REDKNEE

# REDKNEE SOLUTIONS INC.

## *MANAGEMENT'S DISCUSSION AND ANALYSIS*

## FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2011

**DATED: December 1, 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 fourth quarter and year-ended September 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 audited consolidated financial statements and accompanying notes for the fiscal year ended September 30, 2011. The consolidated financial statements are presented in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). The 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 fiscal 2011, 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*** and on the Company's web-site at ***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 the 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. was incorporated on March 29, 1999 and commenced operations in July, 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 more than 90 network operators in over 50 countries. The Company's software products allow its wireless, multi-play and alternate service providers 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 end-to-end real-time converged billing solution provides wireless, multi-play and alternate service providers with the agility to drive a unique user experience, increase profitability and support any new product or business model. Redknee's converged billing platform supports the following solutions:

**Redknee's Real-time Converged billing –** Redknee's award-winning cloud-enabled real-time converged billing platform provides the marketing agility to support service providers achieve their business objectives. Redknee delivers the benefits of a highly scalable converged billing and customer care platform, including real-time unified billing, rating and charging for the operator's data, voice, and messaging services; advanced customer care capabilities with the Microsoft Dynamics CRM framework; real-time subscriber promotions and loyalty programs; and transparent and flexible self-care options for prepaid, postpaid and hybrid subscribers.

**Redknee's Mobile Virtual Network Support** – Redknee's Mobile Virtual Network Solution provides a cloud-based end-to-end converged billing solution for Mobile Network Operators ("MNOs"), Mobile Virtual Network Enablers ("MVNEs") and Mobile Virtual Network Operators ("MVNOs") to launch quickly to the market. Redknee's out-of-the-box solution offers a low risk business model that enables MNOs to launch a second brand, MVNEs to accelerate their growth strategies and MVNOs to improve their differentiation in the market.

**Redknee's Wholesale Settlement** – Redknee's Wholesale Settlement is a cloud-based solution that provides operators with greater visibility into network transactions in order to achieve converged settlement and accurate interconnect billing. Redknee's solution helps service providers maximize the

value of their network with a comprehensive and cost-effective interconnect, wholesale, roaming, MVNO, franchise management and content settlement software solution.

## 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 September 30, 2011 and 2010 and the years ended September 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 as at, and for the three months ended September 30, 2011 and 2010 and the years ended September 30, 2011, 2010 and 2009 respectively, has been derived from the consolidated financial statements.

| **Consolidated Statement of Operations** | **Three Months Ended** | | **Twelve Months Ended** | | |
|---|---|---|---|---|---|
| (all amounts in thousands, except per share amounts) | **September 30** | | **September 30** | | |
| **(unaudited)** | **2011** | **2010** | **2011** | **2010** | **2009** |
| **Revenue** | | | | | |
| Software, services and other | $ 8,643 | $ 7,917 | $ 37,710 | $ 29,814 | $ 32,097 |
| Support | 5,936 | 5,075 | 22,363 | 19,056 | 21,154 |
| | **14,579** | **12,992** | **60,073** | **48,870** | **53,251** |
| **Cost of revenue** | 5,080 | 3,541 | 21,317 | 13,107 | 11,968 |
| **Gross profit** | **9,499** | **9,451** | **38,756** | **35,763** | **41,283** |
| **Operating expenses** | | | | | |
| Selling and marketing | 4,373 | 3,065 | 15,959 | 12,548 | 14,609 |
| General and administrative | 2,087 | 1,866 | 9,789 | 7,638 | 8,983 |
| Research and development | 1,923 | 1,765 | 12,108 | 9,950 | 11,930 |
| Amortization of property, equipment and intangible | 392 | 291 | 1,785 | 777 | 677 |
| Foreign exchange loss (gain) | (579) | 444 | 67 | 1,680 | 872 |
| | **8,196** | **7,431** | **39,707** | **32,593** | **37,071** |
| **(Loss) Income from operations** | **1,303** | **2,020** | **(951)** | **3,170** | **4,212** |
| Interest income | 44 | 43 | 165 | 72 | 98 |
| Interest expense | (85) | (64) | (536) | (86) | (20) |
| **(Loss) Income before income taxes** | **1,262** | **1,999** | **(1,323)** | **3,156** | **4,290** |
| Income taxes | 955 | 1,640 | 1,210 | 2,062 | 962 |
| **(Loss) Income for the period** | **$ 307** | **$ 359** | **$ (2,533)** | **$ 1,094** | **$ 3,328** |
| **(Loss) Income per Common Share** | | | | | |
| Basic | $ 0.00 | $ 0.01 | (0.04) | $ 0.02 | $ 0.06 |
| Diluted | $ 0.00 | $ 0.01 | (0.04) | $ 0.02 | $ 0.06 |
| **Weighted average number of common shares** | | | | | |
| Basic (thousands) | 64,198 | 62,309 | 64,165 | 60,138 | 57,761 |
| Diluted (thousands) | 65,420 | 64,608 | 64,165 | 62,018 | 59,832 |

