

## 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, 2009 ("FY09"), April 30, 2008 ("FY08") and April 30, 2007 ("FY07").

This MD&A should be read in conjunction with the audited consolidated financial statements of the Company for FY09, FY08 and FY07 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 1, 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, economic uncertainty, currency exchange rate fluctuations, fluctuations in quarterly results, 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 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 re-use initiatives, workflow-based collaboration, 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 that 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 FY09 total revenue decreased 5% from FY08, compared with an increase of 27% in FY08 from FY07. License revenue decreased 25% in FY09 from FY08, which resulted in the decline in total revenue. Increases in maintenance and services revenue of 8% and 25%, respectively, for those same periods, partially offset the decline in license revenue. License, maintenance and service revenue increased 34%, 17% and 36%, respectively in FY08 compared to FY07.

Revenue in FY09 was primarily generated from both the North American and European markets, the Company's principal geographic segments. The volume of license and service transactions over \$100,000 in FY09, excluding maintenance renewals, increased over FY08 as the Company completed 70 transactions in FY09 over \$100,000, compared with 62 transactions in FY08 and 50 in FY07. Of the transactions over \$100,000, there were 9 transactions over \$500,000 in FY09, compared with 6 in FY08 and 4 in FY07.

ALM license revenue decreased in FY09 compared to FY08 due to fewer key licensing transactions during FY09. In FY09, The Company earned substantial new mandates from major customers who made decisions to either standardize on, or undertake major implementations, of MKS Integrity. Many of these customers are under severe economic strain, and these new mandates resulted in less immediate license revenue, on average, than the Company has experienced in the past. The Company expects that as economic conditions improve, and the capital budgets of customers become less constrained, the mandates that the Company won in fiscal 2009 will result in additional future license revenue.

In FY08, the Company experienced several large licensing transactions, including one transaction representing approximately \$5 million of license revenue. These licensing transactions in FY08 accounted for the increase in license revenue from FY08 to FY07. There were no license transactions above \$1 million in 2009.

ALM service revenue increased in FY09 as a result of follow on service engagements relating to the licensing activity in FY08 and the increased assistance provided to customers in their increasingly complex planning and rollout initiatives. ALM maintenance revenue continued its steady growth trend from FY09 and FY08 as the Company continued to maintain its high maintenance renewal rates throughout its customer base.

In spite of the decline in overall revenue, operating margin increased in FY09, resulting in a \$0.7 million improvement in operating income to \$4.2 million for the year compared to \$3.5 million in FY08. Total operating costs for FY09 declined \$3.4 million compared to FY08. Costs were lower in FY09 compared with FY08 as the Company benefited from the weakening Canadian dollar compared with the United States dollar as well as lower variable sales compensation, consistent with the lower licensing activity. Costs increased in cost of product and support and services and the Company continues to expand its resources to meet the needs of its growing customer base and to deliver services required by its customers. The decline in the Company's FY09 costs was partially due 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 exchange rate movements had the effect of decreasing costs in the FY09, compared with FY08, by \$1.3 million, compared with an increase of \$1.1 million from FY07 to FY08.

The Company has successfully maintained profits in its Interoperability business segment relative to the segment's revenues over the past three fiscal years. Operating income declined slightly from \$1.9 million in FY08 to \$1.7 million in FY09 and was \$2.3 million in FY07. 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.

Income tax expense has remained minimal in FY07 through FY09, as the Company has utilized tax losses to reduce tax costs. In the fourth quarter of FY09, the Company recorded an income tax recovery of \$1.6 million. This recovery resulted from a reduction in the valuation allowance on the Company's deferred tax asset in certain jurisdictions where it expects to receive a benefit related to historical tax losses. During FY09, the Company recorded a deferred tax provision of \$1.5 million related to the income earned in those jurisdictions where assets have been recognized by the Company.

As a result of higher operating income and the net recovery of income taxes in FY09, the Company reported a net income of \$4.3 million in FY09 compared with \$3.8 million in FY08 and net a net loss of \$2.8 million in FY07.

