# 2007 Annual Report

Enghouse Systems Limited

"We have the financial resources to grow the business, pay a quarterly dividend, implement our share buyback program and fund accretive acquisitions to increase shareholder value."

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# Chairman's Message

Fiscal 2007 presented a challenging environment for the Company on a number of fronts.

The Canadian dollar continued to strengthen compared to the U.S. dollar from an exchange rate of 1.12 at the beginning of the fiscal year, breaking through par value late in the Company's fourth quarter to close at 0.95 on October 31, 2007. A stronger Canadian dollar not only impacted the translated revenue and costs of the Company's U.S. based operations, but also resulted in a significant revaluation of its balance sheet at October 31, 2007. Also as a result of this continued strengthening of the Canadian dollar, the Company wrote-off its investment in its Moore division, which invoiced exclusively in U.S. dollars, in the fourth quarter as a goodwill impairment charge of $1.9 million.

During the year the Company's long-term relationship with IBM Japan Ltd. was completed. This significantly impacted the Asset Management Division's license and maintenance support revenue in fiscal 2007 as this customer contributed revenue of $1.5 million in the current year compared to $7.8 million in the prior year.

As a result of a stronger Canadian dollar and the completion of the IBM Japan contract, Enghouse's overall revenue decreased to $55.2 million in fiscal 2007 from $62.5 million in the prior fiscal year, while net income decreased to $5.5 million from $11 million. The Company continued to generate substantial cash flows from operations, recording approximately $13 million in operating cash flows for the year. Cash flows from operations were used during the year for the acquisition of Ontira, to pay a quarterly dividend beginning in March 2007 and to re-purchase over 352,000 shares of the Company's common shares on the open market.

The U.S. sub-prime debt crisis impacted the debt market for many companies through a general tightening of credit availability. Enghouse was not directly impacted by this as the Company does not hold any positions in asset-backed commercial paper and continues to have no long-term debt. At October 31, 2007, Enghouse had over $100 million in cash and short-term investments.

Early in the year, we focused on emphasizing growth of the Syntellect Division's indirect channel and invested in additional marketing and sales resources to move the business forward. Although progress was slower than anticipated, shortly after year end we announced a reseller agreement with ShoreTel, Inc., which we hope will be the start to achieving increased revenue objectives. The Syntellect Division also launched a new product initiative under the Voiyager brand name late in the year, which appears to have good initial acceptance.

During the year, the Company continued to invest in its Transched unit, which provides a wide variety of software to transit agencies and private transportation companies, and its Networks unit, which provides geospatial software for the utility and telecommunications markets. Ontira Communications Inc. was purchased on March 31, 2007 to provide Transched with Automated Travel Information Systems and enhanced interactive voice response and multi-media systems capability for the transit market. The integration of the development and customer support operations of these entities was the focus for the latter half of fiscal 2007 along with Transched's first release of its private coach software.

At the Company's headquarters, a new accounting system was implemented during the year to improve the transparency of internal financial reporting in this ever increasing regulatory environment for public companies. This activity also positions the Company for future acquisitions on a consistent accounting system.

The Company is positioned to prosper. We remain committed to our acquisition strategy, which will strengthen the Company and continue to investigate opportunities to enter new markets and expand our presence within our current markets. We have the financial resources to grow the business, pay a quarterly dividend, implement our share buyback program and fund accretive acquisitions to increase shareholder value.

We appreciate the continued loyalty and support of our patient shareholders, customers and employees while we actively search for opportunities to increase overall value.

Stephen J. Sadler
Chairman of the Board and
Chief Executive Officer

# Management's Discussion & Analysis

The following Management Discussion and Analysis ("MD&A") should be read in conjunction with Enghouse Systems Limited's ("Enghouse" or "the Company") fiscal 2007 consolidated financial statements and the notes thereto. Unless otherwise indicated, all references to dollar amounts herein are to Canadian dollars, stated in thousands, except per share amounts. This MD&A and all information contained herein is current as of December 17, 2007.

## Forward-Looking Statements

Certain statements made or incorporated by reference in this MD&A are forward-looking and relate to, among other things, anticipated financial performance, business prospects, strategies, regulatory developments, new services, market forces, commitments and technological developments. By its nature, such forward-looking information is subject to various risks and uncertainties, including those discussed in this MD&A or in documents incorporated by reference in this MD&A, such as Enghouse's Annual Information Form, which could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed herein. Readers are cautioned not to place undue reliance on this forward-looking information, and the Company shall have no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except in accordance with applicable securities laws.

## Corporate Overview

Enghouse is a Canadian publicly traded company (TSX:ESL) that develops enterprise software solutions for a variety of vertical markets. The Company is organized around two business segments: the Syntellect Division and the Asset Management Division. The Syntellect Division serves the customer service market segment through the provision of interactive voice response ("IVR") systems and speech and voice recognition solutions as well as an advanced contact center platform that manages multi-channel customer interactions. Its customers include insurance companies, banks, utilities as well as high technology, health care and hospitality companies. The Asset Management Division provides visual-based software solutions for the design and management of complex network infrastructures to telecommunications, utilities, public and private transportation and oil and gas companies.

The Company's strategy is to create a larger and more diverse enterprise software and services company through a combination of strategic acquisitions and managed growth. The Company continues to pursue acquisitions both within and outside its present vertical markets and has over $100 million in cash and short-term investments with which to execute its strategy. On March 31, 2007, Transched Systems Limited, a wholly owned subsidiary of Enghouse, acquired 100% of the issued and outstanding common shares of Ontira Communications Inc. ("Ontira") for $2.15 million including transaction costs. Ontira is a supplier of Automated Travel Information Systems ("ATIS") for the transit and transportation industries, and provides a variety of solutions including enhanced Interactive Voice Response ("IVR") and multi-media systems. Following the acquisition, the operations of Ontira were integrated within Transched to leverage synergies between the two companies and their respective customers. The results of operations have been included in the Asset Management Division since the date of acquisition.

In the prior fiscal year, on November 28, 2005 Syntellect acquired 100% of the issued and outstanding common shares of Apropos Technology, Inc. ("Apropos") of Oakbrook Terrace (Chicago), Illinois for a cash purchase price of $59.4 million (U.S. $50.8 million), which included acquired cash and short-term investments of $42.2 million (US $36.2 million). Apropos develops communications management solutions for contact center operations, which are largely used when differentiated levels of service and support are required to effectively service the customer base. The Company believes Apropos' technology is complementary to Syntellect's contact center product, although offering greater multi-channel interaction management. The results of the operations of Apropos have been included in the Syntellect Division's results from the date of acquisition.

As previously announced, the Company's long-term maintenance contract with its largest customer was terminated on March 31, 2007. This has negatively impacted both revenue and net income compared to prior fiscal years. During this fiscal year, this customer contributed $1.5 million in license and maintenance revenue compared to $7.8 million in the prior fiscal year.

During the fourth quarter, the Company recorded a goodwill impairment charge of $1.9 million to completely write-off its investment in its Moore operations as the Company's annual impairment tests concluded that its carrying value exceeded the fair value of its goodwill. The impairment was the result of the continued strengthening of the Canadian dollar in which Moore incurs the majority of its costs relative to the U.S. dollar in which Moore invoices, which eroded the competitive advantage afforded Moore in prior years.

The Company continues to maintain a significant cash balance, closing the year with over $100 million in cash and short-term investments. During the year, Enghouse generated cash flows from operations of $13 million, compared to cash flows generated in fiscal 2006 of $19.9 million. The Company's ability to generate positive cash flows, remain debt free and augment the Company's overall cash reserves is critical to maintaining its autonomy in executing its acquisition strategy.

Management continues to actively pursue acquisition opportunities and remains committed to its acquisition strategy. Management has taken a long-term view in this regard and continues to carefully evaluate all acquisition opportunities on the basis of their long-term return on invested capital to shareholders.

## Quarterly Results Of Operations

The following table sets forth certain unaudited information for each of the eight most recent quarters (the last of which ended October 31, 2007) and for the past three fiscal years. The annual information has been derived from the Company's audited consolidated financial statements, while quarterly information has been derived from the Company's unaudited consolidated financial statements that, in management's opinion, have been prepared on a basis consistent with the audited consolidated financial statements and include all adjustments necessary for the fair presentation of the information presented therein. Historically, the Company's operating results have fluctuated on a quarterly basis, which the Company expects will continue in the future. Fluctuations in results continue to relate to the timing of software license and hardware sales, which may result in large sales orders in any one quarter, and to the timing of acquisitions, staffing and infrastructure changes. See "Risks And Uncertainties" for more details.

| For the three months ending | Total revenue | Net income | Earnings per share – basic | Earnings per share – diluted | Cash and short-term investments | Total assets |
|---|---|---|---|---|---|---|
| January 31, 2007 | $ 13,428 | $ 1,845 | $ 0.07 | $ 0.07 | $ 105,358 | $ 164,248 |
| April 30, 2007 | 15,036 | 2,285 | 0.09 | 0.09 | 106,109 | 162,486 |
| July 31, 2007 | 13,830 | 2,035 | 0.08 | 0.08 | 105,321 | 157,222 |
| October 31, 2007 | 12,907 | (655) | (0.03) | (0.03) | 100,505 | 146,257 |
| **Year ended October 31, 2007** | **$ 55,201** | **$ 5,510** | **$ 0.22** | **$ 0.21** | **$ 100,505** | **$ 146,257** |
| January 31, 2006* | $ 16,764 | $ 3,076 | $ 0.12 | $ 0.12 | $ 83,397 | $ 152,955 |
| April 30, 2006* | 15,021 | 2,448 | 0.10 | 0.09 | 93,781 | 157,574 |
| July 31, 2006* | 14,848 | 2,666 | 0.10 | 0.10 | 96,040 | 159,229 |
| October 31, 2006 | 15,849 | 2,813 | 0.11 | 0.11 | 98,223 | 159,757 |
| **Year ended October 31, 2006** | **$ 62,482** | **$ 11,003** | **$ 0.43** | **$ 0.42** | **$ 98,223** | **$ 159,757** |
| **Year ended October 31, 2005** | **$ 48,430** | **$ 5,913** | **$ 0.23** | **$ 0.22** | **$ 97,723** | **$ 136,720** |

*Not restated to reflect fair value of equity investments.

The Company had no long-term debt at the end of any of the last three fiscal years.

## Critical Accounting Policies And Estimates

The Company's consolidated financial statements are prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). The preparation of the Company's consolidated financial statements is based on the selection and application of significant accounting policies, some of which require management to make significant estimates that affect the reported amounts of assets, liabilities, revenue and expenses and the related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to revenue, allowance for doubtful accounts, investment tax credits, the useful lives and recoverability of long-term assets, intangible assets, the carrying value of goodwill and the valuation allowance on future income tax assets. The Company bases its estimates on historical experience as well as on various other assumptions that are believed to be reasonable under the circumstances at the time. Under different assumptions or conditions, the actual results would differ, potentially materially, from those previously estimated. Many of the conditions impacting these assumptions and estimates are beyond the Company's control.

The Company believes that the following critical accounting policies affect its more significant judgements and estimates used in the preparation of its consolidated financial statements.

### Revenue Recognition

The Company's policy for revenue recognition is to recognize revenue from software license fees when there is an unconditional sales order, the software is delivered, the fees are fixed with collection reasonably assured and no significant future vendor obligations exist. Maintenance revenue is recognized equally over the term of the maintenance contract and professional consulting and hosted services revenue is recognized as the services are performed over the term of the service agreement.

The Company's software license contracts are typically multiple element arrangements that may also include the provision of maintenance and professional services. The Company evaluates these contracts to determine whether the professional services are essential to the functionality of the software. To the extent that the services are essential, revenue is recognized using the percentage of completion method using labor costs as a measure toward completion. If the services are not essential to the functionality, revenue is allocated to each element based on their relative fair values and recognized when the above-noted revenue recognition criteria have been met for each element.

## Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for the estimated losses resulting from the inability of its customers to make required payments. The Company reviews this provision regularly and performs ongoing credit evaluations of its customers' financial condition. Adverse changes in the financial condition of the Company's customers resulting in an impairment of their ability to make payments would likely require the provision of additional allowances. Actual collections could materially differ from management's estimates.

