

## 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 years ended April 30, 2007 ("FY07"), April 30, 2006 ("FY06") and April 30, 2005 ("FY05").

This MD&A should be read in conjunction with the audited consolidated financial statements of the Company and the related notes. 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 audited consolidated financial statements of MKS prepared in accordance with United States generally accepted accounting principles ("US GAAP").

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

The date of this MD&A is June 5, 2007.

### 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, fluctuations in quarterly results, exchange rate fluctuations, management of growth, dependence on and retention of management and key employees, importance of maintenance contracts, economic uncertainty, 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, limited financial resources, litigation, concentration of ownership, intense competition, rapid technological change and development of the software application lifecycle management 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: 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 and artifacts 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 a software platform and services that facilitate collaboration between large multi-site development teams, control the creation and ongoing maintenance of software systems, 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, all phases of the software development lifecycle and supporting critical business transformations, including service oriented architecture, application rationalization and outsourcing. MKS Integrity's single architecture design 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 its solutions for IT Infrastructure Library (ITIL) software change staging and deployment technology and IT change request 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

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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<sup>®</sup>, that addresses the issues surrounding UNIX-Windows operating system co-existence, cross-platform development, application migration, systems administration and network management.

### Performance Highlights

Overall, in FY07, total revenue was substantially unchanged from FY06. Increases in maintenance and services revenue of 18% and 23%, respectively, offset the decline in new license revenue (a decrease of 18%).

Revenue in FY07 was primarily generated from both the North American and European markets, the Company's principal geographic segments. The volume of transactions over \$100,000 was also substantially unchanged as the Company completed 76 transactions over \$100,000 in FY07 compared with 75 in FY06 and 65 in FY05. The Company closed deals in FY07 with both new customers as well as expanding deployment of its products in its existing installed base of customers. The Company believes that the continued acceptance and usage of its products is evidenced by the strong maintenance and service growth over the last three fiscal years.

ALM license revenue has decreased in FY07 from FY06 due to reduced purchasing from the Company's largest existing customers. Lower purchasing from these customers in FY07 was a result of their internal deployment schedules and plans to deploy the software already purchased. The increased breadth of the product impacts more areas of the customer's operations, increasing the complexity and duration of the implementation. Service revenue to these customers has increased as the Company continues to provide assistance in the increasingly complex planning and rollout initiatives of the customers. While this has resulted in lower licensing activity in FY07, the Company's relationships with these customers has strengthened and is expected to result in additional license purchases in the upcoming year. MKS continues to remain well positioned in the ALM market based on its strong product architecture and feature set that uniquely addresses the needs of the industry.

Operating margin was down substantially in FY07, resulting in an operating loss of \$(3.3) million for the year compared to an operating income of \$3.7 million in FY06. Total operating costs for FY07 increased \$7.0 million from FY06. Costs were higher in FY07 compared with FY06 as the Company continued to invest resources into the development of its products, increased its services resources to meet the higher demand for services and invested in the expansion of its sales force. The increase in development and sales costs had minimal impact on revenue in FY07, but is expected to positively impact revenue in fiscal 2008. In addition, a stock compensation charge of \$1.1 million was incurred in FY07 as the Company adopted the new accounting standard with respect to stock options, SFAS 123R. Included in the incremental FY07 costs was an increase in the Company's average headcount during FY07 to 316 from 278, an average increase of 38 employees or 14%. In FY07, the Company was subject to fluctuations in the exchange rates among the main currencies in which the Company operates, namely the Canadian dollar, US dollar, Pound Sterling and Euro. These fluctuations had the effect of increasing costs in the current year, compared with FY06, by \$0.3 million.

In the fourth quarter of FY06, the Company recorded an income tax recovery of \$5.2 million. This recovery resulted from a reduction of the valuation allowance on the Company's deferred tax asset in certain tax jurisdictions, where it expects to receive a benefit related to historical tax losses. During FY07, the Company recorded a deferred tax provision of \$0.4 million related to the income earned in the applicable jurisdictions. As a result of lower operating income in FY07 and the recovery of income taxes in FY06, the Company reported a net loss of \$(2.8) million in FY07 compared with net income of \$9.1 million in FY06 and net income of \$2.7 million in FY05.

The Company has successfully maintained profits in its Interoperability business segment relative to the segment's revenues. In FY07 operating income was substantially unchanged from FY06 at \$2.3 million in spite of a decline in Interoperability revenue of 2% compared with FY06. 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. However, 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 Company expects to experience a continuing decline in license and maintenance revenue in this segment as the technology and market for these products continues to mature.

