

# 3rd Quarter Fiscal 2006 Report

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

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Dear Shareholder,

I am pleased to report that the third quarter of Fiscal 2006 represented a significant milestone as we achieved the highest revenue in our history. The combination of organic and acquisition-related growth resulted in an 83% growth rate. We also invested in our strategic partner in Latin America positioning us favorably both in the region and with global clients. We made our first marketing initiative in Europe as we are continuing our drive for customer acquisition to further our penetration of the supply chain management software market. Allow me to run through some highlights with you.

## **Financial Highlights:**

- Revenue for the 3<sup>rd</sup> quarter increased by 83% to \$9.7 million compared to \$5.3 million for the same period in fiscal 2005. Product revenue increased by 178% to \$4.5 million and services revenue increased by 38% to \$4.9 million compared to the third quarter of last fiscal year.
- Earnings from operations for the quarter were \$221,000, after being positively impacted by the net reversal of restructuring charges of \$291,000, compared to \$112,000 for the same period in 2005. After accounting for the exchange loss and net interest income, net earnings for the quarter were \$5,000 or \$0.00 per share compared to \$180,000 or \$0.01 per share for the same period in last fiscal year.

## **Customer Acquisitions & Wins:**

- During the quarter new accounts won include: a major distributor for the world's leading manufacturer of construction, mining and agriculture equipment; an import-to-retail North American distributor; a national office products distributor in the U.S. and two other manufacturers/distributors.
- The Company also signed a significant number of product upgrades for all of its product lines and has successfully completed the deployment of its solutions in a number of accounts during the quarter.

On the business development front, and in addition to our on-going sales and marketing activities in North America, we have launched a marketing initiative in Europe starting with the United Kingdom. Initial indications are positive and we look forward to building our business and capitalizing on the opportunities in the European market.

Furthermore, import-to-retail is a growth area where we continue to see good potential and where we have unique expertise and technology. According to the U.S. International Trade Commission and the U.S. Department of Commerce, imports from China have more than doubled in the past five years, growing from US\$87.8 billion in 1999 to \$210.5 billion in 2004. This growth has made offshore manufacturing a significant driving factor in the expanding import-to-retail sector, increasing the need for unique expertise and software solutions, like those offered by TECSYS.

## **Other Key Achievements:**

During the quarter, we acquired 27% of TECSYS Latin America (TLA), making us the second largest shareholder of TLA. TLA, a long standing TECSYS partner since the mid nineties, is a privately held company and is the exclusive reseller of TECSYS' supply chain management software solutions for the region.

TLA's customers include known multinationals such as Diageo, Procter & Gamble, Cargill and Colgate Palmolive, as well as regional leaders in food, retail, auto parts and third party logistics. With over 110 customers and approximately 40 supply chain management experts, TLA is a solid extension of our team and provides us with the presence, expertise and market know-how in Latin America, strengthening our ability to win customers with global reach.

I am also pleased to report that at the end of the third quarter of fiscal 2006, our DSO (days sales outstanding) decreased to 76 days from 81 days at the end of the previous quarter of this fiscal year. Our cash position remains strong. After an investment of about half a million dollars in TECSYS Latin America and the Company's stock buy back during the quarter, cash increased to \$7.1 million compared to \$7.0 million at the end of the second quarter of this fiscal year.

Our business continues to be healthy. Our recurring revenue is substantial and our backlog at the end of the third quarter of fiscal 2006 was \$14.2 million compared to \$10.6 million at the end of the same quarter of last fiscal year.

We are pleased with the resurgence in the supply chain software market. TECSYS is well entrenched in the mid-market and its competitive position is solid in this space. Our technology, expertise and customer for life focus are the primary reasons customers choose us over the competition. We are well positioned for continued growth.

Our management team is making every effort to overcome the challenges presented by the continuing strengthening of the Canadian Dollar, and to improve margins and profitability. We look forward to your support as we continue our efforts to increase shareholders value.

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 February 22, 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 2005. The Company's third quarter for fiscal year 2006 ended on January 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 and nine-month periods ended January 31, 2006 and January 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.

### **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 Symplistech Inc. ("Symplistech"), a Canadian consulting practice specializing in the implementation of SAP solutions for manufacturing, warehousing, and distribution businesses. Symplistech 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 nine-month period ended January 31, 2006, LMG (formerly ASI and Symplistech) contributed \$8.8 million to revenues and \$157,000 to earnings from operations.

### **Results of Operations**

#### ***Three and nine months ended January 31, 2006 compared to three and nine months ended January 31, 2005***

#### **Revenue**

Total revenue for the three months ended January 31, 2006 increased by \$4.4 million or 83% to \$9.7 million compared to \$5.3 million for the same period of fiscal 2005. The increase in revenues is mainly attributable to the Company's latest acquisitions, ASI and Symplistech (LMG) accounting for \$3.3 million, while the remainder of the increase is due to the larger volume of third-party products sold by other business units amounting to \$845,000. One specific order from a customer accounted for \$547,000.

Products revenue increased by 178% or \$2.9 million to \$4.5 million in the third quarter of fiscal 2006 compared to \$1.6 million for the same period in the previous fiscal year. LMG accounted for \$1.9 million and the remainder of the increase is due to the increase of third-party products mentioned earlier, \$845,000, as well as increased proprietary licenses of \$138,000. Services revenue increased 38% or \$1.4 million to \$4.9 million during the third quarter of fiscal 2006 compared to \$3.6 million for the same fiscal period last year. The increase in services revenue is virtually entirely attributable to the addition of LMG accounting for \$1.3 million.

As a percentage of total revenue, products accounted for 47% and services accounted for 51% in the third quarter of fiscal 2006 compared to 31% and 67%, respectively, in the third 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 58% for products and 40% for services in the third quarter of fiscal 2006. Excluding LMG, in the third quarter, the product mix was influenced by the larger volume of third-party products sold and products accounted for 41% and services for 56%.

