

1st Quarter Fiscal 2007 Report

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

Dear Shareholder,

We started the quarter with an exciting new product release — version 7.5 of our flagship product EliteSeries — a substantial offering that strengthens our competitive position to improve our win rate; it also provides us with another foundation to build our recurring revenue stream by hosting our application to certain customers. We increased our penetration of the healthcare industry by signing a substantial contract with a regional health services authority in central Canada and continued to win customers in the import-to-retail segment of our market. Allow me to run through some of the highlights of the quarter:

Financial Highlights:

Please note that all figures are in U.S. currency and the comparable figures for fiscal 2006 have been restated as outlined in our August 15th press release.

- Revenue for the quarter was \$7.8 million, equal to the first quarter of fiscal 2006, 39% of this revenue came from products and 58% from services.
- Product revenue increased 8% to \$3 million compared to the same period in fiscal 2006. Services revenue was \$4.5 million compared to \$4.9 million for the same period in fiscal 2006.
- License revenue of \$375,000 that had been booked in prior quarters was recognized during the first quarter of fiscal 2007, while a portion of license revenue amounting to \$516,000, booked during the same quarter was deferred and will be recognized in future quarters.
- Net loss for the quarter was \$174,000 or \$0.01 per share compared with a net earnings of \$21,000 or \$0.00 per share for the same period in fiscal 2006. Earnings before interest, taxes, depreciation and amortization (EBITDA) for the reporting quarter amounted to \$52,000 compared to \$264,000 for the same period in fiscal 2006.
- At the end of the first quarter of fiscal 2007, backlog was \$14.2 million, while annualized recurring revenue increased to \$8.9 million compared to \$8.7 million at the end of the previous quarter.

Customer acquisition, wins and go lives:

We continued to build our pipeline across our business units despite the usual summer slow down in business activity. Major activities during the quarter include winning contracts with healthcare and import-to-retail distributors and a number of go lives.

- **Healthcare:**
 - Signed a major agreement with a regional health services authority in central Canada, the pilot of which was signed in the last quarter of fiscal 2006. We also signed a US-based third party logistics provider for the healthcare industry, the application of which will be hosted by TECSYS.
- **Import-to-retail:**
 - Signed a new import-to-retail distributor of home décor products.
 - Signed, upgraded and deployed five customers in home décor, house wares and publishing industries.
- **Third-Party Logistics (3PL):**
 - Signed an agreement with an existing 3PL client to proceed with three additional California based facilities. This world-wide leader in 3PL has traditionally used TECSYS solutions only in Canada. This represents a significant next step in this relationship, as we work to become more of a global partner for them.
- **Transportation:**
 - Reached an agreement with a large Canadian greeting card company to implement our Transportation Management solution for all of their outbound transportation needs.

Cost Reductions:

The upward pressure of the Canadian dollar on our operating costs has certainly not abated, although it has been more stable recently. For this reason, we took steps during our first quarter to reduce our annualized operating costs by in excess of \$1 million. While some benefit will be seen almost immediately, the full benefit of this reduction will take effect by the fourth quarter of the fiscal year.

Major New Product Release:

At the beginning of the quarter, we released version 7.5 of our flagship product, EliteSeries. This is the industry's first sales order desk based on pure service-oriented architecture (SOA), handling sales quotations, orders and EDI processing in an environment that can be adapted for the needs of each user without programming, while offering optimum visibility and automation for the customer's order desk. The new TECSYS product platform is designed for application service provider (ASP) deployment, allowing for license or subscription sales. This further differentiates us competitively and provides the basis for expanding our ASP offering to continue to build our recurring revenues.

Moving forward, our efforts are substantially devoted to business development, taking advantage of our unique expertise in distribution and leveraging our latest product release. We will continue to streamline business operations and reduce costs to achieve improved margins and profitability. We look forward to your continued support.

Yours Truly,

A handwritten signature in black ink, appearing to read 'Peter Brereton', with a long horizontal flourish extending to the right.

Peter Brereton
President and Co-CEO

Management's Discussion and Analysis of Financial Condition and Results of Operations dated September 8, 2006

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 2006. The Company's first quarter for fiscal year 2007 ended on July 31, 2006.

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, 2006 and July 31, 2005 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.

