

## 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, 2009 and January 31, 2008.

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 ended January 31, 2009 and January 31, 2008. 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 Canadian generally accepted accounting principles ("Canadian GAAP").

Additional information relating to the Company, including the Company's Annual Information Form, is on SEDAR at [www.sedar.com](http://www.sedar.com).

The date of this MD&A is February 23, 2009.

### 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 regarding 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, fluctuations in quarterly results, economic uncertainty, currency exchange rate fluctuations, intense competition, management of growth, rapid technological change, dependence on and retention of management and key employees, importance of maintenance contracts, international sales, 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, use of open source software, 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, except as required by law.

### About the Company

MKS evaluates operational performance based on two operating segments: 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 application lifecycle management (ALM) segment. ALM encompasses the management of all the activities and the artifacts that relate to or impact custom or packaged software applications including Requirements Management, System Design, Software Configuration Management, Change Management, Test Management and Release Management and the integration and control over a diverse array of software design, modeling and testing tools.

MKS Integrity™ is an enterprise ALM platform that provides consistent capabilities across all disciplines of the application lifecycle by defining hierarchies, relationships and change management processes for numerous user defined application artifacts. Unlike other ALM offerings that have been assembled by acquisition, MKS Integrity is a unified platform providing enterprise class scalability and multi-platform capability to support large scale software reuse initiatives, workflow-based collaboration and rich mining of application activity data to deliver higher team productivity, visibility and compliance for software engineering and IT organizations.

MKS focuses its marketing and sales efforts on enterprises with large software development organizations. The Company targets companies that deliver software within their products such as software vendors and electronics, automotive and defense companies, systems integration companies and the software development departments of major corporations which use internally developed applications to run their businesses, such as banks and pharmaceutical and telecommunications companies.

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

### Performance Highlights

Overall, in the three months ended January 31, 2009 ("Q309") revenue increased 3% from the three months ended January 31, 2008 ("Q308"). In Q309, the Company realized higher maintenance and services revenue, increasing 6% and 21%, respectively, compared to Q308, which offset the 10% decline in license revenue. For the nine months ended January 31, 2009, license, maintenance and service revenue increased by 8%, 10% and 29%, respectively, for a total increase in revenue of 12% compared to the nine months ended January 31, 2008.

The volume of transactions over \$100,000 increased as the Company completed 12 transactions over \$100,000 in Q309 compared with 7 in Q308. In addition, there were no transactions in either Q309 or Q308 in excess of \$500,000. The Company continued to close deals for both new customer installations as well as for expanded deployment of its products with existing customers.

Income from operations ("operating income") increased to \$0.4 million for the quarter ended January 31, 2009 compared with an operating loss of \$0.8 million in the quarter ended January 31, 2008. For the nine months ended January 31, 2009, operating income increased to \$0.4 million compared with an operating loss of \$0.8 million for the nine months ended January 31, 2008. Operating costs decreased by \$0.8 million, or 6%, in Q309 compared to Q308. The decrease in operating costs was primarily attributable to lower sales and marketing costs during the quarter. The decrease in operating costs was partially offset by a general increase in the cost of service, which was in line with the increased service revenue delivered during the quarter, as well as an increase in the Company's average headcount to 308 during Q309 from 302 during Q308.

In Q309, the Company continued to be subject to fluctuations in the exchange rates among the main currencies in which the Company operates, namely the US dollar, Canadian dollar, Pound Sterling and Euro. These fluctuations, most predominantly the strengthening of the US dollar against those other currencies, had the effect of reducing operating costs in the quarter and generating a foreign exchange charge on balances denominated in non-US currencies. Decreased costs in Q309 relating to the stronger US dollar against those other currencies, particularly the Canadian dollar, amounted to a savings of \$0.8 million in the quarter had those costs been recorded at the same exchange rates as existed in Q308. In addition, the Company recorded a foreign exchange gain in the amount of \$0.2 million in Q309 related to the change in valuation of balance sheet items, namely the period end conversion of non-US denominated cash balances as well as inter-corporate debt, compared with a nominal foreign exchange impact in Q308.