The Canadian dollar has strengthened approximately 4% against the U.S. dollar for the third 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 January 31, 2006 have averaged \$0.8573 US in comparison to \$0.8241 US for the same period last year. Consequently, excluding LMG, the strengthening Canadian dollar exchange rate has affected the reported revenues favorably by approximately \$106,000 in the third 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 \$77,000 and \$89,000 respectively, hence a net unfavorable impact of \$60,000 on the earnings from operations.

During the first nine months of fiscal 2006 total revenue increased by \$10.5 million or 65% to \$26.7 million compared to \$16.1 million for the same period of fiscal 2005. LMG's revenue contribution of \$8.8 million accounted for most of the increase and third-party products sold by the other business units accounted for another \$1.5 million.

Products revenue increased by 116% or \$6.0 million to \$11.3 million in the first nine months of fiscal 2006 compared to \$5.2 million for the same period in the previous fiscal year. LMG accounted for \$4.4 million of the increase while third-party products of the other business units increased by \$1.5 million in comparison to the first nine months of fiscal 2005. Services revenue increased 42% or \$4.4 million to \$14.8 million during the first nine months of fiscal 2006 compared to \$10.4 million for the same fiscal period last year. The increase in services revenue is virtually entirely attributable to the addition of LMG accounting for \$4.3 million.

As a percentage of total revenue, products accounted for 42% and services accounted for 56% in the first nine months of fiscal 2006 compared to 32% and 65%, respectively, in the first nine months 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 50% for products and 49% for services in the first nine months of fiscal 2006. Excluding LMG, in the first nine months of fiscal 2006, the product mix was influenced by the larger volume of third-party products as products accounted for 39% and services for 59%.

The Canadian dollar has strengthened approximately 7% against the U.S. dollar for the first nine months of fiscal 2006 as compared to the same period in fiscal 2005. The Canadian dollar to U.S. dollar exchange rates for the nine-month period ended January 31, 2006 have averaged \$0.8351 US in comparison to \$0.7796 US for the same period last year. Consequently, excluding LMG, the strengthening Canadian dollar exchange rate has affected the reported revenues favorably by approximately \$492,000 in the first nine months 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 \$381,000 and \$488,000 respectively. The exchange rate movement affected earnings from operations unfavorably to the tune of \$377,000.

## Cost of Revenue

The total cost of revenue increased 152% or \$3.7 million to \$6.2 million in the third quarter of fiscal 2006 compared to \$2.4 million for the same three-month period in fiscal 2005. The LMG acquisition accounted for \$2.5 million of the increase.

Services costs increased by \$1.6 million or 85% to \$3.4 million for the third quarter of fiscal 2006 compared to \$1.9 million for the comparable period of the previous fiscal year. The LMG acquisition accounts for \$1.2 million of this increase. Excluding LMG, gross services expenses increased by 20% or \$406,000 to \$2.4 million for the third quarter of fiscal 2006 compared to \$2.0 million for the previous fiscal year. Gross service expenses, excluding LMG, have been affected unfavorably by approximately \$81,000 due to the strengthened Canadian dollar and the expansion of the Company's operations in Europe. The total cost of services also includes multimedia tax credits of \$161,000 for the third quarter of fiscal 2006 compared to \$147,000 for the same period in the previous fiscal year.

The cost of products increased by \$2.0 million or 425% to \$2.5 million for the third quarter of fiscal 2006 in comparison to \$471,000 for the same three-month period for the previous fiscal year. LMG accounted for \$1.2 million of the increase. Excluding LMG, \$785,000 of the increase is related to the increased products revenue of \$983,000 realized in the third quarter.

The total cost of revenue increased 116% or \$8.7 million to \$16.2 million in the first nine months of fiscal 2006 compared to \$7.5 million for the same nine-month period in fiscal 2005. The LMG acquisition accounted for \$6.4 million of the increase.

Services costs increased by \$4.5 million or 84% to \$9.9 million for the first nine months of fiscal 2006 compared to \$5.4 million for the comparable period of the previous fiscal year. The LMG acquisition accounts for \$3.4 million of this increase. Excluding LMG, gross services expenses increased by 21% or \$1.2 million to \$7.0 million for the first nine months of fiscal 2006 compared to \$5.8 million for the previous fiscal year. Gross service expenses, excluding LMG, have mainly been affected unfavorably by approximately \$401,000 due to the strengthened Canadian dollar, the use of more outside consultants for \$208,000, and the expansion of the Company's operations in Europe for \$269,000. The total cost of services also includes multimedia tax credits of \$457,000 for the first nine months of fiscal 2006 compared to \$399,000 for the same period in the previous fiscal year.

The cost of products increased by \$4.1 million or 251% to \$5.7 million for the first nine months of fiscal 2006 in comparison to \$1.6 million for the same nine-month period for the previous fiscal year. LMG accounted for \$2.9 million of the increase. Excluding LMG, \$1.2 million of the increase is related to the increased products revenue of \$1.7 million.

## Gross Margin

Gross margin increased by \$690,000 or 24% to \$3.5 million for the third quarter of fiscal 2006 in comparison to \$2.9 million for the same fiscal period last year. LMG contributed \$850,000 to the increased gross margin. Total gross margin percentage in the third quarter of fiscal 2006 was 37% (42% excluding LMG) compared to 54% in the same period of fiscal 2005. The gross margin reduction of 12% on the existing business is mainly attributable to the strengthening Canadian dollar, the higher proportion of third-party products revenue within the revenue mix, and the expanded European operations. The reduction in the overall gross margin percentage is also largely influenced by the addition of LMG, which realized an overall gross margin of 26% in the third quarter.