## Acquired Assets and Liabilities including Intangible Assets and Goodwill

The Company accounts for all business combinations using the purchase method, under which it allocates the excess of the purchase price of business acquisitions over the fair value of identifiable net assets acquired to intangible assets and goodwill. Any goodwill or intangible assets with indefinite useful lives acquired in business combinations are no longer amortized to income over their useful lives but are assessed annually for any potential impairment in value. All other intangible assets are amortized to operations over their estimated useful lives. Where appropriate, purchase price allocations are derived from a formal valuation by an independent third party valuation expert.

The Company's intangible assets relate to acquired technology, customer lists and trademarks. In assessing the recoverability of these intangible assets, the Company must make assumptions regarding estimated future cash flows, market conditions and other factors to determine the fair value of the assets. If these estimates or related assumptions change in the future, the Company may be required to record impairment charges for these assets. In fiscal years 2007 and 2006, the Company did not record an impairment charge related to intangible assets.

The Company has goodwill arising from business acquisitions, which is comprised of the excess of amounts paid over the fair value of net identifiable assets acquired. The Company performs an annual assessment of the fair value of the businesses to which this goodwill relates. In assessing the fair value of these businesses, the Company must make assumptions regarding estimated future cash flows, market conditions and other factors to determine the fair value of the business. If estimates or their related assumptions change in the future, the Company could be required to record impairment charges for these assets.

As a result of the continued strengthening of the Canadian dollar relative to its U.S. counterpart, the Company's competitive advantage in providing Canadian based data conversion services priced in U.S. dollars to the oil and gas industry from its Moore operations have eroded significantly. Accordingly, the Company has recorded an impairment charge of $1.9 million in the year. In fiscal 2006, the Company did not record any impairment charges related to goodwill.

## Income Taxes

Management uses judgement to estimate current and future income taxes. This involves determining taxable income, temporary differences between tax and accounting carrying values and income tax loss carry-forwards. Favorable or unfavorable adjustments to tax provisions may result when tax positions are resolved or settled at amounts that differ from those estimates.

The Company has future income tax assets that are subject to periodic recoverability assessments. Realization of the Company's future income tax assets is largely dependent upon its achievement of projected future taxable income and the continued applicability of ongoing tax planning strategies. The Company's judgements regarding future profitability may change due to future market conditions, changes in tax legislation and other factors that could adversely affect the ongoing value of the future income tax assets. These changes, if any, may require the material adjustment of these future income tax asset balances through an adjustment to the valuation allowance thereon in the future. This adjustment would reduce the future income tax asset to the amount that is considered to be more likely than not to be realized and would be recorded in the period such a determination was to be made.

## Changes In Accounting Policy

### Financial Instruments and Comprehensive Income

Effective November 1, 2006, the Company adopted changes in accounting standards for the recognition and measurement of financial instruments introduced for fiscal years beginning on or after October 1, 2006. The standards are set out in The Canadian Institute of Chartered Accountants ("CICA") Handbook Sections 1530, "Comprehensive Income", 3855, "Financial Instruments – Recognition and Measurement", and 3865, "Hedging".

CICA Section 3855, "Financial Instruments – Recognition and Measurement", prescribes when a financial asset, financial liability or derivative shall be recognized on the balance sheet and the measurement of such amount. It also specifies how financial statement gains and losses are to be recognized depending on their classification. Depending on the financial instruments' classification, changes in subsequent measurements are recognized in net income or comprehensive income.

The Company has implemented the following classifications:

- Cash and short-term investments consisting of commercial paper, mutual funds, bonds and bankers acceptances are classified as financial assets and held-to-maturity investments respectively and are measured at cost and amortized cost using the effective interest rate method.
- Accounts receivable are classified as loans and receivables. After their initial fair value measurement, they are measured at amortized cost using the effective interest rate method. For the Company, this generally corresponds to cost.
- Short-term investments consisting of equity investments are classified as available for sale financial assets. These financial assets are marked-to-market through comprehensive income at each period end and are only taken to income at the time of disposition.
- Accounts payable, accrued liabilities and customer deposits are classified as financial liabilities. After their initial fair value measurement, they are measured at amortized cost using the effective interest rate method. For the Company, the measured amount generally corresponds to cost.

These new standards are to be applied without restatement of prior period amounts with the exception of foreign exchange gains and losses on the translation of the financial statements of self-sustaining foreign subsidiaries. These items were previously recorded in a separate section of shareholders' equity but have been restated and are now presented as accumulated other comprehensive loss. Upon initial application of the new standards, all adjustments to the carrying amounts of financial assets and liabilities were recognized as an adjustment to the opening balance of accumulated other comprehensive loss. The Company has recognized a $0.4 million charge, net of income taxes, to the opening balance of accumulated other comprehensive loss with respect to the change to fair market value of short-term investments designated as available for sale.

### Recent Accounting Pronouncements

On December 1, 2006 the CICA issued Handbook Section 1535, "Capital Disclosures", Section 3862 "Financial Instruments – Disclosures," and Section 3863, "Financial Instruments – Presentation." Section 1535 established disclosure requirements about an entity's capital and how it is managed. The purpose of the new standard is to enable users of the financial statements to evaluate objectives, policies and processes for managing capital. Sections 3862 and 3863 will replace section 3861, "Financial Instruments – Disclosure and Presentation, " revising and enhancing disclosure requirements while carrying forward its presentation requirements. These new sections will place increased emphasis on disclosure about the nature and extent of risks arising from financial instruments and how the entity manages those risks. These sections apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company plans to adopt this new guidance effective November 1, 2007. The Company does not expect the adoption of this guidance to have a material impact on its financial position, results of operations or cash flows.

In July 2006, the CICA revised Section 1506, "Accounting changes". The new standard requires that voluntary changes in accounting policy can only be made if the change results in financial statements that provide reliable and more relevant information, requires changes in accounting policy to be applied retrospectively unless doing so is impracticable and that prior period errors are corrected retrospectively. This section applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2007. The Company does not expect the adoption of this standard in fiscal 2008 to have a material impact on its consolidated financial statements.

## Liquidity And Capital Resources

Enghouse closed the year with $100.5 million in cash and short-term investments, an increase over the prior year's cash reserves of $98.2 million. The Company generated positive operating cash flows of $13 million in fiscal 2007, down from $19.9 million in fiscal 2006 primarily as a result of the impact of decreased revenue, which resulted in lower net income in the fiscal year. Short-term investments continue to be invested in a combination of highly liquid short-term commercial paper, mutual funds, bonds and equities and do not include positions in asset-backed commercial paper.

The Company remains debt-free and has current liabilities related to accounts payable and accrued liabilities, current income taxes payable, dividends payable and deferred revenue, and non-current liabilities related to deferred revenue and future income taxes as at October 31, 2007.

The Company also renewed its stock repurchase plan for a further year that will expire on April 11, 2008. Pursuant to the normal course issuer bid rules of the Toronto Stock Exchange, the Company is entitled to purchase for cancellation up to 1,273,261 common shares, representing approximately 5% of the issued and outstanding shares, at market prices at the time of repurchase. The Company repurchased for cancellation 352,100 of its shares under this plan during fiscal 2007 (2006 – 179,600) at an average price of $7.74 per share. During the current fiscal year, 28,000 stock options were exercised, contributing additional cash of $0.2 million to the Company. As at December 17, 2007 there were 25,171,124 common shares issued and outstanding.

Based on the Company's current plans and projections, management is confident that the Company has the funds necessary to meet its existing and future financial operating commitments. Future acquisition growth may be funded through a combination of cash and equity consideration, which could cause dilution to existing shareholders.

## Dividend Policy

The Company commenced its current dividend policy of paying a quarterly dividend of $0.025 per common share outstanding in fiscal 2007. The Company declared and made the following dividend payments in the three most recently completed fiscal years: (i) $0.025 per common share outstanding on May 31, 2007 ($637) to shareholders of record as at May 14, 2007; (ii) $0.025 per common share outstanding on August 31, 2007 ($629) to shareholders of record as at August 14, 2007; (iii) $0.025 per common share outstanding on November 30, 2007 ($629) to shareholders of record as at November 14, 2007.

The decision on whether to declare a dividend is subject to the Board of Director's discretion. In determining whether to declare and the amount of the dividend, the Board of Directors, among other criteria, takes into account the Company's financial condition, results of operations, capital requirements and such other factors as the Board of Directors deems relevant at such time.

## Commitments And Contractual Obligations

The Company has no significant commercial commitments or obligations other than for the leases of the facilities it currently occupies, the latest of which expires in fiscal 2013, and operating leases for office and computer equipment. The following table summarizes the contractual obligations of the Company for future years.

| | Total | 2008 | 2009 | 2010 | 2011 | 2012 and thereafter |
|---|---|---|---|---|---|---|
| Lease obligations | $ 4,232 | $ 1,431 | $ 1,222 | $ 867 | $ 332 | $ 380 |

The Company has entered into sub-lease agreements on certain properties on which it has lease commitments, which reduce the total operating lease commitments reflected above by $0.1 million over the terms of the sub-lease agreements. The Company does not have a company-funded pension plan or any obligations related to any deferred compensation arrangements.

## Off-Balance Sheet Arrangements

The Company has not entered into off-balance sheet financing arrangements. Except for operating leases and other low probability and/or unmeasurable contingent liabilities (not accrued in accordance with Canadian GAAP), all commitments are reflected on the Company's balance sheet.

## Transactions With Related Parties

The Company has not entered into any transactions with related parties during the year, other than transactions between wholly owned subsidiaries and the Company in the normal course of business, which are eliminated on consolidation.

## Results Of Operations

### General

The Company recorded revenue of $55.2 million for the year ended October 31, 2007 compared to $62.5 million in the prior year and net income of $5.5 million compared to net income of $11 million in the prior year ended October 31, 2006.

Software and services revenue decreased during the year as anticipated as a result of the completion of a major agreement with one customer on March 31, 2007. This customer contributed $1.5 million in revenue in the current fiscal year, compared to $7.8 million in the prior year. Revenue was also adversely impacted by the continued strong performance of the Canadian dollar relative to the U.S. dollar in the year, reaching par in the fourth quarter. Approximately 82% of the Company's revenue was denominated in U.S. dollars, which was reported using an average foreign exchange rate of $1.11 in fiscal 2007 versus $1.14 in fiscal 2006.

### Revenue

Revenue for the year was $55.2 million, a decrease of $7.3 million or 12% from the $62.5 million reported in the prior year and is comprised of license, hardware, maintenance, professional consulting and hosted services revenue.

The majority of this decrease is related to weaker software license sales reported in the Asset Management Division compared to the prior year. Revenue for the Asset Management Division was $9.3 million compared to $14.9 million in the prior year. First, the license revenue contributions from a major customer decreased from $4.8 million to $0.3 million in the year, while maintenance decreased from $3 million to $1.2 million consistent with the termination of that customer's annual maintenance contract. Second, the continued strengthening of the Canadian dollar in the fiscal year had a negative impact on U.S. denominated license and services revenue in the traditional NetWORKS market and eroded the competitive advantage that Moore once had in providing Canadian based data conversion services to the oil and gas industry. This was mitigated by better performance by the Division's Transched operations, which increased revenue by $0.8 million as a number of projects commenced delivery in the fiscal year. The Division's operating results also include revenue from Ontira since the date of acquisition, March 31, 2007.

Revenue for the Syntellect Division decreased from $47.5 million in fiscal 2006 to $45.9 million for the year just ended. This reflects a decrease in software license sales of $1.8 million and a decrease in services revenue of $1.5 million, both of which were mitigated by increased revenue from maintenance of $1.3 million. The decrease in the Syntellect Division's revenue was partially the result of the stronger Canadian dollar when measured using the prior year's average exchange rate on the current year's predominately U.S. dollar denominated revenue base. In U.S. dollars, the Syntellect Division reported revenue of $41.6 million compared to $41.8 million in the prior fiscal year. Had the current year's U.S. dollar denominated revenue base been translated at the average foreign exchange rate for fiscal 2006 of $1.14, the current year's revenue would have been $1.2 million higher.

Software license revenue in the year was $11.4 million compared to $18 million, a decrease of $6.6 million from the prior year. The decrease is primarily attributable to decreased license revenue from a major customer in the Asset Management Division and the impact of foreign exchange on the predominantly U.S. denominated license revenue stream.