**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 for each of the eight quarters ended April 30, 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 comparison should not be relied upon as an indication of the Company's future performance. See "Risk Factors" below.

	Three months ended							
	Jul 31 2005	Oct 31 2005	Jan 31 2006	Apr 30 2006	Jul 31 2006	Oct 31 2006	Jan 31 2007	Apr 30 2007
License revenue	\$ 5,245	\$ 5,431	\$ 7,399	\$ 6,585	\$ 6,014	\$ 4,425	\$ 4,229	\$ 5,566
Maintenance revenue	4,355	4,704	4,853	4,887	5,205	5,491	5,727	5,669
Service revenue	1,205	1,401	1,161	1,096	1,400	1,593	1,594	1,411
Total revenue	\$ 10,805	\$ 11,536	\$ 13,413	\$ 12,568	\$ 12,619	\$ 11,509	\$ 11,550	\$ 12,646
Income (loss) from operations	\$ 516	\$ 900	\$ 1,575	\$ 699	\$ (618)	\$ (1,158)	\$ (1,122)	\$ (414)
Net income (loss) per share, basic	\$ 0.01	\$ 0.02	\$ 0.04	\$ 0.13	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.01)
Net income (loss) per share, diluted	\$ 0.01	\$ 0.02	\$ 0.03	\$ 0.12	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.01)
Total assets	\$ 23,603	\$ 26,017	\$ 32,583	\$ 39,689	\$ 38,083	\$ 35,811	\$ 36,218	\$ 35,506
Cash dividends per share	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.02	\$ 0.02	\$ 0.02	\$ 0.02

As at April 30, 2007, 50,570,000 common shares of the Company and options to purchase 7,652,000 common shares of the Company were outstanding.

**Annual Financial Information**

The table below shows selected consolidated financial information for the three most recently completed financial years:

<i>For the years ended April 30</i>	2007	2006	2005
Total revenue	\$ 48,324	\$ 48,322	\$ 41,291
Operating income (loss)	\$ (3,312)	\$ 3,690	\$ 2,695
Net income (loss) per share, basic	\$ (0.06)	\$ 0.20	\$ 0.07
Net income (loss) per share, diluted	\$ (0.06)	\$ 0.18	\$ 0.06
Total assets	\$ 35,506	\$ 39,689	\$ 24,035
Total long term liabilities	\$ -	\$ -	\$ -
Cash dividends paid per share	\$ 0.08	\$ -	\$ -

Total revenue was unchanged in FY07 compared with FY06 and increased by 17% in FY06 compared with FY05. In FY07, continued growth in ALM segment maintenance and service revenue from levels in FY06 was offset by a decline in new license revenue from the ALM segment. During FY06, growth in total revenue consisted of increased revenue in the ALM segment which was partially offset by declining revenue in the IO segment. The key factor which drove the growth rate in FY06 was an increase in the volume of new licensing of the Company's products to both new and existing customers. New licensing transactions generate ongoing incremental maintenance revenue as well as potential new service engagements. During FY07, new licensing transactions from the ALM segment fell below the Company's expectations, particularly from existing customers, resulting in the decrease in license revenue.

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Operating income decreased in FY07 compared to FY06 as increased operating expenses were incurred during FY07 which failed to generate revenue growth as was expected. Key factors resulting in the increase in operating costs include the investment in increased headcount, marketing expenditures and research and development expenditures as well as the strengthening of the Canadian dollar, Pound Sterling and Euro against the US dollar over the three year period.

Net income in FY06 included an income tax recovery of \$5.2 million as the Company realized the future benefit of a portion of its tax assets, not previously recognized in the financial statements.

These factors are discussed in more detail throughout this MD&A.

### Financial Results Analysis

This section discusses the consolidated financial results of the Company and each of its operating segments for FY07, FY06 and FY05. Revenue and operating income from operations are analyzed on a segmented basis.

#### Revenue

(tabular amounts in thousands)

<i>For the years ended April 30</i>	<b>2007</b>	2006	% Change 2007 to 2006	2005
ALM segment:				
License revenue	\$ 15,248	\$ 19,676	-23%	\$ 16,648
Maintenance revenue	18,934	15,510	22%	12,278
Service revenue	5,988	4,842	24%	3,526
	<b>40,170</b>	40,028	0%	32,452
Interoperability segment:				
License revenue	4,986	4,984	0%	5,472
Maintenance revenue	3,158	3,289	-4%	3,239
Service revenue	10	21	-52%	128
	<b>8,154</b>	8,294	-2%	8,839
Total revenue	\$ <b>48,324</b>	\$ 48,322	0%	\$ 41,291

In FY07, the Company completed a similar number of larger transactions in the ALM segment, which resulted in consistent total revenue in FY 07 as compared to FY06. Revenue was consistent across both of the Company's geographic segments.