Products margin was \$2.1 million or 46% of product revenues in the third quarter of fiscal 2006 compared to \$1.2 million or 71% of product revenues for the same three-month period last year. Excluding LMG, products margin was 52% in the third quarter of fiscal 2006. Excluding LMG, the reduction in product margin, in the third quarter, from 71% to 52% is attributable to the higher proportion of third-party products within the products revenue mix. The proportions for the product mix for products revenue have been inverted as the proprietary products accounted for 58% of the mix in the third quarter of fiscal 2005 whereas in fiscal 2006 the third-party products accounted for 58% of the product mix. Third-party products carry a much lower gross margin than proprietary products. LMG's products gross margin percentage was 37% 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 \$1.5 million or 30% of services revenues in the third quarter of fiscal 2006 compared to \$1.7 million or 48% of services revenues in the same period last year. Excluding LMG, the services gross margin decreased \$361,000 and represented 37% of the services revenue in the third quarter for fiscal 2006 compared to 48% 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 expansion of the European operations. LMG services gross margin was \$140,000 or 11% in the third 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, as well as using more outside consultants to provide consulting services for SAP implementations.

For the first nine months of fiscal 2006, the gross margin increased by \$1.8 million or 21% to \$10.4 million in comparison to \$8.6 million for the same fiscal period last year. LMG contributed \$2.4 million to the increased gross margin. Total gross margin percentage in the first nine months of fiscal 2006 was 39% (45% excluding LMG) compared to 53% in the same period of fiscal 2005. The gross margin reduction of 8% on the existing business is mainly attributable to the strengthening Canadian dollar, the higher proportion of third-party products revenue within the revenue mix, and the increased services expenses related to outside consultants and expanded European operations. The reduction in the overall gross margin percentage is also largely influenced by the addition of LMG, which realized an overall gross margin of 27% in the first nine months of the current fiscal year.

Products margin was \$5.5 million or 49% of product revenues in the first nine months of fiscal 2006 compared to \$3.6 million or 69% of product revenues for the same nine-month period last year. Excluding LMG, products margin was 58% in the first nine months of fiscal 2006. The reduction in product margin in the first nine months, excluding LMG, is largely attributable to higher volume of third-party products resulting in a higher percentage of the third-party component in the products revenue mix. LMG's products gross margin percentage was 34% 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 \$4.9 million or 33% of services revenues in the first nine months of fiscal 2006 compared to \$5.0 million or 48% of services revenues in the same period last year. Excluding LMG, the services gross margin decreased \$1.0 million and represented 38% of the services revenue in the first nine months for fiscal 2006 compared to 48% 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, the use of more outside consultants, and the expansion of the European operations. LMG services gross margin contributed \$930,000 to the overall gross margin and represented 22% of its service revenues in the first nine months 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, as well as using more outside consultants to provide consulting services for SAP implementation. Additionally, LMG does not benefit from the multi-media tax credits.

## Operating Expenses

Total operating expenses increased by \$581,000 or 21% to \$3.3 million in the third quarter of fiscal 2006 compared to \$2.7 million in the third quarter of fiscal 2005. LMG accounted for \$854,000 of the overall increase.

The most significant variances, excluding LMG, accounting for the \$273,000 decrease in operating expenses in the third quarter of fiscal 2006 compared to the same period last year are explained by the following transactions:

a) During the third quarter of fiscal 2003, the Company entered into a sub-lease agreement with a third party regarding one floor at one of its facilities. The Company's remaining lease obligations extended through April 30, 2010, while the sub-lease term expired on December 31, 2007. During the sub-lease, the sub-lessee had the option to renew the sublease for the remainder of the Company's contractual lease term, subject to the consent of the Company. Accordingly, during fiscal 2003, the Company had recorded a provision for restructuring costs, which represented the estimated excess of future contractual lease payments and operating expenses over the estimated future sub-lease revenues.

During the third quarter of the current fiscal year, the sub-lessee and the Company have entered into an agreement to extend the sub-lease for the period December 31, 2007 to April 30, 2010. Accordingly, the company has recorded a reduction of the provision and a recovery of the restructuring costs for CA \$423,000 (US \$366,000) due to more favorable terms of the extended sub-lease agreement in comparison to initial estimates for unrecovered costs.

b) During the quarter ended January 31, 2006, the Company deferred \$60,000 of new product development costs. Prior to the current quarter, qualifying product development costs were insignificant and no development costs were deferred.

c) During the third quarter of fiscal 2006, the Company recorded bad debt expense of \$54,000 in comparison to \$178,000 for the same period for the previous fiscal year resulting in a \$124,000 favorable variance. During the third quarter of fiscal 2005, the Company provided \$156,000 for a single customer that reneged on its commitment to pay overdue amounts.

d) During the third quarter of fiscal 2005, the Company received a unanimous favorable judgment from a panel of three judges at the Quebec Court of Appeal in connection with a lawsuit brought forth by one of the Company's landlords regarding the disputed allocation of common area space. Since inception of the dispute with the landlord, the Company had established accruals for the amounts claimed by the landlord. In consideration of the above, in the third quarter of fiscal 2005, the Company reversed the accumulated accruals of \$276,000, related to the dispute and reduced general and administrative expenses. This favorable variance in fiscal 2005 is obviously not repeated in fiscal 2006.

e) During the third quarter of fiscal 2006, the Company merged the Transportation Management Group (TMG) business unit within LMG. As both groups are focused on logistics, TMG was strategically restructured as a division of the LMG business unit to promote synergies and opportunities. The Company incurred \$75,000 of termination costs associated with this restructuring plan.

For the nine months ended January 31, 2006, operating expenses have increased \$1.8 million or 21% to \$10.1 million in comparison to the same period of the previous fiscal year. Excluding LMG, operating expenses decreased by \$500,000 or 6% as LMG operating expenses accounted for \$2.3 million.

