



**Second Quarter Report
and Management's Discussion and Analysis**

For the Fiscal Year 2011

For the Three and Six Months Ended August 31, 2010

October 29, 2010

ESI Entertainment Systems Inc.

1018 - 4720 Kingsway Ave

Burnaby, BC V5H 4N2

Facsimile 604-299-3984

Telephone 604-299-6922

TO OUR SHAREHOLDERS

For the Quarter Ended August 31, 2010

Dear Shareholder:

We are pleased to present our results for our second quarter ended August 31, 2010.

Gross Revenues for the quarter decreased by 14% to \$822,000 from \$952,000 during the same period last year. Gross profit decreased 4% to \$340,000 from \$355,000 during the same period last year. Operating expenses decreased by 3% to \$729,000 from \$ 752,000 during the same period last year. Net loss was \$283,000 compared to net loss of \$536,000 in the same period last year, a decrease of 47%.

The summer months of June, July and August typically show a decrease or flattening in our revenues usually presaging a renewed surge in the Fall.

During these global financially turbulent times, which bring uncertainty to many businesses, we are pleased that the ESI group is able to keep its costs to a minimum and continue to reduce its net loss.

"Anthony Greening"
Chairman & CEO

"Michael Meeks"
President

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management discussion and analysis ("MD&A") relates to our interim unaudited financial statements for the three and six months ended August 31, 2010. The MD&A should be read in conjunction with the Company's February 28, 2010 year-end audited consolidated financial statements and related notes therein that are prepared in accordance with Canadian generally accepted accounting principles. All financial information is stated in Canadian dollars, unless otherwise stated. Additional information regarding ESI Entertainment Systems Inc ("ESI" or "the Company"), including our MD&A and audited consolidated financial statements for the financial year ended February 28, 2010 can be found on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

Forward Looking Information

This MD&A contains forward-looking statements concerning ESI Entertainment Systems Inc. which statements can be identified by the use of forward-looking terminology such as "expect", "proposed", "may", "plan", "intend", "will", "would" or the negative thereof or any other variations thereon or comparable terminology referring to future events or results. Forward-looking statements are statements about the future and are inherently uncertain, and the actual events or results could be materially different than those anticipated in those forward-looking statements as a result of numerous factors discussed more fully in this document. These risks include risks related to revenue growth, operating results, industry growth, changes in regulation and legislation, products, technology, financing, competition, personnel and other factors affecting the Company and its business, any of which could cause actual events or results to vary materially from ESI's anticipated future results.

Forward-looking statements are based on beliefs, opinions and expectations of ESI's management at the time they are made, and ESI does not assume any obligation to update its forward-looking statements if those beliefs, opinions or expectations, or other circumstances should change. Investors are expected to refer to the "Risks & Uncertainties" section of this MD&A for a discussion of risk factors that could affect the Company's performance.

Business Overview

ESI Entertainment Systems Inc. is a software development company with two main independently operated and controlled subsidiaries: ESI Integrity Inc. and Citadel Commerce Corp. The two active subsidiaries are located in separate physical locations and operate autonomously with completely separate management, personnel and infrastructure. ESI has 14 Citadel employees and 12 Integrity employees located in Burnaby, British Columbia, Canada from where each company markets its products and services globally.

ESI Integrity provides software solutions for real-time auditing of transaction processing systems, fraud control and risk management systems to businesses requiring high levels of security, integrity, and trust, including government lotteries and pari-mutuel (horse tracks) organizations.

Integrity enters into long term customer license and support contracts and charges a fixed license fee for the use of its audit and risk management software, as well as an annual support fee. The license contracts can be perpetual or renewable. The support contracts are renewable. Revenue is typically earned over a two to five year period, depending on a contract's respective term. The cost of licensing revenue primarily consists of the cost of customizing the software and the cost of installing and testing the software. The cost of support revenues primarily relates to personnel support costs.

Citadel provides on-line payment processing services to and from end-users and e-commerce merchants. The payment processing services include Bank Transfers, Instant Bank Transfers, electronic cheques and paper cheques. Transactions are processed with concurrent transactional fraud detection services including full identity pre-authorization via in-house and third party databases and validation of previous transaction history. All of Citadel's services are based on a fee per transaction charged to its merchants and end-users.

The Instant Bank Transfer service uses a software product that assists the consumer to complete the details of an online bank transfer which simplifies the process and eliminates data entry errors. The software also detects when the customer initiated the transfer and the merchant is notified that the funds have been sent. Citadel uses proprietary back-office software to electronically scan Citadel bank accounts for received deposits and to notify merchants of changes in transaction states. Knowing that the funds have been sent by the customer allows the merchant to have a high level of confidence that the funds will soon be received by Citadel. This allows the merchant to provide the customer with instant access to their funds

Critical Accounting Policies and Estimates

The Company's accounting policies are outlined in Note 2 of the audited consolidated financial statements for the year ended February 28, 2010.