Overall, $42 million or 76.1% of all revenue was derived from services, compared to $43 million or 68.8% in fiscal 2006. Maintenance revenue comprised $30.4 million or 72.4% of the total services revenue for the year, compared to $30.6 million or 71.2% in fiscal 2006, with the decrease being primarily attributable to the termination of the maintenance contract of a major customer in the Asset Management Division, which was mitigated in part by the inclusion of Ontira's maintenance revenue since acquisition combined with a full year of Apropos maintenance revenue. The Company's strategy continues to be centered on the belief that a strong recurring maintenance revenue stream is essential to its operations, increasing the predictability and consistency of the Company's earnings.

Hardware revenue increased to $1.8 million in the year from $1.5 million as a result of increased provision of full solution offerings in the Syntellect Division operations.

## Cost Of Sales

Cost of sales was $18.2 million or 33.0% of revenue compared to $18.4 million or 29.4% of revenue in the prior fiscal year. The majority of this percentage increase is related to the proportional increase in the cost of licenses in the fiscal year, which increased from 11.8% to 18.5%, consistent with the decrease in higher margin license revenue from the Asset Management Division's major customer. The cost of services was $14.7 million or 34.9% of services revenue compared to $14.9 million or 34.8% of services revenue in the prior year.

Cost of hardware sales increased from $1.3 million to $1.4 million, consistent with increased hardware revenue contributions in the fiscal year related to the provision of hardware in the Syntellect Division.

## Operating Expenses

The Company's operating expenses were $30.9 million in the fiscal year compared to $30.4 million in the prior fiscal year. These expenses include non-cash charges for acquired software amortization of $5.9 million compared to $5.7 million in the prior fiscal year as a result of incremental amortization charges related to the Ontira acquisition and one additional month of expense related to Apropos, which was acquired on November 28, 2005. Operating costs have benefited from the stronger Canadian dollar in the fiscal year as the majority of the Syntellect Division's operating costs are denominated in U.S. dollars. Approximately $12.1 million of operating expenses were denominated in U.S. dollars, which reduced expenses reported in the year by $0.4 million.

Headcount for the Company on a consolidated basis was 287 as at October 31, 2007 compared to 268 at the prior year end and reflects the additional headcount in the Ontira operations as well as additional sales staff in the Syntellect Division.

Operating costs also included non-cash charges related to compensation expense related to stock options granted, which added $0.5 million to both the current and prior fiscal year (see Note 6(D) to the consolidated financial statements). Investment tax credits ("ITCs") were not booked in the current fiscal year as claims have not yet been assessed. The prior year's research and development costs include a credit for $0.1 million. The Company records ITCs earned under the Income Tax Act (Canada) when there is reasonable assurance of realization. To the extent that the actual ITCs realized vary from the amount accrued, the difference is recognized in the year when such a difference is determined.

## Foreign Exchange

The Company earns a significant portion of revenue from sales denominated in U.S. dollars, including the majority of the Syntellect Division's revenue. The sharp increase in the Canadian dollar relative to the U.S. dollar during fiscal 2007 has negatively impacted operations, as it has for many Canadian companies exporting into the U.S. The Company estimates that the impact of the stronger Canadian dollar has reduced revenue by $1.4 million in the year had the current year's U.S. dollar denominated revenue been recorded at the average fiscal 2006 rate.

During the current fiscal year, the Canadian dollar, measured relative to its U.S. counterpart, peaked at a high of $1.18 and closed the year at a low of $0.95, which resulted in an average foreign exchange rate of $1.11 for the year. The sharp decline in the exchange rate in the fourth quarter has significantly impacted the translation of foreign currency denominated balances at year end. In fiscal 2006, the dollar declined from a high of $1.22 to a low of $1.10, closing at $1.12, resulting in an average exchange rate of $1.14 for the fiscal year.

The Company also maintains U.S. dollar denominated cash positions as necessary to fund operations and potential acquisitions as well as U.S. denominated receivable and payable balances. These amounts have been restated to Canadian dollars at $0.95, the rate in effect as at October 31, 2007. As a result of the strong Canadian dollar, the Company reported foreign exchange losses of $0.6 million in the current year, with the majority of the loss arising in the fourth quarter, compared to losses of $0.4 million in the prior fiscal year. These exchange losses have been included in selling, general and administrative expenses. The Company does not hedge foreign currency exposure but funds its U.S. dollar expenses with U.S. dollar revenue in order to mitigate exposure. Going forward, while fluctuations in exchange rates among the U.S. dollar, the Canadian dollar and other currencies may have a material adverse effect on the Company's business, results of operations and financial condition, they also have a mitigating effect by reducing the relative cost of U.S. acquisitions in Canadian dollars.

## Goodwill Impairment Charge

During the fourth quarter, the Company recorded a goodwill impairment charge of $1.9 million to completely write-down the Company's investment in its Moore operations. The impairment charge was taken to reflect management's view that the continued strengthening of the Canadian dollar relative to the U.S. dollar has significantly impacted any cost advantage that Moore previously held in the data conversion business. The Company has not recorded any income tax benefit from this non-cash impairment charge.

## Interest Income And Other Income

Interest income increased to $4.3 million, an increase of $1 million over the prior year as a result of improved short-term yields on higher average invested cash balances during the current fiscal year on both Canadian and U.S. dollar denominated investments. Other income reported was $1.3 million in the year, up from $0.1 million in the prior year. This amount includes $0.5 million realized on the gain on the sale of patents in the fourth quarter and also reflects gains realized on equity investments sold during the current fiscal year valued at $0.8 million. There can be no assurance that similar gains will be recorded in future years.

## Income Tax Expense

During the year, the Company set up an income tax provision of $4.3 million reflecting a 43.5% effective tax rate as compared to a provision of $6.1 million or a 35.8% effective tax rate in the prior fiscal year. The increase in the provision in the year reflects the non-deductibility for tax purposes of the goodwill impairment charge taken in the fourth quarter. Excluding the $0.7 million tax impact of the goodwill impairment charge, the effective tax rate was 36.3%.

The income tax provision is different from the amount that would be obtained by multiplying the Company's income before income taxes by the combined basic Canadian federal and provincial income tax rate (36.1%) due to the combination of a number of factors including certain expenses being non-deductible for income tax purposes, certain gains being non-taxable or partially taxable, the effect of foreign income tax rates that differ from the Canadian income tax rate and the effect of rate changes on future income taxes.

## Net Income

Enghouse reported net income of $5.5 million in fiscal 2007, compared to $11 million reported in fiscal 2006. This decrease is attributable primarily to the impact of the decreased license and maintenance contributions from a major customer in the fiscal year and to the impact of foreign exchange on revenue. Earnings per share on a diluted basis were $0.21 versus $0.42 in fiscal 2006.

## Fourth Quarter Operating Results

Total revenue for the quarter was $12.9 million compared to $15.8 million in the prior year's fourth quarter. The decrease in revenue in the quarter is primarily attributable to the weaker license revenue compared to the prior year's fourth quarter.

The Syntellect Division contributed $10.6 million in revenue in the quarter, down from $13.3 million reported in the fourth quarter of fiscal 2006. The decrease is attributable to the impact of incremental software license revenue booked in the prior year's fourth quarter, which was the best quarter in either of fiscal 2006 or 2007. The Asset Management Division contributed $2.3 million in revenue in the fourth quarter, compared to $2.6 million reported in the fourth quarter of fiscal 2006 as a result of lower license and maintenance revenue in the quarter from a major customer, which was mitigated in part by increased services revenue booked in its transit operations.

Cost of sales for the quarter was $4.5 million or 35.1% of revenue compared to $5 million or 31.2% in the prior year's fourth quarter and reflects increased proportional contributions from lower margin services revenue in the Asset Management Division. Cost of services was $3.6 million or 36.0% of services revenue compared to $4 million or 36.7% in the prior year's fourth quarter.

Operating expenses for the quarter were $7.8 million, an increase from the $7.6 million reported in the fourth quarter of last year. The increase includes Ontira's operating costs not reflected in the comparative quarter last year as well as foreign exchange losses of $0.6 million for the current quarter. In comparison, the Company recorded foreign exchange losses of $0.2 million in the prior year's fourth quarter. The Company continues to be impacted by the stronger Canadian dollar, which decreases the Canadian dollar equivalent of U.S. denominated operating costs. The exchange rate between Canadian and U.S. dollars averaged $1.04 for the fourth quarter (Q4-2006 - $1.12).

Operating expenses also include non-cash charges related to the compensation expense attributed to stock options granted, totalling $0.1 million in both the current and prior year's fourth quarters. Non-cash charges for amortization of acquired software and other intangibles related to acquisitions were $1.5 million for the quarter consistent with the prior year's fourth quarter charge.

During the fourth quarter, the Company recognized interest income of $1.1 million compared to $1 million in the fourth quarter of fiscal 2006, which reflects increased yields on higher average invested cash balances. The Company recorded $0.5 million in other income from the sale of patents but recorded no gains on the sale of equity positions in the quarter, compared to $0.05 million in gains on the sale of equities in the prior year's fourth quarter.

The Company recorded an impairment charge to goodwill of $1.9 million in the quarter for its Moore operations, for which no corresponding tax benefit was recorded. As a result, the Company established a tax provision of $0.8 million as compared to a provision of $1.6 million or 36% in the prior year's fourth quarter. During the quarter, the Company paid $0.8 million in tax installments compared to payments of $0.7 million in the prior year's fourth quarter.

The Company reported a net loss of $0.7 million or ($0.03) per share in the fourth quarter compared to net income of $2.8 million and $0.11 per share on a dilutive basis respectively in the fourth quarter of fiscal 2006. The net loss is attributable to the goodwill impairment charge of $1.9 million, weaker license revenue and the impact of foreign exchange losses in the quarter. The Company used cash from operations of $1 million compared to cash generated of $3.1 million in the prior year's fourth quarter and closed the year with $100.5 million in cash and short-term investments.

## Risks And Uncertainties

The Company operates in a dynamic business and economic environment that exposes the Company to a number of risks and uncertainties. The following section describes some, but not all, of the risks and uncertainties that may adversely impact our business, financial condition or results of operations. Additional risks and uncertainties not described below or not presently known to the Company may also impact our business. For a full description of the Risk Factors affecting Enghouse, the reader should review the Company's Annual Information Form dated December 18, 2007, filed and available on www.sedar.com, which Risk Factors are incorporated by reference herein.

If any of these risks occur, the Company's business, financial condition or results of operations could be seriously harmed and the trading price of the Company's common shares could be materially affected. The reader should understand that the sole purpose of discussing these risks and uncertainties is to alert the reader to factors that could cause actual results to differ materially from past results or from those described in forward-looking statements and not to describe facts, trends and circumstances that could have a favorable impact on the Company's results or financial position.

### Impact Of Foreign Exchange Fluctuations

The majority of the Company's revenue is denominated in U.S. dollars and is restated to Canadian dollars for financial statement purposes. The relative exchange rate has decreased consistently over the past three fiscal years from an average of $1.22 in fiscal 2005 to $1.14 in fiscal 2006 to an average exchange rate of $1.11 in fiscal 2007. At October 31, 2007, U.S. dollar denominated balances were translated into Canadian dollars at an exchange rate of $0.95, which has had a significant impact on the Company's results of operations. An increasing proportion of the Company's expenses are also denominated in U.S. dollars. This also acts as a natural hedge against the foreign exchange exposure on U.S. denominated revenue. Significant changes in the foreign exchange rates between Canada and the United States could have a material adverse effect on both the revenue and expenses of the Company as seen over the past three fiscal years. As the Canadian dollar strengthens relative to the U.S. dollar, both U.S. dollar denominated revenue and expenses as stated in Canadian dollars will decline. There can be no assurances that the Company will prove successful in its effort to manage this risk, which may adversely impact the Company's operating results.

### Acquisitions

The Company's strategy is to seek acquisitions that will be accretive to earnings and are a good fit for the strategic direction of the Company, both within and outside the Company's current market sectors. While Enghouse has both the experience and financial resources required to execute this strategy, the Company does not have control over the market conditions prevailing or likely to prevail in the future, which may impact the ability to execute this strategy. There can be no assurance that the Company will be able to identify suitable acquisition candidates available for sale at reasonable valuations, consummate any acquisition or successfully integrate any acquired business into its operations. The Company is likely to face competition for acquisition candidates from other parties including those that have greater resources or those willing to pay higher valuation multiples. Acquisitions may involve a number of other risks including: diversion of management's attention; disruption to the Company's ongoing business; failure to retain key acquired personnel; difficulties in integrating acquired operations, technologies, products or personnel; unanticipated expenses, events or circumstances; assumption of disclosed and undisclosed liabilities; and inappropriate valuation of the acquired in-process research and development, or the entire acquired business.