| **Balance Sheet Data**<br>**$Cdn Thousands**<br>**(unaudited)** | **As at September 30, 2011** | **As at September 30, 2010** |
|---|---|---|
| Cash, Restricted Cash, ST Investments and Cash Equivalents | 16,273 | 19,573 |
| Goodwill and Intangible Assets | 12,066 | 13,529 |
| Total Assets | 57,036 | 58,837 |
| Accounts Payable and Accrued Liabilities | 8,034 | 6,327 |
| Long-Term Debt and Other obligations | 5,536 | 7,595 |
| Shareholders' Equity | 29,861 | 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** | **Three Months Ended September 30** | | **Twelve Months Ended September 30** | |
|---|---|---|---|---|
| **(unaudited)** | **2011** | **2010** | **2011** | **2010** |
| Software & Services | 7,541 | 7,650 | 33,357 | 27,360 |
| Support | 5,936 | 5,075 | 22,363 | 19,056 |
| Third Party Software & Hardware | 1,102 | 267 | 4,353 | 2,454 |
| **Total** | **14,579** | **12,992** | **60,073** | **48,870** |

| **Percentage of Total Revenue (unaudited)** | **Three Months Ended September 30** | | **Twelve Months Ended September 30** | |
|---|---|---|---|---|
| | **2011** | **2010** | **2011** | **2010** |
| Software & Services | 52% | 59% | 56% | 56% |
| Support | 41% | 39% | 37% | 39% |
| Third Party Software & Hardware | 7% | 2% | 7% | 5% |
| **Total** | **100%** | **100%** | **100%** | **100%** |

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 September 30, 2011, the Company's revenue increased by 12% from $13.0 million for the same period in fiscal 2010 to $14.6 million in fiscal 2011. For the year ended September 30, 2011 revenue increased by 23% from $48.9 million in fiscal 2010 to $60.1 million in fiscal 2011.

The increase in revenue is primarily due to the increase in both software and services revenue, and 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 year ended September 30, 2011 would have been $62.0 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 Q4 2011 decreased by 1% to $7.5 million, or 52% of total revenue, compared to $7.6 million, or 59% of total revenue for the same period last year. For the year ended September 30, 2011, software and service revenue increased by 22% to $33.4 million, or 56% of total revenue, compared to $27.4 million, or 56% 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 year ended September 30, 2011, would have been at $34.3 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 Q4 2011 grew by 17% to $5.9 million, or 41% of total revenue, compared to $5.1 million, or 39% of total revenue, for the same period last year. The increase is primarily due to the addition of support revenue from contract renewals. For the year ended September 30, 2011, support and subscription revenue increased by 17% to $22.4 million, or 37% of total revenue, compared to $19.1 million, or 39% of total revenue, last year. On a comparative constant dollar basis, the Company's support and subscription revenue for the year ended September 30, 2011, would have been at $23.4 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 Q4 2011 increased to $1.1 million, or 7% of total revenue, compared to $0.3 million, or 2% of total revenue, for the same period last year. For the year ended September 30, 2011, third party software and hardware revenue increased to $4.4 million, or 7% of total revenue, compared to $2.5 million, or 5% of total revenue, last year. This increase was due to

increased initial deployment sales of real-time converged billing solutions that contain third party components as part of the overall turnkey solution. On a comparative constant dollar basis, the Company's third party software and hardware revenue for the year ended September 30, 2011, would have been at $4.5 million.

### *Revenue by Geography*

Revenue is attributed to geographic locations 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 September 30 | | Twelve Months Ended September 30 | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Asia and Pacific Rim | 3,868 | 2,245 | 14,981 | 11,257 |
| North America, South America and Caribbean | 4,706 | 4,818 | 18,968 | 16,125 |
| Europe, the Middle East and Africa | 6,005 | 5,929 | 26,124 | 21,488 |
| **Total** | **14,579** | **12,992** | **60,073** | **48,870** |

| Percentage of Total Revenue (unaudited) | Three Months Ended September 30 | | Twelve Months Ended March 31, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Asia and Pacific Rim | 27% | 17% | 25% | 23% |
| North America, South America and Caribbean | 32% | 37% | 32% | 33% |
| Europe, the Middle East and Africa | 41% | 46% | 43% | 44% |
| **Total** | **100%** | **100%** | **100%** | **100%** |

For Q4 2011, revenue from the APAC region increased by 72% to $3.9 million, or 27% of total revenue, compared to $2.2 million, or 17% of total revenue, last year. The growth mostly relates to an increase in professional services and capacity expansions in the region. For the year ended September 30, 2011, revenue from the APAC region increased by 33% to $15.0 million, or 25% of total revenue, compared to $11.3 million, or 23% of total revenue, last year. The increase is mostly due to capacity expansions and the increased initial deployment sales of real-time converged billing solutions to new customers.

For Q4 2011, revenue from the Americas region decreased by 2% to $4.7 million, or 32% of total revenue, compared to $4.8 million or 37% of total revenue last year. The decrease mostly relates to a reduction in capacity expansions year over year in the region. For the year ended September 30, 2011, revenue from the Americas region increased by 18% to $19.0 million, or 32% of total revenue, compared to $16.1 million, or 33% of total revenue, last year. This increase was mostly due to software upgrades and increased initial deployment sales of real-time converged billing solutions to new customers.