The Company has stable profitability in its Interoperability business segment. In Q309, operating income in its IO segment decreased to \$0.3 million from \$0.4 million in Q308. On a year-to-date basis, operating income for the Interoperability segment has remained constant at \$1.3 million for the nine months ended January 31, 2008 and January 31, 2009, respectively.

The Company believes that the level of ALM licensing in Q309, was largely attributable to normal quarter to quarter variability in major transactions, as it was in Q308, rather than deterioration of ongoing ALM license opportunities. The current economic climate is affecting MKS' ability to sell into several markets where capital constraints among customers have come under pressure, including the financial services and automotive sectors. These sectors have weakened steadily over the past 18 months. Offsetting those declines however has been growth in demand from sectors where capital spending is less restricted and the adverse effects of the economic turmoil are less severe, including the electronic device and healthcare sectors. In addition, many current customers are engaged in long term implementation of the Company's products and continue to make purchases to support those deployments.

### Supplementary Financial Information

(dollar amounts in thousands, except per share amounts)

#### Select Unaudited Consolidated Quarterly Financial Information

The following table presents certain unaudited consolidated quarterly financial information for each of the eight quarters ended January 31, 2009. 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 2007	Jul 31 2007	Oct 31 2007	Jan 31 2008	Apr 30 2008	Jul 31 2008	Oct 31 2008	Jan 31 2009
License revenue	\$ 5,566	\$ 5,802	\$ 5,128	\$ 4,120	\$ 12,128	\$ 6,156	\$ 6,425	\$ 3,702
Maintenance revenue	5,669	6,205	6,402	6,584	6,646	7,035	7,051	6,980
Service revenue	1,411	1,600	2,098	2,086	2,386	2,174	2,792	2,521
Total revenue	\$ 12,646	\$ 13,607	\$ 13,628	\$ 12,790	\$ 21,160	\$ 15,365	\$ 16,268	\$ 13,203
Income (loss) from operations	\$ (300)	\$ (277)	\$ 634	\$ (806)	\$ 4,738	\$ 1,198	\$ 2,001	\$ 497
Net income (loss)	\$ (461)	\$ (320)	\$ 197	\$ (754)	\$ 4,717	\$ 619	\$ 1,353	\$ 325
- per share, basic	\$ (0.01)	\$ (0.01)	\$ 0.00	\$ (0.01)	\$ 0.09	\$ 0.01	\$ 0.03	\$ 0.01
- per share, diluted	\$ (0.01)	\$ (0.01)	\$ 0.00	\$ (0.01)	\$ 0.09	\$ 0.01	\$ 0.03	\$ 0.01
Total assets	\$ 37,576	\$ 36,448	\$ 35,035	\$ 35,463	\$ 44,334	\$ 38,958	\$ 35,921	\$ 38,354
Cash dividends per share	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.02

Key factors which account for the fluctuations in quarterly results include the variability in licensing revenue, the rate of sales force expansion and the impact of currency movements against the US dollar. The timing of large license transactions is uneven, with a significant impact on license revenue from quarter to quarter. In the three months ended April 30, 2008, the Company completed a \$5 million licensing transaction in its ALM segment. As the Company expands its sales force, costs increase in the short term without a corresponding increase in revenue as it generally takes several quarters for new sales representatives to become fully productive. This had a significant impact on financial results in calendar 2007, as outlined in the Company's annual MD&A for the year ended April 30, 2008. In addition, the movement of the Canadian dollar against the US dollar has a direct impact on the

Company's financial results. The Company's main development and administrative costs are based in Canadian dollars, so as the Canadian dollar strengthens against the US dollar, the Company's cost base is increased. Conversely, as the Canadian dollar weakens against the US dollar, the Company's cost base is decreased.

As at January 31, 2009, 49,730,000 common shares of the Company and options to purchase 6,619,000 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 Q309. Revenue and operating income are analyzed on a segmented basis.