The most significant variances, excluding LMG, accounting for the \$500,000 decrease in operating expenses include the following:

- a) \$275,000 of favorable sales & marketing variances due primarily to fewer resources and variable commission expense. Excluding LMG, sales & marketing resources have averaged 25 for the first nine months of fiscal 2006 in comparison to 31 for the same nine-month period last year.
- b) \$366,000 of favorable restructuring cost recoveries related to the extended sub-lease of one of the Company's facilities discussed earlier.
- c) \$191,000 of higher research and development tax credits for the first nine months of fiscal 2006 in comparison to the same period last year largely because amounts for prior years were conservatively under accrued by \$98,000.
- d) \$60,000 of deferred development costs in fiscal 2006 as discussed earlier.
- e) Other favorable variances include lower stock-based compensation and amortization expenses of \$84,000.
- f) \$276,000 of unfavorable variances in fiscal 2006 relating to the favorable legal judgment on disputed common area space realized in fiscal 2005 as discussed earlier.
- g) Higher R&D expenses for \$158,000 the first nine months of fiscal 2006 in comparison to the same period for fiscal 2005, which is entirely attributable to the impacts of the strengthening Canadian dollar.
- h) \$75,000 of termination costs associated with the restructuring of the TMG business unit within LMG.

## Other Income and Expenses

During the third quarter of fiscal 2006, the Company recorded an exchange loss of \$230,000 compared to an exchange gain of \$30,000 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 October 31, 2005, the beginning of the quarter, was \$1 US = \$1.1801 CA. The exchange rate at January 31, 2006 was \$1 US = \$1.1439 CA representing a 3.1% depreciation of U.S. monetary assets for the quarter. The exchange rate at October 31, 2004 was \$1 US = \$1.2207 CA and at January 31, 2005 the rate was \$1 US = \$1.2380 CA representing 1.4% appreciation of U.S. monetary assets in the third quarter of the last fiscal year.

Similarly, for the first nine months of fiscal 2006, the Company recorded an exchange loss of \$357,000 compared to an exchange loss of \$403,000 for the same period a year earlier. The U.S. dollar has been depreciated by CA 11.3 cents or 9.0% in the nine-month period ended January 31, 2006 compared to CA 13.27 cents or 9.7% depreciation for the nine-month period ended January 31, 2005. (The exchange rate at the beginning of the current fiscal year was 1 U.S. dollar, equivalent to CA \$1.2569 and dropped to CA \$1.1439 as at January 31, 2006 – the exchange rate at the beginning of fiscal 2005 was CA \$1.3707 and dropped to CA \$1.2380 as at January 31, 2005).

During the third 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 a rate of \$1.1706. The contract matured before the end of the quarter. There were no foreign exchange contracts outstanding at the end of the quarter. The hedging strategy in the third quarter of fiscal 2006 resulted in reducing the exchange loss for US \$46,000. The Company followed a similar strategy of selling U.S. dollars forward at the end of the third quarter of fiscal 2005 selling \$1.5 million U.S. dollars at an average rate of 1.2042. The hedging strategy in the third quarter of fiscal 2005 resulted in additional exchange losses for US \$41,000 in that quarter. For the first nine months of fiscal 2006, the hedging strategy has resulted in cumulative reduced exchange losses of \$140,000 in comparison to \$67,000 for the same period of fiscal 2005.

Subsequent to the current quarter ended January 31, 2006, the Company undertook another foreign exchange contract to sell \$2.0 million U.S. dollars forward at a rate of 1.1374 on April 28, 2006.

The consolidated financial statements for the three and nine-month periods ended January 31, 2006 and January 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 increases in the cumulative translation adjustment (CTA) account within the shareholder's equity of \$493,000 for the third quarter of fiscal 2006 (\$1.4 million for the first nine months of fiscal 2006) compared to decreases of \$198,000 for the third quarter of fiscal 2005 (\$1.4 million increases for the first nine months 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 \$5,000 or \$0.00 per share in the third quarter of fiscal 2006 compared to net earnings of \$180,000 or \$0.01 per share for the same period last year. For the nine months ended January 31, 2006, the Company recorded net earnings of \$64,000 or \$0.00 per share compared to net earnings of \$0 or \$0.00 per share for the same nine-month period in the previous fiscal year.

Note 7 to the consolidated financial statements reflects that there is only a very small difference of \$9,000 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 nine-month periods ended January 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 income for the first nine months of fiscal 2006 under U.S. GAAP was \$1.5 million compared to \$1.4 million for the corresponding period in fiscal 2005.

## Liquidity and Capital Resources

As of January 31, 2006, current assets totaled \$17.7 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 \$7.1 million compared to \$7.3 million as at April 30, 2005. Trade accounts receivable totaled \$8.2 million at the end of January 31, 2006 compared to \$7.0 million as at April 30, 2005. The Company's DSO (days sales outstanding) increased to 76 days at the end the third quarter of fiscal 2006 in comparison to 70 days at the end of fiscal 2005 and 78 days at the end of the third quarter of fiscal 2005.

Current liabilities as at January 31, 2006 totaled \$8.5 million compared to \$6.9 million at the end of fiscal 2005. Long-term debt representing a term loan for \$409,000 has been shifted to the current liabilities, as it is due in October 2006. Working capital increased to \$9.2 million at the end of the third quarter of fiscal 2006 compared to \$9.0 million at the end of fiscal year 2005.

During the first nine months of fiscal 2006, operating activities generated funds of \$289,000 compared to \$608,000 for the same period last year. During the first nine months of fiscal 2006, positive results in operating activities generated \$657,000 and were offset by increases in net non-cash working capital by \$368,000, represented primarily by the increase of accounts receivable and tax credits receivable and the increase of accounts payable and accrued liabilities. During the first nine months of fiscal 2005, operations generated \$900,000 and were offset by increases in net non-cash working capital by \$292,000, represented primarily by the reduction of accounts payable.