For Q4 2011, revenue from the EMEA region increased slightly by 1% to $6.0 million, or 41% of total revenue, compared to $5.9 million, or 46% of total revenue last year. For the year ended September 30, 2011, revenue from the EMEA region increased by 22% to $26.1 million, or 43% of total revenue, compared to $21.5 million, or 44% of total revenue, last year. This increase is primarily due to the contribution in services and support revenue from Nimbus for the full year.

## 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 the fourth quarter of fiscal 2011, cost of sales increased 46% to $5.1 million from $3.5 million incurred for the same period in 2010. For the twelve-month period ended September 30, 2011, cost of sales increased 63% to $21.3 million from the $13.1 million incurred in the same period last year. The increase is driven by higher personnel expenses for delivering larger services and support revenues, along with the increased purchase of third-party hardware and software components sold as part of Redknee's solution.

The gross margin for the fourth quarter of fiscal 2011 was 65% compared to 73% for the fourth quarter of 2010. For the twelve-month period ended September 30, 2011, the gross margin decreased to 65% in fiscal 2011 compared to 73% for 2010. The decrease in gross margin relates to the change in mix of the revenues recorded, with a higher percentage of sales of services and third-party components recorded throughout the year, which generally carry the lowest gross margins.

## Operating Expenses

Total operating expenses in the fourth quarter of fiscal 2011 increased 5% to $7.8 million from $7.4 million in the fourth quarter of fiscal 2010. For the three-month period ended September 30, 2011, operating expenses excluding amortization and foreign exchange loss (gain) increased to 55% of revenue compared to 52% of revenue in fiscal 2010. The increase is mostly due to the higher costs associated with achieving higher revenues, including the addition of sales personnel and an increase in expenditures attributed to the Nimbus operation. These increased expenses were partially offset by the recognition of $0.9 million of Investment Tax Credits ("ITCs") during the fourth quarter of 2011 which reduced R&D expense accordingly.

Total operating expenses for the twelve-month period ended September 30, 2011 increased by 22% to $39.7 million from $32.6 million for the same period last year. This increase is the result of higher costs associated with achieving higher revenues including the addition of sales personnel, an increase in expenditures attributed to the Nimbus operation, and one-time expense items relating to an allowance for doubtful accounts and severance costs related to synergies achieved from the integration of Nimbus. For the twelve-month period, operating expenses excluding amortization and foreign exchange loss (gain) slightly increased to 63% of revenue compared to 62% of revenue in fiscal 2010. These expenses were partially offset by the recognition of $1.1 million of ITCs during fiscal 2011.

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 September 30 | | Twelve Months Ended September 30 | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Sales and Marketing | 4,373 | 3,065 | 15,959 | 12,548 |
| General and Administrative | 2,088 | 1,866 | 9,789 | 7,638 |
| Research and Development | 1,923 | 1,765 | 12,108 | 9,950 |
| Amortization | 392 | 291 | 1,785 | 777 |
| Foreign Exchange Loss (Gain) | (579) | 444 | 66 | 1,680 |
| **Total Operating Expenses** | **8,197** | **7,431** | **39,707** | **32,593** |
| *Excluding Amortization and FX* | *8,384* | *6,696* | *37,856* | *30,136* |

| Percentage of Total Revenue (unaudited) | Three Months Ended September 30 | | Twelve Months Ended September 30 | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Sales and Marketing | 30% | 24% | 27% | 26% |
| General and Administrative | 14% | 14% | 16% | 16% |
| Research and Development | 13% | 14% | 20% | 20% |
| Amortization | 3% | 2% | 3% | 3% |
| Foreign Exchange Loss (Gain) | -4% | 3% | 0% | 3% |
| **Total Operating Expenses** | **56%** | **57%** | **66%** | **67%** |
| *Excluding Amortization and FX* | *58%* | *52%* | *63%* | *62%* |

## *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 the fourth quarter of fiscal 2011, S&M expenditures increased by 43% to $4.4 million, which represented a $1.3 million increase from the $3.1 million incurred for the same period last year. As a percentage of total revenue, S&M expenses increased to 30% compared to 24% for the same period last year.

For the twelve-month period ended September 30, 2011, S&M expenditures increased by 27% to $16.0 million from $12.5 million for fiscal 2010. The increase in S&M expenses is 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 increased from 26% to 27% in 2011, which reflects the additional investment made in increasing sales coverage.

### *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 the fourth quarter of fiscal 2011, general and administrative expenditures increased 12% to $2.1 million from $1.9 million. As a percentage of total revenue, G&A expenses remained flat at 14% compared to same period last year.

For the year ended September 30, 2011, G&A expenditures increased by 28% to $9.8 million, up from the $7.6 million incurred for the same period in 2010. The increase in G&A expenses are mostly due to the $1.7M for an allowance for doubtful accounts and severances recorded in Q3 and Q4 of fiscal 2011, as well as an increase in stock compensation expenses and an increase in expenses stemming from the Nimbus operation. As a percentage of total revenue, G&A expenses remained flat at 16% each of the two periods. On an adjusted basis excluding the one-time costs, G&A expenses in fiscal 2011 would have been $8.1 million or 13% of revenues, compared to 14% in fiscal 2010.