#### ALM Segment

License revenue is driven primarily by licensing of the Company's main ALM product, MKS Integrity to both new and existing customers. Decreased license revenue in FY07 was primarily a result of fewer than expected large follow-on transactions with existing customers. The increased breadth of the Company's product offering, which now impacts multiple departments and various functional areas in the customers' environment, has added to the complexity, resources involved and length of time to implement and integrate the Company's products into each customer's unique environment, increasing the reliance on MKS consulting services for implementation assistance. Customers continued to deploy licenses purchased prior to FY07 and to plan future deployments, requiring incremental purchases in future periods. In addition, lower productivity from new sales staff hired at the end of FY06 and early in FY07 negatively impacted revenue and operating income during FY07.

Licensing growth in FY06 of 18% compared with FY05 fell below expectations due in part to the delay in hiring of new sales staff at the planned rate during the year and the diverted focus of sales management which was directed towards such hiring efforts. The majority of the planned increase in field sales staff was completed in the fourth quarter of fiscal 2006.

Maintenance revenue consists of maintenance contracts sold with new products for a period that is generally twelve months, as well as renewal maintenance contracts to existing customers for the second and subsequent maintenance periods. Maintenance revenue growth in FY07 and FY06 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 FY07, 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. The Company experiences a higher renewal rate on installations of its products with its Global 1000 accounts compared to smaller accounts.

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 the customers' needs. Services are delivered on a regional basis by the Company's employees and services partners, priced on a daily rate. The increase in service revenue of 24% was driven in FY07 by a strong backlog of services sold in prior licensing transactions. As the Company moved towards larger implementations with its customers, the complexity of the projects increased as well as their scope and timeframes. These longer, more complex, services arrangements with the Company's key customers assisted in the planning and deployment of previously licensed software, which the Company believes will accelerate the timeline for future follow on purchases from the customers. The Company continues to grow its service revenue through key engagements with customers in all of its geographic segments and increasing its penetration into key accounts. In addition, the Company's customers are increasingly willing to enter into services agreements for process assessments prior to licensing. This is a favorable trend for the Company in terms of service revenue and typically leads to more successful future deployment of its software.

### Interoperability Segment

The Interoperability segment is in decline due to the maturity of the market for porting 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. The Interoperability segment experienced a decrease in revenue in FY07 of 2% compared to FY06.

License revenue remained unchanged at \$5.0 million in both FY07 and FY06. License revenue decreased 9% in FY06 compared to FY05. The general maturity of the segment has resulted in stability of licensing fees, with competitive and market conditions resulting in 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 continuing decline in license revenue from its Interoperability segment.

Maintenance revenue declined by 4% in FY07 compared to FY06. This was attributable to a slight 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 the current operating system environments. Maintenance revenue is expected to decline in the future in correlation with the anticipated decline in licensing revenue referred to above.

Service revenue was minimal in FY07. The Interoperability products generally do not require consulting on implementation, and the Company does not expect to consistently generate service revenue on a quarter-by-quarter basis.

### Operating Income

(tabular amounts in thousands)

<i>For the years ended April 30</i>	2007	2006	% Change 2007 to 2006	2005
Revenue				
ALM segment	\$ 40,170	\$ 40,028	0%	\$ 32,452
Interoperability segment	8,154	8,294	-2%	8,839
	<b>48,324</b>	48,322	0%	41,291
Operating costs				
ALM segment	45,827	38,682	18%	31,934
Interoperability segment	5,809	5,950	-2%	6,662
	<b>51,636</b>	44,632	16%	38,596
Operating income (loss)				
ALM segment	(5,657)	1,346	-520%	518
Interoperability segment	2,345	2,344	0%	2,177
	<b>\$ (3,312)</b>	\$ 3,690	-190%	\$ 2,695

The consolidated loss from operations was \$3.3 million in FY07 compared with income from operations of \$3.7 million in FY06. Operating expenses were \$51.6 million in FY07, up from \$44.6 million in FY06, a 16% increase. Costs increased in the ALM segment as resources were invested in FY07 that were intended to generate increased sales during FY07 as well as to develop the market and further develop the Company's ALM products. The emphasis of the Company's ALM spending increases in FY07 was on sales and market development and research and development activity as the Company continued to execute its strategy of building a market leading enterprise

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ALM business. The impact of the strengthening Canadian dollar against the US dollar during FY07 versus FY06 accounted for approximately \$0.6 million of the cost increase.