## Supplementary Financial Information

### Selected Unaudited Consolidated Quarterly Financial Information

(in thousands, except per share amounts)

The following table presents selected unaudited consolidated quarterly financial information for each of the eight quarters ended April 30, 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 its 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							
	Jul 31	Oct 31	Jan 31	Apr 30	Jul 31	Oct 31	Jan 31	Apr 30
	2007	2007	2008	2008	2008	2008	2009	2009
License revenue	\$ 5,802	\$ 5,128	\$ 4,120	\$ 12,128	\$ 6,156	\$ 6,425	\$ 3,702	\$ 3,989
Maintenance revenue	6,205	6,402	6,584	6,646	7,035	7,051	6,980	6,897
Service revenue	1,600	2,098	2,086	2,386	2,174	2,792	2,521	2,696
Total revenue	\$ 13,607	\$ 13,628	\$ 12,790	\$ 21,160	\$ 15,365	\$ 16,268	\$ 13,203	\$ 13,582
Income (loss) from operations	\$ (326)	\$ 487	\$ (806)	\$ 4,123	\$ 1,149	\$ 1,958	\$ 418	\$ 627
Net income (loss)	\$ (320)	\$ 197	\$ (754)	\$ 4,717	\$ 619	\$ 1,353	\$ 325	\$ 1,989
- per share, basic	\$ (0.01)	\$ 0.00	\$ (0.01)	\$ 0.09	\$ 0.01	\$ 0.03	\$ 0.01	\$ 0.04
- per share, diluted	\$ (0.01)	\$ 0.00	\$ (0.01)	\$ 0.09	\$ 0.01	\$ 0.03	\$ 0.01	\$ 0.03
Total assets	\$ 34,378	\$ 32,965	\$ 33,393	\$ 42,264	\$ 36,888	\$ 33,851	\$ 36,284	\$ 37,020
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 the Company's licensing revenue, the pace at which the Company's sales force is expanded and the impact of currency movements against the US dollar. As the timing of larger license transactions changes from quarter to quarter, the impact on license revenue is significant. The current economic environment is a significant factor affecting the Company's license revenue on a quarterly basis.

In the three months ended April 30, 2008, the Company completed a \$5 million licensing transaction in its ALM segment. 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. As a result, as the Canadian dollar strengthens against the US dollar, the Company's cost base is increased.

As at April 30, 2009, 49,890,000 common shares of the Company and options to purchase 6,448,000 common shares of the Company were outstanding.

#### Selected Annual Financial Information

(in thousands, except per share amounts)

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

For the year ended April 30	2009	2008	2007
Total revenue	\$ 58,418	\$ 61,185	\$ 48,324
Operating income (loss)	4,152	3,478	(3,312)
Net income (loss)	4,286	3,840	(2,843)
Per share, basic	\$ 0.09	\$ 0.08	\$ (0.06)
Per share, diluted	\$ 0.08	\$ 0.08	\$ (0.06)
Total assets	37,020	42,264	35,506
Total long term liabilities	-	-	-
Cash dividends paid, per share	\$ 0.08	\$ 0.08	\$ 0.08

Total revenue decreased in FY09 compared with FY08 by 5% and increased by 27% in FY08 compared with FY07. In FY09, strong ALM segment services and maintenance increases partially offset the lower licensing activity. In FY08, strong ALM segment licensing activity as well as continued growth in ALM segment maintenance and service revenue from levels in FY07 provided the revenue growth. The key factor that drove the growth rate in FY08 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 the potential for new service engagements. During FY09, licensing transactions from the ALM segment in FY08 drove the increased services and maintenance revenue.

Operating income increased in FY09 compared to FY08 as a result of decreased costs in the ALM segment due to favourable changes in the currency as well as lower licensing volume. Operating income increased in FY08 compared to FY07 as a result of increased revenue generated from licensing transactions in the ALM segment. Key factors in which contributed to the increase in operating costs in FY07 included an investment in increased 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 period.