### *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 (ITCs) recognized during the period.

For the fourth quarter of fiscal 2011, R&D expenditures increased by 9% to $1.9 million compared to $1.7 million for the same period last year due to the additional expenses from the Nimbus operation. Also included in the fourth quarter is the recognition of $0.9 million in ITCs. In the fourth quarter of fiscal 2010, the Company recognized ITCs for $1.0 million. As a percentage of total revenue, R&D expenditures decreased to 13% for Q4 2011 from 14% in Q4 2010.

For the year ended September 30, 2011, R&D expenditures increased by 22% to $12.1 million from the $10.0 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. Included in fiscal 2011, are $1.1 million of ITCs recognized compared to $1.0 million in fiscal 2010. As a percentage of total revenue, R&D expenses remained flat at 20% for the full year 2011 compared to the same period last year.

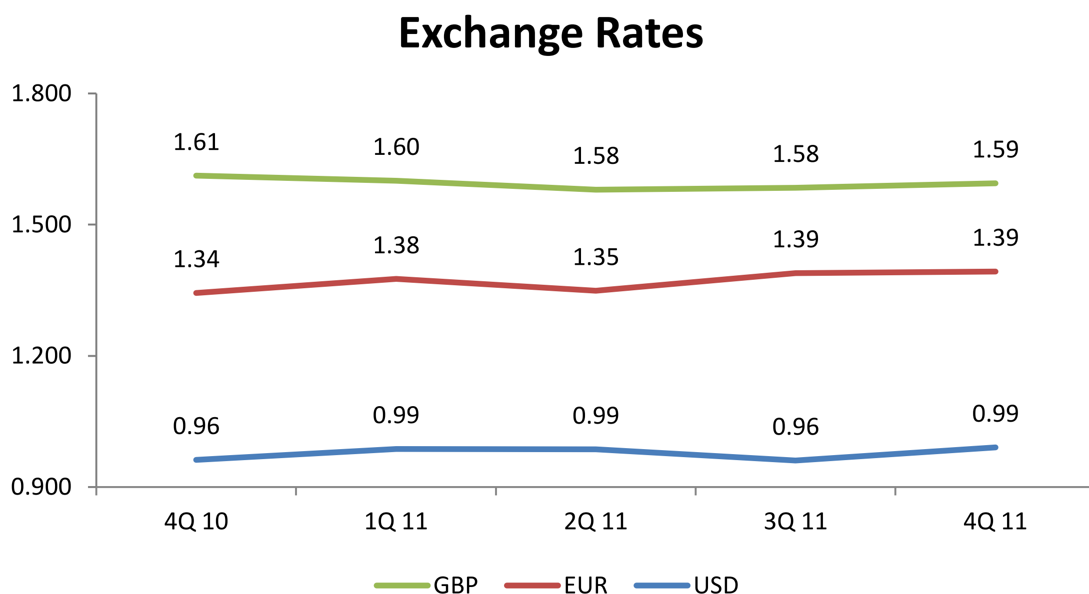
### *Amortization Expense*

Amortization for the fourth quarter ended September 30, 2011 increased to $0.4 million compared to $0.3 million for the same period last year. Amortization for the year ended September 30, 2011 totaled $1.8 million compared to $0.8 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 September 30, 2011, the Company recognized a foreign currency exchange gain of $0.6 million, compared to a foreign currency exchange loss of $0.4 million in the same period of fiscal 2010. For the year period ended September 30, 2011, the Company experienced a foreign exchange loss of $0.1 million versus a foreign exchange loss of $1.7 million recorded for the same period last year. The fourth quarter gain in 2011 was primarily due to the U.S. dollar strengthening against the Canadian dollar.

## Interest Expense

The interest expense of $0.1 million recorded in Q4 2011 was mainly due to the Company's use of a credit facility available from 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 to complete the acquisition of Nimbus. As at September 30, 2011, the amounts drawn totaled $6.7 million (US$6.4 million). The interest expense for the year ended September 30, 2011 totaled $0.5 million compared to $0.1 million in 2010.

## Stock-Based Compensation

For the year ended September 30, 2011, stock options granted totaled 1,003,125 (2010 – 420,000) with a weighted fair value of $1.39 (2010 – $1.40) 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 relating to the Company's stock options, deferred share unit plan and restricted shares under the restricted share plan during the fourth quarter of fiscal 2011 was a credit of $0.1 million compared to a $0.1 million expense in 2010. 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 year ended September 30, 2011 was $0.5 million (2010 - $0.4 million).

## Income Taxes

The current income tax provision is management's estimate of current taxes owing by the Company's foreign subsidiaries. During fiscal 2011, the Company recognized the benefit of Investment Tax Credits ("ITCs") earned during the year for $0.2 million and booked the benefit of a future tax asset relating to past ITCs for $0.9 million since management determined that there is reasonable assurance that the credits will be realized.

