

1st Quarter Fiscal 2006 Report

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

Dear Shareholder,

Fiscal 2006 is off to a good start. Revenues were up on both the product and service side, as were earnings from operations and net income. We signed some key new accounts and continued to make headway into Europe. Here are some of the highlights:

- Revenue increased to \$8.0M from \$5.3M in the same quarter of last year; a 50% increase.
- Product sales rose to \$3.0M from \$1.8M in the comparable quarter of last year; a 71% increase.
- Services revenue rose to \$4.9M from \$3.4M in Q1 of the previous fiscal year; an increase of 43%.
- Earnings from operations increased to \$263K from \$135K in Q1 of the previous fiscal year; an increase of 95%.
- Net income increased 65% in Q1 of fiscal 2006 over the comparable quarter of fiscal 2005.

The increase in earnings from operations of 95% was due to the additional product and service revenue, and had we not faced a rising Canadian dollar, earnings from operations would have tripled rather than doubled in real terms, as it did. After accounting for an exchange loss of \$65,000 and net interest income of \$27,000, the company earned a net income of \$225,000 or \$0.02 per share, an increase of 65% over Q1 2005, when net income was \$136,000 or \$0.01 per share.

We are showing strong momentum in signing new accounts as we start out the year, with a total of seven new contracts, one of which is in the U.K., furthering our foray into Europe. Implementations also continued at a brisk pace in all divisions. The SMB Group brought two companies live during Q1, as did the Logistics Management Group. The Transportation Management Group completed three implementations, and the Enterprise Supply Chain Group finished the quarter with a total of four go-lives.

The market has continued to present its own challenges. In the wholesale marketplace, consolidation has continued at a steady pace, creating greater demand for automation and efficiency among the companies that remain. The impact of China in the globalization equation has stepped up the need for efficiency in the supply chain as well. Both of these trends represent opportunities for our business.

Consolidation continues among our competitors as several additional mergers took place in the last few months alone. We believe that this reduced number of vendors bodes well for the vendors that remain.

Overall, it was a strong quarter. Performance indicators are positive in terms of revenue, profitability, backlog, revenue per employee and international penetration. As these indicators continue to move in the right direction, we are confident share price will respond.

Yours truly,



Peter Brereton
President and Co-CEO

Management's Discussion and Analysis of Financial Condition and Results of Operations dated August 26, 2005

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements of TECSYS Inc. ("The Company") and Notes thereto, which are included in this document. This discussion and analysis should also be read in conjunction with the annual report for fiscal year 2005. The Company's first quarter for fiscal year 2006 ended on July 31, 2005.

These interim unaudited consolidated financial statements have not been reviewed by the Company's auditors.

The Company's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, and all financial data derived therefrom in this interim report are expressed in U.S. dollars. The Company's reporting currency is the U.S. dollar; and the functional currency is the Canadian dollar. Accordingly, the consolidated financial statements for the three-month period ended July 31, 2005 and July 31, 2004 are translated into U.S. dollars using the current rate method. All gains and losses resulting from the translation of the consolidated financial statements into U.S. dollars are reflected in the cumulative translation adjustment in shareholders' equity.

In addition, the consolidated financial statements include a reconciliation of the significant measurement differences between Canadian and United States generally accepted accounting principles as they relate to the Company.

Business Combinations

On February 28, 2005, the Company acquired 100% of the issued and outstanding shares of Application Solutions Inc. ("ASI"), a Canadian provider of warehouse management systems, radio frequency identification device (RFID) solutions, and system integration services on the IBM iSeries platform. ASI's solutions have integrated with key ERP solutions in the market including SAP, SSA, Oracle / Peoplesoft / JDE, and MS Business Solutions. ASI was wound-up into TECSYS Inc. on March 1, 2005, organized as the Logistics Management Group ("LMG") and the results of its operations are included in the consolidated financial statements commencing on that date.

On March 31, 2005, the Company acquired 100% of the issued and outstanding shares of Symplitech Inc. ("Symplitech"), a Canadian consulting practice specializing in the implementation of SAP solutions for manufacturing, warehousing, and distribution businesses. Symplitech was wound-up into TECSYS Inc. on April 1, 2005 as an integral part of the operations of the Logistics Management Group (LMG, formerly ASI), and the results of its operations are included in the consolidated financial statements commencing on that date.

For the three-month period ended July 31, 2005, LMG (formerly ASI and Symplitech) contributed \$2.7 million to revenues and \$143,000 to earnings from operations.