The Company believes that funds on hand at January 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 \$351,000 and \$381,000 respectively for the first nine months of fiscal 2006 and 2005. The repayment of long-term debt and capital lease obligations amounted to \$43,000 in the first nine months of fiscal 2006 compared to \$101,000 for the comparable period in fiscal 2005. During the first nine months of fiscal 2006, the Company purchased 242,300 of its outstanding common shares for cancellation at an average price of CA \$1.50 (US \$1.26) 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 \$366,000 (US \$308,000). The excess of the net book value over the purchase price of the shares of US \$371,000 has been credited to contributed surplus. During the previous fiscal year, for the nine-month period ended January 31, 2005, the Company purchased 225,000 of its outstanding common shares at an average price of CA \$1.50 (US \$1.22) under the Normal Course Issuer Bid. The total costs related to the purchase of these shares, including other related costs, was CA \$344,000 (US \$280,000). The excess of the net book value over the purchase price of these shares of US \$350,000 was 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.

During the first nine months of fiscal 2006, investing activities used funds amounting to \$988,000 as compared to generating \$12,000 for the comparable period of fiscal 2005. The Company used funds of \$336,000 and \$172,000 to increase short-term investments in the first nine months of fiscal 2006 and fiscal 2005, respectively. Funds of \$243,000 and \$184,000 were used for the first nine 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 nine months of fiscal 2006, the Company recorded an additional investment in LMG of \$33,000 representing acquisition costs. In the first quarter of fiscal 2005, the company received funds of \$368,000 representing the purchase price adjustment from former PointForce shareholders pursuant to the acquisition of PointForce.

On December 13, 2005, the Company acquired a 27.52% interest in TECSYS Latin America Inc. for a total consideration of US \$376,000, consisting of US \$336,000 in cash and acquisition costs, plus an estimated balance of US \$40,000 payable following the release of the TECSYS Latin America Inc. audited financial statements for the year ended April 30, 2006. The actual balance payable will be determined based on the audited financial results.

TECSYS Latin America Inc. markets, sells, implements and supports international software solutions in the areas of distribution, warehousing, logistics, and transportation. The company has operating offices in Venezuela, Chile and Colombia, has customers in ten countries in Latin America, and has been a licensed distributor of TECSYS products since 1995.

The investment in TECSYS Latin America Inc. is accounted for on the equity basis. Accordingly, the investment is presented at the acquisition cost, plus the proportional ownership share of the net earnings since acquisition including the amortization of intangible assets. Please refer to note 3 of the consolidated financial statement for a more in-depth discussion of this investment.

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\$94,000) 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 January 31, 2006 and January 31, 2005.

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Management has compiled the unaudited interim consolidated financial information of TECSYS Inc. consisting of the interim Consolidated Balance Sheet as at January 31, 2006 and the Consolidated Statements of Deficit, Operations, and Cash Flows for the three and nine-month periods ended January 31, 2006 and January 31, 2005. An accounting firm has not reviewed or audited these interim consolidated financial statements.

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## Consolidated Balance Sheets

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars)

	<b>January 31, 2006 (unaudited)</b>	<b>April 30, 2005</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	9	1,054
Short-term and other investments	6,497	5,435
Accounts receivable	8,178	7,000
Other accounts receivable	225	177
Tax credits receivable	2,063	1,241
Inventory	235	162
Prepaid expenses	528	749
	<u>17,735</u>	<u>15,818</u>
<b>Restricted cash equivalents and other investments</b>	589	815
<b>Property, plant and equipment, net</b>	2,022	2,044
<b>Intangible assets</b>	2,049	2,239
<b>Long-term investments ( note 3 )</b>	363	-
<b>Goodwill</b>	2,042	1,827
<b>Deferred development costs ( note 4 )</b>	60	-
	<u>24,860</u>	<u>22,743</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	5,929	4,890
Current portion of long-term debt	523	106
Deferred revenue	2,055	1,868
	<u>8,507</u>	<u>6,864</u>
<b>Long-term debt</b>	-	410
<b>Other long-term liabilities</b>	130	548
	<u>8,637</u>	<u>7,822</u>
<b>Shareholders' Equity</b>		
<b>Capital stock ( note 1 )</b>	38,340	39,019
<b>Contributed surplus ( notes 1 and 2 )</b>	7,100	6,624
<b>Cumulative translation adjustment</b>	2,934	1,493
<b>Deficit</b>	<u>(32,151)</u>	<u>(32,215)</u>
	<u>16,223</u>	<u>14,921</u>
	<u>24,860</u>	<u>22,743</u>

**Consolidated Statements of Deficit**

Prepared in Accordance with Canadian Generally Accepted Accounting Principles

(in thousands of U.S. dollars)

	<b>Nine Months Ended January 31, 2006 (unaudited)</b>	<b>Nine Months Ended January 31, 2005 (unaudited)</b>
<b>Balance - Beginning of period as originally stated</b>	(32,215)	(27,764)
Adjustment resulting from a change in accounting policy regarding stock-based compensation ( note 2 )	-	(4,785)
<b>Beginning balance as restated</b>	(32,215)	(32,549)
Net earnings for the period	64	-
<b>Balance - End of period</b>	(32,151)	(32,549)

