

# REDKNEE

**REDKNEE SOLUTIONS INC.**  
***MANAGEMENT'S DISCUSSION AND ANALYSIS***  
**FOR THE QUARTER ENDED June 30, 2011**

**DATED: August 3, 2011**

**SCOPE OF ANALYSIS**

This Management's Discussion and Analysis (MD&A) covers the results of operations, financial condition and cash flows of Redknee Solutions Inc. (the "Company" or "Redknee") for the quarter ended June 30, 2011. This document is intended to assist the reader in better understanding operations and key financial results as they are, in our opinion, at the date of this report.

The MD&A has been prepared in accordance with National Instrument 51-102, Continuous Disclosure Requirements, and should be read in conjunction with the unaudited interim consolidated financial statements and accompanying notes for the quarter ended June 30, 2011. The unaudited interim consolidated financial statements are presented in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). The unaudited interim consolidated financial statements and the MD&A have been reviewed by Redknee's Audit Committee and approved by its Board of Directors. This MD&A should be read in conjunction with the audited consolidated financial statements of the Company for Q3 fiscal 2011, Q3 fiscal 2010 and the related notes.

In this document, "we", "us", "our", "Company" and "Redknee" all refer to Redknee Solutions Inc. collectively with its subsidiaries.

**ADDITIONAL INFORMATION**

Additional information relating to the Company including our most recently completed Annual Information Form ("AIF") is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's web-site at [www.redknee.com](http://www.redknee.com).

**FORWARD-LOOKING STATEMENTS**

Certain statements in this document may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this document, such statements use such words as "may", "will", "expect", "continue", "believe", "plan", "intend", "would", "could", "should", "anticipate" and other similar terminology. These statements reflect current assumptions and expectations regarding future events and operating performance and speak only as of the date of this document. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. A number of factors could cause actual results to vary significantly from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under the "Risk Factors" section of the Company's most recently filed AIF. Although the forward-looking statements contained in this document are based upon what we believe are reasonable assumptions, we cannot assure investors that our actual results will be consistent with these forward-looking statements. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances, except as required by securities law.

## OVERVIEW

Redknee Solutions Inc. commenced operations on March 29, 1999. Redknee is a leading provider of revenue generating software products, solutions and services to some of the largest network operators throughout the world, including wireless, wireline, broadband and satellite. Redknee delivers solutions in the areas of converged billing, interconnect billing, customer care, real-time rating, charging and policy management for voice, messaging and next generation data services to over 90 network operators in over 50 countries. The Company's software products allow its wireless telecommunications network operator customers to extend and enhance their capabilities and service offerings, enabling them to introduce new revenue through the introduction of network-based services, including call and subscriber management, multimedia messaging information services and location aware services. In addition, the Company's software products also manage and analyze, in real time, complex and critical network operations, such as service provisioning, network management and customer care, as well as provide real-time rating, charging and billing.

Redknee solutions enable operators to monetize the value of each transaction while personalizing the subscriber experience to meet mainstream and individual market segmentation requirements. The Company segments its operations in three main geographic areas namely:

1. APAC – Asia Pacific
2. Americas – North America, South America and Caribbean
3. EMEA – Europe, the Middle East and Africa.

Redknee's solutions help to create a better, more personal user experience for telecommunications subscribers all around the globe. Redknee provides software solutions that enable network operators to charge, price, deliver, and bill for all of the newest, cutting-edge communications services. Redknee's software products are packaged into the following solutions:

**Turnkey Converged Billing (TCB)**

A solution designed to deliver real-time rating, charging, billing and customer care to operators around the globe. The solution handles various types of network services and customer segments: wireless, wireline, satellite, WiMax, broadband, pre-paid, post-paid, data, voice, SMS and content. Enhanced with a comprehensive modular suite of real-time value transfer capabilities that focus on serving the financial and commerce requirements of mobile subscribers

**Next Generation Rating and Charging with Policy Manager**

NGRC is designed to provide operators with the means to charge for, and flexibly price and deliver, new data services such as mobile advertising, mobile TV, mobile music and mobile broadband. It also helps operators to reduce CAPEX and better control their network resources, while personalizing the subscriber experience.

**Customer Care**

A solution that provides an intuitive view of subscriber status and context – enabling customer care representatives to resolve problems quickly and efficiently.

**InBill**

A wholesale billing and content management solution.

On August 12, 2010, the Company acquired 100% of the common shares of Nimbus Systems, S.L. in Spain and NMB Lda in Portugal (collectively "Nimbus"). Established in 2001, Nimbus has been engaged in analysis, control and management solutions, with a particular focus on customer relationship management systems and billing, rating and partner relationship management.

### **SELECTED CONSOLIDATED FINANCIAL INFORMATION**

The following table sets out selected consolidated financial information of Redknee for the periods indicated. Each investor should read the following information in conjunction with those financial statements and related notes. The selected financial information for the three months ended June 30, 2011 and 2010 and for the nine months ended June 30, 2011, 2010 and 2009 have been prepared in accordance with Canadian GAAP. The operating results for any past period are not necessarily indicative of results for any future period. The selected financial information set out below has been derived from the consolidated financial statements.

Consolidated Statement of Operations (all amounts in thousands, except per share amounts) (unaudited)	Three Months Ended		Nine Months Ended		
	June 30		June 30		
	2011	2010	2011	2010	2009
<b>Revenue</b>					
Software, services and other	\$ 9,041	\$ 5,739	\$ 29,067	\$ 21,897	\$ 26,195
Support	5,690	4,893	16,427	13,981	16,252
	<b>14,731</b>	<b>10,632</b>	<b>45,494</b>	<b>35,878</b>	<b>42,447</b>
<b>Cost of revenue</b>	5,705	3,113	16,237	9,566	9,301
<b>Gross profit</b>	<b>9,025</b>	<b>7,519</b>	<b>29,257</b>	<b>26,312</b>	<b>33,146</b>
<b>Operating expenses</b>					
Selling and marketing	4,166	2,804	11,586	9,483	12,040
General and administrative	3,217	2,400	7,702	5,772	7,451
Research and development	3,586	2,811	10,185	8,185	9,592
Amortization of property, equipment and intangible	458	165	1,393	486	482
Foreign exchange loss (gain)	(261)	(504)	645	1,236	(909)
	<b>11,166</b>	<b>7,676</b>	<b>31,511</b>	<b>25,162</b>	<b>28,656</b>
<b>(loss) Income from operations</b>	<b>(2,141)</b>	<b>(157)</b>	<b>(2,254)</b>	<b>1,150</b>	<b>4,490</b>
Interest income	38	23	121	29	46
Interest expense	(174)	(4)	(451)	(21)	(15)
<b>(loss) Income before income taxes</b>	<b>(2,277)</b>	<b>(138)</b>	<b>(2,584)</b>	<b>1,158</b>	<b>4,521</b>
Income taxes	66	92	255	422	946
<b>(loss) Income for the period</b>	<b>\$ (2,343)</b>	<b>\$ (230)</b>	<b>\$ (2,839)</b>	<b>\$ 736</b>	<b>\$ 3,575</b>
<b>(loss) Income per Common Share</b>					
Basic	(0.04)	(0.00)	(0.04)	0.01	0.06
Diluted	(0.04)	(0.00)	(0.04)	0.01	0.06
<b>Weighted average number of common shares</b>					
Basic (thousands)	64,195	60,078	64,155	60,078	57,108
Diluted (thousands)	64,195	60,078	64,155	61,786	58,226