Results of Operations

Three months ended July 31, 2005 compared to three months ended July 31, 2004

Revenue

Total revenue for the three months ended July 31, 2005 increased by \$2.7 million or 50% to \$8.0 million compared to \$5.3 million for the same period of fiscal 2005. The increase in revenues is entirely attributable to the Company's latest acquisitions, ASI and Symplitech (LMG).

Products revenue increased by 71% to \$3.0 million in the first quarter of fiscal 2006 compared to \$1.8 million for the same period in the previous fiscal year. Services revenue increased 43% or \$1.4 million to \$4.9 million during the first quarter of fiscal 2006 compared to \$3.4 million for the same fiscal period last year. The increase in products revenue and services revenue is virtually entirely attributable to the addition of LMG.

Excluding LMG, the services revenue mix in fiscal 2006 was characterized by slightly less product adaptations revenue of \$113,000 offset by slightly higher professional services and support revenues resulting in an increase of \$5,000 over the previous fiscal year.

As a percentage of total revenue, products accounted for 37% and services 61% in the first quarter of fiscal 2006 compared to 33% and 64%, respectively, in the first quarter of fiscal 2005. The increase in the products revenue percentage is due to the fact that the LMG revenue mix is more heavily weighted on radio frequency equipment (RF), hardware and supplies. LMG's revenue mix was 45% for products and 54% for services in the first three months of fiscal 2006.

The Canadian dollar has strengthened approximately 9% against the U.S. dollar for the first quarter of fiscal 2006 as compared to the same period in fiscal 2005. The Canadian dollar to U.S. dollar exchange rates for the three-month period ended July 31, 2005 have averaged \$0.8068 US in comparison to \$0.7393 US for the same period last year. Consequently, excluding LMG, the strengthening Canadian dollar has affected the reported revenues favorably by approximately \$193,000 in the first quarter of fiscal 2006 in comparison to the same period last year. On the other hand, excluding LMG, the strengthening Canadian dollar has affected cost of revenue and operating expenses adversely by approximately \$156,000 and \$196,000 respectively.

Cost of Revenue

Total cost of revenue increased 86% or \$2.1 million to \$4.5 million in the first quarter of fiscal 2006 compared to \$2.4 million for the same three-month period in fiscal 2005. The LMG acquisition accounted for all of the increase except \$231,000.

Services costs increased by \$1.3 million or 74% to \$3.0 million for the first quarter of fiscal 2006 compared to \$1.7 million for the comparable period of the previous fiscal year, reflecting primarily the impacts of the LMG acquisition. Excluding LMG, gross services expenses increased by 17% or \$326,000 to \$2.2 million for the first quarter of fiscal 2006 compared to \$ 1.9 million for the previous fiscal year. Gross service expenses, excluding LMG, have been affected unfavorably by approximately \$164,000 due to the strengthened Canadian dollar and the use of more outside consultants. The total cost of services also includes multimedia tax credits of \$143,000 for the first quarter of fiscal 2006 compared to \$132,000 for the same period in the previous fiscal year.

The cost of third-party products increased by \$828,000 or 164% to \$1.3 million for the first quarter of fiscal 2006 in comparison to \$504,000 for the same three-month period for the previous fiscal year. LMG accounted for all of the increase, consistent with the increase in product revenues.

Gross Margin

The gross margin increased by \$580,000 or 20% to \$3.5 million for the first quarter of fiscal 2006 in comparison to \$2.9 million for the same fiscal period last year. LMG contributed \$831,000 to the increased margin. Total gross margin percentage in the first quarter of fiscal 2006 was 44% (50% excluding LMG) compared to 54% in the same period of fiscal 2005. The gross margin reduction of 4% on the existing business is mainly attributable to the strengthening Canadian dollar. The reduction in the overall gross margin percentage is mainly due to the addition of LMG which realized an overall gross margin of 31% in the first quarter and to the reduced margin of the existing services operations due to the stronger Canadian dollar.

Products margin was 56% in the first quarter of fiscal 2006 compared to 71% for the same three-month period last year. Excluding LMG, products margin was 73% in the first quarter of fiscal 2006. LMG's products gross margin percentage was 30% reflecting the fact that its product revenue mix is more heavily weighted on the resale of RF equipment, hardware and supplies, which carry a lower gross margin, than proprietary and third-party software licenses.