Net income in FY09 and FY08 included an income tax recovery of \$1.6 million and \$1.4 million, respectively, 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 FY09, FY08 and FY07. Revenue and operating income from operations are analyzed on a segmented basis.

### Revenue

(in thousands of dollars, except percentages)

For the year ended April 30	2009	2008	% Change 2008 to 2009	2007
<b>ALM segment:</b>				
License revenue	\$ 15,627	\$ 22,857	-32%	\$ 15,248
Maintenance revenue	25,197	22,726	11%	18,934
Service revenue	10,183	8,170	25%	5,988
	51,007	53,753	-5%	40,170
<b>Interoperability segment:</b>				
License revenue	4,645	4,321	7%	4,986
Maintenance revenue	2,766	3,111	-11%	3,158
Service revenue	-	-	0%	10
	7,411	7,432	-0%	8,154
<b>Total revenue</b>	<b>\$ 58,418</b>	<b>\$ 61,185</b>	<b>-5%</b>	<b>\$ 48,324</b>

### ALM Segment

License revenue is generated through the sale of perpetual licenses and is driven primarily by licensing of the Company's main ALM product, MKS Integrity, to both new and existing customers. The increased acceptance of MKS Integrity as an enterprise ALM platform is enabling the Company to compete for larger and more numerous installations than in the past. The increased breadth of the Company's product offering, which impacts multiple departments and various functional areas in the customer's environment, has increased the value and size of implementations in the Company's customer base. Customers continue to deploy licenses previously purchased and to plan future deployments, requiring incremental purchases in future periods. In addition, due to the maturation of the Company's existing sales force, productivity from the sales force has been increasing over the past two fiscal years, which has positively impacted the Company's revenue and operating income.

License revenue declined 32% in FY09 compared with FY08. This was primarily attributable to lower licensing levels from both the Company's existing and new customers. During FY09, the Company was able to increase its customer base with several key wins. As a result of current economic pressures and tightening customer budgets, initial deployment of those wins has been smaller than historically realized. License revenue increased 50% in FY08 compared with FY07, which was primarily attributable to one transaction in FY08, which accounted for approximately \$5 million of license revenue. There was no comparable transaction in FY09 or FY07.

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 FY09 compared with FY08, as well as in FY08 compared with FY07, was primarily attributable to the maintenance component of new transactions and the extension of maintenance contracts by existing customers for additional maintenance periods in order to gain access to product upgrades and MKS support services. The Company continued to consistently experience a high maintenance contract renewal rate in FY09, 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 its customers' needs. Services are delivered on a regional basis by the Company's employees and services partners, and are generally priced based on a daily rate. The increase in service revenue in FY09 and FY08 was driven by a strong backlog of services sold in prior licensing transactions. As the Company has experienced larger implementations with its customers, the complexity of the projects has increased as well as their scope and timeframes. These longer, more complex services arrangements with the Company's key customers has 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 increase 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 favourable trend for the Company in terms of service revenue and typically leads to more successful future deployment of its software.

#### Interoperability Segment

The MKS Interoperability segment's product, MKS Toolkit<sup>®</sup>, addresses the issues surrounding UNIX-Windows operating system co-existence, cross-platform development, application migration, systems administration and network management. 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 has been in long-term decline due to (i) 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 (ii) 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. While this segment is not viewed as strategic to the Company, the segment consistently generates profits and cash flow to fund the ALM segment of the MKS business. The Interoperability segment experienced a slight decline in revenue from FY09 to FY08, and a decline in revenue in FY08 of 9% compared to FY07.

License revenue increased from \$4.3 million in FY08 to \$4.6 million in FY09. This compares with a decline from \$5.0 million in FY07. The general maturity of the segment has resulted in stability of licensing fees, with competitive and market conditions resulting in the general decline of license revenue. Over the long-term and consistent with the maturing of the technology and the market, the Company expects a continuing decline in license revenue from its Interoperability segment.