Balance Sheet Data \$Cdn Thousands (unaudited)	As at	As at
	June 30,	September 30,
	2011	2010
Cash, Restricted Cash, ST Investments and Cash		
Equivalents	14,049	19,573
Goodwill and Intangible Assets	12,655	13,529
Total Assets	57,250	58,837
Accounts Payable and Accrued Liabilities	6,860	6,327
Long-Term Debt and Other obligations	6,036	7,595
Shareholders' Equity	29,789	31,791

**CURRENT PERIOD OPERATING RESULTS****Revenue**

The following tables set forth the Company's revenues by type and as a percentage of total revenue for the periods indicated:

\$Cdn Thousands (unaudited)	Three Months Ended		Nine Months Ended	
	June 30		June 30	
	2011	2010	2011	2010
Software & Services	8,491	4,942	25,816	19,711
Support	5,690	4,893	16,427	13,981
Third Party Software & Hardware	550	797	3,251	2,186
<b>Total</b>	<b>14,731</b>	<b>10,632</b>	<b>45,494</b>	<b>35,878</b>

Percentage of Total Revenue (unaudited)	Three Months Ended		Nine Months Ended	
	June 30		June 30	
	2011	2010	2011	2010
Software & Services	58%	46%	57%	55%
Support	38%	46%	36%	39%
Third Party Software & Hardware	4%	8%	7%	6%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

The Company recognizes revenue from the sale of software licenses including initial licenses, capacity increases and/or upgrades; professional services; third party hardware and software components and customer support contracts. The majority of the Company's revenue is denominated in U.S. dollars and, as a result, revenues are impacted by exchange rate fluctuations. For the three-month period ended June 30, 2011, the Company's revenue increased by 39% to \$14.7 million from \$10.6 million in the third quarter of fiscal 2010. For the nine-month period ended June 30, 2011 revenue increased by 27% from \$35.9 million in fiscal 2010 to \$45.5 million in fiscal 2011.

The increase in revenue for the quarter noted above relates to the increase in both software and services revenue, and in support revenue. On a comparative constant dollar basis to account for foreign exchange fluctuations in their respective operating regions, the Company's revenue for the three-month period ended June 30, 2011 would have been \$15.0 million.

***Software and Services Revenue***

Software and services revenue consists of fees earned from the licensing and deployment of software products to our customers, as well as the revenues resulting from consulting and training services contracts related to the software products.

Software and services revenue for Q3 2011 increased by 72% to \$8.5 million, or 58% of total revenue, as compared to \$4.9 million, or 46% of total revenue, for the same period last year. For the nine-month period ended June 30, 2011, software and service revenue increased by 31% to \$25.8 million, or 57% of total revenue, compared to \$19.7 million, or 55% of total revenue, last year. This increase is primarily due to increased software and services sales in all regions, as well as the incremental contribution in revenue from Nimbus. On a comparative constant dollar basis, the Company's software and services revenue for the three-month period ended June 30, 2011, would have remained at \$8.5 million.

### ***Support and Subscription Revenue***

Support and subscription revenue consists of revenue from our customer support, subscription and maintenance contracts. These recurring revenue agreements allow customers to receive technical support and upgrades in the case of subscription agreements. Support revenue is generated from such agreements relative to current year sales and the renewal of existing agreements for software licenses sold in prior periods. Typically, support contracts commence for a period of one or more years upon completion of acceptance testing and then renew annually thereafter.

Support and subscription revenue for Q3 2011 grew by 16% to \$5.7 million, or 38% of total revenue, compared to \$4.9M, or 46% of total revenue, for the same period last year. This is primarily due to the addition of support revenue from contract renewals as well as the incremental support revenue from Nimbus, and offset by the appreciation of the Canadian dollar against other currencies. For the nine-month period ended June 30, 2011, support and subscription revenue increased by 17% to \$16.4 million, or 36% of total revenue, compared to \$14.0 million, or 39% of total revenue, last year. On a comparative constant dollar basis, the Company's support and subscription revenue for the three-month period ended June 30, 2011, would have been at \$5.9 million.

### ***Third Party Software and Hardware Revenue***

Third party software and hardware revenue consists of revenue from the sale of other vendor's hardware and software components as part of Redknee's solutions, including server platforms, database software and other ancillary components.

Third party software and hardware revenue for Q3 2011 decreased by 31% to \$0.6 million, or 4% of total revenue, compared to \$0.8 million, or 8% of total revenue, for the same period last year. For the nine-month period ended June 30, 2011, third party software and hardware revenue increased by 49% to \$3.3 million, or 7% of total revenue, compared to \$2.2 million, or 6% of total revenue, last year. This was due to increased initial deployment sales of turnkey converged billing solutions to new customers that contain third party components as well as the incremental revenue from Nimbus. On a comparative constant dollar basis, the Company's third party software and hardware revenue for the three-month period ended June 30, 2011, would have remained at \$0.6 million.

*Revenue by Geography*

Revenue is attributed to geographic location based on the location of the customer. The following tables set forth revenues by main geographic area and as a percentage of total revenue for the periods indicated:

\$Cdn Thousands (unaudited)	Three Months Ended		Nine Months Ended	
	June 30		June 30	
	2011	2010	2011	2010
Asia and Pacific Rim	2,738	1,646	11,094	9,012
North America, South America and Caribbean	4,957	3,682	14,279	11,307
Europe, the Middle East and Africa	7,036	5,304	20,120	15,559
<b>Total</b>	<b>14,731</b>	<b>10,632</b>	<b>45,494</b>	<b>35,878</b>

Percentage of Total Revenue (unaudited)	Three Months Ended		Nine Months Ended	
	June 30		March 31,	
	2011	2010	2011	2010
Asia and Pacific Rim	19%	15%	24%	25%
North America, South America and Caribbean	33%	35%	32%	32%
Europe, the Middle East and Africa	48%	50%	44%	43%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

For Q3 2011, revenue from the APAC region increased by 66% to \$2.7 million, or 19% of total revenue, compared to \$1.6 million, or 15% of total revenue, last year. The increase mostly relates to initial deployments with new customers in the region. For the nine-month period ended June 30, 2011, revenue from the APAC region increased by 27% to \$11.1 million, or 24% of total revenue, compared to \$9.0 million, or 25% of total revenue, last year.

For Q3 2011, revenue from the Americas region increased by 35% to \$5.0 million, or 33% of total revenue, compared to \$3.7 million or 35% of total revenue last year. The increase mostly relates to software upgrades and capacity increases with existing customers in the region. For the nine-month period ended June 30, 2011, revenue from the Americas region increased by 26% to \$14.3 million, or 32% of total revenue, compared to \$11.3 million, or 32% of total revenue, last year.

For Q3 2011, revenue from the EMEA region increased by 33% to \$7.0 million, or 48% of total revenue, compared to \$5.3 million, or 50% of total revenue last year. For the nine-month period ended June 30, 2011, revenue from the EMEA region increased by 29% to \$20.1 million, or 44% of total revenue, compared to \$15.6 million, or 43% of total revenue, last year. This increase is primarily due to the contribution in services and support revenue from Nimbus.