Services gross margin was 38% in the first quarter of fiscal 2006 compared to 49% in the same period last year. Excluding LMG, the services gross margin was 40% in the first quarter for fiscal 2006 compared to 49% for the same fiscal period last year. This decrease in services gross margin is due primarily to the unfavorable impact of the strengthening Canadian dollar and the use of more outside consultants. LMG services gross margin was 33% in the first quarter of fiscal 2006. LMG's gross margin for services is lower compared to the existing business mainly due to the fact that a portion of their services revenue comprises the repair of third-party RF equipment and hardware products which carry a significantly lower gross margin. Additionally, LMG does not benefit from the multi-media tax credits.

Operating Expenses

Total operating expenses increased by \$452,000 or 16% to \$3.2 million in the first quarter of fiscal 2006 compared to \$2.8 million in the first quarter of fiscal 2005. Excluding LMG, operating expenses decreased \$236,000 as LMG accounted for \$688,000 of the overall increase.

The most significant variances, excluding LMG, accounting for the \$236,000 reduction in operating expenses are characterized by fewer sales and marketing resources and variable commission expense accounting for \$143,000, fewer general and administration resources accounting for \$30,000, as well as \$56,000 of higher research and development investment tax credits.

Due to the strengthened Canadian dollar in the first quarter of fiscal 2006 in comparison to the same period in fiscal 2005, excluding LMG, operating expenses have been affected unfavorably by approximately \$196,000.

Other Income and Expenses

During the first quarter of fiscal 2006, the Company recorded an exchange loss of \$65,000 compared to an exchange loss of \$33,000 for the same period in the previous fiscal year. The exchange loss arises because the Company carries net monetary assets, primarily cash and accounts receivable, denominated in U.S. dollars. The net U.S. monetary assets are devalued due to the strengthened Canadian dollar against the U.S. dollar. The exchange rate at April 30, 2005, the beginning of the quarter, was \$1 US = \$1.2569 CA. The exchange rate at July 31, 2005 was \$1 US = \$1.2259 CA representing a 2.5% depreciation of U.S. monetary assets for the quarter. The exchange rate at April 30, 2004 was \$1 US = \$1.3707 CA and at July 31, 2004 the rate was \$1 US = \$1.3292 CA representing a 3.0% depreciation of U.S. monetary assets in the first quarter of the last fiscal year.

During the first quarter of fiscal 2006, the Company protected a portion of its net monetary assets by means of a forward exchange contract selling \$2.0 million U.S. dollars forward at an average rate of \$1.2522. The contract matured before the end of the quarter. There were no foreign exchange contracts outstanding at the end of the quarter. The transaction for the hedging strategy in the first quarter of fiscal 2006 yielded an exchange gain of US \$43,000. The Company followed a similar strategy of selling U.S. dollars forward at the end of the first quarter of fiscal 2005 selling 1.5 million U.S. dollars at an average rate of 1.3713. The transaction for the hedging strategy in the first quarter of fiscal 2005 yielded an exchange gain of US \$48,000.

Subsequent to the current quarter ended July 31, 2005, the Company undertook another foreign exchange contract to sell \$2.0 million U.S. dollars forward at a rate of 1.21 on October 31, 2005.

The consolidated financial statements for the three-month period ended July 31, 2005 and July 31, 2004 are translated into U.S. dollars using the current rate method. All gains and losses resulting from the translation of the Canadian dollar consolidated financial statements into U.S. dollars are reflected in the cumulative translation adjustment in shareholders' equity.

The Company has recorded increases in the cumulative translation adjustment (CTA) account within the shareholder's equity of \$361,000 for the first quarter of fiscal 2006 compared to \$402,000 for the first quarter of fiscal 2005. The increases to CTA account represent exchange gains arising on the translation of the Canadian dollar financial statements into U.S. dollar financial statements where such exchange gains are posted directly into the shareholder's equity section rather than flowing through the statement of operations.

Net Earnings

The Company recorded net earnings of \$225,000 or \$0.02 per share in the first quarter of fiscal 2006 compared to net earnings of \$136,000 or \$0.01 per share for the same period last year.

Note 4 to the consolidated financial statements reflects that there is only a very small difference of \$3,000 between the Company's reported net earnings and no difference between the basic and diluted net earnings per share under Canadian GAAP as compared to U.S. GAAP for the three-month periods ended July 31, 2005 and 2004. However, under U.S. GAAP, the cumulative translation adjustment (CTA) is an integral part of arriving at the comprehensive income. The comprehensive income for the first three months of fiscal 2006 under U.S. GAAP was \$589,000 compared to \$538,000 for the corresponding period in fiscal 2005.

