successful in attracting and retaining the personnel it requires to continue to maintain and expand its business. The Company does not have key person life insurance for any of its management team.

**Currency Exchange Rate Fluctuations**

The Company's financial results are reported in US dollars. Recent changes in the exchange rate between the United States dollar and the Canadian dollar, Pound Sterling and the Euro have had the effect of decreasing revenues and operating income earned and decreasing reported expenses incurred in Europe, while increasing reported expenses incurred in Canada, as a significant portion of the Company's expenses are incurred in non-US currencies. Future fluctuations in those exchange rates could continue to have an effect on the Company's business and results of operations. In particular, a further decline in the value of the United States dollar relative to the Canadian dollar could have a material adverse effect on the Company's results of operations and cash flows. The Company does not currently undertake any exchange rate hedging activities.

A portion of the Company's sales outside of Canada and the United States are denominated in local currencies such as Pound Sterling and Euros. Fluctuations in the value of the United States dollar in relation to foreign currencies may adversely affect the ability of the Company to compete with respect to sales to foreign customers, or compel the Company to maintain price levels in local currencies, which could reduce the realized price in US dollars, thereby negatively impacting revenue and profitability of foreign operations.

**International Sales**

The Company believes that its future revenue and operating results will depend in part upon its ability to increase sales in international markets outside North America. Approximately 35% of the Company's revenue is derived from sales outside of North America, primarily Europe. Recently, the Company has expanded its Asia-Pacific sales force in order to expand its operations in that region. International sales are subject to various risks, including exposure to currency fluctuations, political and economic instability, increased difficulty of administering business and the need to comply with a wide variety of international and domestic export laws and regulatory requirements. There are a number of risks inherent in the Company's international activities, including unexpected changes in Canadian or other governmental policies concerning the import and export of goods, services and technology and other regulatory requirements, tariffs and other trade barriers, costs and risks of localizing products for foreign languages, longer accounts receivable payment cycles, limits on repatriation of earnings and the burdens of complying with a wide variety of foreign laws. The financial stability of foreign markets could also affect the Company's international sales. There can be no assurance that such factors will not have a material adverse affect on revenues and expenses of the Company related to international sales and, consequently, the Company's business, results of operations, liquidity and financial condition. In addition, international income may be subject to taxation by more than one jurisdiction, which could also materially adversely affect the Company's results of operations.

**Importance of Maintenance Contracts**

Under the Company's annual maintenance contracts, customers are provided with telephone support to assist them in solving technical issues that arise from time to time in deploying and using the Company's software products and are supplied upgrades and patches for the Company's products for the duration of the maintenance period. The upgrades and patches provide new features and functionality as well as fixes to technical problems encountered by the customer installed base. The Company has historically experienced a high rate of renewal of customer contracts and relies on the cash flow generated from these renewals to fund operations and provide liquidity as the maintenance fees are paid at the beginning of the contract period. Deterioration in the renewal rate of maintenance contracts could adversely impact the revenue, profitability and liquidity of the Company.

**Economic Uncertainty**

The majority of the Company's revenue has been, and is expected to continue to be, derived from customers in North America. Trends in general economic activity in the United States impact spending by corporations in the area of information technology, which includes the ALM and Interoperability markets.

**Dependence on a Limited Number of Products**

Substantially all of the Company's revenues are currently derived from a limited number of products and services offered by the Company in the ALM and Interoperability markets. Accordingly, the Company's future results of operations will depend, in part, on maintaining and increasing market acceptance of these products and services, as well as on the Company's ability to continue to enhance these products and services to meet the evolving needs of its customers. A reduction in demand or increase in competition in the market for ALM or Interoperability solutions, or a decline in sales of such products and related services, could have a material adverse effect on the Company's business, results of operations, liquidity and financial condition.