### Revenue

(dollar amounts in thousands)

	Three Months Ended January 31			Nine months Ended January 31		
	2009	2008	% Change 2009 to 2008	2009	2008	% Change 2009 to 2008
<b>ALM segment:</b>						
License revenue	\$ 2,768	\$ 3,134	-12%	\$ 12,794	\$ 11,999	7%
Maintenance revenue	6,277	5,803	8%	18,933	16,819	13%
Service revenue	2,521	2,086	21%	7,487	5,784	29%
	<b>11,566</b>	<b>11,023</b>	<b>5%</b>	<b>39,214</b>	<b>34,602</b>	<b>13%</b>
<b>Interoperability segment:</b>						
License revenue	934	986	-5%	3,489	3,051	14%
Maintenance revenue	703	781	-10%	2,133	2,372	-10%
	<b>1,637</b>	<b>1,767</b>	<b>-7%</b>	<b>5,622</b>	<b>5,423</b>	<b>4%</b>
<b>Total revenue</b>	<b>\$ 13,203</b>	<b>\$ 12,790</b>	<b>3%</b>	<b>\$ 44,836</b>	<b>\$ 40,025</b>	<b>12%</b>

### ALM Segment

License revenue in the ALM segment decreased 12% in Q309 over Q308. The volume of large ALM transactions was up in Q309 (12 deals over \$100,000) compared with Q308 (7 deals over \$100,000). A decline was experienced in the total value of licensing transactions under \$100,000 in Q309 compared with Q308. There were no transactions in either Q309 or Q308 that were in excess of \$500,000. For the nine months ended January 31, 2009, license revenue increased 7% compared with the nine months ended January 31, 2008. The Company believes that the level of licensing in Q309 was largely attributable to normal quarter to quarter variability in major transactions, as it was in Q308, rather than deterioration in ongoing license opportunities.

Maintenance revenue growth in Q309 was attributable to the maintenance component of new transactions and the renewal of maintenance contracts by existing customers for additional maintenance periods. Due to the US dollar strengthening against the other major currencies in which the Company operates, maintenance revenue declined sequentially in Q309 from Q2 of 2009. Approximately two-thirds of the Company's maintenance contracts are denominated in US dollars with the majority of the balance denominated in Euro and Pound Sterling. In Q309 approximately \$11 million, or just over one third, of the Company's annual maintenance contracts are renewed. During the quarter the Company did not see any deterioration in its' historical maintenance renewal rate which remains at over 90% of the total value of expiring annual enterprise ALM customer maintenance contracts. The Company enjoys a higher renewal rate on installations of its products with its large accounts compared to smaller accounts.

Service revenue was driven in Q309 by the strong backlog of services sold in prior licensing transactions, in addition to the growing trend of standalone services engagements. The Company continues to grow its service revenue through key engagements with customers in each of its geographic segments and by increasing its penetration into key accounts. The Company believes that its customers are increasingly recognizing the value in Company-delivered services, as the percentage of services sold by the Company in relation to new licensing is on an increasing trend.

### Interoperability Segment

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. 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, and 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. In Q309, the Interoperability segment experienced a decrease in revenue of 7% compared to Q308 and an increase of 4% for the nine months ended January 31, 2009 compared with the nine months ended January 31, 2008.

License revenue decreased 5% in Q309 compared to Q308, with no transactions in excess of \$100,000 in either period. On a year to date basis, for the nine months ended January 31, 2009, license revenue increased 14% from the nine months ended January 31, 2008. The general maturity of the segment has limited the potential for these larger transactions, resulting in volatility in the licensing fees realized. Over the long term and consistent with the maturing of the technology and the market, the Company expects to experience a continuing decline in license revenue from its Interoperability segment.

Maintenance revenue declined 10% in Q309 compared to Q308 and 10% for the nine months ended January 31, 2009 compared to the nine months ended January 31, 2008, consistent with MKS' overall expectations. Maintenance revenue is expected to decline in the future consistent with the company's expectations for steady long term decline in its interoperability business.