Liquidity and Capital Resources

As of July 31, 2005, current assets totaled \$16.2 million compared to \$15.8 million at the end of fiscal 2005. Cash, restricted cash equivalents, and short-term and other investment securities decreased to \$6.7 million compared to \$7.3 million as at April 30, 2005. Accounts receivable totaled \$7.9 million at the end of July 31, 2005 compared to \$7.0 million as at April 30, 2005. The Company's DSO (days sales outstanding) increased to 89 days at the end of the first quarter of fiscal 2006 in comparison to 70 days at the end of fiscal 2005 and 78 days at the end of the first quarter of fiscal 2005. The increase in the DSO was influenced adversely by personnel turnover during the first quarter of fiscal 2006.

Current liabilities as at July 31, 2005 totaled \$6.7 million compared to \$6.9 million at the end of fiscal 2005. Working capital increased to \$9.5 million at the end of the first quarter of fiscal 2006 compared to \$9.0 million at the end of fiscal year 2005.

During the first three months of fiscal 2006, operating activities used funds of \$512,000 compared to \$99,000 for the same period last year. During the first quarter of fiscal 2006, positive results in operating activities generated \$534,000 and were offset by increases in net non-cash working capital by \$1.0 million, represented primarily by the increase of accounts receivable and the decrease of accounts payable and accrued liabilities. During the first quarter of fiscal 2005, positive results in operating activities generated \$399,000 and were offset by increases in net non-cash working capital by \$498,000, represented primarily by the reduction of accounts payable.

The Company believes that funds on hand at July 31, 2005, together with short term investments and cash flow from operations will be sufficient to meet its needs for working capital, R&D, capital expenditures and debt repayment for at least the next twelve months.

Financing activities used funds of \$85,000 and \$75,000 respectively for the first three months of fiscal 2006 and 2005. The repayment of long-term debt and capital lease obligations amounted to \$5,000 in the first quarter fiscal 2006 compared to \$75,000 for the comparable period in fiscal 2005. During the first quarter of fiscal 2006, the Company purchased 65,500 of its outstanding common shares for cancellation at an average price of CA \$1.51 (US \$1.22) per share under a Normal Course Issuer Bid (NCIB). The total cost related to the purchasing of these shares, including other related costs, was CA \$100,000 (US \$80,000). The excess of the net book value over the purchase price of the shares of CA \$170,000 has been credited to contributed surplus. As per note 1 to the consolidated financial statements, the Company may purchase common shares under the NCIB, if it considers it advisable, at any time, and from time to time, to July 18, 2006. No shares were purchased under the NCIB in the first quarter of fiscal 2005.

During the first quarter of fiscal 2006, investing activities generated funds amounting to \$632,000 as compared to \$573,000 for the comparable period of fiscal 2005. The Company generated funds of \$703,000 and \$273,000 by decreasing short-term investments in the first quarter of fiscal 2006 and the first quarter of fiscal 2005 respectively. Funds of \$71,000 and \$68,000 were used for the first three months of fiscal 2006 and 2005 respectively for the acquisition of property, plant, and equipment, and computer software for internal use (intangible assets). In the first quarter of fiscal 2005, the company received funds of \$368,000 representing the purchase price adjustment from the former PointForce shareholders pursuant to the acquisition of PointForce.

Strategically, the Company will continue to consider growth opportunities through acquisition. Funding for these potential acquisitions will be determined as the opportunities and circumstances are identified.

Critical Accounting Policies

The Company's critical accounting policies are those that it believes are the most important in determining its financial condition and results. A summary of the Company's significant accounting policies, including the critical accounting policies discussed below, is set out in the notes to the consolidated financial statements in the annual report for the year ended April 30, 2005.

Use of estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the reporting periods.

As the Company's software implementation period may typically span from six to twelve months, the most significant area requiring judgement and estimation is revenue recognition relating to multiple element arrangements, where the resulting revenue recognition per element and the related timing must be assessed in relation to contract terms, Statement of Position ("SOP") 97-2 criteria, future services, and other criteria as discussed later. The estimates and assumptions are based on past experience and other factors that the Company considers reasonable. As this involves varying degrees of judgement and uncertainty, actual results could differ from those estimates.

Based on a structured methodology, portions of the purchase price paid in business acquisitions (PointForce Inc. in fiscal 2004 and Application Solutions Inc. and Symplitech Inc. in fiscal 2005) have been assigned to intangible assets acquired, consisting of customer relationships, acquired technology, in-process research and development, reseller agreement and vendor non-solicitation engagements. Determination of the fair values assigned to each of these acquired intangible assets has required management estimates of revenue growth, gross margins, retention of customer base, technology obsolescence, operating expenses, capital requirements and expected future cash flows. Fair values attributed to the intangible assets acquired in each business acquisition were determined based on the specific circumstances of each acquisition together with management's outlook based on past performance, the business plan, and as incorporated in initial operating and capital budgets. The acquired intangible assets are being amortized on a straight-line basis over five years based on the current estimates of technological obsolescence of five years and a projected 20% annual attrition of the existing customer base. The carrying values of the intangible assets acquired in business acquisitions are reviewed annually for impairment as described below.