Maintenance revenue declined by 11% in FY09 compared to FY08 and declined 1% in FY08 compared to FY07. In each case, the decline was attributable to a reduction in maintenance renewals over the previous fiscal year. Over time, customers re-write their software code and during that process, eliminate the reliance on the Interoperability segment's products to port the application from one operating system to another. During FY09, this was more prevalent than in the past. In line with the Company's expectations, a decline in the maintenance base is expected to continue to occur. The Company's strong support organization and relevant updates it provides to its products help maintain existing maintenance customers, and reduce the rate of decline in the future.

Service revenue for the Interoperability segment is minimal. 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

(in thousands of dollars)

For the year ended April 30	2009	2008	% Change 2008 to 2009	2007
Revenue:				
ALM segment	\$ 51,007	\$ 53,753	-5%	\$ 40,170
Interoperability segment	7,411	7,432	-0%	8,154
	<u>58,418</u>	<u>61,185</u>	<u>-5%</u>	<u>48,324</u>
Operating expenses:				
ALM segment	48,586	52,191	-7%	45,827
Interoperability segment	5,680	5,516	3%	5,809
	<u>54,266</u>	<u>57,707</u>	<u>-6%</u>	<u>51,636</u>
Operating income (loss):				
ALM segment	2,421	1,562	55%	(5,657)
Interoperability segment	1,731	1,916	-10%	2,345
	<u>\$ 4,152</u>	<u>\$ 3,478</u>	<u>19%</u>	<u>\$ (3,312)</u>

The consolidated income from operations was \$4.2 million in FY09 compared with \$3.5 million in FY08 and a loss from operations of \$3.3 million in FY07. Operating expenses were \$54.3 million in FY09 compared to \$57.7 million in FY08, a 6% decrease, and were \$51.6 million in FY07. In FY09, costs decreased in the ALM segment mainly due to lower licensing activity, which led to lower variable compensation costs, as well as more favourable currency rate trends during the fiscal year. In FY08, costs increased in the ALM segment as resources were invested to generate increased sales during the year as well as to develop the market and further develop the Company's ALM products in the future. The emphasis of the Company's ALM spending increases in FY08 was on sales and market development, service delivery resources and research and development activity, as the Company executed its strategy of building a market leading enterprise ALM business. The impact of currency movements against the US dollar during FY09 versus FY08 accounted for a reduction in costs of approximately \$1.3 million, compared with a cost increase in FY08 versus FY07 of approximately \$3.2 million.

The impact of the weakening Canadian dollar against the US dollar during FY09 versus FY08 accounted for approximately \$0.6 million of the cost decrease. This cost decrease affected the departmental areas containing a significant number of the Company's Canadian employees, namely research and development and general and administrative costs. In addition, the Company recorded a foreign exchange loss on balance sheet items of \$0.4 million in FY09 compared with a foreign exchange gain of \$0.5 million in FY08.

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.

	FY08 Q1	FY08 Q2	FY08 Q3	FY08 Q4	FY09 Q1	FY09 Q2	FY09 Q3	FY09 Q4
Quarterly Canadian dollar costs	\$ 4,606	\$ 4,756	\$ 4,905	\$ 5,744	\$ 5,644	\$ 5,189	\$ 5,180	\$ 5,245
Percentage of total costs	31%	35%	36%	34%	39%	33%	33%	37%
Average exchange rate	\$ 0.91	\$ 0.97	\$ 1.01	\$ 1.00	\$ 0.99	\$ 0.92	\$ 0.82	\$ 0.80
Effective exchange rate after hedging activities	\$ 0.91	\$ 0.97	\$ 1.01	\$ 1.00	\$ 0.99	\$ 0.96	\$ 0.93	\$ 0.91

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 \$0.91 for the fourth quarter of fiscal 2009. 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.