## Intellectual Property Claims

A number of competitors and other third parties have been issued patents and may have filed patent applications or may obtain additional patents and proprietary rights for technologies similar to those used by the Company in our products. Some of these patents may grant very broad protection to the owners of the patents. The Company cannot determine with certainty whether any existing third party patents or the issuance of any third party patents would require the Company to alter its technology, obtain licenses or cease certain activities. The Company may become subject to claims by third parties that its technology infringes their property rights due to the growth of software products in the Company's target markets, the overlap in functionality of these products and the prevalence of software products. The Company provides its customers with a qualified indemnity against the infringement of third party intellectual property rights. From time to time, various owners of patents and copyrighted works send the Company or its customers letters alleging that the Company's products do or might infringe upon the owner's intellectual property rights. Accordingly, where appropriate, the Company forwards any such allegation or licensing request to outside counsel for review. The Company generally attempts to resolve any such matter by informing the owner of the Company's position concerning non-infringement or invalidity. Even though the Company attempts to resolve these matters without litigation, it is always possible that the owner of a patent or copyrighted work will sue the Company. Litigation may be necessary to determine the scope, enforceability and validity of such third party proprietary rights or to establish the Company's proprietary rights. Some competitors have substantially greater resources and may be able to sustain the costs of complex intellectual property litigation to a greater degree and for a longer period of time than the Company could. Regardless of their merit, any such claims could: be time consuming; be expensive to defend; divert management's attention and focus away from the business; cause product shipment delays or stoppages; subject the Company to significant liabilities; and require the Company to enter into costly royalty or licensing agreements or to modify or stop using the infringing technology.

## Litigation

In addition to being subject to litigation in the ordinary course of business, the Company may become subject to class actions, securities litigation or other actions, including anti-trust and anti-competitive actions. Any litigation may be time consuming, expensive and distracting from the conduct of the Company's day-to-day business. The adverse resolution of any specific lawsuit could have a material adverse effect on the Company's financial condition and liquidity. In addition, the resolution of those matters may require the Company to issue additional Common Shares, which could potentially result in dilution. Expenses incurred in connection with these matters (which include fees of lawyers and other professional advisors and potential obligations to indemnify officers and directors who may be parties to such actions) could adversely affect the Company's cash position. (See Note 13 to the consolidated financial statements).

## Competition

The Company experiences intense competition from other software companies. Competitors may announce new products, services or enhancements that better meet the needs of customers or changing industry standards. Increased competition may cause price reductions, reduced gross margins and loss of market share, any of which could have a material adverse effect on the business, results of operations and financial condition of the Company. Many of the Company's competitors and potential competitors have significantly greater technical, marketing, service or financial resources. Other competitive factors include price, performance, product features, market timing, brand recognition, product quality, product availability, breadth of product line, design expertise, customer service and post contract support. A very important selection factor from a customer perspective is a large installed customer base that has widely and productively implemented the software product, which not only increases the potential for repeat business, but also provides reference accounts to promote the Company's products and solutions with new customers. While management believes that the Company has a significant installed customer base in its Asset Management and Syntellect Divisions, many of its competitors have a larger installed base of users, have longer operating histories or have greater name recognition. In addition, if one or more of the Company's competitors were to merge or partner with other competitors, the change in the competitive landscape could adversely affect the Company's ability to compete effectively.

## Development Of New Products And Enhancement Of Existing Products

To keep pace with technological developments, satisfy increasingly sophisticated customer requirements and achieve market acceptance, the Company must enhance and improve existing products and continue to introduce new products and services. If the Company is unable to successfully develop new products or enhance and improve existing products or if it fails to position and/or price its products to meet market demand, the Company's business and operating results will be adversely affected. Accelerated product introductions and short product life cycles require high levels of expenditures for research and development that could adversely affect the Company's results of operations. Further, the introduction of new products could require long development and testing periods and may not be introduced in a timely manner or may not achieve the broad market acceptance necessary to generate significant revenue.

No assurance can be provided that the Company's software products will remain compatible with evolving computer hardware and software platforms and operating environments. In addition, competitive or technological developments and new regulatory requirements may require the Company to make substantial, unanticipated investments in new products and technologies. If the Company is required to expend substantial resources to respond to specific technological or product changes, its operating results would be adversely affected.

The continuing ability of the Company to address these risks will depend, to a large extent, on its ability to retain a technically competent research and development staff and to adapt to rapid technological advances in the industry.

## Customer Dependency

The Company has reduced its economic dependence on revenue from any particular customer over time as the Company diversifies its revenue stream to the point where this is not a significant factor going forward. During fiscal 2007, the Company's former largest customer, IBM Japan, accounted for 3% of the Company's total revenue, compared to fiscal 2006 when this customer accounted for 12% of the Company's revenue.

## Loss Of Rights To Use Software Licensed By Third Parties

The Company licenses certain technologies used in its products from third parties, generally on a non-exclusive basis. The termination of any of these licenses, or the failure of the licensors to adequately maintain or update their products, could delay the Company's ability to ship its products while it seeks to implement alternative technology offered by other sources and may require significant unplanned investments. In addition, alternative technology may not be available on commercially reasonable terms. In the future, it may be necessary or desirable to obtain other third party technology licenses relating to one or more of the Company's products or relating to current or future technologies. There is a risk that the Company will not be able to obtain licensing rights to the needed technology on commercially reasonable terms, if at all.

## Reliance On Maintenance Renewals

The Company continues to realize a significant portion of its revenue from maintenance and support services provided in connection with the products it licenses as part of its core business strategy. The continued expansion of this revenue stream as a result of increased license sales and through the acquisition of companies with an existing maintenance customer base is a key driver to the continued revenue growth of the Company. There can be no assurances that the rate of customer attrition, which would result in lower revenue, will be offset by a combination of new maintenance revenue associated with incremental license sales, acquisitions and contract price increases.

### Tax Issues

The Company conducts business operations in various foreign jurisdictions and through legal entities in Canada, the United States and the United Kingdom. Accordingly, the Company is subject to income taxes as well as non-income based taxes in Canada, the United States, the United Kingdom and various foreign jurisdictions and our tax structure is subject to review by numerous taxation authorities. The tax laws of these jurisdictions have detailed tax rules.

Significant judgement is required in determining the Company's worldwide provision for income taxes and other tax liabilities. Although the Company strives to ensure that its tax estimates and filing positions are reasonable, no assurance can be provided that the final determination of any tax audits and litigation will not be different from what is reflected in the Company's historical income tax provisions and accruals, and any such differences may materially affect the Company's operating results for the affected period or periods. The Company also has exposure to additional non-income tax liabilities such as payroll, sales, use, value-added, net worth, property and goods and services taxes in Canada, the United States and various foreign jurisdictions.

International taxation authorities, including Canada Revenue Agency, the United States Internal Revenue Service and the United Kingdom HM Revenue and Customs, could challenge the validity of the Company's tax filings. If any of these taxation authorities are successful in challenging the Company's tax filings, the Company's income tax expense may be adversely affected and it could also be subjected to interest and penalty charges. Any such increase in the Company's income tax expense and related interest and penalties could have a significant impact on future net earnings and future cash flows.

## Outlook

The Company remains confident that its operating activities and acquisition strategy will provide shareholder value over the long-term. During the year the Company implemented a quarterly dividend program and remained active in the share buy-back program repurchasing the Company's common stock. The Company generated $13 million in cash from operations to fund these programs and increased its overall cash reserves to over $100 million, with which to fund acquisitions. While the Company's long-term relationship with a key customer came to an end in the fiscal year, Enghouse did acquire a number of new customers and was active in securing new business partners for its Syntellect Division. The Company continues to respond to a number of requests for proposals in the transit market and during the year completed the acquisition of Ontira to help leverage its efforts in this area. As a result, management believes that the Company is more balanced and is well positioned to further diversify and grow its revenue stream in the years to come.

## Disclosure Controls And Procedures

Disclosure controls and procedures have been designed under the supervision of the Chief Executive Officer and Vice President Finance, with the participation of other management, to provide reasonable assurance that all relevant information required to be disclosed by the Company is recorded, processed, summarized and reported on a timely basis to senior management, as appropriate, to allow timely decisions regarding required public disclosure. Pursuant to Multilateral Instrument 52-109, as of October 31, 2007, an evaluation of the effectiveness of the Company's disclosure controls and procedures was carried out under the supervision of the Chief Executive Officer and Vice President Finance. The evaluation concluded that the disclosure controls were effective.

## Internal Controls Over Financial Reporting

The Company's Chief Executive Officer and Vice President Finance are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements in accordance with Canadian GAAP.

The Company's Chief Executive Officer and Vice President Finance have concluded that, as at October 31, 2007, the Company has designed such internal control over financial reporting (as defined in Multilateral Instrument 52-109) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

During the fiscal year the Company implemented new ERP consolidation software at the Asset Management Division and Corporate offices in order to streamline its back office functions and to provide a common accounting software platform across the enterprise. There were no other changes to the Company's internal control over financial reporting during the year ended October 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## Additional Information

Additional information relating to the Company, including the Annual Information Form, has been filed and is available on SEDAR at www.sedar.com.

# Management's Responsibility for Financial Reporting

The consolidated financial statements and other financial information for this annual report were prepared by the management of Enghouse Systems Limited, reviewed by the Audit Committee of the Board of Directors and approved by the Board of Directors.

Management is responsible for the preparation of the consolidated financial statements and believes that they fairly represent the Company's financial position, the results of its operations and its cash flows in accordance with Canadian generally accepted accounting principles. Management has included amounts in the Company's consolidated financial statements based on estimates, judgements and policies that it believes reasonable in the circumstances.

To discharge its responsibilities for financial reporting and for the safeguarding of assets, management believes that it has established appropriate systems of internal accounting control, which provide reasonable assurance, at appropriate costs, that the assets are maintained and accounted for in accordance with its policies, and that transactions are recorded accurately on the Company's books and records.

PricewaterhouseCoopers LLP were appointed the Company's auditors at the Annual General Meeting of Shareholders. Their report on the consolidated financial statements of the Company for the years ended October 31, 2007 and 2006 outlines the scope of their examination and their opinion thereon.

Stephen J. Sadler
Chairman of the Board and
Chief Executive Officer

Douglas C. Bryson
Vice President Finance and
Corporate Secretary

Markham, Ontario
December 17, 2007

# Auditor's Report

To the Shareholders of
Enghouse Systems Limited

We have audited the consolidated balance sheets of Enghouse Systems Limited ("the Company") as at October 31, 2007 and 2006 and the consolidated statements of operations and retained earnings, comprehensive income (loss) and accumulated other comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