Goodwill represents the excess of the purchase price of businesses acquired over the fair value of the underlying net identifiable assets acquired or liabilities assumed. Goodwill related to business combinations initiated or completed prior to July 1, 2001 was amortized on a straight-line basis over the estimated useful life of five years. Following the adoption of the recommendations of the CICA Handbook Section 3062 on May 1, 2002, goodwill is not amortized, but rather is evaluated for impairment annually, or when events or changed circumstances indicate that an impairment may have occurred. In connection with the goodwill impairment test, if the carrying value of the Company's reporting unit to which goodwill relates exceeds its estimated fair value, the goodwill related to that reporting unit is tested for impairment. If the carrying value of such goodwill is determined to be in excess of its fair value, an impairment loss is recognized in the amount of the excess of the carrying value over the fair value. The goodwill impairment test entails the use of a number of estimates including future cash flows and involving varying degrees of judgement and uncertainty. Actual results will differ from those estimates.

The Company assesses the carrying value of its long-lived assets, which include property, plant and equipment and definite-life intangible assets, for future recoverability when events or changed circumstances indicate that the carrying value may not be recoverable. An impairment loss is recognized if the carrying value of a long-lived asset exceeds the sum of the estimated undiscounted future cash flows expected from its use. The amount of impairment loss, if any, is determined as the excess of the carrying value of the assets over their fair value. The long-lived assets impairment test entails the use of a number of estimates including future cash flows and involving varying degrees of judgement and uncertainty. Actual results will differ from those estimates.

The Company maintains an allowance for doubtful accounts at an amount estimated to be sufficient to provide adequate protection against losses resulting from collecting less than full payment on its receivables. Individual overdue accounts are reviewed and allowance adjustments are recorded when determined necessary to state receivables at the realizable value. If the financial condition of customers deteriorate resulting in their diminished ability or willingness to make payment, additional provisions for doubtful accounts are recorded. Considerable judgement is required to assess the realizable value of the receivables including the probability of collection and the current creditworthiness of each customer. As this involves varying degrees of judgement and uncertainty, actual results could differ from those estimates.

The company accrues refundable investment tax credit benefits related to qualifying activities, including research and development projects. Considerable judgement is required to assess the various criteria of whether activities qualify. As these activities are audited periodically, the actual results attributable to a fiscal period may differ from the accounting estimates posted.

Revenue Recognition

The Company licenses software under non-cancellable license agreements and provides services including training, installation, consulting and maintenance, consisting of product support services and periodic updates. The Company recognizes revenue in accordance with Statement of Position ("SOP") 97-2, "Software Revenue Recognition". Revenues generated by the Company include the following:

- **License Fees**

Revenues from licenses sold separately are recognized when a non-cancellable license agreement has been signed, the software product has been shipped, there are no uncertainties surrounding product acceptance, the fees are fixed or determinable, and collection is considered probable. Fees from multiple element arrangements are allocated to the various elements based on vendor-specific objective evidence of fair value provided that services, if any, are not essential to the functionality of the software. Revenues from licenses sold under multiple element arrangements are recognized upon shipment of the software product, provided that all of the above criteria have been met.

Where services are considered to be essential to the functionality of the software, fees from licenses and services are aggregated and recognized as revenue as the related services are performed using the percentage-of-completion method. The percentage of completion is generally determined based on the number of hours incurred to date in relation to the total expected hours of services. The cumulative impact of any revision in estimates of the percent completed is reflected in the period in which the changes become known. Losses on such contracts in progress are recognized when known. Work in process is established for revenue based on the percent completed in excess of progress billings as of the balance sheet date. Any excess of progress billings over revenue based on the percent completed is deferred and included in deferred revenue. Generally, the terms of long-term contracts provide for progress billing based on completion of certain phases of work. Where acceptance criteria are tied to specific milestones, the percentage of completion up to that milestone is recognized upon acceptance.

- **Support Agreements**

Support agreements generally call for the Company to provide technical support and unspecified software updates to customers. Revenues from technical support and unspecified software update rights are recognized ratably over the term of the support agreement.

- **Consulting and Education Services**

The Company provides consulting and education services to its customers. Revenues from such services are recognized as the services are performed.