	FY10 Q1	FY10 Q2	FY10 Q3	FY10 Q4	FY11 Q1
Quarterly Canadian dollars hedged	\$ 3,949	\$ 3,624	\$ 3,787	\$ 3,800	\$ 3,787
Average hedged rate for the period	\$ 0.94	\$ 0.83	\$ 0.79	\$ 0.80	\$ 0.80

#### 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 increased 11% in FY09 compared to FY08 and 20% in FY08 compared to FY07. Royalty costs paid to third parties continued to decrease in FY09 from FY08 as the Company continued to replace third party software in its product with internally developed alternatives. The increases in cost of product and support costs were driven by increased support personnel costs, as new staff was added to support the Company's growing maintenance base. Average support headcount for the fiscal year increased from 30 in FY07 to 35 in FY08 and further increased to 45 in FY09.

#### Cost of Service

Cost of service increased 13% from \$6.3 million in FY08 compared with \$7.1 million in FY09. Services margins increased to 30% in FY09 compared with 23% in FY08. The Company was involved with several long-term service engagements resulting from FY08 licensing activity, which increased the utilization and margin obtained on those services. Cost increases in FY09 were attributable to the increased use of resources utilized to deliver the services, both through added staff and through an increase in solution provider partners used to deliver services to the Company's customers, resulting in a \$0.8 million increase compared to FY08. Average service headcount increased by four from FY08 to FY09.

Cost of service for FY08 increased 29% from FY07. The Company achieved a 23% margin on service revenue in FY08 compared with a 19% margin in FY07. Cost increases in FY08 were attributable to the increased use of solution provider partners used to deliver services to the Company's customers, resulting in a \$1.2 million increase compared to FY07. Average service headcount remained unchanged from FY07 to FY08.

#### Sales and Marketing

Sales and marketing costs declined \$3.2 million, or 13%, in FY09 compared with FY08 through a combination of lower headcount, lower variable pay and reduced marketing spend in the year. Average headcount decreased by eight during the year. Lower variable pay costs, consistent with the lower licensing volumes in FY09 compared with FY08, accounted for \$1.1 million of the decrease. Marketing spending declined \$0.6 million from FY08 to FY09.

Sales and marketing costs increased 8% in FY08 compared with FY07. Average sales and marketing staff decreased by 14 during the year. Lower salary costs were more than offset by higher variable pay costs, consistent with the higher licensing volumes in FY08 compared with FY07. Increased productivity from the Company's more tenured sales force contributed to the higher licensing per sales representative. Marketing spending remained flat from FY07 to FY08.

### Research and Development

Research and development expenses decreased 10% from \$13.9 million in FY08 to \$12.4 million in FY09. Since the majority of the Company's development takes place in Canada, the effect of the weakening Canadian dollar accounted for \$0.3 million of the decrease in costs. Also included in the FY08 costs were one-time severance costs totaling \$0.6 million. Headcount remained constant from FY09 to FY08. 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. Research and development costs for the IO segment remained constant from FY09 to FY08.

Research and development expenses increased 11% from \$12.6 million in FY07 to \$13.9 million in FY08. The effect of the strengthening Canadian dollar accounted for \$0.8 million of the increase in costs. Also included in the increase in costs were one-time severance costs totaling \$0.6 million. Headcount remained constant from FY07 to FY08.

### General and Administrative

General and administrative expenses decreased \$1.3 million, or 14%, in FY09 compared with FY08. Of the \$1.3 million decrease, \$0.5 million related to lower variable pay costs and \$0.2 million was due to the lower Canadian dollar versus the US dollar in FY09, when compared with FY08. As a percentage of total revenue, general and administrative costs were 13% in FY09, compared with 14% in FY08 as the Company continued to leverage its general and administrative base. Headcount for the Company's general and administrative organization remained relatively consistent from FY09 to FY08.

General and administrative expenses increased \$1.2 million, or 17%, in FY08 compared with FY07. Costs increased \$0.7 million due to the higher Canadian dollar versus the US dollar in FY08, when compared with FY07. The remainder of the increase resulted from higher variable pay costs in FY08, in line with the Company's improved financial results in FY08. As a percentage of total revenue, general and administrative costs were 14% in FY08, compared with 15% in FY07. Headcount for the Company's general and administrative organization remained unchanged from FY07 to FY08.