**Cost of Sales and Gross Margin**

Cost of sales consists of the expense of personnel providing professional services to implement and provide post sales technical support for our solutions, and the costs of third party hardware and software components sold as part of Redknee's solution. In addition, it includes an allocation of certain direct and indirect costs attributable to these activities.

For Q3 2011, cost of sales increased by \$2.6 million to \$5.7 million from the \$3.1 million incurred for the same period in 2010. For the nine-month period ended June 30, 2011, cost of sales increased by \$6.6 million to \$16.2 million from the \$9.6 million incurred in the same period last year. The increase is due to the increased costs of third party components recorded in the quarter, as well as the increased costs of services delivered in Q3 of fiscal 2011.

The gross margin for Q3 2011 was 61% as compared to 71% for the third quarter of fiscal 2010. For the nine-month period ended June 30, 2011, the gross margin was 64% as compared to 73% in the same period last year. The decrease in gross margin relates to the decreased margins in third party sales and in services revenues recorded in the quarter.

## Operating Expenses

Total operating expenses in Q3 2011 increased by 45% to \$11.2 million from \$7.7 million in Q3 2010, primarily due to the operating costs associated with Nimbus. Operating expenses, excluding amortization and foreign exchange loss (gain), decreased to 74% of revenue as compared to 75% for the same period last year. Included in the third quarter of fiscal year 2011 are one-time expense items of approximately \$1.4M relating to an allowance for doubtful accounts and the one-time charge for severance costs related to synergies achieved from the integration of the Nimbus acquisition. Excluding the one-time costs, total operating expenses were 67% of revenues in Q3 of fiscal 2011. For the nine-month period ended June 30, 2011, operating expenses excluding amortization and foreign exchange loss (gain) remained at 65% of revenue for the same period last year.

The following tables set forth total operating expenses by function and as a percentage of total revenue for the periods indicated:

\$Cdn Thousands (unaudited)	Three Months Ended		Nine Months Ended	
	June 30		June 30	
	2011	2010	2011	2010
Sales and Marketing	4,166	2,804	11,586	9,483
General and Administrative	3,217	2,400	7,702	5,772
Research and Development	3,586	2,811	10,185	8,185
Amortization	458	165	1,393	486
Foreign Exchange loss	(261)	(504)	645	1,236
<b>Total Operating Expenses</b>	<b>11,166</b>	<b>7,676</b>	<b>31,511</b>	<b>25,162</b>
<i>Excluding Amortization and FX</i>	<i>10,969</i>	<i>8,015</i>	<i>29,473</i>	<i>23,440</i>

Percentage of Total Revenue (unaudited)	Three Months Ended		Nine Months Ended	
	June 30		June 30	
	2011	2010	2011	2010
Sales and Marketing	28%	26%	25%	26%
General and Administrative	22%	23%	18%	16%
Research and Development	24%	26%	22%	23%
Amortization	4%	2%	3%	2%
Foreign Exchange loss	-2%	-5%	1%	3%
<b>Total Operating Expenses</b>	<b>76%</b>	<b>72%</b>	<b>69%</b>	<b>70%</b>
<i>Excluding Amortization and FX</i>	<i>74%</i>	<i>75%</i>	<i>65%</i>	<i>65%</i>

## Sales and Marketing Expenses

Sales and Marketing ("S&M") expenses consist primarily of salaries, variable compensation costs and other personnel costs, travel, advertising, marketing and conference costs plus the allocation of certain overhead costs to support the Company's sales and marketing activities.

For Q3 2011, S&M expenditures increased by \$1.4 million to \$4.2 million from \$2.8 million incurred for the same period last year mainly due the higher costs associated with achieving higher revenues,

including the addition of sales personnel. As a percentage of total revenue, S&M expenses increased from 26% to 28% between the two periods

For the nine-month period ended June 30, 2011, S&M expenditures increased by \$2.1 million to \$11.2 million from the \$9.5 million incurred for the same period in 2010. The increase in S&M expenses are mostly due to the higher costs associated with achieving higher revenues including the addition of sales personnel. As a percentage of total revenue, S&M expenses decreased from 26% to 25% between the two periods.

### ***General and Administrative Expenses***

General and administrative (“G&A”) expenses consist of the Company’s support activities such as finance, human resources, information technology, and professional costs associated with tax, accounting, and legal expenditures. Certain overhead costs such as facilities, communications and computer costs are allocated to G&A and the other departments on a per headcount basis.

For Q3 2011, general and administrative expenditures increased from \$2.4 million to \$3.2 million. As a percentage of total revenue, G&A expenses decreased from 23% to 22% between the two periods. Included in Q3 2011 G&A expenses are one-time expense items in the quarter of approximately \$1.3M relating to an allowance for doubtful accounts and severance costs, as well the increase in run-rate expenses stemming from the operation of Nimbus. Excluding one-time expenses, G&A expenses were 13% of revenues in Q3 of fiscal 2011.

For the nine-month period ended June 30, 2011, G&A expenditures increased by \$1.9 million to \$7.7 million, up from the \$5.8 million incurred for the same period in 2010. As a percentage of total revenue, G&A expenses increased from 16% to 18% between the two periods. The increase in G&A expenses are mostly due to the allowance for doubtful accounts, an increase in stock compensation expenses, an increase in expenses stemming from the Nimbus operation.

### ***Research and Development Expenses***

Research and development expenses consist primarily of personnel costs associated with product management and the development and testing of new products plus the allocation of certain overhead costs. Research and development expenses are reduced by investment tax credits recognized during the period.

For Q3 2011, R&D expenditures increased by \$0.8 million to \$3.6 million from the \$2.8 million incurred in the same period last year. The increase in R&D expenditures can be attributed to the additional expenses of the Nimbus operation. As a percentage of total revenue, R&D expenditures decreased to 24% for Q3 2011 vs. 26% for Q3 2010.

For the nine-month period ended June 30, 2011, R&D expenditures increased by \$2.0 million to \$10.2 million from the \$8.2 million incurred for the same period in 2010. The increase in R&D expenditures can be attributed to the additional expenses of the Nimbus operation. As a percentage of total revenue, R&D expenses decreased to 22% from 23% for the same period last year.