Related Party Transactions

The company has a subordinated loan for CA\$107,000 (US\$87,000) from a person related to certain shareholders, bearing interest at 12.67%. The loan is payable on the earlier of demand or on the death of the lender. The same amount was outstanding as at July 31, 2005 and July 31, 2004.

Management has compiled the unaudited interim consolidated financial information of TECSYS Inc. consisting of the interim Consolidated Balance Sheet as at July 31, 2005 and the Consolidated Statements of Deficit, Operations, and Cash Flows for the three-month period ended July 31, 2005 and July 31, 2004. An accounting firm has not reviewed or audited these interim consolidated financial statements.

Consolidated Balance Sheets

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars)

	July 31, 2005 (unaudited)	April 30, 2005
Assets		
Current assets		
Cash and cash equivalents	1,075	1,054
Short-term and other investments	4,836	5,435
Accounts receivable	7,912	7,000
Other accounts receivable	204	177
Tax credits receivable	1,409	1,241
Inventory	131	162
Prepaid expenses	667	749
	<u>16,234</u>	<u>15,818</u>
Restricted cash equivalents and other investments	835	815
Property, plant and equipment	2,043	2,044
Intangible assets	2,160	2,239
Goodwill	1,874	1,827
	<u>23,146</u>	<u>22,743</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	4,486	4,890
Current portion of long-term debt	108	106
Deferred revenue	2,145	1,868
	<u>6,739</u>	<u>6,864</u>
Long-term debt	415	410
Other long-term liabilities	531	548
	<u>7,685</u>	<u>7,822</u>
Shareholders' Equity		
Capital stock (note 1)	38,836	39,019
Contributed surplus (notes 1 and 2)	6,761	6,624
Cumulative translation adjustment	1,854	1,493
Deficit	<u>(31,990)</u>	<u>(32,215)</u>
	<u>15,461</u>	<u>14,921</u>
	<u>23,146</u>	<u>22,743</u>

Consolidated Statements of Deficit

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars)

	Three Months Ended July 31, 2005 (unaudited)	Three Months Ended July 31, 2004 (unaudited)
Balance - Beginning of period as originally stated	(32,215)	(27,764)
Adjustment resulting from a change in accounting policy regarding stock-based compensation (note 2)	-	(4,785)
Beginning balance as restated	(32,215)	(32,549)
Net earnings for the period	225	136
Balance - End of period	(31,990)	(32,413)

Consolidated Statements of Operations

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars, except share and per share data)

	Three Months Ended July 31, 2005 (unaudited)	Three Months Ended July 31, 2004 (unaudited)
Revenue		
Products (note 3a)	2,996	1,753
Services	4,854	3,406
Reimbursable expenses	155	186
	<u>8,005</u>	<u>5,345</u>
Cost of revenue		
Products	1,332	504
Services (note 3b)	3,025	1,742
Reimbursable expenses	155	186
	<u>4,512</u>	<u>2,432</u>
Gross margin	<u>3,493</u>	<u>2,913</u>
Operating expenses		
Sales & marketing	1,454	1,178
General & administration	639	539
Gross research & development	991	909
Research & development tax credits	(157)	(101)
Stock-based compensation	33	51
Amortization of property, plant and equipment	135	130
Amortization of intangible assets	135	72
	<u>3,230</u>	<u>2,778</u>
Earnings from operations	263	135
Interest income	47	43
Interest expense	(20)	(9)
Foreign exchange losses	(65)	(33)
Net earnings for the period	<u>225</u>	<u>136</u>
Weighted average number of common shares outstanding		
- basic	<u>13,883,449</u>	<u>14,158,797</u>
- diluted	<u>13,937,724</u>	<u>14,282,404</u>
Basic and diluted net earnings per common share (in U.S. dollars)	<u>\$ 0.02</u>	<u>\$ 0.01</u>

Consolidated Statements of Cash Flows

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars)