### Foreign exchange

Due to significant changes in currency exchange rates during the fiscal year, a foreign exchange loss of \$0.4 million was incurred in FY09 compared to a foreign exchange gain of \$0.5 million in FY08. The foreign exchange gains and losses in FY08 and FY09 related to the conversion of balance sheet items to the period end exchange rates. For FY07, the Company realized a foreign exchange gain of \$0.2 million.

### Interest Income

Interest was generated from short-term investment grade interest-bearing securities. Low short-term interest rates in FY09 and FY08 resulted in lower overall interest income.

### Income Taxes

In FY09, the Company recorded an income tax recovery for accounting purposes of \$1.6 million. This recovery resulted from the Company's regular quarterly analysis of its valuation allowance during the fourth quarter of FY09. The valuation allowance was reduced on the Company's deferred tax asset in FY09, increasing the net asset that will be utilized to offset taxable income, mainly in Canada and the United States in the future. This was offset by the utilization of opening deferred tax asset balances in FY09 of \$1.5 million.

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.

## Liquidity and Capital Resources

The Company's cash balance as at April 30, 2009 increased by \$4.2 million to \$17.1 million from \$12.9 million at April 30, 2008 due to significant collection from accounts receivable during FY09.

### Operating Activities

The Company generated \$12.3 million of cash from operating activities in FY09 compared with \$2.4 million in FY08. Days sales outstanding in accounts receivable at April 30, 2009 were 50 days compared to 69 days at April 30, 2008. The decrease in days sales outstanding was primarily attributable to the collection of the high volume of sales transactions completed in the last quarter of FY08. Deferred revenue increased by \$0.7 million at April 30, 2009 compared to April 30, 2008 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 cash balances in the third and fourth quarters will continue.

### Investing Activities

Purchases of fixed assets amounted to \$1.3 million in FY09 compared with \$1.2 million in FY08. Capital spending relates 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

The Company maintains a policy to pay quarterly dividends and declared and paid quarterly dividends on its common shares of \$0.02 per share each quarter in FY09 amounting to total dividends of \$4.0 million being paid during the year. The Company's intention is to pay a quarterly 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 FY09, the Company purchased 2.2 million shares under the NCIB, at an average cost of Cdn\$1.70 per share, for a total cost, including commissions, of \$3.6 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 \$0.7 million during FY09 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 \$17.1 million as at April 30, 2009, compared with \$12.9 million at April 30, 2008.

The Company continues to perform relatively well under the current economic climate. In FY09, the Company had higher profitability and cash flow compared to the prior 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 the Company 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.

(tabular amounts in thousands)	Fiscal year ended April 30						
	2010	2011	2012	2013	2014	Thereafter	Total
Operating lease obligations <sup>1</sup>	\$ 1,650	\$ 1,100	\$ 392	\$ 284	\$ 189	\$ 199	\$ 3,814
Purchase obligations <sup>2</sup>	600	16	-	-	-	-	616
	\$ 2,250	\$ 1,116	\$ 392	\$ 284	\$ 189	\$ 199	\$ 4,430

<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 2010

MKS is committed to profitable organic growth in its primary operating segment, ALM. The Company strives to maintain a balance between increasing current shareholder returns and funding research and sales force investments for long-term growth.

The Company also expects a continued decline in the Interoperability business of approximately 10 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. 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

Total revenue in the fourth quarter of fiscal 2009 was \$13.6 million, down 36% from \$21.2 million in the fourth quarter of fiscal 2008. ALM license revenue decreased 74% to \$2.8 million from \$10.9 million for the same periods. Sales transactions over \$100,000 were 18 in the fourth quarter of FY09 (of which 2 transactions were over \$500,000) compared to 19 in the fourth quarter of FY08 (of which 5 transactions were over \$500,000).