Restatement of Prior Years' Financial Statements

The Company has restated the consolidated balance sheets, statements of operations, statements of deficit, and statements of cash flows, including the applicable notes thereto for the years ended April 30, 2005 and 2004, and for the first three quarters of fiscal 2006 in order to be fully compliant with Statement of Position (SOP) 97-2, "Software Revenue Recognition".

Historically, the Company generally recognized license revenue from perpetual software licenses sold under multiple element arrangements upon delivery of the software product, provided that a non-cancellable agreement exists, the fees are fixed and determinable, and collection is deemed probable. Based on the general framework of Statement of Position (SOP) 97-2, the fees associated with such agreements are allocated to the various revenue elements based on the vendor specific objective evidence (VSOE) of the fair value of each element. The revenue is recognized at the earlier point at which either sufficient vendor specific objective evidence of fair value exists or all the elements of the agreement have been delivered.

In the course of preparing the financial statements for the year ended April 30, 2006, it was determined that certain software license agreements signed during fiscal 2006 and prior years, which included a contractual provision requiring the customers to renew annual support agreements in order to maintain the right to use the software, had not been accounted for appropriately. This provision has the effect of transforming a perpetual license into a renewable annual license. The VSOE of fair value cannot be established for annual support contracts under these circumstances since the customer is considered not to be renewing the annual support on a standalone basis, but rather is essentially making a decision to renew both the software license and the support agreement. Hence, the license revenue cannot be recognized upon delivery. Under generally accepted accounting principles for software revenue recognition as specified in Statement of Position (SOP) 97-2, a license fee from such agreements representing a significant and incremental premium over subsequent year renewal fees should be deferred and recognized as revenue over the period in which support is expected to be provided, which is generally considered to be the estimated useful life of the software license. Where the up-front license fee is not considered to represent a significant and incremental premium over subsequent year renewal fees, the license fee is recognized ratably over the initial contractual support period, which is generally one year.

The Company's objective for promoting this contractual provision with its customers is to insure that they are well supported and to maximize the occurrence of annual support renewals representing recurring revenue. The Company's approach regarding these license agreements requiring the annual support renewal is essentially the same as those without the mandatory support renewals. From an economic perspective, there are no discernible and distinct policy differences regarding pricing for licenses, annual support, services, and the related payment terms. Additionally, the Company's outstanding future support obligations do not differ in any respects between the agreements with and without mandatory support.

The Company has restated its financial statements to fully comply with generally accepted accounting principles. The restatement of revenue for each period represents the difference between the revenue originally reported as recognized but now deferred and the amortization of such deferred revenue over the initial contractual support period. Accordingly, the reported revenue and net earnings have been restated unfavorably by \$184,000 and \$436,000 for fiscal 2004 and fiscal 2005 respectively. Additionally, the application of the revenue recognition principles discussed above has adversely affected revenue and net earnings of the first three quarters of 2006 by \$238,000. At the end of the fiscal year 2006, total license revenue deferred as a result of this restatement was \$946,000. This will be recognized in fiscal year 2007. The restatement has no impact on cash flow from operating activities.

The impact of this restatement on the quarterly consolidated statements of operations is presented in the table below. The relevant figures for fiscal 2006 included in this management discussion and analysis have been restated to reflect the restatement principles discussed above.

Quarterly Selected Financial Data (Restated) (Quarterly data are unaudited)

In thousands of U.S. dollars, except per share data

	Fiscal Year 2006					Fiscal Year 2005					Fiscal Year 2004				
	Q1	Q2	Q3	Q4*	Total	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
Total Revenue															
As previously reported	8,005	8,968	9,713	7,363	34,049	5,345	5,495	5,303	8,129	24,272	3,766	4,147	4,175	5,462	17,550
Adjustment	(204)	193	(227)	-	(238)	(170)	(150)	154	(270)	(436)	(474)	90	139	61	(184)
As restated	7,801	9,161	9,486	7,363	33,811	5,175	5,345	5,457	7,859	23,836	3,292	4,237	4,314	5,523	17,366
Net Earnings (Loss)															
As previously reported	225	(166)	5	(1,431)	(1,367)	136	(316)	180	334	334	10	24	20	361	415
Adjustment	(204)	193	(227)	-	(238)	(170)	(150)	154	(270)	(436)	(474)	90	139	61	(184)
As restated	21	27	(222)	(1,431)	(1,605)	(34)	(466)	334	64	(102)	(464)	114	159	422	231
Basic & Diluted Net Earnings (Loss) per Common Share (In U.S. dollars)															
As previously reported	0.02	(0.02)	-	(0.10)	(0.10)	0.01	(0.02)	0.01	0.02	0.02	-	-	-	0.03	0.03
Adjustment	(0.02)	0.02	(0.02)	-	(0.02)	(0.01)	(0.01)	0.01	(0.02)	(0.03)	(0.03)	0.01	0.01	-	(0.01)
As restated	-	-	(0.02)	(0.10)	(0.12)	-	(0.03)	0.02	-	(0.01)	(0.03)	0.01	0.01	0.03	0.02