### Operating Income

(dollar amounts in thousands)

	Three Months Ended January 31			Nine months Ended January 31		
	2009	2008	% Change 2009 to 2008	2009	2008	% Change 2009 to 2008
<b>Revenue</b>						
ALM segment	\$ 11,566	\$ 11,023	5%	\$ 39,214	\$ 34,602	13%
Interoperability segment	1,637	1,767	-7%	5,622	5,423	4%
	<b>13,203</b>	12,790	3%	<b>44,836</b>	40,025	12%
<b>Operating costs</b>						
ALM segment	11,3776	12,224	-7%	36,864	36,348	1%
Interoperability segment	1,329	1,372	-3%	4,276	4,126	4%
	<b>12,706</b>	13,596	-7%	<b>41,140</b>	40,474	2%
<b>Operating income(loss)</b>						
ALM segment	189	(1,201)	116%	2,350	(1,746)	235%
Interoperability segment	308	395	-22%	1,346	1,297	4%
	<b>\$ 497</b>	\$ (806)	152%	<b>\$ 3,696</b>	\$ (449)	923%

Consolidated income from operations was \$0.5 million in Q309 compared with a loss from operations of \$0.8 million in Q308. Operating expenses were \$12.7 million in Q309, down from \$13.6 million in Q308, a 7% decrease. For the nine month period ended January 31, 2009, consolidated income from operations was \$3.7 million, compared to a loss from operations of \$(0.4) million in the nine month period ended January 31, 2008. Operating expenses increased 2% to \$41.1 million for the nine months ended January 31, 2009 compared with \$40.5 million for the nine months ended January 31, 2008.

The Company's operating costs were impacted by an increase in the value of the US dollar relative to the Canadian dollar, Euro and Pound Sterling. This resulted in lower operating costs in Q309 compared with Q308 of \$0.8 million in addition to a foreign exchange gain of \$0.2 million. The Company's primary exposure to foreign currency rate fluctuations is between the value of the Canadian dollar and the US dollar.

The following table sets forth, for the periods indicated, in thousands of dollars, except exchange rate information, (i) the Company's operating costs incurred in Canadian dollars and as a percentage of its total operating costs, (ii) the average exchange rate for one Canadian dollar expressed in US dollars based upon the noon buying rates provided by the Bank of Canada, and (iii) the effective exchange rate between the US dollars and Canadian dollars, after giving effect to hedging activities undertaken by the Company.

	<u>FY08 Q1</u>	<u>FY08 Q2</u>	<u>FY03 Q3</u>	<u>FY08 Q4</u>	<u>FY09 Q1</u>	<u>FY09 Q2</u>	<u>FY09 Q3</u>
Quarterly Canadian dollar costs	\$ 4,606	\$ 4,756	\$ 4,905	\$ 5,744	\$ 5,644	\$ 5,189	\$ 5,180
Percentage of total costs	31%	35%	36%	34%	39%	33%	33%
Average exchange rate for the period	\$ 0.91	\$ 0.97	\$ 1.01	\$ 1.00	\$ 0.99	\$ 0.92	\$ 0.82
Effective exchange rate for the period after hedging activities	\$ 0.91	\$ 0.97	\$ 1.01	\$ 1.00	\$ 0.99	\$ 0.96	\$ 0.93

In order to mitigate the fluctuations between the value of Canadian and US dollars, the Company initiated a currency hedging program in the second quarter of fiscal 2009. The program resulted in Canadian dollar operating costs being recorded at an average rate of \$0.93 for Q309. The Company has also entered into hedging transactions to buy Canadian dollars on a schedule consistent with the Company's expected requirements.

The following table sets forth, for the periods indicated, in thousands of dollars, except exchange rate information, information concerning the total amount of Canadian dollars subject to hedging transactions entered into by the Company as of the date of this MD&A and the average exchange rate for one Canadian dollar expressed in US dollars.

	<u>FY09 Q4</u>	<u>FY10 Q1</u>	<u>FY10 Q2</u>	<u>FY10 Q3</u>
Quarterly Canadian dollars hedged	\$ 3,787	\$ 3,949	\$ 3,624	\$ 3,787
Average hedged rate for the period	\$ 0.95	\$ 0.94	\$ 0.83	\$ 0.79

### Cost of Product and Support

Cost of product and support consists of costs incurred to deliver the Company's products 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 increased 11% in Q309 compared to Q308 and increased 18% for the nine months ended January 31, 2009 compared to the nine months ended January 31, 2008. The increase in product and support costs was primarily driven by the increased headcount in the quarter, as the average headcount increased by 8, from 38 employees for the quarter ended January 31, 2008 to 46 employees for the quarter ended January 31, 2009.