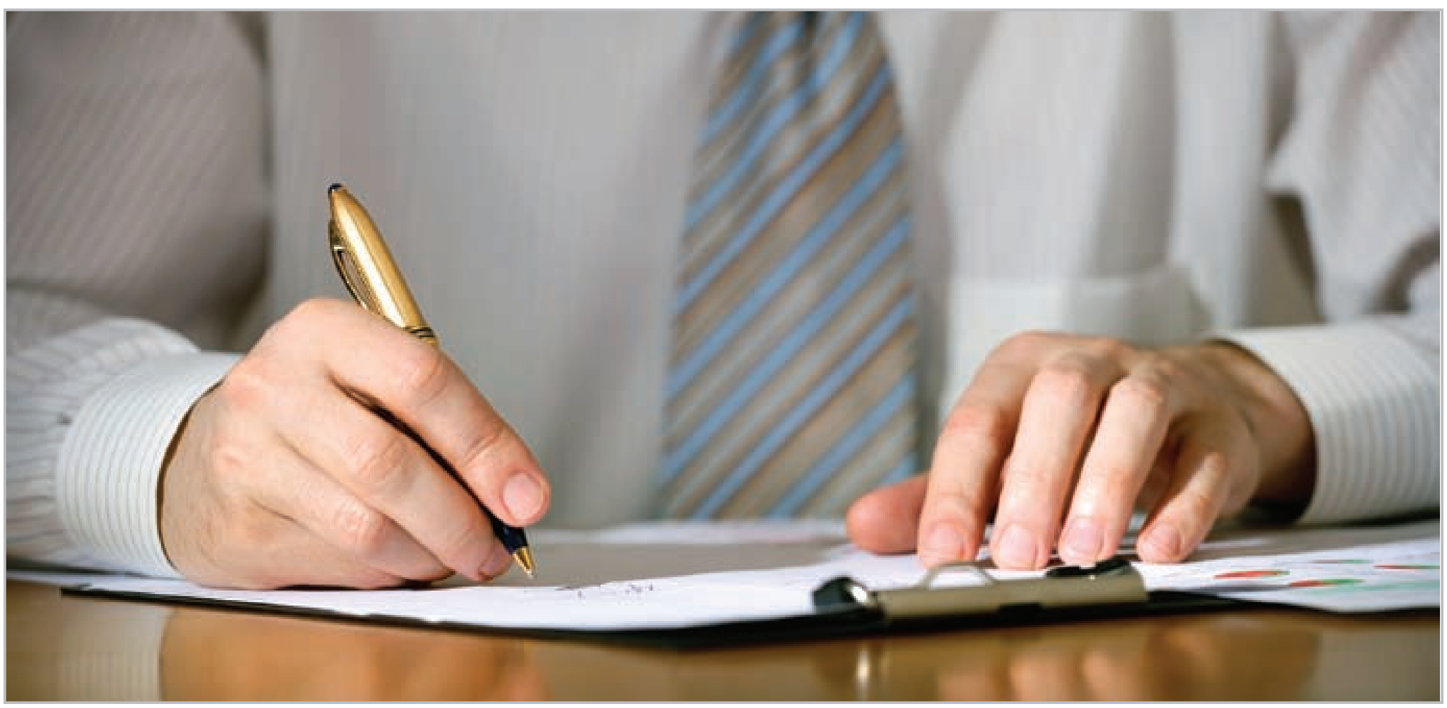
We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Ontario
December 17, 2007



# Consolidated Financial Statements

## Enghouse Systems Limited

October 31, 2007 and 2006

# Consolidated Balance Sheets

(in thousands of Canadian dollars)

| | October 31 2007 | October 31 2006 |
|---|---|---|
| **Assets** | | |
| Current Assets: | | |
| Cash | $ 11,321 | $ 5,602 |
| Short-term investments (Note 2) | 89,184 | 92,621 |
| Accounts receivable, net | 10,376 | 15,253 |
| Future income taxes (Note 8) | 1,359 | 3,480 |
| Prepaid expenses and other assets | 1,488 | 2,074 |
| | **113,728** | **119,030** |
| Property and equipment (Note 3) | 1,930 | 1,667 |
| Acquired software and other intangibles (Note 4) | 15,819 | 21,370 |
| Goodwill (Note 5) | 10,652 | 13,929 |
| Future income taxes (Note 8) | 4,128 | 3,761 |
| | **$ 146,257** | **$ 159,757** |
| **Liabilities** | | |
| Current Liabilities: | | |
| Accounts payable and accrued liabilities | $ 9,258 | $ 12,688 |
| Income taxes payable | 7,342 | 7,629 |
| Dividends payable | 629 | - |
| Deferred revenue | 12,602 | 16,143 |
| | **29,831** | **36,460** |
| Future income taxes (Note 8) | 7,964 | 10,227 |
| Deferred revenue | 953 | 64 |
| | **38,748** | **46,751** |
| **Shareholders' Equity** | | |
| Share capital (Note 6(B)) | 48,670 | 49,177 |
| Contributed surplus (Note 6(B)) | 1,771 | 1,314 |
| Retained earnings | 69,931 | 68,367 |
| Accumulated other comprehensive loss | (12,863) | (5,852) |
| | **107,509** | **113,006** |
| | **$ 146,257** | **$ 159,757** |

Commitments and contingencies (Notes 11 and 13)

*The accompanying notes form an integral part of these consolidated financial statements.*

On Behalf of the Board of Directors:

Stephen J. Sadler
Director

Eric Demirian
Director

# Consolidated Statements of Operations and Retained Earnings

(in thousands of Canadian dollars, except per share amounts)

| | Years ended October 31 2007 | 2006 |
|---|---|---|
| **Revenue** | | |
| Software licenses | $ 11,386 | $ 17,984 |
| Services | 41,997 | 42,990 |
| Hardware | 1,818 | 1,508 |
| | **55,201** | **62,482** |
| **Cost of sales** | | |
| Software licenses | 2,112 | 2,126 |
| Services | 14,663 | 14,946 |
| Hardware | 1,428 | 1,298 |
| | **18,203** | **18,370** |
| **Gross margin** | **36,998** | **44,112** |
| **Operating expenses** | | |
| Selling, general and administrative | 15,522 | 15,005 |
| Research and development (Note 7) | 8,105 | 7,991 |
| Stock-based compensation (Note 6(D)) | 472 | 530 |
| Amortization of property and equipment | 852 | 1,184 |
| Amortization of acquired software and other intangibles | 5,931 | 5,660 |
| | **30,882** | **30,370** |
| **Income before the undernoted** | **6,116** | **13,742** |
| Interest income, net | 4,315 | 3,313 |
| Other income | 1,272 | 87 |
| Goodwill impairment | (1,942) | - |
| **Income before income taxes** | **9,761** | **17,142** |
| **Provision for income taxes (Note 8)** | 4,251 | 6,139 |
| **Net income for the year** | **$ 5,510** | **$ 11,003** |
| **Retained earnings – beginning of year** | $ 68,367 | $ 58,452 |
| Net income for the year | 5,510 | 11,003 |
| Dividends | (1,895) | - |
| Purchase and cancellation of common shares | (2,051) | (1,088) |
| **Retained earnings – end of year** | **$ 69,931** | **$ 68,367** |
| **Earnings per share (Note 9)** | | |
| Basic | $ 0.22 | $ 0.43 |
| Diluted | $ 0.21 | $ 0.42 |

*The accompanying notes form an integral part of these consolidated financial statements.*

# Consolidated Statements of Comprehensive Income (Loss) and Accumulated Other Comprehensive Loss

(in thousands of Canadian dollars)

| | Years ended October 31 2007 | 2006 |
|---|---|---|
| Net income for the year | $ 5,510 | $ 11,003 |
| **Other comprehensive loss:** | | |
| Unrealized loss on translating financial statements of self-sustaining foreign operations | (7,298) | (1,691) |
| Transfer to net income of realized gains on available for sale investments, net of tax of $292 | (518) | - |
| Unrealized gain on available for sale investments, net of tax of $578 | 1,022 | - |
| Unrealized foreign currency translation loss on available for sale investments, net of tax of $122 | (217) | - |
| **Other comprehensive loss** | **$ (7,011)** | **$ (1,691)** |
| **Comprehensive (loss) income** | **$ (1,501)** | **$ 9,312** |
| **Accumulated other comprehensive loss, beginning of period** | **$ (5,852)** | **$ (3,760)** |
| Unrealized loss on available for sale investments, net of tax of $227 | - | (401) |
| Other comprehensive loss | (7,011) | (1,691) |
| **Accumulated other comprehensive loss, end of period** | **$ (12,863)** | **$ (5,852)** |

*The accompanying notes form an integral part of these consolidated financial statements.*

# Consolidated Statements of Cash Flows

(in thousands of Canadian dollars)

| | Years ended October 31 2007 | 2006 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income for the year | $ 5,510 | $ 11,003 |
| **Add (deduct) items not involving cash:** | | |
| Amortization of property and equipment | 852 | 1,184 |
| Amortization of acquired software and other intangibles | 5,931 | 5,660 |
| Stock-based compensation expense | 472 | 530 |
| Goodwill impairment | 1,942 | - |
| Gain on sale of short-term investments | (810) | (87) |
| Gain on sale of patents | (462) | - |
| Future income taxes | (177) | 1,645 |
| | **13,258** | **19,935** |
| **Changes in operating assets and liabilities** | | |
| Decrease (increase) in accounts receivable, net | 3,850 | (3,887) |
| Decrease (increase) in prepaid expenses and other assets | 356 | (92) |
| Decrease in accounts payable and accrued liabilities | (2,840) | (418) |
| Increase in current income taxes payable | 83 | 3,032 |
| (Decrease) increase in deferred revenue | (711) | 898 |
| Unrealized foreign exchange (loss) gain | (1,040) | 418 |
| **Cash flows from operating activities** | **12,956** | **19,886** |
| **Cash flows from investing activities** | | |
| Purchase of property and equipment, net | (1,245) | (560) |
| Acquisitions, net of cash acquired (Note 10) | (2,004) | (38,202) |
| Proceeds from sale of patents | 462 | - |
| Net sale of short-term investments | 1,507 | 20,088 |
| | **(1,280)** | **(18,674)** |
| **Cash flows from financing activities** | | |
| Issuance of share capital (Note 6(B)) | 151 | 903 |
| Payment of cash dividend | (1,266) | - |
| Purchase and cancellation of common shares (Note 6(B)) | (2,724) | (1,430) |
| | **(3,839)** | **(527)** |
| Effect of foreign exchange rate changes on cash | (2,118) | (345) |
| **Net increase in cash during the year** | **5,719** | **340** |
| Cash - beginning of year | 5,602 | 5,262 |
| **Cash - end of year** | **$ 11,321** | **$ 5,602** |
| **Supplemental cash flow information** | | |
| Cash paid during the year for income taxes | $ 5,386 | $ 1,186 |

Cash excludes short-term investments (Note 2)

*The accompanying notes form an integral part of these consolidated financial statements.*

# Notes to Consolidated Financial Statements

## October 31, 2007 and 2006

(in thousands of Canadian dollars, except per share amounts)

## 1. Summary of significant accounting policies

These consolidated financial statements have been prepared by management in Canadian dollars in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). The significant accounting policies are as follows:

### Basis of consolidation

These consolidated financial statements include the accounts of Enghouse Systems Limited and its wholly owned subsidiaries ("the Company"): Enghouse (U.K.) Limited, Enghouse Systems Limited (New Zealand), Enghouse Systems, LLC, Moore Resource Systems (Ontario) Limited, Syntellect Inc. (including its subsidiaries Syntellect Interactive Services Inc. and Syntellect Limited ("Syntellect")), Enghouse Services Limited (formerly Visual Insights Canada, Inc.), Teloquent Communications Corporation ("Teloquent"), Transched Systems Limited, Transit Solutions Inc. and Transched Systems, LLC ("Transched"), Apropos Technology, Inc. and Apropos Technology, Ltd. ("Apropos") both since acquisition on November 28, 2005 and Ontira Communications Inc., ILink Technologies Corporation and Quantura Solutions Inc., all since acquisition on March 31, 2007.

### Use of estimates

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates are required to determine revenue recognition, the allowance for doubtful accounts, the useful lives and recoverability of long-term assets, recoverability of goodwill and the valuation allowance on future income tax assets. Actual results could differ from those estimates and the differences could be material to these consolidated financial statements.

### Revenue recognition

Revenue consists primarily of fees for software licenses of the Company's software products, maintenance fees and professional services and hardware revenue. Support and services revenue is comprised of professional services revenue from consulting, implementation and training services related to the Company's products and maintenance and technical support, which also includes unspecified software upgrades and enhancements.

Revenue from license fees for software products and the resale of hardware products is recognized when there is an unconditional sales order under a license agreement, the product is delivered, the fee is fixed or determinable, provided that no significant future vendor obligations exist and, at the time of performance, the ultimate collection of the consideration is reasonably assured.

Typically, software license agreements are multiple element arrangements that also include the provision of maintenance and professional services. The Company evaluates these contracts to determine whether the professional services are essential to the functionality of the software. Revenue from arrangements that include services that are not essential to the functionality of the software is allocated to each element of the arrangement based on their relative fair values and is recognized when the above-noted revenue recognition criteria have been met for each element. The Company uses objective evidence to determine the fair values of the multiple elements, including the price charged when the same elements are sold separately.

If services are deemed essential to the functionality of the licensed software, the licensed software and services revenues are recognized using contract accounting under the percentage of completion method. The Company uses the ratio of incurred labor costs to estimated total labor costs as the measure of its progress toward completion on each contract. If a loss on a contract is considered probable, the loss is recognized at the date such loss determination is made.

If services are not deemed essential to the functionality of the software, the service revenue (including hosted services revenue) is recognized as the services are delivered to the customer.

Maintenance contracts entitle the customer to telephone support, solutions to technical problems, and the right to receive software updates as they are released. Revenue from maintenance contracts is recognized over the term of the maintenance contract, which is normally one year.