## 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:

| $Cdn Thousands (unaudited) | 4Q 11 | 3Q 11 | 2Q 11 | 1Q 11 | 4Q 10 | 3Q 10 | 2Q 10 | 1Q 10 |
|---|---|---|---|---|---|---|---|---|
| Revenue | $14,579 | $14,731 | $16,635 | $14,128 | $12,992 | $10,632 | $13,466 | $11,780 |
| Net Income (Loss) | $ 307 | $(2,344) | $ 408 | $(905) | $359 | $(230) | $401 | $564 |
| Basic Income (Loss) per Share | $ - | $(0.04) | $ 0.01 | $(0.01) | $ 0.01 | $0.00 | $ 0.01 | $ 0.01 |
| Diluted Income (Loss) per Share | $ - | $(0.04) | $ 0.01 | $(0.01) | $ 0.01 | $0.00 | $ 0.01 | $ 0.01 |
| Weighted average shares outstanding – Basic | 64,198 | 64,195 | 64,158 | 63,941 | 62,309 | 60,078 | 59,604 | 58,800 |
| Weighted average shares outstanding - Diluted | 65,420 | 64,195 | 65,800 | 63,941 | 64,608 | 60,078 | 61,739 | 60,923 |

In prior periods where net income was negative, options were considered to be anti-dilutive for the calculation of Fully Diluted Earnings per Share (“FDEPS”).

## LIQUIDITY AND CAPITAL RESOURCES

The Company’s objective in managing capital is to ensure sufficient liquidity to drive 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 on hand.

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

| Statement of Cash Flows Summary<br>($ Cdn Thousands)<br>(Unaudited) | Three Months ended September 30, 2011 | 2010 | Twelve Months ended September 30, 2011 | 2010 |
|---|---|---|---|---|
| Cash inflows and (outflows) by activity: | | | | |
| Operating activities | 2,321 | (13) | (1,641) | (6,488) |
| Investing activities | (17) | (9,215) | (246) | (9,031) |
| Financing activities | (629) | 7,899 | (1,718) | 9,576 |
| Effect of foreign currency exchange rate changes on cash and cash equivalents | 509 | 256 | 324 | (981) |
| Net cash inflows (outflows) | 2,183 | (1,073) | (3,281) | (6,924) |
| Cash and cash equivalents, beginning of period | 13,275 | 19,812 | 18,739 | 25,663 |
| Cash and cash equivalents, end of period | 15,458 | 18,739 | 15,458 | 18,739 |

| Key Ratios | September, 30 2011 | September, 30 2010 |
|---|---|---|
| Working Capital | $20,968 | $24,361 |
| Day Sales Outstanding | 90 | 82 |

*The Company uses Working Capital and Days Sales Outstanding in Accounts Receivable as measures to enhance comparisons between periods. These terms do not have a standardized meaning under GAAP and are not necessarily comparable to similar measures presented by other companies. The calculation of each of these items is more fully described below.

## Cash from Operating Activities

Cash provided by operating activities was $2.3 million in the three months ended September 30, 2011, compared to a nil use of cash for the same period last year. This is mostly attributed to a decrease in trade receivables, an increase in accrued liabilities partially offset by a decrease in accounts payable. Cash used by operating activities was $1.6 million in the year ended September 30, 2011, compared to a use of cash of $6.5 million for the same period last year. This year's use of cash is mostly attributed to the net loss of $2.2 million and a use of future income taxes and investment tax credits of $1.1 million partially offset by the amortization of intangible assets of $1.5 million.

The Company's Days Sales Outstanding in Accounts Receivable ("DSO") was at 90 days as at September 30, 2011 compared to 89 days as of June 30, 2011 and March 31, 2011, but is higher than the 87 days as at September 30, 2010. Redknee calculates DSO based on the annualized revenue and the trailing four 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 $21.0 million as at September 30, 2011 from $24.4 million as at September 30, 2010. This decrease is mainly attributed to decrease in cash and cash equivalents of $3.3 million, the decrease in trade accounts and other receivables of $1.4 million, and a net increase in accounts payable and accrued liabilities of $1.7 million partially offset by increase in unbilled revenue of $3.7 million.

## Financial Instruments and Credit Concentration

The fair value of accounts receivable, other receivables, accounts payable, and accrued liabilities approximates their carrying value due to the immediate or short-term maturity of these financial instruments. At September 30, 2011, the Company's two largest customers accounted for 15% of sales (2010 – 23%). In order to minimize the risk of loss for trade receivables, the Company's extension of credit to customers involves review and approval by senior management, as well as progress payments as contracts are executed.

## Cash from Financing Activities

In the fourth quarter of fiscal 2011, cash used for financing activities was $0.6 million compared to a source of cash of $7.9 million in 2010. For the twelve months ended September 30, 2011, cash used for financing activities was $1.7 million compared to a source of cash of $9.6 million in 2010. This was mainly due to the payments made in 2011 towards the EDC loan compared to the proceeds received from EDC for the acquisition of Nimbus in 2010.

## Cash from Investing Activities

Cash used for investing activities during the quarter ended September 30, 2011 was nil compared to $9.2 million in 2010. For the twelve months ended September 30, 2011, cash used was $0.2 million compared to $9.0 million in 2010. These changes are mainly due to the acquisition of Nimbus on August 12, 2010. The total purchase price, net of cash acquired, of $13.0 million consists of cash paid on closing of $7.9 million, 3,628,044 common shares issued, including 1,814,022 common shares placed in escrow, valued at $4.5 million and acquisition costs of $0.8M.

## Long Term Debt and Credit Facilities

As at September 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.