### **Cost of Service**

Cost of service increased 10% in Q309 compared with Q308 and increased 27% for the nine months ended January 31, 2009 compared with the nine months ended January 31, 2008. The Company achieved a 35% margin on service revenue in Q309 compared with a 29% margin in Q308 primarily due to higher utilization of the Company's service personnel. On a year to date basis, the service margins were consistent in both periods at approximately 28%. Costs increased \$0.2 million to \$1.6 million in Q309 from \$1.4 million in Q308 due to the increase in services delivered during the quarter. The total cost increase of \$0.2 million related to personnel cost as the average services headcount increased by 6 in Q309 compared to Q308.

### **Sales and Marketing**

Sales and marketing expenses in Q309 declined 13%, or \$0.7 million, compared to Q308. The reductions in costs were primarily attributable to a lower average headcount in Q309, which declined by 9 compared to Q308. The headcount decrease resulted in a modest decrease in compensation costs amounting to \$0.3 million and a reduction in the Company's attendance at trade shows during Q309 resulted in a savings of an additional \$0.3 million. As a percentage of revenue, sales and marketing expenses decreased by 7% to 36% in Q309 from 43% in Q308. For the nine months ended January 31, 2009 compared with the nine months ended January 31, 2008, sales and marketing expenses declined 5% to \$16.0 million.

### **Research and Development**

Research and development expenses for Q309 decreased 8%, or \$0.3 million, compared with Q308. The total decrease in the quarter of \$0.2 million related to compensation costs as a result of the lower Canadian dollar as the average headcount remained constant in Q309 compared to Q308. On a year to date basis, expenses decreased \$1.0 million, or 10%, for the first nine months of fiscal 2009 compared with the same period in fiscal 2008. As the Company continues to expand its customer base, sustained spending in the ALM segment on research and development is essential to maintain and further expand on its products. As a percentage of total revenue, research and development costs decreased from 26% in Q308 to 24% in Q309. Research and development costs for the IO segment remained constant.

### **General and Administrative**

General and administrative expenses remained constant at \$2.0 million in both Q309 and Q308. Headcount for the Company's general and administrative structure remained consistent in Q309 compared with Q308. On a year to date basis, general and administrative expenses also remained constant at \$5.9 million. General and administrative expenses remained constant at 15% of total revenue for Q309 and Q308 and 13% of revenue for the nine months ended January 31, 2009, compared to 15% for the same period in fiscal 2008.

### **Foreign exchange**

Due to significant changes in currency exchange rates during Q309, a foreign exchange gain of \$0.2 million was incurred during Q309 compared to a modest foreign exchange gain during Q308. The foreign exchange gain in Q309 related to the conversion of balance sheet items to the period end exchange rates. For the nine months ended January 31, 2009 and January 31, 2008, the Company realized a foreign exchange gain of \$0.0 million and \$0.3 million, respectively.

### **Interest Income**

Marginal interest income was generated from short-term investment grade interest-bearing securities in Q309 compared with \$0.1 million in Q308. Lower interest rates have limited the Company's return.

### **Income Taxes**

During Q309, a deferred tax provision was recorded in the amount of \$0.2 million related to accounting income realized during the period in Canada and the United States that decreased the tax asset previously set up. Refer to note 3 in the audited consolidated financial statements of the Company for the year ended April 30, 2008 for a summary of tax losses available and a summary of the deferred tax asset to which a valuation allowance still applies.

### **Liquidity and Capital Resources**

The Company's cash balance as at January 31, 2009 increased by \$3.3 million to \$16.3 million compared to April 30, 2008 due primarily to cash generated from operations and working capital of \$11.5 million, offset by cash used in financing activities of \$6.1 million, related to shares repurchased for cancellation and dividends paid during the nine months ended January 31, 2009. The cash balance increased by \$5.6 million from the \$10.6 million at October 31, 2008.