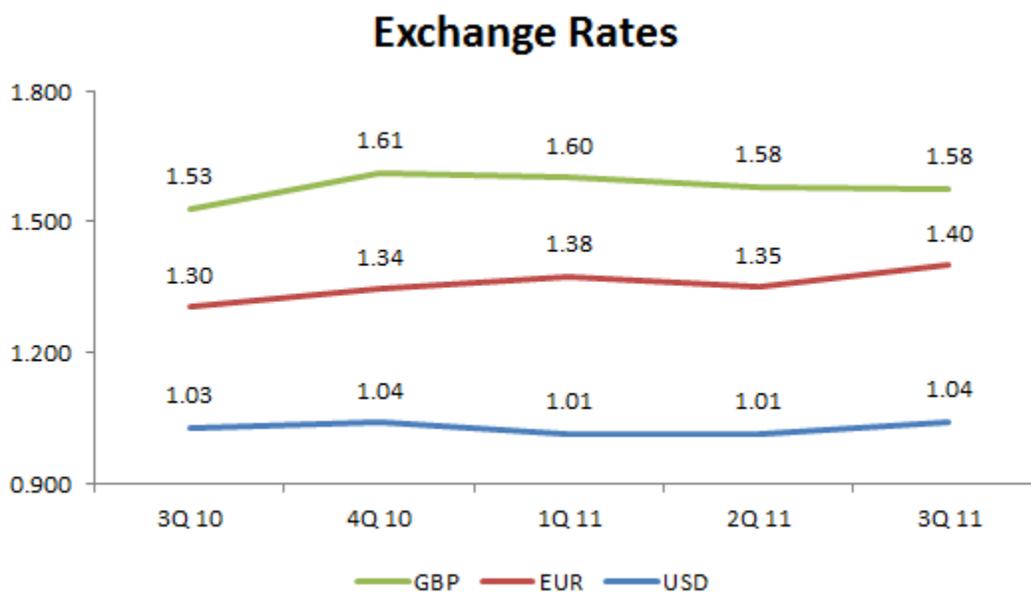
### *Amortization Expense*

Amortization for the third quarter ended June 30, 2011 increased to \$0.5 million as compared to \$0.2 million for the same period last year. Amortization for the nine months ended June 30, 2011 totaled \$1.4 million as compared to \$0.5 million for the same period last year. The increase relates to the amortization of intangible assets which arose from the acquisition of Nimbus.

### *Foreign Exchange Gain/Loss*

The Company conducts a significant portion of its business activities in foreign currencies including U.S. dollars, Euros and Pounds Sterling. The Company's objective in managing its foreign currency risk is to minimize its net exposures to foreign currency cash flows by converting foreign-denominated cash balances into Canadian dollars to the extent practical. The majority of the Company's revenues are denominated in U.S. dollars and, as a result, revenues are impacted by exchange rate fluctuations. An increase in the value of the Canadian dollar relative to the U.S. dollar will reduce the amount of revenue and margins in Canadian dollar terms reported by the Company from sales made in U.S. dollars. In addition, foreign currency net monetary assets/liabilities in fully integrated foreign operations cause a foreign exchange gain/loss on translation where the Canadian dollar changes against these currencies. An increase in the value of the Canadian dollar relative to the foreign currency will cause a foreign exchange loss when there are net monetary assets and a foreign exchange gain when there are net monetary liabilities.

The graph below displays the change in rates relative to the Canadian dollar.



Source: Bank of Canada

For the quarter ended June 30, 2011, the Company recognized a foreign currency exchange gain of \$0.3 million, as compared to a foreign currency exchange gain of \$0.5 million in the same period of

fiscal 2010. The gain in the third quarter of 2011 was primarily due to the Euro and Pound Sterling strengthening against the Canadian dollar.

For the nine month period ended June 30, 2011, the Company experienced a foreign exchange loss of \$0.6 million versus a foreign exchange loss of \$1.2 million recorded for the nine month period ended June 30, 2010. This is mainly due to significant fluctuation in the exchange rates between our principal currencies – US dollar, Pound Sterling and Euro with the Canadian dollar.

### **Interest Income and Interest Expense**

The interest expense of \$0.2 million recorded in Q3 2011 was mainly due to the Company's use of a credit facility available with Export Development Corporation ("EDC) for up to an aggregate principal amount of US\$10.0 million. During the fourth quarter of fiscal 2010, the Company borrowed against this credit facility such that the Nimbus acquisition could be completed. As at June 30, 2011, the amounts drawn totaled \$7.0 million (US\$7.3 million).

### **Stock-Based Compensation**

Stock options granted during the third quarter ended June 30, 2011 totaled nil (2010 – 305,000) with a weighted fair value of \$nil (2010 - \$1.08) at the dates the grants were issued to employees. For the nine month period ended June 30, 2011, stock options granted totaled 678,125 (2010 – 305,000) with a weighted fair value of \$0.93 (2010 – \$1.08) at the dates the grants were issued to employees. The fair value of the stock options was determined using a Black-Scholes option pricing model. The stock based compensation expense relating to the Company's stock options, deferred share unit plan and restricted shares under the restricted share plan during the third quarter of fiscal 2011 was \$0.2 million (2010 - \$0.1 million). The stock-based compensation expense relating to the Company's stock options, deferred share unit plan and restricted shares under the restricted share plan during the nine months ended June 30, 2011 was \$0.6 million (2010 - \$0.3 million).

### **Income Taxes**

The Company had income tax expense of \$0.1 million recorded in Q3 of fiscal 2011 similar to Q3 of fiscal 2010. As at September 30, 2010, the Company has approximately \$34.2 million of federal non-capital losses and scientific research and experimental development (SRED) pools for income tax purposes that will begin to expire in 2014, which are available to reduce future years' income for income tax purposes. In addition, the Company has approximately \$8.8 million and \$0.5 million of non-capital losses from foreign subsidiaries with an indefinite life and a three year life respectively. The utilization of these non-capital losses will reduce intangible assets. The Company has \$9.4 million of unrecorded income tax credits, which can be also used to reduce future federal income taxes. These credits have a life of ten to twenty years and will not begin to expire until 2024.

**SUMMARY OF RESULTS**

All financial results are in thousands, unless otherwise stated, with the exception of per share amounts. The table below provides summarized information for our eight most recently completed quarters:

<b>\$Cdn Thousands (unaudited)</b>	<b>3Q 11</b>	<b>2Q 11</b>	<b>1Q 11</b>	<b>4Q 10</b>	<b>3Q 10</b>	<b>2Q 10</b>	<b>1Q 10</b>	<b>4Q 09</b>
Revenue	\$14,731	\$16,635	\$14,128	\$12,992	\$10,632	\$13,466	\$11,780	\$10,803
Net Income (Loss)	\$(2,343)	\$ 408	\$(905)	\$359	\$(230)	\$401	\$564	\$(248)
Basic Income (Loss) per Share	(0.04)	0.01	(0.01)	0.01	0.00	0.01	0.01	0.00
Diluted Income (Loss) per Share	(0.04)	0.01	(0.01)	0.01	0.00	0.01	0.01	0.00
Weighted average shares outstanding – Basic	64,195	64,158	63,941	62,309	60,078	59,604	58,800	57,761
Weighted average shares outstanding - Diluted	64,195	65,800	63,941	64,608	60,078	61,739	60,923	57,761

In periods where net income was negative, options were considered to be anti-dilutive for the calculation of Basic Earnings per Share (BEPS) and Diluted Earnings per Share (DEPS).

**LIQUIDITY AND CAPITAL RESOURCES**

The Company's objective in managing capital is to ensure sufficient liquidity to pursue its organic growth, fund operations and undertake selective acquisitions, while at the same time taking a conservative approach toward financial leverage and management of financial risk. The Company currently funds its operations, changes in non-cash working capital and capital expenditures from internally generated cash flows and cash balances.

The table below outlines a summary of cash inflows and outflows by activity.