	Three Months Ended July 31, 2005 (unaudited)	Three Months Ended July 31, 2004 (unaudited)
Cash flows from		
Operating activities		
Net earnings for the period	225	136
Adjustments for		
Amortization of property, plant and equipment	135	130
Amortization of intangible assets	135	72
Stock-based compensation	33	51
Unrealized foreign exchange losses	6	10
Changes in non-cash working capital items related to operations		
Decrease (increase) in accounts receivable	(683)	292
Decrease (increase) in other accounts receivable	(23)	109
Increase in tax credits receivable	(136)	(237)
Decrease in inventory	35	-
Decrease in prepaid expenses	98	65
Increase in long-term accounts receivable	-	(34)
Decrease in accounts payable and accrued liabilities	(538)	(507)
Increase (decrease) in deferred revenue	201	(186)
	<u>(512)</u>	<u>(99)</u>
Financing activities		
Repayment of long-term debt and capital lease obligations	(5)	(75)
Purchase of common shares for cancellation	(80)	-
	<u>(85)</u>	<u>(75)</u>
Investing activities		
Decrease in short-term and other investments	703	273
Acquisitions of property, plant and equipment	(71)	(45)
Acquisitions of intangible assets	-	(23)
Business combination, purchase price adjustment	-	368
	<u>632</u>	<u>573</u>
Effect of foreign exchange rate fluctuations on cash and cash equivalents	<u>(14)</u>	<u>(13)</u>
Change in cash and cash equivalents	21	386
Cash and cash equivalents - Beginning of Period	1,054	2,388
Cash and cash equivalents - End of Period	<u>1,075</u>	<u>2,774</u>

Interim financial information

The interim financial statements for the three-month period ended July 31, 2005 and July 31, 2004 are unaudited and have not been reviewed the Company's auditors. In the opinion of management, all necessary adjustments were made to present fairly the results of these periods. The adjustments made were of a normal recurring nature. The results of operations for the three-month period ended July 31, 2005 and 2004 are not necessarily indicative of the trends for the operating results for the full year.

The disclosures in these interim financial statements do not conform in all respects to the requirements of generally accepted accounting principles for annual financial statements; therefore these interim financial statements should be read in conjunction with the audited annual financial statements for the year ended April 30, 2005. These interim financial statements follow the same accounting policies and methods of their application as the annual financial statements for the year ended April 30, 2005.

1. Capital stock

On July 14, 2005, the Company renewed its Notice of Intention to Make a Normal Course Issuer Bid (NCIB) with the Toronto Stock Exchange. The Notice stated the Company's intention to purchase on the open market at prevailing prices, through the facilities of the Toronto Stock Exchange, up to a maximum of 690,000 of its common shares, being approximately 5% of the 13,857,797 common shares outstanding as of June 30, 2005, but not more than 2% of such outstanding common shares as at June 30, 2005 in any 30-day period. Under the renewal, the Company may purchase common shares, if it considers it advisable, at any time, and from time to time during the period of July 19, 2005 to July 18, 2006. The common shares will be purchased for cancellation.

During the three-month period ended July 31, 2005, the Company purchased 65,500 of its outstanding common shares at an average price of CA \$1.51 (US \$1.22) under the Normal Course Issuer Bid. The total cost related to the purchasing of these shares, including other related costs, was CA \$100,000 (US \$80,000). The excess of the net book value over the purchase price of these shares of CA \$170,000 has been credited to contributed surplus. The Company did not purchase any of its outstanding common shares for cancellation during the three-month period ended July 31, 2004.

The total number of common shares outstanding at July 31, 2005 is 13,857,797.

As at July 31, 2005, options to purchase 1,020,454 common shares at exercise prices ranging between CA \$0.99 and CA \$5.92 and warrants to purchase 85,000 common shares at exercise prices ranging between CA \$1.64 and CA \$2.03 were outstanding. During the three months ended July 31, 2005, the Company granted options to purchase 27,000 common shares with exercise prices ranging from CA \$1.50 to CA \$1.62. No warrants were issued during the period. During the three-month period ended July 31, 2004, the Company granted options to purchase 1,000 common shares with an exercise price of CA \$1.70.

During the three months ended July 31, 2005, options to purchase 16,466 common shares at exercise prices ranging from CA \$1.61 to CA \$5.92 were forfeited. During the three-month period ended July 31, 2004, options to purchase 21,244 common shares at exercise prices ranging from CA \$0.99 to CA \$5.43 were either forfeited or expired.

No options or warrants to purchase common shares were exercised during the three-month period ended July 31, 2005 or July 31, 2004.

2. Stock-based compensation costs

The Company maintains a stock-based compensation plan, which is described in note 11(d) in the audited financial statements for the year ended April 30, 2005. Effective May 1, 2004, the Company adopted the fair value based method of accounting for stock options and warrants granted to employees and directors and elected to apply the new standard retroactively without restatement as prescribed by the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870, "Stock-based Compensation and Other Stock-based Payments".

Under the fair value based method, compensation cost is measured at the fair value of options and warrants at the date of grant and is expensed over the award's vesting period with a corresponding credit to contributed surplus. Stock-based compensation expense is recorded in the statement of operations commencing May 1, 2004.