### **Operating Activities**

The Company generated \$6.2 million of cash from operating activities in Q309 compared with \$1.9 million in Q308. Days sales outstanding in accounts receivable at January 31, 2009 were 61 days compared to 66 and 69 days at January 31, 2008 and April 30, 2008, respectively.

The Company's maintenance renewals are unevenly distributed through the fiscal year, with 65% of its maintenance contracts renewable in the last two quarters of each fiscal year typically leading to higher receivable and deferred revenue balances in the last two quarters of the fiscal year. Accordingly, deferred revenue increased by \$3.9 million during Q309. A strong level of receivables collection, particularly annual maintenance renewals, in the third quarter of fiscal 2009 resulted in lower receivable and higher cash balances at January 31, 2009.

As at January 31, 2009, the Company had entered into foreign exchange contracts to purchase \$15.1 million Canadian dollars at an average rate of Cdn\$0.88 to US\$1. These contracts represent approximately 75% of the Company's future anticipated Canadian dollar requirements, and mature on a periodic basis, through to January 2010.

## Investing Activities

Purchases of fixed assets and intangibles amounted to \$0.2 million in Q309 compared to \$0.4 million in Q308. The Company's 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

The Company maintains a policy to pay quarterly dividends to limit the accumulation of cash excess to the needs of its business. In the two previous fiscal years, the Company declared and paid quarterly dividends on its common shares at the rate of \$0.02 per share each quarter. The dividend payment in Q309 was \$1.0 million, consistent with Q308. The Company's intention is to continue to pay a dividend, so long as the payment of the dividend does not impair the Company's financial position.

On June 26, 2008, MKS instituted a Normal Course Issuer Bid ("NCIB"). Under the terms of the NCIB, the Company is permitted to purchase up to a maximum of 3.8 million of its common shares representing 10% of the total public float outstanding as at May 31, 2008 on the Toronto Stock Exchange ("TSX").

Purchases under the NCIB were permitted to commence on June 26, 2008 and will terminate on the earlier of June 25, 2009, the date on which the Company completes its purchases pursuant to the notice of intention to make an NCIB and the date of notice by the Company of termination of the bid.

Common shares purchased under the NCIB have been cancelled. Purchase and payment for the shares will be made by the Company in accordance with the by-laws and rules of the TSX and the price that the Company will pay for any shares acquired by it will be at the market price of the shares at the time of acquisition. The Company may make purchases of shares under the NCIB from time to time in the open market in accordance with the rules and policies of the TSX, and when management believes that the market price of the Company's shares is attractive and that the purchase of shares would be an appropriate use of corporate funds in light of potential benefits to remaining shareholders.

During Q309, the Company did not purchase or cancel any common shares under the NCIB. On a cumulative to date basis, the Company has purchased 2.2 million shares under the NCIB, at an average cost of Cdn\$1.71 per share, for a total cost, including commissions, of \$3.5 million.

A copy of the notice of the Company's intention to make the NCIB as filed with the TSX can be obtained, without charge, by contacting the Company at 410 Albert Street, Waterloo, Ontario N2L 3V3 Attention: Corporate Secretary or by calling 519-884-2251.

The Company received \$0.1 million during Q309 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. The Company had cash and cash equivalents totaling \$16.3 million at January 31, 2009, compared with \$10.6 million at January 31, 2008.

The Company continues to perform well under the current economic climate. Through the first nine months of this fiscal year, it has shown higher revenue, profitability and cash flow compared to the same period last year. Maintenance contracts continue to provide positive cash flow and have not been affected by the current global economic climate to date. The Company's cash balance grew, consistent with its normal seasonal cycle, and it believes that it is well positioned to finance its working capital and capital expenditure requirements for the next twelve months. If the Company's spending plans change, the Company may find it necessary to seek additional sources of equity or debt financing and/or reduce or eliminate its quarterly dividend and or NCIB purchases 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, or at all, and not dilutive to the Company's shareholders.