* Q4 of fiscal 2006 is not a restatement, however it is included in the table to reflect the impact of the appropriate application of generally accepted accounting principles as discussed earlier.

Results of Operations

Three months ended July 31, 2006 compared to three months ended July 31, 2005 (as restated for July 31, 2005 only)

Revenue

Total revenue for the three months ended July 31, 2006 were flat \$7.8 million compared to the same period of fiscal 2006.

Products revenue increased by \$229,000 or 8% to \$3.0 million in the first quarter of fiscal 2007 compared to \$2.8 million for the same period in the previous fiscal year. Services revenue decreased by 7% or \$329,000 to \$4.5 million during the first quarter of fiscal 2007 compared to \$4.9 million for the same fiscal period last year. The increase in products revenue is mainly attributable to a slight increase of proprietary licenses and third party products. The decrease in services revenue is mainly due to lower professional and training services as a result of some project delays.

As a percentage of total revenue, products accounted for 39% and services 58% in the first quarter of fiscal 2007 compared to 36% and 62%, respectively, in the first quarter of fiscal 2006.

The Canadian dollar has strengthened approximately 11% against the U.S. dollar for the first quarter of fiscal 2007 as compared to the same period in fiscal 2006. The Canadian dollar to U.S. dollar exchange rates for the three-month period ended July 31, 2006 have averaged \$0.895 US in comparison to \$0.807 US for the same period last year. Consequently, the strengthening Canadian dollar has affected the reported revenues favorably by approximately \$438,000 in the first quarter of fiscal 2007 in comparison to the same period last year. On the other hand, the strengthening Canadian dollar has affected cost of revenue and operating expenses adversely by approximately \$352,000 and \$317,000 respectively. Hence, earnings from operations have been affected unfavorably by \$231,000.

Cost of Revenue

Total cost of revenue increased 4% or \$200,000 to \$4.7 million in the first quarter of fiscal 2007 compared to \$4.5 million for the same three-month period in fiscal 2006. The increase is mainly due to higher cost of third party products of \$138,000.

Services costs were flat at \$3.0 million for the first quarter of fiscal 2007 in comparison to the same period of the previous fiscal year. The total cost of services also includes multimedia tax credits of \$145,000 for the first quarter of fiscal 2007 compared to \$143,000 for the same period in the previous fiscal year.

Gross Margin

The gross margin decreased by \$177,000 or 5% to \$3.1 million for the first quarter of fiscal 2007 in comparison to \$3.3 million for the same fiscal period last year. Total gross margin percentage in the first quarter of fiscal 2007 was 40% compared to 42% in the same period of fiscal 2006. The gross margin reduction of 2% is mainly attributable to lower services revenue.

Products margin was 51% in the first quarter of fiscal 2007 compared to 52% for the same three-month period last year. This 1% reduction was due to lower margin realized on third party products.

Services gross margin was 35% in the first quarter of fiscal 2007 compared to 38% in the same period last year. This decrease in services gross margin is due primarily to lower services revenue of \$329,000 compared to the same period of the prior fiscal year.

Operating Expenses

Total operating expenses increased by \$138,000 or 4% to \$3.4 million in the first quarter of fiscal 2007 compared to \$3.2 million in the first quarter of fiscal 2006. Operating expenses have been affected unfavorably by approximately \$317,000 due to the strengthened Canadian dollar in the first quarter of fiscal 2007 in comparison to the same period in fiscal 2006.