Statement of Cash Flows Summary (\$ Cdn Thousands) (Unaudited)	Three Months ended		Nine Months ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Cash inflows and (outflows) by activity:				
Operating activities	(4,106)	(324)	(3,961)	(6,475)
Investing activities	839	(73)	(229)	183
Financing activities	1,119	477	(1,089)	1,677
Effect of foreign currency exchange rate changes on cash and cash equivalents	176	(44)	(185)	(1,237)
Net cash inflows (outflows)	(1,971)	36	(5,464)	(5,851)
Cash and cash equivalents, beginning of period	15,246	19,776	18,739	25,663
Cash and cash equivalents, end of period	13,275	19,812	13,275	19,812

\*The Company uses Working Capital and Days Sales Outstanding in Accounts Receivable as measures to enhance comparisons between periods. The calculation of each of these items is more fully described below.

### Cash from Operating Activities

Cash used by operating activities was \$4.1 million in the three months ended June 30, 2011, as compared to a use of cash of \$0.3 million for the same period last year. This is mostly attributed to net loss of \$2.3 million and an increase in trade accounts and other receivables along with an increase in unbilled and decrease in deferred revenue.

Cash used by operating activities was \$4.0 million in the nine months ended June 30, 2011, as compared to a use of cash of \$6.5 million for the same period last year. This is mostly attributed to a net loss of \$2.8 million and an increase in trade accounts and other receivables along with an increase in unbilled revenue.

The Company's Days Sales Outstanding in Accounts Receivable ("DSO") remained at 89 days as of June 30, 2011 as compared to March 31, 2011, but is higher than the 82 days as at September 30, 2010. Redknee calculates DSO based on the annualized revenue and the trailing quarterly average accounts receivable balance.

Working capital represents the Company's current assets less its current liabilities. The Company's working capital balance decreased to \$21.3 million as at June 30, 2011 from \$24.4 million as at September 30, 2010. This decrease in Redknee's working capital level is mainly to the decrease in cash and cash equivalents of \$5.4 million, an increase in current loans payable of \$0.9 million partially offset by an increase in trade accounts and other receivables of \$1.0 million and an increase in unbilled revenue of \$3.0 million.

### Cash from Financing Activities

In the third quarter of fiscal 2011, cash provided by financing activities was \$1.1 million mainly due to proceeds from a short-term loan. For the nine months ended June 30, 2011, cash used by financing activities was \$1.1 million mainly due to loans paid for \$1.2 million partially offset by proceeds from the exercise of stock options of \$0.2 million.

### **Cash from Investing Activities**

Cash provided from investing activities during the quarter ended June 30, 2011 was \$0.8 million mainly due to a decrease in restricted. For the nine months ended June 30, 2011, cash used from investing activities was \$0.2 million mainly due to the additional costs capitalized for the acquisition of Nimbus.

### **Long Term Debt and Credit Facilities**

As at June 30, 2011, the Company has a credit facility with Export Development Canada for up to an aggregate principal amount of US\$10.0 million to assist in financing (i) one or more acquisitions and/or (ii) working capital requirements.

During the fourth quarter of 2010, the Company borrowed against this credit facility for the Nimbus acquisition. As at June 30, 2011, US\$7.3 million (CA\$7.0 million) remains outstanding and is repayable semi-annually over five years. Interest on the amount drawn is LIBOR plus 4% and is payable semi-annually after the first specified repayment date. Accounts receivable, chattel paper, documents of title, equipment, intangible assets, inventory and securities are pledged as security for the credit facility.

Certain non-financial covenants exist under the agreement, which, if interpreted to be violated by the lender, could result in the amounts borrowed being due and payable to the lender on demand. Management has determined that no covenants are in breach as of the reporting date.

As a result of the acquisition of Nimbus, the Company currently holds several secured bank loans, as of June 30, 2011, through its wholly owned subsidiary, Redknee Spain S.L. for a total of \$2.4 million.

### **Litigation**

The Company is involved in certain claims and litigation arising out of the ordinary course and conduct of business. Management assesses such claims and, if considered likely to result in a loss and, when the amount of the loss is quantifiable, provisions for loss are made, based on management's assessment of the most likely cause of outcome. Management does not provide for claims for which the outcome is not determinable or claims where the amount of the loss cannot be reasonably estimated. Any settlements or awards under such claims are provided for when reasonably determinable. The Company is not currently a party to, or has any of its property as the subject of, legal proceedings, which could be material to the Company's financial condition or results of operations.

### Acquisition of Nimbus

On August 12, 2010, the Company acquired 100% of the shares of Nimbus. The total purchase price, net of cash acquired, of \$13.0 million consists of cash paid on closing of \$8.1 million, 3,628,044 common shares issued, including 1,814,022 placed in escrow, valued at \$4.5 million and acquisition costs of \$0.8 million. The fair value of the common shares issued was determined to be \$1.37 per common share. The fair value reflects the Company's market value of their common shares on August 12, 2010. The common shares held in escrow, which are subject to the terms and conditions of an escrow agreement, reflect a 20% discount to the fair value referred to above. The discount takes into consideration the length of the escrow period and the inability to transact with these shares during this time. The purchase price also contains an earn-out provision, which outlines that the aggregate amount of up to €1.05 million will be paid by the Company to the sellers in cash if certain future criteria are met. The earn-out has not been accrued at either the date of purchase or the reporting date. Management has determined that the earn-out is non-compensatory in nature and will be accrued as part of the purchase equation once likelihood of payment can be reasonably determined.

The purchase price was allocated to the assets and liabilities acquired are as follows:

	<b>Final allocation \$</b>
Stocks/investments	63,950
Trade accounts and other receivables	4,122,736
Unbilled receivables	1,831,000
Prepaid expenses	102,341
Property and equipment	421,499
Future income taxes	134,208
Indebtedness	(1,939,473)
Accounts payable and accrued liabilities	(1,888,893)
Long term debt	(512,614)
Deferred revenue	(236,868)
Other Liabilities	(345,000)
Taxes payable	(124,685)
Future tax liabilities	(1,491,159)
	<u>137,042</u>
Intangible assets	
Customer relationships	2,841,649
Technology	1,326,192
Backlog	802,690
Goodwill	<u>7,935,373</u>
	<u>12,905,904</u>
<b>Total purchase consideration, net of cash acquired</b>	<b><u>13,042,946</u></b>

The customer relationships and technology arising from this acquisition will be amortized into earnings over their estimated useful life of 10 years. The backlog will be amortized over its estimated useful life of one year.

### Goodwill

The changes in the carrying amount of goodwill during the period are as follows:

	<b>Balance September 30, 2010</b>	<b>Additions</b>	<b>Balance June 30, 2011</b>
Goodwill	\$7,668,157	267,216	\$7,935,373

The additional \$267,216 recorded in the period relates to acquisition costs of \$147,216 and \$120,000 in future tax liabilities.

### COMMITMENTS AND CONTRACTUAL OBLIGATIONS

As at June 30, 2011, the Company has a credit facility with Export Development Canada for up to an aggregate principal amount of US\$10.0 million to assist in financing (i) one or more acquisitions and/or (ii) working capital requirements. As at June 30, 2011, US\$7.3 million (CA\$7.0 million) remains outstanding and is repayable semi-annually over five years. Interest on this facility is LIBOR plus 4% and is payable semi-annually after the first specified repayment date. Accounts receivable, chattel paper, documents of title, equipment, intangible assets, inventory and securities are pledged as security for the credit facility.

Certain non-financial covenants exist under the agreement, which, if interpreted to be violated by the lender, could result in the amounts borrowed being due and payable to the lender on demand. Management has determined that no covenants are in breach as of the reporting date.