The key factors that could negatively impact the liquidity of the Company include: the profitability of the Company; fluctuation in exchange rates, particularly the weakening of the US dollar compared with the Canadian dollar as the Company's financial results are reported in US dollars while the Company incurs approximately one-third of its expenses in Canadian dollars; fluctuations in the price of the Company's common shares below the current market price of those shares; the long sales cycles associated with selling to Global 1000 companies, which could lead to fluctuating quarterly results; continued high levels of renewal of annual maintenance contracts with installed base customers; and the extent and duration of the current economic downturn in the North American economy where the Company derives approximately sixty to seventy percent of its revenue as that impacts general levels of capital procurement by large corporations. See "Risk Factors".

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						
<i>(tabular amounts in thousands)</i>	2009	2010	2011	2012	2013	Thereafter	Total
Operating lease obligations <sup>1</sup>	\$ 374	\$ 1,543	\$ 1,074	\$ 350	\$ 282	\$ 390	\$ 4,013
Purchase obligations <sup>2</sup>	552	123	6	-	-	-	681
	\$ 926	\$ 1,666	\$ 1,080	\$ 350	\$ 282	\$ 390	\$ 4,694

<sup>1</sup> The Company is also responsible for certain common area costs at its various leased premises.

<sup>2</sup> 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 2009**

The Company is performing well under the current economic climate.

MKS has grown its revenue and profit to date in fiscal 2009 driven by the positive performance of the Company's primary operating segment, ALM. During the quarter, the Company did not see any deterioration in its historical maintenance renewal rate which remains at over 90%. Service revenue continues to grow and backlog remains stable.

While MKS' license pipeline growth has slowed due to the economic uncertainties faced by its customers, the Company believes that the level of licensing in the third quarter of fiscal 2009 was primarily attributable to normal quarter to quarter variability in major transactions, as it was in third quarter of fiscal 2008, rather than to the deterioration of ongoing license opportunities.

MKS expects that license revenue, total revenue and income from operations will be higher in the fourth quarter of fiscal 2009 compared with the third quarter of fiscal 2009.

MKS recorded growing operating profits and cash flow through the first nine months of this fiscal year. The Company maintains a policy to pay quarterly dividends with a view to limiting the accumulation of cash excess to the needs of its business.

The Company expects a continued decline in the Interoperability business of approximately ten percent annually.

Income tax expense is recorded in the Company's financial statements going forward 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 33% to 34%. 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.

## **Impact of New Accounting Pronouncements**

The CICA's Accounting Standards Board has announced that Canadian publicly accountable enterprises will adopt International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board effective January 1, 2011. IFRS will require increased financial statement disclosures. Although IFRS uses a conceptual framework similar to Canadian GAAP, differences in accounting policies will need to be addressed. The Company is currently assessing the impact of this announcement.

Please see note 1 to the consolidated financial statements of the Company for the fiscal year ended April 30, 2008 for more information about the accounting policies of the Company.

## **Impact of Recent Accounting Pronouncements**

Please see note 1 to the consolidated financial statements of the Company for the fiscal year ended April 30, 2008 for more information about the accounting policies of the Company.

## **Related Party Transactions**

During Q309 the Company did not engage in any transactions involving related parties.

## **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 Chief Financial Officer ("CFO") 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**

The CEO and CFO have designed disclosure controls and procedures, or have caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Company has been made known to them and has been properly disclosed in the Company's annual regulatory filings. As of January 31, 2009, an evaluation was carried out, under the supervision of the CEO and CFO, of the effectiveness of the Company's disclosure controls and procedures as defined in NI 52-109. Based on this evaluation, the CEO and the CFO concluded that the design and operation of these disclosure controls and procedures were effective. This evaluation took into consideration the Company's disclosure policy, a sub-certification process and the functioning of its Disclosure Committee.

### **Changes in internal controls over financial reporting**

There were no changes in the Company's internal controls over financial reporting that occurred during the third quarter of fiscal year 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

## **Critical Accounting Policies and Estimates**

The consolidated financial statements of the Company for the quarter ended January 31, 2009 have been prepared in accordance with Canadian 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 Canadian 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 recognizes revenue in accordance with Canadian GAAP, which, in the Company's circumstances, is not materially different from the amounts that would be determined under the provisions of the American Institute of Certified Public Accountants' Statement of Position ("SOP") No. 97-2, "Software Revenue Recognition", as modified. 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 continue to worsen and customer losses increase, the allowance for doubtful accounts would be increased by recording additional bad debt 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 future 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, 2008, a valuation reserve has been taken against a portion of the future tax assets of the Company, impacting the future tax assets recorded in the Company's financial statements.