Additionally, the preparation of the consolidated financial statements in conformity with Canadian Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions, which affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses for the period. Actual results could differ from these estimates.

Basis of consolidation and financial statement preparation

The unaudited interim Consolidated Financial Statements dated August 31, 2010, have been prepared in accordance with GAAP on a basis consistent with those followed in the most recent audited annual financial statements for the year ended February 28, 2010. The unaudited interim Consolidated Financial Statements do not include all note disclosures required by GAAP for annual consolidated financial statements. Accordingly, these statements should be read in conjunction with the Company's annual audited financial statements for the year ended February 28, 2010.

Financial Highlights for the Three and Six Months ended August 31, 2010

The highlights for ESI, on a consolidated basis, compared to the same period last year, are:

- Revenue for the three months to August 31, 2010, decreased from \$952,271 to \$822,029, 14% decrease over the comparative period in the prior year;
- Revenue for the six months to August 31, 2010 decreased from \$1,786,262 to \$1,565,294, 12% decrease over the comparative period in the prior year;
- Gross profit for the three months to August 31, 2010 decreased from \$354,983 to \$339,430, 4% decrease over the comparative period in the prior year;
- Gross profit for the six months to August 31, 2010, increased from \$514,736 to \$585,282, 14% increase over the comparative period in the prior year;
- Net loss for the three months to August 31, 2010 decreased by 47% to \$283,424 from \$535,677 in the comparative period in the prior year;
- Net loss for the six months to August 31, 2010 decreased by 34% to \$698,224 from \$1,057,800 in the comparative period in the prior year;

Results of Operations

Consolidated Revenues

The following table provides a breakdown of the Company's revenues from its subsidiaries for the reported periods:

(\$ 000)	Three months ended August 31			Six months ended August 31		
	2010	2009	% Change	2010	2009	% Change
Integrity	440	706	(38%)	874	1,286	(32%)
Citadel	382	246	55%	691	500	38%
Total Revenue	822	952	(14%)	1,565	1,786	(12%)

Total revenue decreased by 14% to \$822,000 for the three months ended August 31, 2010 from \$952,000 for the three months ended August 31, 2009.

Integrity Revenues

ESI Integrity provides software solutions for real-time auditing of transaction processing systems to businesses requiring high levels of security, integrity, and trust, including government regulated lotteries and pari-mutuel (horse tracks) organizations.

Integrity Revenues are generated from long term customer license and support contracts where it charges a fixed license fee for the use of its audit and risk management software, as well as an annual support fee. Revenue is typically earned over a two to five year period, depending on a contract's respective term.

Approximately 54% of ESI's revenues were generated by ESI Integrity during the three months ended August 31, 2010 compared to 74% for the same period in the prior year.

The decrease in revenue is due to a reduction in work plan and consulting revenues combined with the adverse effect of the weakened US dollar and Euro currencies relative to the Canadian dollar. The majority of Integrity's revenues are contracted in US dollars or Euros.

Citadel Revenues

Citadel revenues are generated from its on-line payment processing which include electronic cheques and paper cheques but its main focus is its Instant Bank Transfer service. All of Citadel's services are charged on a fee per transaction charged to its merchants.

Approximately 46% of ESI's revenues were generated by Citadel during the three months ended August 31, 2010 compared to 26% for the same period in the prior year.

The increase in revenue is due to new merchants implementing Citadel's Instant Bank Transfer service as well as additional volume from existing customers.

Consolidated Gross Profit

The following table provides a summary of the Company's gross profit for the reported periods:

(\$ 000)	Three months ended Aug 31		Six months ended Aug 31	
	2010	2009	2010	2009
Revenues	822	952	1,565	1,786
Direct Costs	483	597	980	1,271
Gross profit	339	355	585	515
Gross profit margin (%)	41%	37%	37%	29%

Product Development

All Product Development expenses are now being capitalized

Sales, Marketing and Customer Service

Sales, marketing and customer service expenses were \$29,035 and \$60,419 during the three and six months ended August 31, 2010 respectively, a decrease of 24% and 23% respectively compared to \$37,954 and \$78,279 for the three and six months ended August 31, 2009.

General and Administrative

General and administrative expenses were \$687,397 and \$1,346,436 during the three and six months ended August 31, 2010 respectively, representing an increase of 15% and 6% compared to \$594,803 and \$1,270,538 for the three months and six months ended August 31, 2009.

Amortization of Property and Equipment

Amortization expenses were \$12,370 and \$26,345 during the three month and six month periods ended August 31, 2010, respectively, a decrease of 79% and 80% compared to \$59,276 and \$131,502 for the corresponding periods ended August 31, 2009. The decrease in amortization expense mainly relates to very few new assets being purchased and amortization being reduced on older equipment.