Other Income and Expenses

During the first quarter of fiscal 2007, the Company recorded an exchange gain of \$34,000 compared to an exchange loss of \$65,000 for the same period in the previous fiscal year. The exchange gains or losses arise because the Company carries net monetary assets, primarily cash and accounts receivable, denominated in U.S. dollars. The exchange rate at April 30, 2006, the beginning of the quarter, was \$1 US = \$1.1203 CA. The exchange rate at July 31, 2006 was \$1 US = \$1.1309 CA representing a 1% appreciation of U.S. monetary assets for the quarter. The exchange rate at April 30, 2005 was \$1 US = \$1.2569 CA and at July 31, 2005 the rate was \$1 US = \$1.2259 CA representing a 2% depreciation of U.S. monetary assets in the first quarter of the last fiscal year.

During the first quarter of fiscal 2007, 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 \$1.0926. 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 2007 yielded an exchange loss of US \$69,000. A similar transaction for the hedging strategy in the first quarter of fiscal 2006 yielded an exchange gain of US \$43,000.

Subsequent to the current quarter ended July 31, 2006, the Company undertook another foreign exchange contract to sell \$2.0 million U.S. dollars forward at a rate of 1.1187 on October 31, 2006.

The consolidated financial statements for the three-month periods ended July 31, 2006 and July 31, 2005 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 a decrease in the cumulative translation adjustment (CTA) account within the shareholder's equity of \$110,000 for the first quarter of fiscal 2007 compared to an increase of \$341,000 for the first quarter of fiscal 2006. The increase or decrease to the CTA account represents exchange gains or losses arising on the translation of the Canadian dollar financial statements into U.S. dollar financial statements where such exchange gains or losses are posted directly into the shareholder's equity section rather than flowing through the statement of operations.

Net Earnings

The Company recorded a net loss of \$174,000 or \$0.01 per share in the first quarter of fiscal 2007 compared to net earnings of \$21,000 or \$0.00 per share for the same period last year.

Note 5 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, 2006 and 2005. However, under U.S. GAAP, the cumulative translation adjustment (CTA) is an integral part of arriving at the comprehensive income. The comprehensive loss for the first three months of fiscal 2007 under U.S. GAAP was \$281,000 compared to a comprehensive income of \$365,000 for the corresponding period in fiscal 2006.

Liquidity and Capital Resources

As of July 31, 2006, current assets totaled \$15 million compared to \$15.7 million at the end of fiscal 2006. Cash, restricted cash equivalents, and short-term and other investment securities decreased to \$5.5 million compared to \$6.9 million as at April 30, 2006. Accounts receivable totaled \$7.8 million at the end of July 31, 2006 compared to \$7.1 million as at April 30, 2006. The Company's DSO (days sales outstanding) increased to 89 days at the end the first quarter of fiscal 2007 in comparison to 87 days at the end of fiscal 2006 and 91 days at the end of the first quarter of fiscal 2006.

Current liabilities as at July 31, 2006 totaled \$8.2 million compared to \$8.7 million at the end of fiscal 2006. Working capital decreased to \$6.7 million at the end of the first quarter of fiscal 2007 compared to \$7.0 million at the end of fiscal year 2006.

During the first three months of fiscal 2007, operating activities used funds of \$1.3 million compared to \$512,000 for the same period last year. During the first quarter of fiscal 2007, unfavorable results in operating activities used \$38,000 and net non-cash working capital also used funds of \$1.3 million, represented primarily by the increase of accounts receivable and the decrease in deferred revenue. During the first quarter of fiscal 2006, positive results in operating activities generated \$330,000 and were offset by increases in net non-cash working capital using funds of \$842,000, represented primarily by the reduction of accounts payable and the increase of accounts receivable.

The Company believes that funds on hand at July 31, 2006, 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 \$72,000 and \$85,000 respectively for the first three months of fiscal 2007 and 2006. The repayment of long-term debt and capital lease obligations amounted to \$6,000 in the first quarter fiscal 2007 compared to \$5,000 for the comparable period in fiscal 2006. During the first quarter of fiscal 2007, the Company purchased 50,000 of its outstanding common shares for cancellation at an average price of CA \$1.44 (US \$1.29) per share under a Normal Course Issuer Bid (NCIB). The total cost related to the purchasing of these shares, including other related costs, was \$66,000. The excess of the net book value over the purchase price of the shares of \$74,000 has been credited to contributed surplus. As per note 2 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, 2007. In the first quarter of fiscal 2006, the Company purchased 65,500 shares at an average price of CA \$1.51 (US \$1.22) per share. The total cost related to the purchasing of these shares, including related costs, was \$80,000. The excess of the net book value over the purchase price of the shares of \$103,000 has been credited to contributed surplus.