This cost increase affected the departmental areas containing a significant number of the Company's Canadian employees, namely research and development and general and administrative costs.

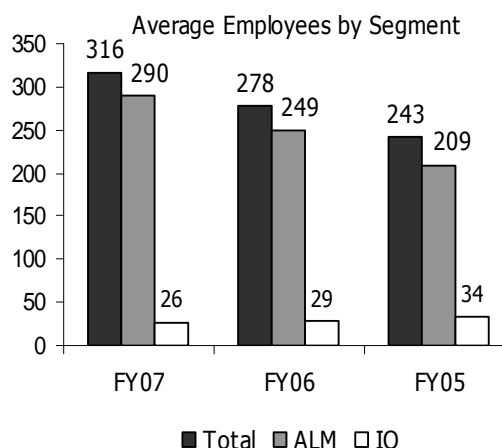
The consolidated income from operations was 8% of total revenue in fiscal 2006 compared with 7% in fiscal 2005. Operating expenses were \$44.6 million in FY06, up from \$38.6 million in FY05, a 16% increase. Costs increased in the ALM segment as resources were invested in FY06 to generate sales, develop the market and further develop the Company's ALM products. The emphasis of ALM spending increases in FY06 was on sales and market development and research and development activity as the Company executed its strategy of building a market leading enterprise ALM business. The impact of the strengthening Canadian dollar against the US dollar during FY06 versus FY05 accounted for approximately \$0.9 million of the cost increase. This 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 Company-wide basis, cost of product and support decreased 4% in FY07 compared to FY06, but remained consistent as a percent of license revenue at approximately 16% in both fiscal years. The decrease in product and support costs was primarily driven by the decrease in license sales transaction volume in the ALM segment. Cost of product and support increased 14% in FY06 compared to FY05, but remained consistent as a percent of license revenue at 15% in both fiscal years. The increase in product and support costs was primarily driven by the increase in license revenue sales volume in the ALM segment.

### Cost of Service

Cost of service for FY07 increased 19% from FY06. The Company achieved a 19% margin on service revenue in FY07 compared with a 16% margin in FY06. Costs increased in FY07 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 headcount of 3 compared to FY06) as well as external contractors. These additional employees were hired to address the trend of increasing demand for services. Cost of service for FY06 increased 50% from FY05. The Company achieved a 16% margin on service revenue in FY06 compared with a 25% margin in FY05. Costs increased in FY06 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 headcount of 12 compared to FY05) as well as external contractors.



### Sales and Marketing

Sales and marketing expenses in FY07 rose 16%, or \$3.2 million, compared to FY06. These cost increases were primarily attributable to the direct costs incurred that were intended to generate higher revenue in the ALM segment as well as to expand into the Asia Pacific market. The increase was driven by higher personnel-related costs totaling \$2.4 million as a result of the increased hiring activity during the year. The average headcount increased during the fiscal year by a net 20 positions from fiscal 2006. Staffing levels in sales and marketing were higher during the first half of FY07. Marketing program spending also increased by \$0.5 million in FY07, compared to FY06.

Sales and marketing expenses in fiscal 2006 rose 13%, or \$2.2 million, compared to fiscal 2005. These cost increases were primarily attributable to the direct costs incurred to generate higher revenue in the ALM segment. The increases were driven by higher travel and compensation costs, a \$1.4 million increase, consistent with higher sales volumes. To generate increased sales volumes, marketing program spending increased by \$0.7 million in FY06, compared to FY05. Headcount increased by 25 positions from April 30, 2005 to April 30, 2006.

### Research and Development

Research and development expenses for FY07 increased 19%, or \$1.9 million, compared with FY06. 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. On average, headcount increased by 12 during fiscal 2007 compared with fiscal 2006. 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 costs. As the Company continues to expand its customer base, increased 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 increased 4% to 24% in FY07 from 20% in FY06. Research and development costs for the IO segment declined 3% in FY07 compared to FY06.