The Nimbus purchase agreement contains an earn-out provision, which outlines that an aggregate amount of up to €1,050,000 will be paid by the Company to the sellers in cash if certain future criteria are met.

The Company has no other significant commercial commitments or obligations other than for the leases of the facilities it currently occupies, the latest of which expires in fiscal 2017, and operating leases for office and computer equipment.

### MANAGEMENT OF CAPITAL

The Company's objective in managing capital is to ensure sufficient liquidity to pursue its growth strategy, fund research and development and undertake selective acquisitions, while at the same time taking a conservative approach toward financial leverage and management of financial risk. The Company's capital is composed of share capital and credit used plus credit available under certain credit facilities which assist in financing (a) acquisitions and/or (b) provide working capital requirements. The Company's primary uses of capital are to finance its operations, increases in non-

cash working capital, capital expenditures, debt repayments, and acquisitions. The Company currently funds these requirements from cash flows from operations, cash raised through past share issuances, and lines available under certain credit facilities. The Company's objectives when managing capital are to ensure that the Company will continue to have enough liquidity so it can provide services to its customers and returns to its shareholders. Management monitors its compliance of covenants imposed by loan agreements on a recurring basis. The Company has complied with all externally imposed capital requirements.

## **DISCLOSURE CONTROLS AND PROCEDURES**

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), the design and effectiveness of the Company's disclosure controls and procedures as at the three month period ended June 30, 2011. Management has concluded that these disclosure controls and procedures, as defined in National Instrument 52-109 - Certification of Disclosure in Issuers' Annual and Interim Filings ("NI 52-109"), are adequate and effective and that material information relating to the Company was made known to them and was recorded, processed, summarized and reported within the time periods specified under applicable securities legislation.

Our management, under the supervision and with the participation of our CEO and CFO, has designed and evaluated the effectiveness of the Company's internal controls over financial reporting ("ICFR") to provide reasonable assurance that our financial reporting is reliable and that our consolidated financial statements were prepared in accordance with GAAP. Management has concluded that ICFR, as defined in NI 52-109 and using the Committee of Sponsoring Organization of the Treadway Commission ("COSO") Framework are effective as at the quarter ended June 30, 2011.

Under the supervision of and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the internal controls over financial reporting as at June 30, 2011 and have concluded that those internal controls were effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian generally accepted accounting principles.

## **ACCOUNTING CHANGES AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In October 2008, the CICA issued Section 1582, Business Combinations ("Section 1582"), concurrently with Sections 1601, Consolidated Financial Statements ("Section 1601"), and 1602, Non-controlling Interests ("Section 1602"). Section 1582, which replaces Section 1581, Business Combinations, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. Section 1601, which replaces Section 1600, carries forward the existing guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition other than non-controlling interests. Section 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards are effective for the Company's interim and annual periods commencing January 1, 2011 with earlier adoption permitted as at the beginning of a fiscal year. We are currently assessing the impact of the new standards on our consolidated financial statements.

In December 2009, the Emerging Issues Committee Abstract of the CICA issued EIC 175, Multiple Deliverable Revenue Arrangements, replacing EIC 142, Revenue Arrangements with Multiple Deliverables, addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue generating activities. This new standard is effective for the Company's interim and annual consolidated financial statements commencing on January 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Company is assessing the impact of the new standard on its consolidated financial statements.

### **INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)**

The Canadian Accounting Standards Board has confirmed that International Financial Reporting Standards ("IFRS") will replace current Canadian GAAP for publicly accountable enterprises, including Redknee, effective for fiscal years beginning on or after January 1, 2011.

Accordingly, we will report interim and annual financial statements in accordance with IFRS beginning with the quarter ended December 31, 2011. Our fiscal 2012 interim and annual financial statements will include comparative fiscal 2011 financial statements, adjusted to comply with IFRS.

Redknee has developed a comprehensive IFRS transition plan, established an implementation team and engaged a third party adviser to assist with preparation for this transition.

To date, the transition team has completed the identification of the key areas where changes to current accounting policies may be required and is currently preparing detailed analyses of IFRS requirements for these key areas. These analyses include a detailed assessment of the alternatives or requirements for changes to our current accounting policies.

The table below summarizes progress to date on the transition plan and the expected timing of future activities.

Identification of key areas for which changes to accounting policies may be required	Complete
Detailed analysis of all relevant IFRS requirements and identification of areas requiring accounting policy changes or those with accounting policy alternatives.	Complete
Assessment of first-time adoption (IFRS 1) requirements and alternatives.	Complete
Final determination of expected changes to accounting policies and choices to be made with respect to first-time adoption alternatives.	Q4 fiscal 2011
Resolution of the expected accounting policy change implications on information technology, internal controls and contractual arrangements.	Q4 fiscal 2011
Management and employee education and training	Throughout the transition process
Quantification of the expected financial statement impact of changes in accounting policies	Q4 fiscal 2011
Preparation of pro forma Q1 fiscal 2012 financial statements consistent with IFRS presentation and disclosure requirements	Q4 fiscal 2011 – Q1 fiscal 2012

### ***Impact of Adopting IFRS on the Organization***

As the transition progresses, the Board of Directors and Audit Committee are being regularly updated on the progress of the IFRS implementation plan, and provided with information regarding the potential for changes to significant accounting policies. As part of the implementation plan, our employees that are involved in the preparation of financial statements are receiving training on the relevant aspects of IFRS and the potential for changes to accounting policies.

As part of its analysis of potential changes to significant accounting policies, the implementation team is assessing what changes may be required to its accounting systems and business processes. To date, changes to systems and process that have been identified are minimal and the Company believes the systems and processes can accommodate the necessary changes.

The team is also assessing whether any contractual arrangements may be impacted by potential changes to accounting policies.

### ***Impact of Adopting IFRS on Internal Controls over Financial Reporting***

Any changes to accounting policies or business processes have the potential to affect Redknee's internal controls over financial reporting ("ICFR"). As part of its analysis of potential changes to accounting policies, the implementation team is assessing whether changes to ICFR are required. Based on the analysis performed to date, the Company does not currently expect the adoption to IFRS to have a significant impact on ICFR.

The company has augmented certain existing controls and procedures to include the ongoing activities of the IFRS transition plan.

### ***Impact of Adopting IFRS on Redknee's Financial Statements***

The adoption of IFRS may result in changes to significant accounting policies and have an impact on the recognition and measurement of transactions and balances within Redknee's financial statements.

Although Redknee has not yet determined the full effects of adopting IFRS on its financial statements, included below are highlights of the areas that have been identified as having the most potential for a change to significant accounting policies. The list is not intended to be a complete list of areas where the adoption of IFRS will require a change in accounting policies, but to highlight the areas identified to have the most potential for significant changes.

As the IFRS implementation plan continues, the Company will make a final determination of changes to its accounting policies that will result from adopting IFRS, and may identify other changes that will have an impact on the financial statements.

### **Revenue Recognition**

IFRS contains significantly less specific guidance with respect to revenue recognition, particularly with respect to the criteria to separate multiple element arrangements and the allocation of revenue to the separated elements. Resulting changes in accounting policy may have an impact on the timing of revenue recognition.