During the first quarter of fiscal 2007, investing activities generated funds amounting to \$1.5 million as compared to \$632,000 for the comparable period of fiscal 2006. The Company generated funds of \$1.6 million and \$703,000 by decreasing short-term investments in the first quarter of fiscal 2007 and the first quarter of fiscal 2006 respectively. Funds of \$32,000 and \$71,000 were used for the first three months of fiscal 2007 and 2006 respectively for the acquisition of property, plant, and equipment, and computer software for internal use (intangible assets).

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, 2006.

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 perpetual licenses sold separately are recognized when a non-cancellable license agreement has been signed, the software product has been delivered, 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 perpetual licenses sold under multiple element arrangements are recognized upon shipment of the software product, provided that all of the above criteria have been met and subject to the following.

Certain of the Company's license agreements require the customer to renew its annual support agreement in order to maintain its right to continue to use the software. In such cases, the perpetual license is effectively transformed into a renewable annual license. An upfront license fee representing a significant and incremental premium over subsequent year renewal fees is deferred and recognized as revenue over the period in which support is expected to be provided, which is generally considered to be the estimated useful life of the software license. Where an upfront fee is not considered to represent a significant and incremental premium over subsequent year renewal fees, the license fee is recognized ratably over the initial contractual support period, which is generally one year.

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 percentage 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 percentage completed in excess of progress billings as of the balance sheet date. Any excess of progress billings over revenue based on the percentage completed is deferred and included in deferred revenue. Generally, the terms of long-term contracts provide for progress billings 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\$95,000) 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, 2006 and July 31, 2005.

Pursuant to the equity investments in TECSYS Latin America Inc (TLA) as described in note 9 of the annual report of fiscal year 2006, the Company has provided a loan in the amount of \$50,000 to TLA in July 2006. This amount is repayable over four years commencing six months following each advance. The loan bears interest of 5% per annum.

Management has compiled the unaudited interim consolidated financial information of TECSYS Inc. consisting of the interim Consolidated Balance Sheet as at July 31, 2006 and the Consolidated Statements of Deficit, Operations, and Cash Flows for the three-month period ended July 31, 2006 and July 31, 2005. 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, 2006 (unaudited)	April 30, 2006
Assets		
Current assets		
Cash and cash equivalents	1,355	1,180
Short-term and other investments	3,589	5,159
Accounts receivable	7,778	7,134
Other accounts receivable	99	88
Tax credits receivable	1,536	1,362
Inventory	134	147
Prepaid expenses	469	599
	<u>14,960</u>	<u>15,669</u>
Restricted cash equivalents and other investments	596	602
Long-term receivable	43	-
Property, plant and equipment, net	1,896	2,010
Intangible assets	1,784	1,945
Long-term investments	309	321
Goodwill	2,024	2,042
Deferred development costs	416	265
	<u>22,028</u>	<u>22,854</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	4,907	4,910
Current portion of long-term debt	515	527
Deferred revenue	2,811	3,247
	<u>8,233</u>	<u>8,684</u>
Other long-term liabilities	62	100
	<u>8,295</u>	<u>8,784</u>
Shareholders' Equity		
Capital stock (note 2)	38,115	38,256
Contributed surplus (notes 2 and 3)	7,257	7,169
Cumulative translation adjustment	2,975	3,085
Deficit	<u>(34,614)</u>	<u>(34,440)</u>
	<u>13,733</u>	<u>14,070</u>
	<u>22,028</u>	<u>22,854</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, 2006 (unaudited)	Three Months Ended July 31, 2005 (restated - note 1) (unaudited)
Balance - Beginning of period	(34,440)	(32,835)
Net earnings (loss) for the period	(174)	21
Balance - End of period	(34,614)	(32,814)