**Acquisitions**

The Company may in the future further expand its operations or product offerings through the acquisition of additional businesses, products or technologies. There can be no assurances that the Company will be able to identify, acquire or profitably manage additional businesses without substantial expenses, delays or other operational or financial problems. Furthermore, acquisitions also entail numerous risks, including: difficulties in assimilating acquired operations, products and personnel; unanticipated costs, events and legal liabilities; diversion of management's attention from other business concerns; adverse effects on existing business relationships with suppliers and customers; risks of entering markets in which the Company has limited or no prior experience; and potential loss of key employees from either the Company’s pre-existing business or the acquired organization. Some or all of these risks could have a material adverse effect on the Company's business, results of operations and financial condition. In addition, there can be no assurance that acquired businesses, products or technologies, if any, will achieve anticipated revenues and income.

Acquisitions could also use a substantial portion of the Company's available cash; may result in the Company incurring substantial debt, which may not be available on favourable terms and may adversely affect the liquidity of the Common Shares; may result in the Company assuming contingent liabilities and taking substantial charges in connection with the impairment of goodwill and amortization of other intangible assets; and may result in the issuance of equity securities that would dilute existing shareholders. The failure of the Company to manage its acquisition strategy successfully could have a material adverse effect on the Company's business, results of operations, liquidity and financial condition.

**Distribution Channels in the Interoperability Market**

The Company employs a multi-channel sales and marketing strategy, using direct sales, OEMs, distributors and other resellers to address its global market for its Interoperability products. The Company expects that its Interoperability division will remain dependent upon these parties to distribute its products. In addition, the performance of OEMs, distributors and other resellers is outside the control of the Company, and the Company is unable to predict the extent to which these organizations will be successful in marketing and selling the Company's Interoperability products. The Company's failure to attract and retain sufficient direct sales personnel or to maintain its existing third-party relationships or to establish new relationships with OEMs, distributors and other resellers could have a material adverse effect on the Company's business, results of operations, liquidity and financial condition.

**Potential for Undetected Errors in Software**

Software products, as complex as those offered by the Company, often encounter development delays and may contain undetected defects when introduced or when new versions are released. The Company has encountered delays and discovered previously undetected defects in the introduction of new products and product enhancements. There can be no assurance that the Company will not encounter product development delays in the future or that, despite testing by the Company, errors will not be found in new products or product enhancements after commencement of commercial shipments, resulting in damage to the Company's reputation, loss of revenue, loss of market share, delay in market acceptance or warranty claims, any of which could have a material adverse effect upon the Company's business, results of operations, liquidity and financial condition. This risk is amplified for the Company because a portion of its sales have been derived, and are expected in the future to be derived, from arrangements under which third parties embed the Company's products in their own products.

Any significant errors in the Company's products, or in the products of third parties which embed the Company's products, might discourage such third parties or other customers from utilizing the Company's products, which could have a material adverse effect on the Company's business, results of operations, liquidity and financial condition. Although the Company generally attempts to limit by contract its exposure to incidental and consequential damages, if a court failed to enforce the liability limiting provisions of the Company's contracts for any reason, or if liabilities arose which were not effectively limited, the Company's business, results of operations, liquidity and financial condition could be materially and adversely affected.

**Protection of Intellectual Property**

The Company relies primarily on a combination of copyright, trademark and trade secrets laws, confidentiality procedures and contractual provisions to protect its proprietary rights. Substantial portions of the Company’s sales are derived from the licensing of the Company’s products under shrink-wrap license agreements that are not signed by licensees and therefore may be unenforceable under the laws of certain jurisdictions. The Company generally enters into confidentiality agreements with its other licensees, employees and third-party distributors. Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy and may succeed in copying aspects of the Company's products or to obtain and use information that the Company regards as proprietary. Furthermore, there can be no assurance that others will not independently develop products similar to those of the Company.

In addition, the laws of some foreign countries do not protect the Company's proprietary rights to as great an extent as do the laws of Canada or the United States. There can be no assurance that the Company's competitors will not independently develop similar technology or that the Company's means of protecting its proprietary rights will be adequate, and consequently the Company's business, results of operations, liquidity and financial condition could be materially adversely affected.