## 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)

	<b>Three Months Ended January 31, 2006 (unaudited)</b>	<b>Three Months Ended January 31, 2005 (unaudited)</b>	<b>Nine Months Ended January 31, 2006 (unaudited)</b>	<b>Nine Months Ended January 31, 2005 (unaudited)</b>
<b>Revenue</b>				
Products ( note 5a )	4,543	1,632	11,259	5,223
Services	4,915	3,552	14,815	10,403
Reimbursable expenses	255	119	612	517
	<u>9,713</u>	<u>5,303</u>	<u>26,686</u>	<u>16,143</u>
<b>Cost of revenue</b>				
Products	2,471	471	5,738	1,635
Services ( note 5b )	3,439	1,855	9,889	5,369
Reimbursable expenses	255	119	612	517
	<u>6,165</u>	<u>2,445</u>	<u>16,239</u>	<u>7,521</u>
<b>Gross margin</b>	<u>3,548</u>	<u>2,858</u>	<u>10,447</u>	<u>8,622</u>
<b>Operating expenses</b>				
Sales & marketing	1,605	1,156	4,573	3,476
General & administration	708	445	2,186	1,511
Gross research & development	1,177	996	3,276	2,838
Research & development tax credits	(144)	(124)	(544)	(299)
Deferred development costs ( note 4 )	(60)	-	(60)	-
Stock-based compensation	36	42	105	155
Amortization of property, plant and equipment	151	150	427	420
Amortization of intangible assets	145	81	422	230
Restructuring charges ( note 6 )	(291)	-	(291)	-
	<u>3,327</u>	<u>2,746</u>	<u>10,094</u>	<u>8,331</u>
<b>Earnings from operations</b>	221	112	353	291
Interest income	44	50	129	141
Interest expense	(11)	(12)	(42)	(29)
Foreign exchange losses	(230)	30	(357)	(403)
Share of net loss of company subject to significant influence ( note 3 )	(19)	-	(19)	-
<b>Net earnings for the period</b>	<u>5</u>	<u>180</u>	<u>64</u>	<u>-</u>
<b>Weighted average number of common shares outstanding</b>				
- basic	<u>13,762,084</u>	<u>14,110,177</u>	<u>13,820,843</u>	<u>14,142,590</u>
- diluted	<u>13,802,597</u>	<u>14,153,445</u>	<u>13,868,272</u>	<u>14,226,766</u>
<b>Basic and diluted net earnings per common share ( in US dollars )</b>				
	<u>\$ 0.00</u>	<u>\$ 0.01</u>	<u>\$ 0.00</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)

	<b>Three Months Ended January 31, 2006 (unaudited)</b>	<b>Three Months Ended January 31, 2005 (unaudited)</b>	<b>Nine Months Ended January 31, 2006 (unaudited)</b>	<b>Nine Months Ended January 31, 2005 (unaudited)</b>
<b>Cash flows from</b>				
<b>Operating activities</b>				
Net earnings for the period	5	180	64	-
Adjustments for				
Amortization of property, plant and equipment	151	150	427	420
Amortization of intangible assets	145	81	422	230
Stock-based compensation	36	42	105	155
Unrealized foreign exchange losses	24	9	46	95
Restructuring charges	(366)	-	(366)	-
Deferred development costs	(60)	-	(60)	-
Share of net loss of company subject to significant influence	19	-	19	-
Changes in non-cash working capital items related to operations				
Decrease ( increase ) in accounts receivable	161	89	(341)	716
Decrease ( increase ) in other accounts receivable	(40)	7	(30)	157
Decrease ( increase ) in tax credits receivable	(313)	808	(675)	376
Increase in inventory	(140)	-	(57)	-
Decrease ( increase ) in prepaid expenses	135	(15)	279	77
Increase in long-term accounts receivable	-	(42)	-	(48)
Increase ( decrease ) in accounts payable and accrued liabilities	877	(556)	531	(1,173)
Decrease in deferred revenue	(102)	(219)	(75)	(397)
	<u>532</u>	<u>534</u>	<u>289</u>	<u>608</u>
<b>Financing activities</b>				
Repayment of long-term debt and capital lease obligations	(6)	(6)	(43)	(101)
Purchase of common shares for cancellation	(120)	(277)	(308)	(280)
	<u>(126)</u>	<u>(283)</u>	<u>(351)</u>	<u>(381)</u>
<b>Investing activities</b>				
Decrease ( increase ) in short-term and other investments	(792)	1,638	(336)	(172)
Acquisitions of property, plant and equipment	(89)	(75)	(214)	(168)
Acquisitions of intangible assets	(10)	(7)	(29)	(16)
Long-term investments	(376)	-	(376)	-
Business combinations and purchase price adjustment	-	-	(33)	368
	<u>(1,267)</u>	<u>1,556</u>	<u>(988)</u>	<u>12</u>
<b>Effect of foreign exchange rate fluctuations on cash and cash equivalents</b>				
	(6)	(21)	5	42
<b>Change in cash and cash equivalents</b>	(867)	1,786	(1,045)	281
<b>Cash and cash equivalents - Beginning of Period</b>	876	883	1,054	2,388
<b>Cash and cash equivalents - End of Period</b>	<u>9</u>	<u>2,669</u>	<u>9</u>	<u>2,669</u>

## Interim financial information

The interim financial statements for the three and nine-month periods ended January 31, 2006 and January 31, 2005 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 and nine-month periods ended January 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, 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

a) On July 14, 2005, the Company renewed its Notice of Intention to Make a Normal Course Issuer Bid (the "Notice") 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 nine-month period ended January 31, 2006, the Company purchased 242,300 of its outstanding common shares at an average price of CA \$1.50 (US \$1.26) under the Normal Course Issuer Bid. The total cost related to the purchasing of these shares, including other related costs, was CA \$366,000 (US \$308,000). The excess of the net book value over the purchase price of these shares of US \$371,000 has been credited to contributed surplus.