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, 2006 (unaudited)	Three Months Ended July 31, 2005 (restated - note 1) (unaudited)
Revenue		
Products (note 4a)	3,021	2,792
Services	4,525	4,854
Reimbursable expenses	278	155
	<u>7,824</u>	<u>7,801</u>
Cost of revenue		
Products	1,470	1,332
Services (note 4b)	2,964	3,025
Reimbursable expenses	278	155
	<u>4,712</u>	<u>4,512</u>
Gross margin	<u>3,112</u>	<u>3,289</u>
Operating expenses		
Sales & marketing	1,430	1,454
General & administration	724	639
Gross research & development	1,187	991
Research & development tax credits	(106)	(157)
Deferred development costs	(155)	-
Stock-based compensation	14	33
Amortization of property, plant and equipment	132	135
Amortization of intangible assets	142	135
	<u>3,368</u>	<u>3,230</u>
Earnings (loss) from operations	(256)	59
Interest income	77	47
Interest expense	(19)	(20)
Foreign exchange gains (losses)	34	(65)
Share of net earnings and amortization of intangible assets of a company subject to significant influence	(10)	-
Net earnings (loss) for the period	<u>(174)</u>	<u>21</u>
Weighted average number of common shares outstanding		
- basic	<u>13,628,423</u>	<u>13,883,449</u>
- diluted	<u>13,628,423</u>	<u>13,937,724</u>
Basic and diluted net earnings (loss) per common share (in US dollars)	<u>\$ (0.01)</u>	<u>\$ 0.00</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, 2006 (unaudited)	Three Months Ended July 31, 2005 (restated - note 1) (unaudited)
Cash flows from		
Operating activities		
Net earnings (loss) for the period	(174)	21
Adjustments for		
Amortization of property, plant and equipment	132	135
Amortization of intangible assets	142	135
Stock-based compensation	14	33
Unrealized foreign exchange losses (gains)	(8)	6
Deferred development costs	(154)	-
Share of net earnings and amortization of intangible assets of a company subject to significant influence	10	-
Changes in non-cash working capital items related to operations		
Increase in accounts receivable	(732)	(683)
Increase in other accounts receivable	(12)	(23)
Increase in tax credits receivable	(189)	(136)
Decrease in inventory	9	35
Decrease in prepaid expenses	127	98
Increase in long-term receivable	(43)	-
Decrease in accounts payable and accrued liabilities	(14)	(538)
Increase (decrease) in deferred revenue	(395)	405
	<u>(1,287)</u>	<u>(512)</u>
Financing activities		
Repayment of long-term debt and capital lease obligations	(6)	(5)
Purchase of common shares for cancellation	(66)	(80)
	<u>(72)</u>	<u>(85)</u>
Investing activities		
Decrease in short-term and other investments	1,574	703
Acquisitions of property, plant and equipment	(32)	(71)
	<u>1,542</u>	<u>632</u>
Effect of foreign exchange rate fluctuations on cash and cash equivalents	<u>(8)</u>	<u>(14)</u>
Change in cash and cash equivalents	175	21
Cash and cash equivalents - Beginning of Period	1,180	1,054
Cash and cash equivalents - End of Period	<u>1,355</u>	<u>1,075</u>

Interim financial information

The interim financial statements for the three-month periods ended July 31, 2006 and July 31, 2005 are unaudited and have not been reviewed by 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, 2006 and 2005 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, 2006. 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, 2006.

1. Restatement of Prior Years' Financial Statements

Historically, the Company generally recognized license revenues from perpetual software licenses sold under multiple element arrangements upon delivery of the software product. In the course of preparing the financial statements for the year ended April 30, 2006, it was determined that certain software license agreements signed during fiscal 2006 and prior years which included a contractual provision requiring the customers to renew annual support agreements in order to maintain the right to use the software, had not been accounted for appropriately. This provision has the effect of transforming a perpetual license into a renewable annual license. Under generally accepted accounting principles for software revenue recognition as specified in Statement of Position (SOP) 97-2, license revenues from such agreements should be deferred and recognized ratably over the initial support period.

Accordingly, the Company has restated the financial statements for the years ended April 30, 2005 and 2004 and the interim financial statements for the first three quarters of fiscal 2006. The restatement has no impact on cash flows from operating activities.

2. Capital stock

On July 17, 2006, 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 680,000 of its common shares, being approximately 5% of the 13,600,697 common shares outstanding as of July 5, 2006, but not more than 2% of such outstanding common shares 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, 2006 to July 18, 2007. The common shares will be purchased for cancellation.

During the three-month period ended July 31, 2006, the Company purchased 50,000 of its outstanding common shares at an average price of CA \$1.44 (US \$1.29) under the Normal Course Issuer Bid. The total cost related to the purchasing of these shares, including other related costs, was CA \$74,000 (US \$66,000). The excess of the net book value over the purchase price of these shares of CA \$133,000 (US \$74,000) has been credited to contributed surplus.