The Company assesses the realization of these future tax assets quarterly by jurisdiction to determine whether an income tax valuation allowance is required. Based on available evidence, both positive and negative, it is determined whether it is more likely than not that all or a portion of the future tax assets will be realized on a jurisdiction by jurisdiction basis. The main factors that provide evidence about the ability to realize the net future tax asset include the following:

- the amount of, and trends related to, cumulative earnings or losses realized over the most recent 12 quarters;
- the current period net earnings (loss);
- future earnings projections as determined through the use of internal forecasts, including the impact of sales pipeline and existing and future maintenance contracts;
- the ability of the Company to carry forward tax losses and investment tax credits, including tax planning strategies to accelerate utilization of such assets;
- industry, business, or other circumstances that may adversely affect future operations; and
- the nature of the future income required to realize the Company's future tax assets.

In evaluating the positive and negative evidence, the weight that is assigned to each type of evidence is proportionate to the extent to which it can be objectively verified.

Any future change to the valuation allowance of the future tax asset would result in an income tax expense or recovery on the income statement in that future period. Realization of the net future 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 future 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.

### **Stock Option Accounting**

In accordance with CICA 3870 the Company estimates the fair value of its options for financial accounting purposes using the Black-Scholes model, which requires a number of subjective assumptions, including the expected life of the option, risk-free interest rate, dividend rate, forfeiture rate, future volatility of the price of our common shares and vesting period. The use of subjective assumptions could materially affect the fair value estimate. The Company estimates the volatility of the share price based on the historical trading information of the Company. The Company estimates the risk-free interest rate based on US Treasury rates with a yield equal to the expected life of the option. The Company bases the estimate of the expected life of the option based on historical Company data and the period for which the Company's options can be exercised. The Company assesses our forfeiture rate through an analysis of the turnover of the Company's employees since it commenced issuing options. The fair values of the options issued are being recognized as compensation expense over the applicable vesting period of four years on a straight line basis.

### **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 maintenance and 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, 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 license revenue 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.

#### **Economic Uncertainty**

Many of the Company's customers are being affected by economic conditions affecting the broader market. Current and future conditions in the domestic and global economies remain uncertain. As a result, it is difficult to estimate the level of growth or contraction for the economy as a whole. It is even more difficult to estimate growth or contraction in various parts, sectors and regions of the economy, including the markets in which the Company participates. Because all components of the Company's budgeting and forecasting are dependent upon estimates of growth or contraction in the markets it serves and demand for its products and services, the prevailing economic uncertainties render estimates of future income and expenditures very difficult to make. Adverse changes may occur as a result of soft economic conditions, wavering consumer confidence, unemployment, declines in stock markets, contraction of credit availability, declines in real estate values, or other factors affecting economic conditions generally. These changes may negatively affect the sales of the Company's products and services, increase exposure to losses from bad debts, or increase the cost and decrease the availability of financing.

#### **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 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 enters into foreign currency cash flow hedges to partially mitigate this risk.

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. Appreciation 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.

#### **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, liquidity 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., 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 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.

#### **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 40% 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 effect 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 materially adversely impact the business, results from operations, liquidity and financial condition of the Company.

#### **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 favorable 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.

#### **Use of Open Source Software**

The Company uses a variety of "open source" and "free-ware" software products in its products that are not maintained or supported by the original developers of such products. The Company has not conducted any independent investigations to determine if the sources of these third party software products have the rights necessary to permit the Company to use these products free of infringement claims by third parties. The Company could possibly be required to replace these third party software products with internally developed or commercially licensed components, which could delay the Company's product development plans or require it to pay licensing fees to third parties.

#### **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 results from operations, liquidity and 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. The Company's license revenue from the IO segment has declined in each of the past three fiscal years and the Company expects to experience a continuing decline in license revenue from this segment. 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.