Research and development expenses for FY06 increased 12%, or \$1.1 million, compared with FY05 as the Company continued to invest in the development of its core ALM products to expand the features and functionality needed to remain competitive in the marketplace. Since the majority of the Company's development took place in Canada, the effect of the strengthening Canadian dollar accounted for \$0.3 million of the increase. As the Company continues to expand its customer base, increased 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 1% from 21% in FY05 to 20% in FY06. Research and development costs for the IO segment declined 28%.

### General and Administrative

General and administrative expenses increased \$0.3 million, or 4%, in FY07 compared to FY06. This increase was partially attributable to the higher Canadian dollar versus the US dollar in FY07, which increased costs by \$0.2 million in FY07 from FY06. Headcount for the Company's general and administrative structure remained relatively consistent in FY07 compared with FY06. As a result of an increase in revenue in FY06 compared to FY05, general and administrative expenses decreased by 1% of total revenue from 15% in FY05 to 14% in FY06, as the Company continued to further leverage its investment in its general and administrative structure.

### Interest Income

Interest was generated from short-term investment grade interest-bearing securities. Low short-term interest rates in FY07 minimized available returns. During the second quarter of fiscal 2006, the Company completed its final payment under deferred compensation arrangements with certain former and current employees, which were the Company's main source of interest cost. This resulted in the Company reporting interest income in FY07 and FY06.

### Income Taxes

In FY06, the Company recorded an income tax recovery for accounting purposes of \$5.2 million. This recovery resulted from the Company's regular quarterly analysis of its valuation allowance during the fourth quarter of FY06. The valuation allowance was reduced on the Company's deferred tax asset in FY06, creating an asset that 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 a portion of the deferred tax asset will be realized, and as a result the appropriate recovery has been recorded. As factors change in the future, this estimate could change in the near term as estimated future taxable income in each legal entity changes.

The Company recorded the benefit of Investment Tax Credits during FY07 in the amount of \$0.4 million (\$nil for FY06). This amount reduced the Company's current tax expense and is reflected as a reduction of the income tax provision.

During FY07, a deferred tax provision was recorded in the amount of \$0.4 million related to accounting income realized during the year in Canada and the United States that decreased the tax asset set up in FY06. Refer to note 3 in the audited consolidated financial statements of the Company for the year ended April 30, 2007 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 April 30, 2007 decreased by \$0.4 million to \$15.3 million compared to April 30, 2006 due to cash used to pay dividends and purchase fixed assets that were offset by cash generated from operations during FY07.

### Operating Activities

The Company generated \$5.7 million of cash from operating activities in FY07 compared with a generation of \$4.0 million in FY06. Days sales outstanding in accounts receivable at April 30, 2007 were 45 days compared to 79 days at April 30, 2006. The decrease in days sales outstanding is primarily attributable to the timing of sales transactions completed in the last quarter of FY07, which were completed earlier in the quarter than is typical. In addition, with the

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implementation of a new system to manage maintenance renewals, payments are received earlier than in the past, which has resulted in an ongoing reduction of working capital requirements. Deferred revenue increased by \$1.5 million at April 30, 2007 from April 30, 2006, due to the timing of maintenance renewals and the growing end user base of the Company. As the Company expects to renew the majority of the maintenance contracts in the last two quarters of each fiscal year, the Company believes that the usual trend of higher balances in the third and fourth quarters will continue.

### Investing Activities

Purchases of fixed assets amounted to \$2.4 million in FY07 compared with \$0.9 million in FY06. Capital spending in FY07 consisted primarily of IT infrastructure improvements in relocating the Company's existing data center totaling \$1.0 million. The remainder of the capital spending related to leasehold improvements and 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. Quarterly dividends were paid throughout FY07, amounting to total dividends of \$4.0 million being paid during the year. 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 FY07 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 generated by operations and working capital. The Company had cash and cash equivalents totaling \$15.3 million at April 30, 2007, compared with \$15.7 million at April 30, 2006. The Company believes for the next twelve month period, based on current estimates, that its current cash balances will be sufficient to meet its expected increase in working capital requirements and lower capital expenditure requirements. If the Company's spending plans change, the Company may find it necessary to seek additional sources of equity or debt financing 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 favorable to the Company and not dilutive to the Company's shareholders.

The key factors that could impact the liquidity of the Company include; the Company's ability to re-establish profitability, fluctuation in exchange rates, particularly the weakening of the US dollar compared with the Canadian dollar; 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 relative strength of the North American economy where the Company derives approximately 65% of its revenue as that economic strength 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.