Notes to Consolidated Financial Statements for the three months ended July 31, 2005 (Unaudited)
 Prepared in Accordance with Canadian Generally Accepted Accounting Principles
 (in U.S. dollars, tabular amounts in thousands, except as otherwise noted)

For periods prior to May 1, 2004, the Company provides only pro forma disclosures of net earnings (loss) and net earnings (loss) per common share as if the fair value based method of accounting had been used to account for stock options and warrants granted to employees and directors.

No compensation cost is recognized when shares are issued to employees. Any consideration received from the stock-option plan participants is credited to capital stock. Any stock-based compensation costs related to awards given to individuals other than employees and directors are accounted for at fair value.

The change in accounting policy for stock-based compensation became effective May 1, 2004 and resulted in a restatement of the opening balance of deficit for the 2005 fiscal year of \$4.8 million, with corresponding credits to contributed surplus of \$4.4 million, reflecting the cost of unexercised options and warrants granted since the inception of the plan in the 1998 fiscal year, and to capital stock of \$353,000, representing the fair value of stock options exercised in prior years.

The fair value of options and warrants granted in the three-month period ended July 31, 2005 and July 31, 2004 was estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

	Three months ended July 31, 2005	Three months ended July 31, 2004
Volatility	62.5%	75%
Risk-free interest rate	3.7%	3.0%
Dividend yield	nil	nil
Expected lives (in years)	4	3

Following is a summary of the weighted average grant date fair value of options granted during the three-month periods ended July 31, 2005 and 2004:

	Three months ended July 31, 2005	Three months ended July 31, 2004
Number of options	27,000	1,000
Weighted average exercise price US \$	1.23	1.26
Weighted average grant date FV US \$	0.62	0.64

3. Other Information

a) Products revenue

Products revenue is broken down as follows:

	Three months ended July 31, 2005	Three months ended July 31, 2004
Software products	1,205	1,091
Third-party hardware and software	1,791	662
	<u>2,996</u>	<u>1,753</u>

b) Cost of services consist of the following:

	Three months ended July 31, 2005	Three months ended July 31, 2004
Gross expenses	3,168	1,874
Refundable tax credits	(143)	(132)
	<u>3,025</u>	<u>1,742</u>

c) Earnings (loss) per share

Basic earnings (loss) per share is calculated using the weighted average number of shares outstanding during the period.

Diluted earnings per share is calculated based on the weighted average number of common shares outstanding during the period plus the effects of dilutive potential common shares outstanding during the period. This method requires that the dilutive effect of outstanding options and warrants be calculated using the treasury stock method, as if all dilutive options and warrants had been exercised at the later of the beginning of the reporting period or date of issuance, and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of the common shares during the period.

The diluted weighted average number of shares has been calculated as follows:

	Three months ended July 31, 2005	Three months ended January 31, 2004
Weighted average number of shares - basic	13,883,449	14,158,797
Additions to reflect the impacts of:		
Exercise of employee stock options and warrants	54,275	123,607
Weighted average number of shares-diluted	<u>13,937,724</u>	<u>14,282,404</u>

Options and warrants to purchase 524,127 common shares for the three months ended July 31, 2005 (320,616 - three months ended July 31, 2004) have been excluded from the above calculations since they would have an anti-dilutive effect. There are no differences between basic and diluted net earnings per common share figures.

4. Significant differences between Canadian and United States GAAP

The Company's financial statements are prepared in accordance with Canadian GAAP, which differs in some respects from U.S. GAAP. Significant measurement differences between Canadian GAAP and U.S. GAAP as they relate to the Company, are set forth below:

a) Statement of Operations

The following summary sets out the material differences between the Company's net earnings under Canadian GAAP as compared to U.S. GAAP for each period presented.

	Three months ended July 31, 2005	Three months ended July 31, 2004
Net earnings for the period in accordance with Canadian GAAP	225	136
Amortization of in-process research & development relating to the ASI acquisition	3	-
Net earnings for the period in accordance with U.S. GAAP	228	136
Other comprehensive income (loss):		
Foreign currency translation adjustments	361	402
Comprehensive income	589	538

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The statements in this report relating to matters that are not historical fact are forward looking statements that are based on management's beliefs and assumptions. Such statements are not guarantees of future performance, and are subject to a number of uncertainties, including but not limited to future economic conditions, the markets that TECSYS Inc. serves, the actions of competitors, major new technological trends and other factors beyond the control of TECSYS Inc., which could cause actual results to differ materially from such statements.

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