### **Foreign Currencies**

IFRS requires that the functional currency of the company and its subsidiaries be determined separately, and the process of considering factors to determine functional currency are somewhat different than current Canadian GAAP. It is possible that a change in the functional currency of the Company and one or more its subsidiaries would be required on adoption of IFRS. The Company has not finalized this assessment or determined whether retrospective application of any change would have a significant effect on the financial statements.

## Impairment of Assets

IFRS requires a write down of assets if the higher of the fair market value and the value in use of a group of assets is less than its carrying value. Value in use is determined using discounted estimated future cash flows. Current Canadian GAAP requires a write down to estimated fair value only if the undiscounted estimated future cash flows of a group of assets are less than its carrying value. In addition, the grouping of assets for the purposes of impairment may be different under IFRS than currently used under Canadian GAAP. Depending on the circumstances, this may lead to the recognition of impairment losses under IFRS that would not otherwise have been recognized under current Canadian GAAP.

Goodwill is tested annually for impairment under both Canadian GAAP and IFRS. However, there are differences in the methods used to determine whether an impairment loss should be recognized, and the measurement of the impairment loss (if any). Under Canadian GAAP, goodwill is first tested for impairment by comparing the carrying amount of the goodwill and associated assets to their fair value. If the carrying amount of the goodwill and associated assets exceeds their fair value, an impairment loss is calculated by comparing the carrying amount of the goodwill to the implied fair value of the goodwill. Goodwill is tested for impairment under IFRS by comparing the carrying amount of the goodwill and associated assets to their recoverable amount (defined as the higher of the fair value less costs to sell and the value in use). Value in use is determined using discounted estimated future cash flows. The Company is in the process of determining whether these differences will have an impact on the carrying amounts of goodwill and associated assets in its opening IFRS balance sheet.

## Share-based Payments

In certain circumstances, IFRS requires a different measurement of share-based compensation than current Canadian GAAP. In particular, a change may be required to the measurement and timing of recognizing the expense associated with grants under the stock option plan. The Company is determining the impact of the change on the measurement of compensation expense associated with the stock option plan.

## Provisions

In certain circumstances, IFRS guidance with respect to the recognition and measurement of liabilities differs from current Canadian GAAP. Changes in accounting policies on adoption of IFRS may result in the recognition of additional liabilities, or a different measurement of the liabilities currently recognized under current Canadian GAAP.

## Income Taxes

While accounting for income taxes is similar under IFRS and Canadian GAAP, in certain circumstances there are differences in the measurement of future tax assets and future tax liabilities. The Company is determining whether any changes in its accounting policies related to income taxes will have a significant effect on its financial statements.

As the IFRS implementation plan continues, the Company will make a final determination of changes to its accounting policies that will result from adopting IFRS, and may identify other changes that will have an impact on the financial statements.

### *First-time adoption of IFRS*

The adoption of IFRS requires the application of IFRS 1 *First-time Adoption of International Financial Reporting Standards* ("IFRS 1"), which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires retrospective application of IFRS as effective at the end of its first annual IFRS reporting period. However, IFRS 1 also provides certain optional exemptions and mandatory exceptions to this retrospective treatment.

We are considering the possibility of electing the following IFRS optional exemptions in our preparation of an opening IFRS statement of financial position as at October 1, 2010, our "Transition Date":

- To apply IFRS 2 *Share-based Payments* only to equity instruments that were issued after November 7, 2002 and had not vested by the Transition Date.
- To apply IFRS 3 *Business Combinations* prospectively from the Transition Date, therefore not restating business combinations that took place prior to the Transition Date.
- To deem the cumulative translation differences for all foreign operations to be zero at the Transition Date.
- To apply IAS 23 *Borrowing Costs* prospectively from the Transition Date. IAS 23 requires the capitalization of borrowing costs directly attributable to the acquisition, production or construction of certain assets.
- To not reassess whether arrangements contain a lease under IFRS where the same determination that would be made under IFRIC 4 *Determining whether an Arrangement Contains a Lease* (IFRIC 4) was made previously in accordance with Canadian GAAP.
- To apply the transitional provisions of IFRIC 4 to leases which the same determination as IFRIC 4 was not made previously in accordance with Canadian GAAP. Therefore, the determination of whether these arrangements contain a lease is based on the circumstances existing at the Transition Date.

As the analyses of accounting policies under IFRS continues, the Company may decide to elect to apply these, or other, optional exemptions contained in IFRS 1.

IFRS 1 does not permit changes to estimates that have been made previously. Accordingly, estimates used in the preparation of the opening IFRS statement of financial position as at the Transition Date will be consistent with those made under current Canadian GAAP. If necessary, estimates will be adjusted to reflect any difference in accounting policy.

### *Subsequent Disclosures*

The information above is provided to allow investors and others to obtain a better understanding of our IFRS changeover plan and the resulting possible effects on, for example, our financial statements and operating performance measures. Readers are cautioned, however, that it may not be appropriate to use such information for any other purpose. This information also reflects our most recent assumptions and expectations; circumstances may arise, such as changes in IFRS, regulations or economic conditions, which could change these assumptions or expectations.

Further disclosures of the IFRS Transition process are expected as follows:

- The Company's future interim and annual MD&A for fiscal 2011 will include updates on the progress of the transition plan, and, to the extent known, information regarding the impact of adopting IFRS on key line items in the annual financial statements.
- The Company's first financial statements prepared in accordance with IFRS will be the interim financial statements for the three months ending December 31, 2011, which will include notes disclosing transitional information and disclosure of new accounting policies under IFRS. The interim financial statements for the three months ending December 31, 2011 will also include fiscal 2011 financial statements for the comparative period, adjusted to comply with IFRS, and the Company's transition date IFRS statement of financial position (as at October 1, 2010).

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

### *Revenue Recognition*

#### **General**

The Company's revenue is derived primarily from licensing of software products under non-cancellable licence agreements, the provision of related professional services (including installation, integration and training) and post-contract customer support (PCS). In certain cases, the Company also provides customers with hardware in conjunction with its software offerings.

The Company recognizes revenue in accordance with Canadian GAAP. Revenue is not recognized unless persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collectability is reasonably assured.

## Multiple element arrangements

The Company enters into multiple element revenue arrangements, which may include any combination of software, service, support and/or hardware.

A multiple element arrangement is separated into more than one unit of accounting if all of the following criteria are met:

- i) reliable and objective evidence of fair value exists for all undelivered elements (for software related deliverables, fair value is established through vendor-specific objective evidence (VSOE));
- ii) undelivered elements are not considered essential to the functionality of delivered elements;
- iii) the delivered elements have stand-alone value to the customers;
- iv) delivery or performance of the undelivered elements is considered probable and substantially in the control of the Company; and
- v) fees related to delivered elements are not subject to refund, forfeiture or other concession if undelivered elements are not delivered.

If these criteria are not met, the arrangement is accounted for as one unit of accounting, which would result in revenue being deferred until the earlier of when such criteria are met or when the last undelivered element is delivered.

If these criteria are met for each element and there is objective and reliable evidence of fair value for all units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting, based on each unit's relative fair value. There may be cases, however, in which there is objective and reliable evidence of fair value of the undelivered elements but no such evidence for the delivered elements. In those cases, the residual method is used to allocate the arrangement consideration. Under the residual method, the amount of consideration allocated to the delivered elements equals the total arrangement consideration, less the aggregate fair value of the undelivered elements. The revenue policies below are then applied to each unit of accounting, as applicable.