<i>(tabular amounts in thousands)</i>	Fiscal year ended April 30						
	2008	2009	2010	2011	2012	Thereafter	Total
Operating lease obligations	\$ 1,977	\$ 1,611	\$ 1,481	\$ 501	\$ 39	\$ -	\$ 5,609
Purchase obligations <sup>1</sup>	1,328	-	-	-	-	-	1,328
<b>Total</b>	<b>\$ 3,305</b>	<b>\$ 1,611</b>	<b>\$ 1,481</b>	<b>\$ 501</b>	<b>\$ 39</b>	<b>\$ -</b>	<b>\$ 6,937</b>

<sup>1</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 2008

MKS expects that ALM license revenue will improve in 2008 from the levels of 2007, which combined with continued increases in maintenance and services revenue will result in higher total revenue for the fiscal year compared to FY07, more than offsetting expected modest declines expected in Interoperability revenue.

MKS is committed to an early return to quarterly profitability and is managing its cost base with a view to sustaining current capacity and making further investments in sales resources only when acceptable levels of profitability are re-established. MKS expects full year profitability based on increasing revenue and carefully managed costs.

MKS expects to maintain more than sufficient cash balances through fiscal 2008. The combination of expected improvements in net income, reduced capital expenditures over fiscal 2007, a continuation of lower overall receivables days, and expected stock option exercises due to expiry schedules are expected to more than offset the cash needed to fund higher license sales and the maintenance of the company's dividend policy. The Company expects that seasonal factors will continue to cause modest outflows of cash in the first half of the fiscal year and inflows in the second half.

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 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.

#### **Significant Fourth Quarter Events**

During the fourth quarter of FY07, the Company increased revenue by 1% from the comparable quarter of FY06. Sales transactions over \$100,000 were 19 in the fourth quarter of FY07 compared to 21 in the fourth quarter of FY06. Revenue increased 9% from the third quarter of FY07 due to strengthening new licensing revenue during the fourth quarter.

Total operating expenses in the fourth quarter of FY07 were \$13.1 million, up from \$11.9 million in the fourth quarter of FY06 and up from \$12.7 million in the third quarter of FY07.

During the fourth quarter of FY07, the Company generated \$0.2 million of cash, driven primarily by cash generated from operations of \$2.2 million which was offset by fixed asset purchases of \$0.9 million and a dividend payment of \$1.0 million during the quarter.

#### **Impact of New Accounting Pronouncements**

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109. It prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosures. FIN 48 is effective for fiscal years beginning after December 15, 2006. The provisions of FIN 48 apply to all tax positions upon initial adoption of FIN 48. Only tax positions that meet the recognition threshold criteria at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 will be reported as an adjustment to the opening balance of retained earnings for that fiscal year unless the adjustment relates to tax positions taken by an acquired entity that existed at the time of the acquisition, in which case the adjustment would be recorded to goodwill. We are currently evaluating the impact of the adoption of FIN 48 and expect to adopt it as required at the beginning of our fiscal year ended April 30, 2008.

In September 2006, the Financial Standards Board released FASB 157, "Fair Value Measurements", which is effective for fiscal years beginning after November 15, 2007, which is the year ended April 30, 2009 for us. FASB 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. We are currently assessing the impact the adoption of this pronouncement will have on the financial statements.

Please see note 1 to the consolidated financial statements of the Company for the fiscal year ended April 30, 2007 for more information about the accounting policies of the Company.

#### **Related Party Transactions**

During FY07, the Company did not engage in any transactions involving related parties.

#### **Controls and Procedures**

In compliance with the Canadian Securities Administrators' Multilateral Instrument 52-109 ("MI 52-109"), the Company has filed with applicable Canadian securities regulatory authorities, certificates signed by its Chief

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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 annual regulatory filings. As of April 30, 2007, 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 MI 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 fourth quarter of fiscal year 2007 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 year ended April 30, 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 believes 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, 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.

The Company assesses the realization of these deferred 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 deferred tax assets will be realized on a jurisdiction by jurisdiction basis. The main factors that provide evidence about the ability to realize the net deferred 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 deferred 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 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.

### Stock Option Accounting

In accordance with SFAS 123(R) we estimate the fair value of our 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. We estimate the volatility of the share price based on the historical trading information of the Company. We estimate the risk-free interest rate based on US Treasury rates with a yield equal to the expected life of the option. We base our estimate of the expected life of the option based on historical Company data and the period for which our options can be exercised. We assess our forfeiture rate through an analysis of the turnover of our employees since we 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,

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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.

### 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.

#### **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.

### 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 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 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

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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.

### 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. 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.