## Foreign exchange translation

The Company considers its investments in foreign subsidiaries to be integrated foreign operations with the exception of Syntellect, Teloquent and Apropos, which are considered to be self-sustaining. Integrated foreign subsidiaries are accounted for under the temporal method. This method is also used to translate foreign currency transactions and balances. Under this method, monetary assets and liabilities are translated at the exchange rate in effect at the consolidated balance sheet dates. Non-monetary assets and liabilities are translated at historical rates. Revenue and expenses are translated at the average exchange rate in effect for the month of the transactions with amortization translated at the historical rate of the underlying asset to which it relates. Exchange gains or losses arising from the translation are charged to income in the year incurred. During the year, the Company reported foreign exchange losses of $0.6 million, compared to losses of $0.4 million in the prior year, which have been included in selling, general and administrative expenses.

Self-sustaining subsidiaries are accounted for under the current rate method. Under this method assets and liabilities of subsidiaries are translated into Canadian dollars at the exchange rate in effect at the consolidated balance sheet dates. Revenue and expenses are translated at average exchange rates during the year. Resulting unrealized gains or losses are accumulated and reported as a cumulative translation adjustment in accumulated other comprehensive income or loss.

## Research and development costs

Research costs are expensed as incurred and are reduced by related investment tax credits. Development costs are expensed as incurred unless the project meets the criteria under Canadian GAAP for deferral and amortization. Income tax credits are recognized when reasonable assurance of realization exists. No costs have been deferred on the consolidated balance sheets as at October 31, 2007 and 2006.

## Short-term investments

Short-term investments are highly liquid financial instruments. Equity securities are considered to be available for sale and are carried at fair market value, and fixed-income securities with original maturities of one year or less are carried at cost plus accrued interest, as they are held to maturity.

## Property and equipment, acquired software and other intangibles

Property and equipment, acquired software and other intangibles are recorded at acquisition cost and amortized to operations over their estimated useful lives as follows:

| | |
|---|---|
| **Furniture and fixtures** | 20% declining balance |
| **Computer hardware and software** | 3-years straight-line |
| **Leasehold improvements** | Shorter of useful life or initial lease term |
| **Acquired software** | 6-years straight-line, 5-years straight-line (Transched/Ontira) |
| **Other intangibles** | 8-years straight-line |
| **Patents** | Remaining life |

The unamortized portions of property and equipment, acquired software, other intangibles and patents are reviewed when events or circumstances indicate that the carrying amounts may not be recoverable. If the projected undiscounted future cash flows are less than the carrying amounts, the assets are considered to be impaired and an impairment loss is measured as the amount by which the carrying amounts exceed fair values.

## Goodwill

Goodwill represents the excess of the purchase price of business acquisitions over the fair values of identifiable net assets acquired in such acquisitions and is allocated as at the date of the business combination. Goodwill and intangible assets with indefinite useful lives are not subject to amortization but are subject to annual impairment tests. Any impairment in the carrying value of goodwill is recognized in operating income. Additional disclosure regarding the results of the annual goodwill impairment test is provided in Note 5.

## Income taxes

The Company uses the asset/liability method of measuring income taxes based on temporary differences between the financial reporting and income tax bases of assets and liabilities. Future income tax expense represents the change during the year in the future income tax assets and future income tax liabilities. In addition, the future benefits of income tax assets, including unused tax losses, are recognized to the extent that it is more likely than not, that such losses will ultimately be utilized. These standards also require that the future income tax assets and liabilities are measured using substantively enacted income tax rates and laws that are expected to apply when the income tax liabilities or assets are to be either settled or realized. The Company provides a valuation allowance on future income tax assets when it is more likely than not that such assets will not be realized.

## Fair value of financial instruments

Effective November 1, 2006 the Company adopted the new Canadian Institute of Chartered Accountants (CICA) accounting recommendations for the recognition, presentation and disclosure of financial instruments and comprehensive income. The standards have been adopted on a prospective basis, with the exception of the cumulative translation adjustment, which has been applied retroactively. These standards include

CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement"; Section 1530, "Comprehensive Income"; Section 3861, "Financial Instruments – Disclosure and Presentation"; and Section 3251, "Equity".

The new recommendations require the Company to present, among other things, certain unrealized gains and losses outside of net income or loss. Section 1530 defines comprehensive income as the change in equity (net assets) arising from transactions and other events and circumstances from non-owner sources. The new standard requires presentation of a statement of comprehensive income. In accordance with the provisions of these new standards, foreign exchange gains and losses on the translation of the financial statements of the Company's self-sustaining foreign operations, previously recorded in a separate section of shareholders' equity, are now presented as accumulated other comprehensive income. The Company's earnings per share presented on the consolidated statements of income are based upon its net income and not comprehensive income.

The new standard for financial instruments prescribes when a financial instrument is to be recognized on the balance sheet and at what amount. It also specifies how gains and losses on financial instruments are to be presented. Financial instruments are classified into various categories. Held-to-maturity investments and loans and receivables are measured at amortized cost, with the amortization of premiums or discounts, losses and impairments being included in current period interest income or expense. Held for trading financial assets and liabilities are measured at fair market value with all gains and losses included in net income in the period in which they arise. Available for sale financial assets are measured at fair market value, except where the instrument does not have a quoted market price in an active market, with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Losses due to impairment are included in net income. All other financial liabilities are carried at amortized cost.

The Company's cash, banker's acceptances, mutual funds, bonds and commercial paper are classified as held-to-maturity investments and continue to be recorded at cost or amortized cost. The Company accrues interest income over the expected life of each instrument. The Company does not recognize gains and losses arising from changes in the fair value of these instruments until the gains and losses are realized, or there is impairment in the value of an asset. When recognized, such gains and losses are recorded directly in net income.

The Company considers its portfolio of equity investments to be available for sale assets. As such, these investments are carried at fair market value with foreign exchange and revaluation gains and losses included in other comprehensive income or loss until the gains and losses are realized or there is impairment in the value.

The Company's accounts receivable are classified as loans and receivables while accounts payable, accrued liabilities and customer deposits are classified as financial liabilities. After their initial fair value measurement, both accounts receivable and financial liabilities are measured at amortized cost using the effective interest rate method. For the Company the measured amount generally corresponds to cost. The Company is not party to any derivative financial instruments.

### Earnings per share

Basic earnings per share are computed using the weighted average number of common shares outstanding during the year. The Company uses the treasury stock method to calculate diluted earnings per share. This method assumes that proceeds, which could be obtained upon the exercise of in-the-money options, would be used to purchase common shares at the average market price during the year.

### Stock-based compensation plans

The Company uses the fair value method to account for all stock-based awards to employees and directors granted after November 1, 2002. The estimated fair value of options granted is determined using the Black-Scholes option pricing model and is recorded as a charge to income on a straight-line basis over the vesting period of the options with a corresponding credit to contributed surplus. Stock options are granted at a price equal to or above the market value of the shares at the date of the grant. The consideration received on the exercise of stock options is credited to share capital at the time of exercise. The Company's stock option compensation plan is described in Note 6(D).

(in thousands of Canadian dollars, except per share amounts)

### Recent accounting pronouncements

On December 1, 2006 the CICA issued Handbook Section 1535, "Capital Disclosures", Section 3862 "Financial Instruments – Disclosures," and Section 3863, "Financial Instruments – Presentation." Section 1535 established disclosure requirements about an entity's capital and how it is managed. The purpose of the new standard is to enable users of the financial statements to evaluate objectives, policies and processes for managing capital. Sections 3862 and 3863 will replace section 3861, "Financial Instruments – Disclosure and Presentation, " revising and enhancing disclosure requirements while carrying forward its presentation requirements. These new sections will place increased emphasis on disclosure about the nature and extent of risks arising from financial instruments and how the entity manages those risks. These sections apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company plans to adopt this new guidance effective November 1, 2007. The Company does not expect the adoption of this guidance to have a material impact on its financial position, results of operations or cash flows.

In July 2006, the CICA revised Section 1506, "Accounting changes". The new standard requires that voluntary changes in accounting policy can only be made if the change results in financial statements that provide reliable and more relevant information, requires changes in accounting policy to be applied retrospectively unless doing so is impracticable and that prior period errors are corrected retrospectively. This section applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2007. The Company does not expect the adoption of this standard in fiscal 2008 to have a material impact on its consolidated financial statements.

## 2. Short-term investments

Short-term investments consist of the following:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Cost | Market Value | Cost | Market Value |
| Mutual funds | $ 19,165 | $ 19,166 | $ 8,850 | $ 8,852 |
| Commercial paper | 43,687 | 43,692 | 48,321 | 48,310 |
| Corporate bonds | 25,282 | 25,259 | 33,848 | 33,836 |
| Equities | 1,050 | 1,050 | 1,602 | 1,602 |
| | **$ 89,184** | **$ 89,167** | **$ 92,621** | **$ 92,600** |

## 3. Property and equipment

| | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value | Cost | Accumulated Amortization | Net Book Value |
| Furniture and fixtures | $ 1,277 | $ 884 | $ 393 | $ 1,995 | $ 1,754 | $ 241 |
| Computer hardware and software | 6,022 | 4,896 | 1,126 | 11,682 | 10,859 | 823 |
| Leasehold improvements | 1,034 | 623 | 411 | 952 | 349 | 603 |
| | **$ 8,333** | **$ 6,403** | **$ 1,930** | **$ 14,629** | **$ 12,962** | **$ 1,667** |

## 4. Acquired software and other intangibles

| | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value | Cost | Accumulated Amortization | Net Book Value |
| Acquired software | $ 28,966 | $ 17,886 | $ 11,080 | $ 28,115 | $ 13,023 | $ 15,092 |
| Other intangibles | 9,460 | 4,721 | 4,739 | 9,110 | 2,832 | 6,278 |
| | **$ 38,426** | **$ 22,607** | **$ 15,819** | **$ 37,225** | **$ 15,855** | **$ 21,370** |

## 5. Goodwill

Goodwill is assessed for impairment on at least an annual basis and, additionally, whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair values of the reporting units are estimated using a combination of the income or discounted cash flow approach and the market approach, which utilizes comparable companies' data. If the carrying amount of the reporting unit exceeds its fair value, then a second step is performed to quantify the amount of the impairment loss, if any.

The impairment test for intangibles with indefinite useful lives consists of a comparison of the fair value of the intangible asset with its carrying amount. When the carrying amount of the intangible asset exceeds its fair value, an impairment loss would be recognized for the difference.

In 2007, the Company performed the annual impairment test and determined that the carrying value of the goodwill established on the acquisition of Moore Resource Systems (Ontario) Limited exceeded its fair value. As a result, the Company recorded in operating income a non-cash goodwill impairment charge of $1,942 relating to this goodwill, representing 100% of the Company's investment in Moore. The Company recorded no income tax benefit from this non-cash goodwill impairment charge. The determination that the fair value of goodwill was less than its carrying value resulted from the continued increase in the Canadian dollar relative to its U.S. counterpart during the year and its resulting erosion of the Company's competitive advantage. The majority of Moore's data conversion business is conducted for its U.S. based customers in U.S. dollars.

The continuity of goodwill by reportable segment is as follows:

| | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Syntellect Division | Asset Management Division | Total | Syntellect Division | Asset Management Division | Total |
| Opening balance | $ 11,177 | $ 2,752 | $ 13,929 | $ 6,863 | $ 2,774 | $ 9,637 |
| Additions, net | - | 1,414 | 1,414 | 5,828 | - | 5,828 |
| Acquired tax benefit adjustment | (212) | - | (212) | (219) | - | (219) |
| Purchase price adjustments | (240) | (589) | (829) | (781) | (22) | (803) |
| Goodwill impairment | - | (1,942) | (1,942) | - | - | - |
| Foreign exchange | (1,708) | - | (1,708) | (514) | - | (514) |
| **Ending balance** | **$ 9,017** | **$ 1,635** | **$ 10,652** | **$ 11,177** | **$ 2,752** | **$ 13,929** |

(in thousands of Canadian dollars, except per share amounts)

During each of 2007 and 2006, adjustments for previously unrecognized tax benefits from earlier acquisitions were accounted for as a credit to goodwill. Certain adjustments to the preliminary purchase price allocation related to the acquisition of Transched and Apropos acquired in fiscal 2005 and 2006 respectively, including the resolution of potential litigation, were booked in the year and resulted in a $829 reduction to goodwill and accrued liabilities.