The Company borrowed against this credit facility for the Nimbus acquisition. As at September 30, 2011, US$6.4 million (CA$6.7 million) remains outstanding and is repayable semi-annually over the next four years. Interest on this credit 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 financial and 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. The Company is in compliance with its debt covenants as at September 30, 2011.

As a result of the acquisition of Nimbus, the Company currently holds bank loans through its wholly owned subsidiary, Redknee Spain SAL, S.L.U. These loans are secured by shareholder guarantees.

Interest of $0.5 million in connection with loans payable has been charged to the consolidated statements of operations for the year ended September 30, 2011 (2010 - $0.1 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 outcome. Management does not provide 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 would be material to the Company's financial condition or results of operations.

The Company is currently involved in a legal dispute with one of its customers. The Company has expensed $0.4 million of costs to date, $0.2 million of which was recorded in the current year. The remaining exposure is $0.2 million on this contingency.

### 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 $7.8 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:

| | Final allocation $ |
|---|---|
| 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) |
| | 137,042 |
| | |
| Intangible assets | |
| Customer relationships | 2,841,649 |
| Technology | 1,326,192 |
| Backlog | 802,690 |
| Goodwill | 7,935,373 |
| | 12,905,904 |
| **Total purchase consideration, net of cash acquired** | **13,042,946** |

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

## Goodwill

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

| | **Balance September 30,2010** | **Additions** | **Balance June 30,2011** |
|---|---|---|---|
| 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 September 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 one or more acquisitions. As at September 30, 2011, US$6.4 million (CA$6.7 million) remains outstanding and is repayable semi-annually over four 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 financial and 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. As at September 30, 2011, no amount has been recorded in the consolidated financial statements.

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.

Future minimum lease payments for premises and equipment under non-cancellable operating leases are as follows:

| | $ |
|---|---|
| 2012 | 1,870,831 |
| 2013 | 1,264,433 |
| 2014 | 835,794 |
| 2015 | 877,029 |
| 2016 and thereafter | 1,534,801 |

## 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 (i) acquisitions and/or (ii) working capital requirements. The Company's primary uses of capital are financing 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 increase shareholder value. Management monitors its compliance with financial and non-financial covenants imposed by loan agreements on a quarterly basis. The Company has complied with all externally imposed capital requirements.

## DISCLOSURE CONTROLS AND PROCEDURES

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") as at September 30, 2011 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 September 30, 2011.

## ACCOUNTING CHANGES AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Effective October 1, 2009, the Company adopted Canadian Institute of Chartered Accountants (CICA) Handbook Section 1506, Accounting Changes, which was amended to exclude from its scope changes in accounting policies on the complete replacement of an entity's primary basis of accounting. The impact of this amendment did not have an impact on the annual consolidated financial statements.

For the year ended September 30, 2010, the Company adopted the amendments to Section 3862, Financial Instruments - Disclosures. The amendments require enhanced disclosures about fair value measurements, including the relative reliability of the inputs used in those measurements and about the liquidity risk of financial instruments, which are included in note 4 of the annual audited financial statements.

The Company will cease to prepare its consolidated financial statements in accordance with Canadian GAAP as set out in Part V of the CICA Handbook - Accounting (Canadian GAAP) for the periods beginning on October 1, 2011 when it will start to apply International Financial Reporting Standards as published by the International Accounting Standards Board. Consequently, future accounting changes to Canadian GAAP are not discussed in these consolidated financial statements as they will never be applied by the Company.

## 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 ending December 31, 2011. Our fiscal 2012 interim and annual financial statements will include comparative fiscal 2011 interim and annual financial statements, adjusted to comply with IFRS.

### *IFRS Transition Plan*

During Q4 fiscal 2011, Redknee has been working with its external advisors to complete its detailed analysis of the relevant IFRS requirements and identified the areas where accounting policy changes are required, and those for which accounting policy alternatives are available. The team has also been working to complete its assessment of the first-time adoption requirements and alternatives.

Discussions of the results of this analysis with management and the Company's advisors will continue during Q1 fiscal 2012, after which the Company will finalize its determination of changes to accounting policies under IFRS and the resulting impact on the opening IFRS balance sheet (as at October 1, 2010).

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

| Activity | Status |
|---|---|
| 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. | In progress, to complete during Q1 fiscal 2012 |
| Resolution of the expected accounting policy change implications on information technology, internal controls and contractual arrangements. | In progress, to complete during Q1 fiscal 2012 |
| Management and employee education and training | Throughout the transition process |
| Quantification of the expected financial statement impact of changes in accounting policies | In progress, to complete during Q1 fiscal 2012 |
| Preparation of pro forma Q1 fiscal 2012 financial statements consistent with IFRS presentation and disclosure requirements | Q1 fiscal 2012 |

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

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 continuing to assess 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.

### *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.

The Company expects to elect to apply the following IFRS optional exemptions in the preparation of its 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 elect to designate certain existing financial instruments as available-for-sale as 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.

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.

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

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

The Company has not yet completed its final determination of the changes in accounting policies, or the quantification of the impact on its financial statements. Included below are highlights of the areas that are expected to result in 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.

During Q1 2012, the Company will make a final determination of changes to its accounting policies that will result from adopting IFRS, and quantify the impact on its 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. Specifically, the Company expects to change its accounting policies so that under IFRS the Company will allocate the total contract value to the various components of a multiple element arrangement based on the relative fair value of each deliverable. Currently under Canadian GAAP, the revenue allocated to the license and implementation element of contracts is determined using residual method.