During the previous fiscal year, for the nine-month period ended January 31, 2005, the Company purchased 225,000 of its outstanding common shares at an average price of CA \$1.50 (US \$1.22) under the Normal Course Issuer Bid. The total costs related to the purchase of these shares, including other related costs, was CA \$344,000 (US \$280,000). The excess of the net book value over the purchase price of these shares of US \$350,000 was credited to contributed surplus.

The total number of common shares outstanding at January 31, 2006 is 13,680,997.

b) The following table summarizes the capital stock activity since April 30, 2004:

	<b>Common shares</b>	
	<b>Number of shares</b>	<b>Amount</b>
Balance - April 30, 2004	14,158,797	39,326
Repurchase of common shares	(235,500)	(660)
Change in accounting policy regarding prior years' stock-based compensation related to options exercised (note 2)	-	353
Balance - April 30, 2005	<u>13,923,297</u>	<u>39,019</u>
Repurchase of common shares	(242,300)	(679)
Balance - January 31, 2006	<u>13,680,997</u>	<u>38,340</u>

The following table summarizes the contributed surplus activity since April 30, 2004:

	<b>Amount</b>
Balance - April 30, 2004	1,606
Repurchase of 235,500 common shares - excess of net book value over the purchase price and related costs	365
Change in accounting policy regarding prior years' stock-based compensation (note 2)	4,785
Change in accounting policy regarding prior years' stock-based compensation related to options exercised (note 2)	(353)
Fiscal 2005 stock-based compensation	174
Fair value of warrants issued regarding ASI acquisition	20
Fair value of warrants issued regarding Symplictech acquisition	27
Balance - April 30, 2005	<u>6,624</u>
Repurchase of 242,300 common shares - excess of net book value over the purchase price and related costs	371
Current year's stock-based compensation for six months	105
Balance - January 31, 2006	<u>7,100</u>

c) As at January 31, 2006, options to purchase 896,838 common shares at exercise prices ranging between CA \$0.99 and CA \$2.65 and warrants to purchase 55,000 common shares at exercise prices ranging between CA \$1.64 and CA \$1.73 were outstanding. During the nine months ended January 31, 2006, the Company granted options to purchase 49,000 common shares with exercise prices ranging from CA \$1.50 to CA \$1.62 (during three-month period ended January 31, 2006, 4,000 options were granted with an exercise price of CA \$1.52). No warrants were issued during the period. During the previous fiscal year, for the nine-month period ended January 31, 2005, the Company granted options to purchase 13,000 common shares with exercise prices ranging from CA \$1.53 to CA \$1.76 (during the three-month period ended January 31, 2005, the Company granted options to purchase 9,000 common shares with exercise prices ranging from CA \$1.53 to CA \$1.60).

During the nine months ended January 31, 2006, options to purchase 162,082 common shares at exercise prices ranging from CA \$1.50 to CA \$5.92 and warrants to purchase 30,000 common shares with an exercise price of CA \$2.03 were forfeited or expired. During the nine-month period ended January 31, 2005, options to purchase 59,485 common shares at exercise prices ranging from CA \$0.99 to CA \$27.64 were either forfeited or expired.

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

## 2. Stock-based compensation and other stock-based payments

The Company maintains a stock-based compensation plan ("Option Plan"), which is described in note 11(d) in the audited financial statements for the year ended April 30, 2005. The Option Plan was amended on September 8, 2005 to increase the maximum number of common shares which may be issued under the Option Plan to 10% of the issued and outstanding common shares at any time (the "Evergreen Maximum"). The Option Plan will also be amended to add a reloading feature which will permit any common shares issued upon the partial or full exercise of an option to become automatically available to be made the subject of a new option, provided that the total number of common shares reserved for issuance under options does not exceed the Evergreen Maximum.

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.

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 and nine-month periods ended January 31, 2006 and January 31, 2005 was estimated using the Black-Scholes options pricing model with the following weighted average assumptions:

	<b>Three months ended January 31, 2006</b>	<b>Three months ended January 31, 2005</b>	<b>Nine months ended January 31, 2006</b>	<b>Nine months ended January 31, 2005</b>
Volatility	62.5%	75%	62.5%	75%
Risk-free interest rate	3.7%	3.00%	3.7%	3.00%
Dividend yield	nil	nil	nil	nil
Expected lives (in years)	4	3	4	3

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

	<b>Three months ended January 31, 2006</b>	<b>Three months ended January 31, 2005</b>	<b>Nine months ended January 31, 2006</b>	<b>Nine months ended January 31, 2005</b>
Number of options	4,000	9,000	49,000	13,000
Weighted avg. exercise price US \$	1.30	1.30	1.27	1.27
Weighted avg. grant date FV US \$	0.66	0.66	0.64	0.63

### 3. Long-term Investments

On December 13, 2005, the Company acquired a 27.52% interest in TECSYS Latin America Inc. for a total consideration of US \$376,000, consisting of US \$336,000 in cash and acquisition costs, plus an estimated balance of US \$40,000 payable following the release of the TECSYS Latin America Inc. audited financial statements for the year ended April 30, 2006. The amount payable relates to shares acquired from existing shareholders of TECSYS Latin America Inc. The balance payable will be determined on a defined valuation basis to be applied against the audited financial results for the year ended on April 30, 2006.

TECSYS Latin America Inc. markets, sells, implements and supports international software solutions in the areas of distribution, warehousing, logistics, and transportation. The company has operating offices in Venezuela, Chile and Colombia, has customers in ten countries in Latin America, and has been a licensed distributor of TECSYS products since 1995.

The Company has an option to acquire, in each of the three years ending April 30, 2006, 2007, and 2008, an additional 10% ownership up to a maximum total ownership of 45%. The cost of any additional shares acquired under this option will be determined based on the audited financial results of TECSYS Latin America Inc. The basis of valuation for the share pricing for these potential future purchases consists of a predetermined methodology to be applied on revenue achievement, profitability, debt and cash positions.