Total operating expenses in the fourth quarter of FY09 were \$13.0 million, down from \$17.0 million in the fourth quarter of FY08 and up from \$12.8 million in the third quarter of FY09. The decrease in operating expenses from the fourth quarter of FY09 to FY08 related to decreased variable compensation costs as a result of lower licensing revenue. In addition, 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 the fourth quarter of FY09 compared with the fourth quarter of FY08 of \$0.8 million in addition to a foreign exchange gain of \$0.2 million.

During the fourth quarter of FY08, the Company generated \$0.8 million of cash, driven primarily by cash generated from operations of \$0.9 million.

## Changes in Accounting Policies

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.

Effective May 1, 2007, the Company adopted the provisions of FIN 48 and as a result of the implementation of FIN 48 there was no material impact to the Company's opening tax balances based on the tax positions taken.

Upon adoption of FIN48, the Company's policy is to include interest and penalties related to gross unrecognized tax benefits within the Company's income tax provision. Previously, interest paid related to income taxes was classified in the Company's financial statements as interest expense. As of April 30, 2008, the Company had accrued \$nil related to the payment of such interest and penalties.

## Impact of New Accounting Pronouncements

In September 2006, the Financial Standards Board released FASB 157, "Fair Value Measurements", which is effective for fiscal years beginning after November 15, 2007. FASB 157 defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. The adoption of this pronouncement had no impact on the Company's financial statements.

Please see note 1 to the consolidated financial statements of the Company for the fiscal year ended April 30, 2009 for more information about the accounting policies of the Company.

## Related Party Transactions

During FY09, 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 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 April 30, 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 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 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

### Effectiveness of internal controls over financial reporting

Under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, management assessed the effectiveness of the Company's internal control over financial reporting (as defined in National Instrument 52-109) as of April 30, 2009, based on criteria established in "Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission".

Based on the assessment, the Company's CEO and CFO concluded that, as of April 30, 2009, the Company's internal control over financial reporting was effective.

## Adoption of International Financial Reporting Standards

In January 2006, the Accounting Standards Board (the "AcSB") announced its decision to require all publicly accountable enterprises to report under International Financial Reporting Standards ("IFRS") for years beginning on or after January 1, 2011. On February 13, 2008, the AcSB confirmed that publicly accountable enterprises will be required to use IFRS, as issued by the International Accounting Standards Board, unless modifications or additions to the requirements of IFRS are issued by the AcSB. IFRS must be adopted for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, with restatement of comparative periods.

The Company is currently finalizing the IFRS changeover plan to achieve adoption of IFRS by May 1, 2011. Components of the plan include assessment of accounting policy choices and implementation decisions under IFRS, determining the impact of transition on information systems, internal control over financial reporting and disclosure controls and development of financial expertise in IFRS. The Company is completing the initial determination of differences in Canadian GAAP and IFRS and is currently assessing the impact on accounting policies and financial reporting.

## Critical Accounting Policies and Estimates

The consolidated financial statements of the Company for the year ended April 30, 2009 have been prepared in accordance with US GAAP. Refer to note 1 in the annual consolidated financial statements for more information about the accounting policies applied in the preparation of the financial statements. The preparation of the financial statements in accordance with US GAAP requires management to make certain estimates, judgments and assumptions. Management continually evaluates these estimates, judgments and assumptions based on past experience and other relevant factors and believe them to be reasonable based upon information available to management at the time. Because this involves varying degrees of judgment and uncertainty, the amounts currently reported in the financial statements could, in the future, prove to be inaccurate. The accounting policies that reflect management's estimates that are more significant, 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 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 that 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 4 in the audited annual financial statements of the Company for the year ended April 30, 2009, a valuation reserve has been taken against a portion of the deferred tax assets of the Company, affecting 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), 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.

#### 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 affecting revenue and profitability of foreign operations.

#### **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, general economic conditions, 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, 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.

#### **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 entail 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. A portion 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 affect 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.