This change in accounting policy may have an impact on the timing of revenue recognition for multiple element arrangements. The Company has not yet quantified the impact of this change in accounting policy on its financial statements.

#### Foreign Currencies

IFRS requires that the functional currency of the Company and its subsidiaries be determined separately, as the factors in determining 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, at this time, does not expect a required change in functional currencies as a result of the adoption of IFRS. Any changes in functional currencies would have an effect on how foreign currency transactions and balances are translated to the presentation currency.

As a result of business circumstances, the Company, effective fiscal 2012, will change its functional currencies to U.S. dollars. This change will be in effect on a prospective basis. In addition, beginning fiscal 2012, all results will be reported in U.S. dollars including comparatives.

**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. With the exception of goodwill, any impairment losses may potentially be offset by the requirement under IAS 36 to reverse any previous impairment losses where circumstances have changed. Canadian GAAP prohibits reversal of impairment losses.

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).

On adoption of IFRS, the Company will change its accounting policies to reflect these differences. The Company is continuing to assess whether these differences will have an impact on the carrying amounts of goodwill and associated assets in its opening IFRS balance sheet.

**Business Combinations**

As permitted under IFRS 1, the Company expects to apply IFRS 3 *Business Combinations* prospectively from the Transition Date, therefore not restating business combinations that took place prior to the Transition Date. However, the adoption of IFRS requires the recognition of all liabilities required by IFRS. The acquisition of Nimbus includes contingent consideration, which is not recognized as a liability under Canadian GAAP unless the amount can be determined beyond a reasonable doubt. IFRS requires a liability be recognized for contingent consideration at the estimated fair value of the obligation on the date of the acquisition and updated each reporting period thereafter.

The Company expects this change in accounting policy will result in the recognition of a liability for the contingent consideration related to the Nimbus acquisition, with a corresponding increase in the deficit. The Company has not yet finalized its determination of the quantitative impact of this change on its financial statements.

**Share-based Payments**

In certain circumstances, IFRS requires a different measurement of share-based compensation than current Canadian GAAP. In particular, a change will be required to the measurement and timing of recognizing the expense associated with grants with graded vesting under the stock option plan. In addition, IFRS requires forfeitures of the Company’s stock options to be estimated when the instruments are granted and updated each reporting period. Under current GAAP, it is not required to account for forfeitures at the time of grant (with updates); the Company records forfeitures when they occur.

The Company will change its accounting policies to reflect these differences. The Company has not yet determined the quantitative impact on its financial statements, but expects the change will result in a reclassification between contributed surplus and the deficit at the Transition Date.

**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 recognized under current Canadian GAAP.

The Company is continuing to assess whether these differences will have an impact on the carrying amounts of liabilities in its opening IFRS balance sheet.

**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 continuing to assess these differences and expects to change its accounting policy to recognize deferred taxes arising from the exchange rate fluctuations on non-monetary assets and liabilities of foreign operations. Deferred taxes of this type are not recognized under Canadian GAAP. The Company has not yet determined the quantitative impact on its financial statements.

***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 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 the 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 contain 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 12 of its September 30, 2011 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.

### *Investment Tax Credits*

The Company is entitled to certain Canadian investment tax credits for qualifying research and development activities performed in Canada. These credits can be applied against future income tax liabilities and are subject to a 20-year carry-forward period or, in some cases, are refundable. Management determines investment tax credits that should be accrued for qualifying expenditures when there is reasonable assurance that the credits will be realized. The recognized investment tax credits have been accounted for as a reduction of research and development expenses in the consolidated statements of operations.

### *Income Tax Expense*

The ultimate realization of future tax assets is dependent upon future taxable income during the years in which these assets are used. 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 14 of the September 30, 2011 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, 2011, the Company has approximately $37.3 million (2010 - $34.2 million) of federal non-capital losses (that will begin to expire in 2014) and scientific research and experimental development pools for income tax purposes, which are available to reduce future years’ income for Canadian income tax purposes. In addition, the Company has approximately $8.3 million (2010 - $8.8 million) and $nil (2010 - $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 first reduce the related intangible assets, and any amounts in excess of this will be included in net income (loss) in the applicable reporting period.

The Company’s Canadian income tax losses available for carry-forward expire as follows:

| | $ |
|---|---|
| 2014 | 1,500,000 |
| 2025 | 2,500,000 |
| 2026 | 2,900,000 |
| 2027 | 2,300,000 |
| 2028 | 300,000 |
| 2029 | 300,000 |
| 2030 | 200,000 |
| 2031 | 100,000 |
| | 10,100,000 |

The Company has $10.0 million (2010 - $9.4 million) of unrecorded investment tax credits, which can be also used to reduce future federal income taxes. These credits have a life of 10 to 20 years and will not begin to expire until 2023.

### *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 such as the customer’s financial position, past experience with the customer and other factors 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 year ended September 30, 2011, the Company recorded an allowance 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 over 100 filed and over 30 granted.  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 September 30, 2011 is 64,197,904. In addition, there were 5,512,014 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.

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.