# 6. Share capital

## (A) Authorized

Unlimited common shares
Unlimited Class A, redeemable, retractable, non-voting, non-cumulative, preference shares
Unlimited Class B, redeemable, retractable, non-voting, preference shares
All shares are issued without par value.

## (B) Issued and outstanding

| | Number of Shares | Share Capital | Contributed Surplus Amount |
|---|---|---|---|
| **Balance – October 31, 2005** | **25,495,724** | **$ 48,524** | **$ 875** |
| Stock options exercised (C) | 179,100 | 995 | (91) |
| Stock options expensed (D) | - | - | 530 |
| Shares repurchased and cancelled under common share re-purchase plan (E) | (179,600) | (342) | - |
| **Balance – October 31, 2006** | **25,495,224** | **$ 49,177** | **$ 1,314** |
| Stock options exercised (C) | 28,000 | 166 | (15) |
| Stock options expensed (D) | - | - | 472 |
| Shares repurchased and cancelled under common share re-purchase plan (E) | (352,100) | (673) | - |
| **Balance – October 31, 2007** | **25,171,124** | **$ 48,670** | **$ 1,771** |

There were no Class A and no Class B preference shares issued and outstanding as at October 31, 2007 or 2006.

## (C) Common share purchase options

The Company has granted options to purchase common shares to certain directors, officers and employees of the Company, pursuant to the terms of the Company's stock option plan (the "Plan"). The Plan provides that a total of 3,077,300 common shares are reserved for options and that the shares reserved for options, which could become exercisable in any one year, will not exceed more than 10% of the issued and outstanding common shares of the Company at the time such options may be exercisable. These options vest at various times over four years and expire seven to ten years after the grant date. The exercise price of each option equals the market price of the Company's stock on the date the options are granted.

A summary of the status of the Company's Plan as at October 31, 2007 and 2006, and changes during the years ended on those dates is presented as follows:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Outstanding at beginning of year | 2,177,600 | $ 4.95 | 2,252,200 | $ 4.33 |
| Granted | 60,000 | 7.93 | 130,000 | 8.78 |
| Exercised | (28,000) | 5.40 | (179,100) | 5.04 |
| Forfeited | - | - | (25,500) | 7.23 |
| Outstanding at end of year | **2,209,600** | **$ 5.03** | **2,177,600** | **$ 4.95** |
| Options exercisable at end of year | **1,849,100** | **$ 4.42** | **1,585,600** | **$ 4.07** |

A summary of stock options outstanding as at October 31, 2007 is set out below:

| | Outstanding Stock Options | | | Exercisable Stock Options | |
|---|---|---|---|---|---|
| Exercise Price | Number Outstanding as at October 31, 2007 | Weighted Average Remaining Contractual Life in Years | Weighted Average Exercise Price | Number Exercisable as at October 31, 2007 | Weighted Average Exercise Price |
| $2.80 to $4.00 | 942,500 | 2.24 | $ 2.94 | 942,500 | $ 2.94 |
| $4.20 to $5.50 | 622,100 | 4.09 | 4.79 | 622,100 | 4.79 |
| $7.50 to $7.75 | 300,000 | 5.85 | 7.65 | 153,000 | 7.67 |
| $7.85 to $10.00 | 345,000 | 4.95 | 8.88 | 131,500 | 9.47 |
| | **2,209,600** | | | **1,849,100** | |

## (D) Stock-based compensation

The Company uses the fair value method for recording compensation expense related to equity instruments awarded to employees and directors in accordance with CICA 3870. For the purposes of expensing stock options, the estimated fair value of the options is amortized to expense over the vesting period of the options on a straight-line basis with a corresponding credit to contributed surplus. During fiscal 2007, the Company recorded a non-cash charge to net income of $472 (2006 - $530). The fair value of each stock option on the date of grant was estimated using the Black-Scholes option pricing model with the following assumptions at the measurement date:

| | Options Granted 2007 | Options Granted 2006 |
|---|---|---|
| Risk-free interest rate | 3.91% to 4.63% | 4.20% to 4.38% |
| Estimated volatility | 30% to 32% | 30% |
| Dividend yield | $ 0.075 | Nil |
| Expected life in years | 5 | 5 |
| Weighted average fair value (in dollars) | $2.69 to $3.30 | $2.78 to $3.46 |

(in thousands of Canadian dollars, except per share amounts)

### (E) Common share repurchase plan

On April 12, 2007, the Company renewed its common share repurchase plan, whereby it may repurchase up to a maximum of 1,273,261 common shares of the Company, expiring on April 11, 2008. During the year, the Company repurchased 352,100 shares (2006 – 179,600) for cancellation for $2,724 (2006 - $1,431), of which $673 (2006 - $342) was allocated to share capital and the remainder offset against retained earnings.

## 7. Research and development expense

| | 2007 | 2006 |
|---|---|---|
| Research and development costs incurred | $ 8,105 | $ 8,096 |
| Less: Investment tax credits recognized | - | 105 |
| Net research and development expense | **$ 8,105** | **$ 7,991** |

## 8. Income taxes

(A) The provision for income taxes consists of the following:

| | 2007 | 2006 |
|---|---|---|
| Current income taxes | $ 4,428 | $ 4,494 |
| Future income taxes | (177) | 1,645 |
| | **$ 4,251** | **$ 6,139** |

(B) The Company operates in several tax jurisdictions. The provision for income taxes differs from the expense that would be obtained by applying the combined federal and provincial statutory rate as a result of the following:

| | | 2007 | | 2006 |
|---|---|---|---|---|
| | **$** | **%** | **$** | **%** |
| Combined federal and provincial statutory income tax amount and rate | 3,525 | 36.1 | 6,193 | 36.1 |
| Non-deductible expenses | 207 | 2.1 | 175 | 1.0 |
| Foreign earnings subject to different income tax rates | 323 | 3.3 | 61 | 0.4 |
| Non-taxable portion of capital gain | (391) | (4.0) | (15) | (0.1) |
| Other | (115) | (1.2) | (275) | (1.6) |
| Effective income tax amount and rate before impact of non-deductible goodwill impairment charge | **3,549** | **36.3** | **6,139** | **35.8** |
| Impairment of goodwill | 702 | 7.2 | - | - |
| **Effective income tax amount and rate** | **4,251** | **43.5** | **6,139** | **35.8** |

(C) Significant components of future income tax assets and liabilities as at October 31, 2007 and 2006 are as follows:

| | 2007 | 2006 |
|---|---|---|
| **Future income tax assets:** | | |
| Provisions and reserves | $ 1,348 | $ 3,472 |
| Income tax loss carry-forwards | 20,629 | 25,545 |
| Difference in accounting and tax bases of property and equipment | 1,311 | 1,049 |
| Adjustment to available for sale investments | 65 | - |
| Investment tax credit | 11 | 8 |
| | 23,364 | 30,074 |
| Less: Valuation allowance | (17,877) | (22,833) |
| | 5,487 | 7,241 |
| **Future income tax liabilities:** | | |
| Acquired software | 6,182 | 7,798 |
| Other intangibles | 1,782 | 2,429 |
| | 7,964 | 10,227 |
| **Future income tax liabilities, net** | **$ (2,477)** | **$ (2,986)** |
| **Future income tax liabilities, net is comprised of:** | | |
| Future income tax assets – current | $ 1,359 | $ 3,480 |
| Future income tax assets – long-term | 4,128 | 3,761 |
| Future income tax liabilities – long-term | (7,964) | (10,227) |
| | $ (2,477) | $ (2,986) |

The Company and its subsidiaries have non-capital losses available for carry-forward for income tax purposes of approximately $53,421 (2006 - $66,302), the majority of which are related to the Company's U.S. operations. These non-capital losses expire over periods commencing in 2008 through 2027 and may be subject to restriction on their availability to shelter income.

# 9. Earnings per share

## (A) Basic earnings per share

| | 2007 | 2006 |
|---|---|---|
| Numerator: | | |
| Net income for the year | $ 5,510 | $ 11,003 |
| Denominator: | | |
| Number of weighted average common shares outstanding | 25,389 | 25,549 |
| **Basic earnings per share** | **$ 0.22** | **$ 0.43** |

(in thousands of Canadian dollars, except per share amounts)

### (B) Diluted earnings per share

| | Income (Numerator) | Number of Shares (Denominator) | Per Share Amount |
|---|---|---|---|
| **Year ended October 31, 2007** | | | |
| Basic earnings per share | $ 5,510 | 25,389 | $ 0.22 |
| Effect of dilutive securities: | | | |
| Stock options | | 850 | |
| Income available to common shareholders and assumed conversions and exercised options | **$ 5,510** | **26,239** | **$ 0.21** |
| **Year ended October 31, 2006** | | | |
| Basic earnings per share | $ 11,003 | 25,549 | $ 0.43 |
| Effect of dilutive securities: | | | |
| Stock options | | 949 | |
| Income available to common shareholders and assumed conversions and exercised options | **$ 11,003** | **26,498** | **$ 0.42** |

Options to purchase 295,000 (2006 – 205,000) common shares at an average price of $9.05 (2006 – $9.28) per share were outstanding during the year but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of common shares during the fiscal year.

## 10. Acquisitions

### Ontira:

On March 31, 2007, Transched Systems Limited, a wholly owned subsidiary of Enghouse, acquired 100% of the issued and outstanding common shares of Ontira Communications Inc. ("Ontira") for consideration of $2.15 million including transaction costs, after adjustment for purchase price adjustments settled in November 2007.

Ontira is a supplier of Automated Travel Information Systems ("ATIS") for the transit and transportation industries, providing a variety of solutions including enhanced Interactive Voice Response ("IVR") and multi-media systems.

The acquisition has been recorded under the purchase method of accounting and results have been included in the consolidated statements of operations from the acquisition date. Accordingly, the allocation of the purchase price to assets and liabilities is based on their fair value, with the excess of the purchase price over the fair value of the assets acquired being allocated to goodwill. Management has established the preliminary purchase price allocation taking into account all relevant information at the time of preparing these consolidated financial statements. However, the preliminary purchase price allocation is subject to further refinements.

Goodwill is assessed annually for any potential impairment in value. Other intangibles representing acquired software, patents and customer relationships are being amortized over a period of five, three and seven years, respectively.

### Apropos:

On November 28, 2005, Syntellect, a wholly owned subsidiary of Enghouse, acquired 100% of the issued and outstanding common shares of Apropos Technology, Inc. ("Apropos") for a cash purchase price of $59.4 million (U.S. $50.8 million), which included acquired cash and short-term investments of $42.2 million (U.S. $36.2 million) and transaction costs of $0.4 million. Apropos develops, markets and supports communication management solutions for contact center operations. Its real-time, multi-channel interaction management application platform allows for customer interactions across a variety of communications channels, including email, fax, web and voice. The acquisition has been recorded under the purchase method of accounting and results have been included in the consolidated statements of operations from the acquisition date. Accordingly, the allocation of the purchase price to assets and liabilities is based on their fair value, with the excess of the purchase price over the fair value of the assets acquired being allocated to goodwill. Management established the purchase price allocation taking into account all relevant information at the time of preparing the fiscal 2006 consolidated financial statements.

Goodwill is assessed annually for any potential impairment in value. Other intangibles representing acquired software and customer relationships are being amortized over a period of six and eight years respectively. During the year the Company reduced the goodwill related to the Apropos acquisition by $0.2 million in respect of the resolution of obligations accrued for in the original purchase equation.

The Company's purchase price allocations are as follows:

| | 2007 Ontira | 2006 Apropos |
|---|---|---|
| Cash | $ 150 | $ 21,161 |
| Short-term investments | - | 21,087 |
| Accounts receivable, net | 312 | 3,124 |
| Prepaids and other current assets | 11 | 383 |
| Property and equipment | 60 | 281 |
| Future income tax assets | 367 | 5,683 |
| Acquired software | 850 | 8,059 |
| Other intangibles | 350 | 5,256 |
| Goodwill | 1,414 | 5,828 |
| Total assets acquired | $ 3,514 | $ 70,862 |
| Less: Current liabilities assumed | $ 1,283 | $ 8,009 |
| Less: Future income tax liabilities | 77 | 3,490 |
| Total liabilities assumed | $ 1,360 | $ 11,499 |
| Net assets acquired | $ 2,154 | $ 59,363 |

## 11. Commitments

As at October 31, 2007, the Company had minimum future payments under operating lease commitments for facilities and equipment requiring annual payments for the years ending October 31, as follows:

| | |
|---|---|
| 2008 | $ 1,431 |
| 2009 | 1,222 |
| 2010 | 867 |
| 2011 | 332 |
| 2012 | 283 |
| 2013 and thereafter | 97 |
| | **$ 4,232** |

(in thousands of Canadian dollars, except per share amounts)

The Company has entered into sub-lease agreements on certain properties on which it has lease commitments, which reduce the total operating lease commitments reflected above by $66 over the terms of the sub-lease agreements.