The Company has also committed to advance funds to TECSYS Latin America Inc. as loans for an aggregate maximum of US \$250,000. Loans under this commitment bear interest at 5% per annum and are repayable over four years commencing six months following each advance. There are no loans that have been advanced as at January 31, 2006.

Under the terms of the purchase agreement, the majority shareholder and creditor has the right to convert an existing loan of US \$200,000 to common shares. The exercise of this conversion right would result in a dilution of TECSYS investment from 27.52% to 22.96%.

The net assets of TECSYS Latin America Inc. at the date of the investment were as follows: (\$000's)

	<b>US\$</b>
Current assets	1,492
Intangible assets:	
Customer relationships	9
Distribution agreements	720
Property, plant and equipment	112
Other long-term assets	92
Total assets	<u>2,425</u>
Current liabilities	1,052
Debt	200
Total liabilities	<u>1,252</u>
Net identifiable assets	1,173
Goodwill	188
	<u>1,361</u>
Ownership share acquired 27.52%	<u>376</u>

The investment in TECSYS Latin America Inc. is accounted for on the equity basis. Accordingly, the investment is presented at the acquisition cost, plus the proportional ownership share of the net earnings since acquisition including the amortization of intangible assets. The amortization period of all the intangible assets is five years. The equity loss recorded to date is \$19,000.

#### 4. Deferred Development Costs

All costs related to development activities which do not meet generally accepted criteria for deferral and all costs related to research are expensed as incurred.

Development costs of new software products for sale or lease are charged to expense as incurred until generally accepted criteria for deferral are met as prescribed by the CICA Handbook section 3450.21, "Research and Development Costs". Once the deferral criteria has been met, additional qualifying software product development costs, net of government assistance, which have an anticipated future economic benefit are deferred and amortized against earnings over the estimated product life. Amortization commences when the product is available for general release and sale.

Deferred development costs are stated at the lower of cost less accumulated amortization. If it is determined that the unamortized deferred costs are not recoverable from future revenues less related costs, an impairment loss is recognized at that time in the amount of the excess of the carrying value over the net recoverable amount.

During the quarter ended January 31, 2006, the Company deferred \$60,000 of new product development costs. Prior to the current quarter, qualifying product development costs were insignificant and no development costs were deferred.

## 5. Other Information

### a) Products revenue

Products revenue is broken down as follows:

	Three months ended January 31, 2006	Three months ended January 31, 2005	Nine months ended January 31, 2006	Nine months ended January 31, 2005
Software products	1,333	946	3,649	2,997
Third-party hardware and software	3,210	686	7,610	2,226
	<u>4,543</u>	<u>1,632</u>	<u>11,259</u>	<u>5,223</u>

### b) Cost of services consist of the following:

	Three months ended January 31, 2006	Three months ended January 31, 2005	Nine months ended January 31, 2006	Nine months ended January 31, 2005
Gross expenses	3,600	2,002	10,346	5,768
Refundable tax credits	(161)	(147)	(457)	(399)
	<u>3,439</u>	<u>1,855</u>	<u>9,889</u>	<u>5,369</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 January 31, 2006	Three months ended January 31, 2005	Nine months ended January 31, 2006	Nine months ended January 31, 2005
Weighted average number of shares - basic	13,762,084	14,110,177	13,820,843	14,142,590
Additions to reflect the impacts of:				
Exercise of employee stock options and warrants	40,513	43,268	47,429	84,176
Weighted average number of shares-diluted	<u>13,802,597</u>	<u>14,153,445</u>	<u>13,868,272</u>	<u>14,226,766</u>

Options and warrants to purchase 637,138 common shares for the nine-month period ended January 31, 2006 (three-month period ended January 31, 2006 – 793,138, nine-month period ended January 31, 2005 – 339,137, three month period ended January 31, 2005 – 665,044) 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.

## 6. Restructuring Charge

a) During the third quarter of fiscal 2003, the Company entered into a sub-lease agreement with a third party regarding one floor at one of its facilities. The Company's remaining lease obligations to the lessor extended through April 30, 2010, while the sub-lease term expired on December 31, 2007.

During the sub-lease, the sub-lessee had the option to renew the sublease for the remainder of the Company's contractual lease term, subject to the consent of the Company. Accordingly, during fiscal 2003, the Company had recorded a provision for restructuring charges, which represented the estimated excess of future contractual lease payments and operating expenses over the estimated future sub-lease revenues.

During the third quarter of the current fiscal year, the sub-lessee and the Company have entered into an agreement to extend the sub-lease for the period December 31, 2007 to April 30, 2010. Accordingly, the company has recorded a reduction of the provision and a recovery of the restructuring charges in the amount of CA \$423,000 (US \$366,000) due to more favorable terms of the extended sub-lease agreement in comparison to initial estimates.

b) During the third quarter of fiscal 2006, the Company merged the Transportation Management Group (TMG) business unit within LMG. As both groups are focused on logistics, TMG was strategically restructured as a division of the LMG business unit to promote synergies and opportunities.

The Company incurred \$75,000 of termination costs associated with this restructuring plan.

## 7. 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:

### Statement of Operations

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

	<b>Three months ended January 31, 2006</b>	<b>Three months ended January 31, 2005</b>	<b>Nine months ended January 31, 2006</b>	<b>Nine months ended January 31, 2005</b>
Net earnings for the period in accordance with Canadian GAAP	5	180	64	-
Amortization of in-process research & development relating to the ASI acquisition	3	-	9	-
Net earnings for the period in accordance with U.S. GAAP	8	180	73	-
Other comprehensive income (loss):				
Foreign currency translation adjustments	493	(198)	1,441	1,424
Comprehensive income	501	(18)	1,514	1,424

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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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