## FINANCIAL RISK MANAGEMENT

### *Overview:*

The Company’s Board of Directors has overall responsibility for the establishment and oversight of the Company’s risk management policies on an annual basis. The finance department identifies and evaluates the financial risks and is charged with the responsibility of establishing controls and procedures to ensure the financial risks are mitigated in accordance with the approved policies.

### *Credit risk:*

Credit risk arises from the potential that a counterparty will fail to perform its obligations. The Company is exposed to credit risk from banks and customers.

The Company has credit risk relating to cash and cash equivalents, restricted cash, which it manages by dealing with large chartered Canadian and international banks and investing in highly liquid investments of a rating of no less than R1, the credit rating assigned to those who pay on time.

The Company's exposure to credit risk geographically for cash and cash equivalents, restricted cash and short-term investments as at September 30 was as follows:

| | 2011<br>% | 2010<br>% |
|---|---|---|
| Europe, Middle East and Africa | 60 | 21 |
| North America, Latin America and Caribbean | 37 | 73 |
| Asia and Pacific Rim | 3 | 6 |
| | 100 | 100 |

As at September 30, 2011, the Company's two largest customers accounted for 15% (2010 - 23%) of sales. In order to minimize the risk of loss for trade receivables, the Company's extension of credit to customers involves review and approval by senior management, as well as progress payments as contracts are executed.

Credit reviews take into account the counterparty's financial position, past experience and other factors. Management regularly monitors customer credit limits. The Company believes that the concentration of credit risk from trade receivables is limited, as they are widely distributed among customers in various countries.

While the Company's credit controls and processes have been effective in mitigating credit risk, these controls cannot eliminate credit risk and there can be no assurance that these controls will continue to be effective or that the Company's low credit loss experience will continue. Most sales are invoiced with payment terms in the range of 30 to 60 days.

The Company reviews its trade receivable accounts regularly and reduces amounts to their expected realizable values by making an allowance for doubtful accounts, as soon as the account is perceived not to be fully collectible.

The Company's net trade receivables had a carrying value of $14.0 million as at September 30, 2011 (2010 - $14.8 million), representing the maximum exposure to credit risk of those financial assets, exclusive of the allowance for doubtful accounts. Of the net trade receivables balance, $1.6 million is factored without recourse. Normal credit terms for amounts due from customers call for payment within 30 to 60 days. Approximately 22% of trade receivables were past due as at September 30, 2011, of which $4.1 million was outstanding for more than 120 days (2010 - 20% over 120 days in the amount of $3.6 million). The activity of the allowance for doubtful accounts for the year ended September 30 is as follows:

| | 2011 $ | 2010 $ |
|---|---|---|
| Allowance for doubtful accounts - Beginning of year | 722,946 | 234,000 |
| Bad debt expense | 1,600,422 | 554,744 |
| Write off of bad debts | (1,128,728) | (65,798) |
| Allowance for doubtful accounts - End of year | 1,194,640 | 722,946 |

The allowance for doubtful accounts is charged to the consolidated statements of operations. Shortfalls in collections are applied against this provision. Estimates for allowance for doubtful accounts are determined by a customer-by-customer evaluation of collectability at each consolidated balance sheet reporting date, taking into account the amounts that are past due and any available relevant information on the customers' liquidity and going concern problems.

The Company's exposure to credit risk for trade receivables by geographic area as at September 30 was as follows:

| | 2011 % | 2010 % |
|---|---|---|
| Europe, Middle East and Africa | 38 | 59 |
| North America, Latin America and Caribbean | 36 | 22 |
| Asia and Pacific Rim | 26 | 19 |
| | 100 | 100 |

***Liquidity risk***

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with its financial liabilities. The Company's financial liabilities, excluding operating leases, will mature as follows:

| | |
|---|---|
| Accounts payable and accrued liabilities | Less than 1 year |
| Loans payable | 4 – 5 years |

The Company also has contractual obligations in the form of operating leases.

Management believes the Company's existing cash and cash equivalents, restricted cash and short-term investment resources will be adequate to support all of its financial liabilities and contractual commitments.

***Interest rate risk:***

Interest rate risk arises because of the fluctuation in interest rates. The Company is subject to interest rate risk on its cash and cash equivalents, restricted cash and certain loans payable. If a shift in interest rates of 10% were to occur, the impact on cash and cash equivalents and restricted cash and the related income for the year would not be material. On the loans payable, an incremental increase or decrease in the LIBOR rate of 0.25% will result in an increase or decrease in interest expense of $16,827, respectively.

***Foreign currency risk:***

Foreign currency risk arises because of fluctuations in foreign currency exchange rates. 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 to match Canadian dollar obligations. The Company conducts a significant portion of its business activities in foreign countries. The monetary assets and liabilities that are denominated in foreign currencies are affected by changes in the exchange rate between the Canadian dollar and these foreign currencies. The Company recognized a foreign currency exchange loss in 2011 of $0.1 million, compared to a foreign currency exchange loss in 2010 of $1.7 million.

If a shift in foreign currency exchange rates of 10% were to occur, the foreign currency exchange gain or loss on the Company's net monetary assets could change by approximately $2.1 million due to the fluctuation and this would be recorded in the consolidated statements of operations.

## 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.