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 (US \$103,000) has been credited to contributed surplus.

The total number of common shares outstanding at July 31, 2006 is 13,600,697.

The following table summarizes the capital stock activity since April 30, 2005:

	Common shares	
	Number of shares	Amount
Balance - April 30, 2005	13,923,297	39,019
Repurchase of common shares	(272,600)	(763)
Balance - April 30, 2006	13,650,697	38,256
Repurchase of common shares	(50,000)	(141)
Balance - July 31, 2006	13,600,697	38,115

The following table summarizes the contributed surplus activity since April 30, 2005:

	Amount
Balance - April 30, 2005	6,624
Repurchase of 272,600 common shares - excess of net book value over the purchase price and related costs	414
Fiscal 2006 stock-based compensation	131
Balance - April 30, 2006	7,169
Repurchase of 50,000 common shares - excess of net book value over the purchase price and related costs	74
Current year's stock-based compensation for three months	14
Balance - July 31, 2006	7,257

As at July 31, 2006, options to purchase 843,426 common shares at exercise prices ranging between CA \$0.99 and CA \$2.65 and warrants to purchase 50,000 common shares at exercise prices ranging between CA \$1.64 and CA \$1.73 were outstanding. During the three months ended July 31, 2006, the Company granted options to purchase 3,000 common shares with exercise prices ranging from CA \$1.15 to CA \$1.65, while options to purchase 56,693 common shares at exercise prices ranging from CA \$1.50 to CA \$2.65 were either forfeited or expired. No warrants were issued during the period.

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, while options to purchase 16,466 common shares at exercise prices ranging from CA \$1.61 to CA \$5.92 were either forfeited or expired. No warrants were issued during the period.

No options or warrants to purchase common shares were exercised during the three-month periods ended July 31, 2006 or July 31, 2005.

3. Stock-based compensation costs

The Company maintains a stock-based compensation plan ("Option Plan"), which is described in note 13(d) in the audited financial statements for the year ended April 30, 2006. 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. No compensation cost is recognized for this plan when shares are issued to employees and directors upon the exercise of the options. 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. Forfeitures are accounted for as they occur, with any previously recognized compensation cost related to unvested options being reversed in the period of forfeiture.

The fair value of options and warrants granted in the three-month periods ended July 31, 2006 and July 31, 2005 was estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

	Three months ended July 31, 2006	Three months ended July 31, 2005
Volatility	51.7%	62.5%
Risk-free interest rate	4.3%	3.7%
Dividend yield	nil	nil
Expected lives (in years)	4	4

Following is a summary of the weighted average grant date fair value of options granted during the three-month periods ended July 31, 2006 and 2005:

	Three months ended July 31, 2006	Three months ended July 31, 2005
Number of options	3,000	27,000
Weighted average exercise price US \$	1.25	1.23
Weighted average grant date FV US \$	0.56	0.62

4. Other Information

a) Products revenue

Products revenue is broken down as follows:

	Three months ended July 31, 2006	Three months ended July 31, 2005 (restated— note 1)
Software products	1,130	1,001
Third-party hardware and software	1,891	1,791
	<u>3,021</u>	<u>2,792</u>

b) Cost of services consist of the following:

	Three months ended July 31, 2005	Three months ended July 31, 2005
Gross expenses	3,109	3,168
Refundable tax credits	(145)	(143)
	<u>2,964</u>	<u>3,025</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, 2006	Three months ended July 31, 2005
Weighted average number of shares - basic	13,628,423	13,883,449
Additions to reflect the impacts of:		
Exercise of employee stock options and warrants	-	54,275
Weighted average number of shares-diluted	<u>13,628,423</u>	<u>13,937,724</u>

Options and warrants to purchase 893,426 common shares for the three months ended July 31, 2006 (524,127 - three months ended July 31, 2005) 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.

5. 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, 2006	Three months ended July 31, 2005 (restated— note 1)
Net earnings (loss) for the period in accordance with Canadian GAAP	(174)	21
Amortization of in-process research & development relating to the ASI acquisition	3	3
Net earnings (loss) for the period in accordance with U.S. GAAP	(171)	24
Other comprehensive income (loss):		
Foreign currency translation adjustments	(110)	341
Comprehensive income	(281)	365

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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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