The Company is not aware that any of its products infringe the proprietary rights of third parties. There can be no assurance, however, that third parties will not claim infringement by the Company with respect to current or future products. The Company expects that software product developers will increasingly be subject to infringement claims as the number of products and competitors in the ALM and Interoperability markets grow and the functionality of products in these markets overlaps. Defense of such claims, with or without merit, could be time-consuming, result in costly litigation, cause product shipment delays or require the Company to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to the Company or at all, either of which could have a material adverse effect upon the Company's business, results of operations, liquidity and financial condition.

**Reliance on Third Party Relationships**

The Company has a number of third-party relationships that are significant to its marketing, sales and related support activities and product development efforts. The Company relies upon relational database management systems applications, and development tool vendors, software and hardware vendors to strengthen its product offerings through integration with industry-standard tools and utilities. The Company's intent in entering into these relationships is to keep pace with the technological and marketing developments of major software vendors, to acquire technical assistance for the Company's product development efforts and to leverage the Company's sales and marketing capabilities. There can be no assurance that these companies, many of which have significantly greater financial and marketing resources than the Company, will not develop or market software products that compete with the Company's products in the future or will not otherwise discontinue their relationships with or support of the Company. The failure of the Company to maintain its existing relationships, or to establish new relationships in the future, for any reason, could have a material adverse effect on the Company's business, results of operations, liquidity and financial condition.

**Limited Financial Resources**

The Company believes that expected cash flow from operations combined with existing cash and cash equivalents will be sufficient to meet the Company's cash requirements for the next twelve months. The Company does not currently have any specific plans for external investments, but may make modest strategic investments in related products or acquire customer bases, which could result in a utilization of cash balances or create a need for external financing. The Company may utilize a portion of its cash balances or issue additional share capital or debt to finance such investments. Failure to obtain such financing could result in the delay or abandonment of some or all of the Company's business plans, which could have a material adverse effect on its business, results of operations, liquidity and financial condition.

**Litigation**

The nature of the Company's business subjects the Company to regulatory investigations, claims, lawsuits and other proceedings in the ordinary course of the Company's business. The results of these legal proceedings cannot be predicted with certainty. There can be no assurance that these matters will not have a material adverse effect on the Company's results of operations in any future period, depending partly on the results for that period, and a substantial judgment could have a material adverse impact on the Company's financial condition.

From time to time, the Company may be required to enforce its rights under contractual arrangements with its customers, including for non-payment of amounts owing. There can be no assurance that the Company will be successful in any such action or that the Company will not incur significant expenses in the course of the litigation or be required to devote a material portion of the Company's management resources to any such action.

**Concentration of Ownership**

The directors and executive officers of the Company as a group beneficially own, directly or indirectly, approximately 25% of the Common Shares outstanding. As a result, these shareholders, if acting together, could have significant influence over matters requiring the approval of the shareholders of the Company, including the election of the Company's Board of Directors and significant transactions. This concentration of ownership may have the effect of delaying or preventing a change in control of the Company or otherwise cause the Company to take action that may not be in the best interests of all shareholders, either of which in turn could reduce the market price per share of the Common Shares.

**Market Maturity in the Interoperability Market**

The Company has, in the past, derived significant growth from its products and services targeted at the Interoperability market. The Interoperability market is now considered by the Company to be mature relative to the other markets that it addresses, and is expected to undergo limited growth and may decline in the future. The market for Interoperability products and services generally is subject to aggressive competition, resulting in increasing downward pressure on product licensing fees and gross margins. As a result of the relative maturity of the Interoperability market and increasing competition in that market, the Company may be unable to maintain or increase its current level of revenues from its Interoperability products and services, or to achieve the same level of gross margins as it has achieved on the licensing of Interoperability products in the past, each of which may have a material adverse impact on the Company's business, results of operations and financial condition.