## Software

If services are not deemed essential to the functionality of the licensed software, revenue from licensed software is recognized at the later of delivery or the inception of the licence term. When the fair value of a delivered element has not been established, the Company uses the residual method to recognize revenue if the fair value of the undelivered elements is determinable.

If services are deemed essential to the functionality of the licensed software (which is the frequent arrangement), the licensed software and service revenues are recognized using contract accounting, following the percentage-of-completion method. The Company uses either the ratio of incurred costs to estimated total costs or the completion of applicable milestones, as appropriate, as the measure of its

progress to completion on each contract. If a loss on a contract is considered probable, the loss is recognized at the date determinable.

### **Services**

If services are deemed essential to the functionality of the licensed software, the licence and service revenues are recognized under contract accounting, as described above.

If services are not deemed essential to the functionality of the software, the service revenue is recognized as the services are delivered to the customer. The Company has established VSOE for service elements, based on the normal pricing and discounting practices for those elements when they are sold separately.

### **Support**

PCS revenue is recognized rateably over the term of the support agreement, which is typically one year. The Company has established VSOE of PCS, based on the PCS rates (percentage of licence fees) contractually agreed with customers. Absent a stated PCS rate or when there is a low contracted PCS rate, the Company uses a rate which represents the price when PCS is sold separately based on PCS renewals.

### **Hardware**

Hardware revenue is recognized as hardware is delivered to customers, when the risks and rewards of ownership have been transferred. The fair value of hardware is established based on the prices charged when hardware is sold separately.

### **Unbilled and deferred revenue**

Amounts are generally billable on reaching certain performance milestones, as defined by individual contracts. Revenue in excess of contract billings is recorded as unbilled revenue. Cash proceeds received in advance of performance under contracts are recorded as deferred revenue.

### ***Business Combinations***

The Company allocates the purchase price of a business acquisition to tangible assets, intangible assets and liabilities based on their estimated fair values at the date of acquisition with the excess of purchase price amount over these fair values being allocated to goodwill. The allocation of the purchase price to acquisitions involves considerable judgment in determining the fair value assigned to tangible and intangible assets acquired and the liabilities assumed on acquisition. Among other things, the determination of these fair values involves the use of discounted cash flow analyses, estimated future revenues and margins. In estimating future revenues and margins, the Company considers information published by third parties describing the size of the market and its growth rate, the planned margins for the acquired business and current costs to produce the solution offered by the acquired enterprise.

### *Long-Lived Assets*

Intangible assets are stated at cost less accumulated amortization and are comprised of acquired non-patented software technology and customer relationships purchased through the Company's business acquisitions. Acquired non-patented technology assets are amortized on a straight line basis over five to ten years. Acquired customer relationship assets are amortized on a straight line basis over nine to ten years. The Company reviews long-lived assets for impairment annually or whenever events and/or changes in circumstances indicate that the carrying amount may not be recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the excess of the carrying amount over the fair value of the asset. The Company's impairment analysis contains estimates due to the inherently speculative nature of forecasting long term estimated cash flows and determining the ultimate useful lives of assets. Actual results will differ, which could materially impact our impairment assessment.

### *Stock Based Compensation*

The Company has adopted a stock option plan as further described in notes 1 and 10 of its September 30, 2010 audited consolidated financial statements.

In accordance with CICA Handbook Section 3870, awards granted on or after December 1, 2003 are accounted for using the fair value method of accounting, whereby the Company recognizes compensation expense equal to the fair value of the award over its vesting period. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating the expected term of stock options, the expected volatility of the Company's stock and expected dividends. If actual results differ significantly from these estimates, stock-based compensation expense and the Company's results of operations could be materially impacted. The fair value of the awards is determined using the Black-Scholes option pricing model.

### *Income Tax Expense*

The provision for income taxes predominantly relates to the Company's foreign subsidiaries.

The ultimate realization of future tax assets is dependent upon future taxable income during the years in which these assets are deductible. Management considers the likelihood of future profitability, the character of the tax assets and applicable tax planning strategies of the Company to make this assessment. To the extent that management believes that the realization of future tax assets does not meet the more likely than not realization criterion, a valuation allowance is provided against its future tax assets. Note 12 of the September 30, 2010 financial statements describe the nature of the assets and related valuation allowance. Tax reserves are established for uncertain income tax positions based on management's best estimates.

As at September 30, 2010, the Company has approximately \$34.2 million of federal non-capital losses and scientific research and experimental development (SRED) pools for income tax purposes that will begin to expire in 2014, which are available to reduce future years' income for income tax purposes. In addition, the Company has approximately \$8.8 million and \$0.5 million of non-capital losses from foreign subsidiaries with an indefinite life and a three year life respectively. The utilization of these non-capital losses will reduce intangible assets. The Company has \$9.4 million of unrecorded income

tax credits, which can be also used to reduce future federal income taxes. These credits have a life of ten to twenty years and will not begin to expire until 2024.

### *Allowance for doubtful accounts*

The allowance for doubtful accounts represents the Company's best estimate of probable losses that may result from the inability of its customers to make required payments. The Company regularly reviews accounts receivable and uses judgment to assess its ability to collect specific accounts and, based on this assessment, an allowance is maintained for those accounts that are deemed to be uncollectible. For the quarter ended June 30, 2011, the Company recorded a reserve for doubtful accounts of \$1.2 million.

## **PATENT PORTFOLIO**

As part of Redknee's commitment to Research and Development ("R&D") to maintain its position as a key industry innovator in the real-time OSS/BSS software space, the Company currently has a portfolio of 30+ patents granted and 70+ patent applications. To date we have not initiated any action with respect to assertions and/or claims of patent infringement.

## **OUTSTANDING SHARE DATA**

The current number of common shares outstanding as at June 30, 2011 is 64,032,904. In addition, there were 5,854,380 stock options outstanding with exercise prices ranging from \$0.23 to \$2.16 per share.

## **RISK FACTORS**

As previously discussed, many factors could cause the actual results of Redknee to differ materially from the results, performance, achievements or developments expressed or implied by such forward-looking statements, including, without limitation, each of the following factors, which are further discussed in the section of the Company's AIF entitled Risk Factors.

Factors such as:

- Currency fluctuations may adversely affect the Company
- Software Defects
- Customer Credit Risk
- Defects in components or design of the Company's solutions could result in significant costs to the Company and could impair its ability to sell its solutions
- The Company's lengthy and variable sales cycle makes it difficult for it to predict its operating results
- The Company relies on a small number of customers for a large percentage of its revenue

- Technological Change
- Economic and geopolitical uncertainty may negatively affect the Company
- Maintaining Business Relationships
- Product Liability
- System Failures and Breaches of Security

We caution that period-to-period comparison of results of operations is not necessarily meaningful and should not be relied upon as any indication of future performance.

**ADDITIONAL INFORMATION**

Additional information, including the quarterly and annual consolidated financial statements, annual information form, management proxy circular and other disclosure documents may be examined by accessing the SEDAR website at [www.sedar.com](http://www.sedar.com).