## 12. Segmented information

The Company has two reportable segments, the Syntellect Division and the Asset Management Division, based on the nature of the operations and markets that each of these segments serves. The accounting policies followed by these segments are the same as those described in the summary of significant accounting policies.

The Company's reportable segments each develop and market software products and provide services for their respective markets. The Syntellect Division, which includes Apropos' operations since the date of acquisition, November 28, 2005, serves the customer service market segment through the provision of interactive voice response systems and speech and voice recognition solutions as well as an advanced contact center platform that manages multi-channel customer interactions. The Asset Management Division, which includes the results of Ontira since the date of acquisition, March 31, 2007, develops, markets and provides services related to visual-based network management software solutions to customers in the telecommunications, transit, cable, electric and gas markets. The Company evaluates segment performance based on revenue and profit or loss before corporate expenses, foreign exchange, interest and other income and income taxes.

| | Syntellect Division | Asset Management Division | Total |
|---|---|---|---|
| **Year ended October 31, 2007** | | | |
| Revenue | $ 45,876 | $ 9,325 | $ 55,201 |
| Operating expenses, excluding non-cash charges | 31,494 | 8,155 | 39,649 |
| Amortization of property and equipment | 730 | 122 | 852 |
| Amortization of acquired software and other intangibles | 5,417 | 514 | 5,931 |
| Segmented profit from operations | **$ 8,235** | **$ 534** | **$ 8,769** |
| Goodwill impairment | - | (1,942) | (1,942) |
| **Segmented profit** | **$ 8,235** | **$ (1,408)** | **$ 6,827** |
| Corporate expenses | | | (2,018) |
| Foreign exchange | | | (635) |
| Other income | | | 1,272 |
| Interest income | | | 4,315 |
| Income before income taxes | | | **$ 9,761** |
| Goodwill | $ 9,017 | $ 1,635 | $ 10,652 |
| Other assets | 36,651 | 9,770 | 46,421 |
| Short-term investments | | | 89,184 |
| **Total assets** | | | **$ 146,257** |
| Capital expenditures | 1,208 | 37 | 1,245 |

| | Syntellect Division | Asset Management Division | Total |
|---|---|---|---|
| **Year ended October 31, 2006** | | | |
| Revenue | $ 47,537 | $ 14,945 | $ 62,482 |
| Operating expenses, excluding non-cash charges | 31,345 | 7,572 | 38,917 |
| Amortization of property and equipment | 1,015 | 169 | 1,184 |
| Amortization of acquired software and other intangibles | 5,290 | 370 | 5,660 |
| **Segmented profit** | **$ 9,887** | **$ 6,834** | **16,721** |
| Corporate expenses | | | (2,545) |
| Foreign exchange | | | (434) |
| Other income | | | 87 |
| Interest income | | | 3,313 |
| Income before income taxes | | | **$ 17,142** |
| Goodwill | $ 11,177 | $ 2,752 | $ 13,929 |
| Other assets | 47,015 | 6,192 | 53,207 |
| Short-term investments | | | 92,621 |
| **Total assets** | | | **$ 159,757** |
| Capital expenditures | 475 | 85 | 560 |

Revenue is distributed geographically as follows: U.S. 81% (2006 – 71%), U.K. 14% (2006 – 10%), Canada 5% (2006 – 18%) and other 0% (2006 – 1%). Revenue from customers is attributable to individual countries based on the reporting entity that records the transaction.

The Company's largest business partner, IBM Japan, Ltd., accounted for $1.5 million (2006 – $7.8 million) or 3% (2006 – 12%) of total revenue during the year and is included in the revenue reported in Canada, within the Asset Management Division segment.

## 13. Litigation and contingencies

Apropos Technology, Inc. ("Apropos"), an indirect wholly owned subsidiary of the Company, was named as a defendant in a shareholder class action litigation suit filed in federal court in New York City in November 2001 against Apropos and certain of its former directors and officers and the underwriters of Apropos' initial public offering ("IPO"). This lawsuit alleges that the prospectus and registration statement for the IPO failed to disclose that the underwriters allegedly solicited and received excessive commissions from investors and that some of the investors in the IPO allegedly agreed with the underwriters to buy additional shares in the aftermarket in order to inflate the price of Apropos' stock. The Company understands that approximately 300 other publicly traded companies and their public offering underwriters have had similar suits filed against them.

In June 2003, Apropos and certain issuer defendants entered into a proposed settlement that will be funded from participating issuers' directors and officers insurance proceeds, less any settlement amounts by the underwriter defendants.

Prior to consummation of the proposed settlement on December 5, 2006, the Third Circuit Court of Appeals issued a ruling concerning class certification that may complicate or prevent final approval of the proposed settlement by the issuer plaintiffs. The Court of Appeals concluded that no class of IPO purchasers can appropriately be certified as the issues are not common among all class members. In light of this Court of Appeals ruling, it appears that the plaintiffs would need to pursue whatever claims they have against the underwriters on an individual, non-class-action basis. A petition seeking a rehearing of this December 5, 2006 ruling was denied by the Court on April 6, 2007. All proceedings against Apropos and the 300 other publicly traded companies have been stayed pending further submissions to the Court regarding class certification. It is not expected that the Court will provide a further ruling on class certification until the summer of 2008, at the earliest. As a result of the Court's current ruling on the class certification, the viability of the proposed settlement cannot yet be determined. Apropos expects that its insurance proceeds will be sufficient to cover its allocable share of the legal costs and settlement costs, if any.

### General

The Company provides its customers a qualified indemnity against the infringement of third party intellectual property rights. From time to time, various owners of patents and copyrighted works send the Company or its customers letters alleging that the Company's products do or might infringe upon the owner's intellectual property rights, and/or suggesting that the Company or its customers should negotiate a license agreement with the owner. The Company's policy is to never knowingly infringe upon any third party's intellectual property rights. Accordingly, where appropriate, the Company forwards any such allegation or licensing request to its outside legal counsel for review. The Company generally attempts to resolve any such matter by informing the owner of the Company's position concerning non-infringement or invalidity. Even though the Company attempts to resolve these matters without litigation, it is always possible that the owner of a patent or copyrighted work will sue the Company.

In response to correspondence from and, in a few instances, litigation initiated by, third party patent holders, a few of the Company's customers have attempted to tender to the Company the defense of its products under contractual indemnity provisions. The Company does not believe that it currently has any obligation to provide such a defense or that the Company's products infringe any third party patent. The Company is not aware of any claims or allegations having been made by any third party patent holder that a specific product offered by the Company infringes any third party patent claim. If the Company does become involved in litigation, under a contractual indemnity or any other legal theory, the Company will vigorously contest the claims and will assert all appropriate defenses.

## 14. Financial instruments

The Company manages its short-term investments to maximize returns, maintain liquidity and diversify its credit risk exposure to safeguard its principal. To achieve this objective, the Company has established an investment committee consisting of the Company's Chief Executive Officer, Vice President Finance and Chairman of the Audit Committee. The Company has also adopted a formal investment policy to govern the management of the Company's investment portfolio, which specifies eligible investments, investment limits, minimum allowable credit ratings of investments and the permissible concentration of credit risk. The Company's investment portfolio consists of banker's acceptances, commercial paper, mutual funds, and corporate bonds classified as held-to-maturity investments and equities classified as available for sale investments. The cost and market value of positions in the Company's short-term investment portfolio are disclosed in Note 2. The Company does not enter into any hedge transactions in its investment portfolio.

### Asset-backed commercial paper

The Company does not own any asset-backed commercial paper.

### Banker's acceptances

The Company holds banker's acceptances issued by Canadian banks with varying maturities of 120 days or less to a specified maximum investment limit per issuer and bear interest at a weighted average of 4.47% as at October 31, 2007. Banker's acceptances represented less than 2% of the Company's investment portfolio as at October 31, 2007.

### Commercial paper

The Company invests in commercial paper issued by multi-national corporations with maturities of 180 days or less to a specified maximum investment limit per issuer, a credit rating of R1-high and bear interest at 5.07% for U.S. positions held, and between 4.30% and 4.40% for Canadian positions as at October 31, 2007. Commercial paper represented the largest exposure in the Company's short-term investment portfolio as at October 31, 2007 and was spread amongst five positions, the latest of which matured on November 9, 2007.

### Mutual funds

The Company invests in U.S. and Canadian denominated mutual and money market funds, which hold positions in commercial paper, T-bills, banker's acceptances and other money market instruments as a short-term investment strategy. The Company's mutual funds are carried at cost, which approximates market value and represented 21% of the Company's short-term investments as at October 31, 2007. Returns are subject to fluctuations in the money market.

### Corporate bonds

The Company holds bonds issued by financial institutions with maturity or call dates of less than one year at the time of purchase, the latest of which is callable on February 4, 2008 and bear coupon interest at rates ranging from 4.75% to 6.10%. The Company's bonds are denominated in either U.S. or Canadian dollars and represented approximately 28% of the Company's short-term investments. As at October 31, 2007 the cost exceeded the market value by $23. The Company faces interest rate risk on its bond portfolio based on changes to prevailing interest rates.

### Equities

The fair value of the Company's equity portfolio is subject to fluctuations in equity markets and is denominated in U.S. dollars as at October 31, 2007. Equities are carried at fair value, which are publicly traded and are determined by the quoted market values for each investment. Equities represented less than 2% of the total short-term investments as at October 31, 2007.

### Accounts receivable

Accounts receivable are a financial instrument classified as loans and receivables and potentially expose the Company to credit risk. The Company maintains reserves for potential credit losses and returns, but historically has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area.

## 15. Comparative consolidated financial statements

Certain comparative figures have been reclassified to conform to the current year's consolidated financial statement presentation.

# Corporate Directory

## Board Of Directors

**Stephen J. Sadler**
*Chief Executive Officer and*
*Chairman of the Board*
Enghouse Systems Limited

**Eric Demirian** [1]
*Chief Executive Officer*
Parklea Capital Inc.

**Reid Drury** [1, 3]
*Partner and Vice President*
Polar Capital Corporation

**John Gibson** [1, 2, 3]
*President and Chief Executive Officer*
E.E.S. Financial Services Limited

**Paul Stoyan** [3]
*Chairman*
Gardiner Roberts LLP

**Pierre Lassonde** [2]
*Chairman*
Franco-Nevada Corporation

## Executive Officers

**Stephen J. Sadler**
*Chief Executive Officer and*
*Chairman of the Board*

**Douglas C. Bryson**
*Vice President Finance and*
*Corporate Secretary*

**Jason D. Meretsky**
*Vice President and*
*General Counsel*

**Anthony R. Pearlman**
*President*
Asset Management Division

**Steven W. Dodenhoff**
*President*
Syntellect Division

[1] Member of Audit Committee
[2] Member of Compensation Committee
[3] Member of Corporate Governance Committee

# Corporate Information

## Independent Auditors

**PricewaterhouseCoopers LLP**
Chartered Accountants
77 King Street West, Suite 3000
Toronto, Ontario M5K 1G8
Canada

## Legal Counsel

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Toronto, Ontario M5J 2T7
Canada

## Transfer Agent

**Equity Transfer Services Inc.**
200 University Avenue, Suite 400
Toronto, Ontario M5H 4H1
Canada

## Stock Information

Shares of Enghouse Systems Limited are traded on the Toronto Stock Exchange under the symbol **ESL**.

## Investor Inquiries

Inquiries should be directed to:

**Investor Relations**
**Enghouse Systems Limited**
80 Tiverton Court, Suite 800
Markham, Ontario L3R 0G4 Canada
Email: investor@enghouse.com

## Annual Meeting of Shareholders

The Annual Meeting of Shareholders will be held on **Wednesday, March 5, 2008 at 4:30 p.m.** at the TSX Broadcast and Conference Centre Gallery Toronto, Ontario, Canada

# Principal Offices

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