Net Loss

Net loss for the three and six month periods ended August 31, 2010 was \$283,424 (\$0.02 net loss per share) and \$698,224 (\$0.05 net loss per share), respectively, compared to net loss of \$535,677 (\$0.04 net loss per share) and \$1,057,800 (\$0.07 net loss per share) for the prior comparative periods.

Citadel Processing Accounts

Citadel processing accounts as at August 31, 2010 totaled \$5.7 million compared to \$5.6 million as at February 28, 2010. These accounts are comprised of cash, which are segregated bank funds arising from the processing of deposits and payments for Citadel merchants and consumers, and accounts receivable relating to Citadel processing accounts for funds in transit from merchants and consumers.

Summary of Quarterly Results

The following Table sets out comparative information in respect of the past eight Quarters to August 31, 2010 derived from unaudited statements prepared by Management.

<i>(\$000)</i>	31-Aug	31-May	28-Feb	30-Nov	31-Aug	31-May	28-Feb	30-Nov
<i>except for per share data</i>	2010	2010	2010	2009	2009	2009	2009	2008
Consolidated Revenue	822	743	963	832	952	834	1,147	1,196
Consolidated Gross Profit	339	246	253	198	355	160	251	619
% of revenues	41%	33%	26%	24%	37%	19%	22%	52%
Total Operating Expenses	729	704	682	825	752	851	1,297	1,313
% of revenues	87%	95%	71%	99%	78%	102%	113%	110%
Consolidated Net Income (loss)	(283)	(415)	(199)	(525)	(535)	(522)	(1,103)	(1,106)
% of revenues	-34%	-56%	-21%	-63%	-56%	-63%	-96%	-92%
Earnings per share								
Basic	(\$0.02)	(\$0.04)	(\$0.02)	(\$0.04)	(\$0.04)	(\$0.04)	(\$0.09)	(\$0.07)
Diluted	(\$0.02)	(\$0.04)	(\$0.02)	(\$0.04)	(\$0.04)	(\$0.04)	(\$0.09)	(\$0.07)

Liquidity and Capital Resources

ESI has historically financed its operations through the sale of equity and through cash generated by its operations.

During the three month period ended August 31, 2010, cash used in operating activities was \$79,210 and during the six months ended August 31, 2010, cash provided in operating activities was \$7,390, compared to cash provided in operating activities of \$66,842 and cash used of \$398,268 during the comparative periods ended August 31, 2009, respectively.

Cash provided in financing activities totaled \$72,247 and \$73,215 during the three months and six months ended August 31, 2010 respectively. These activities related mainly to the loan payable. Cash used by financing activities for the comparative periods for the three and six months ending August 31, 2009, were \$38,271 and \$381,765 respectively.

Certain employees have voluntarily deferred part of their compensation. The unpaid deferred amounts are being accrued with interest and are recorded in the Company's financial statements. The salary deferrals are payable upon termination or when the Company's economic conditions have strengthened to accommodate for the repayment. As at August 31, 2010, the total amount of the deferred salaries is \$1,158,502.

As at August 31, 2010, the Company had cash and cash equivalents of \$94,794, compared to \$134,954 on August 31, 2009.

For the three month period ending August 31, 2010 the Company incurred a loss from operations of \$283,424 with a decrease of operating cash flow of \$80,982. In addition, the Company has incurred significant operating losses and net utilization of cash in operations in prior periods. Accordingly, the Company will require continued financial support from its shareholders and creditors and/or new debt or equity financing until it is able to generate sufficient cash flow from operations on a sustained basis.

Contingent Off-Balance Sheet Arrangements

The Company did not have any contingent off-balance sheet arrangements during the three month or six month period ending August 31, 2010. (August 31, 2009 – nil)

Outstanding Share Data

ESI's outstanding share data is listed in the table below as at the dates indicated:

	Aug 31/10	Aug 31/09	Date of this Report
Weighted average shares used in computation of basic earnings per share	14,324,726	14,324,726	14,324,726
Fully diluted weighted average common shares	14,324,726	14,324,726	14,324,726

During the three and six month periods ended August 31, 2010, no options were granted and a total of 1,781,750 were surrendered (without compensation), forfeited or expired unexercised. (August 31, 2009: 50,000, nil and 29,000 respectively).

As at August 31, 2010, there were 145,000 options outstanding (August 31, 2009 – 1,937,000), and as at the date of this report, there were 1,559,000 options outstanding, exercisable at a Weighted Average Price of \$ 0.05 (August 31, 2009 - \$0.64).

Disclosures, Controls and Procedures

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed in filings made pursuant to Multilateral Instrument 52-109 is recorded, processed, summarized and reported within the time periods specified in the Canadian Securities Administrators rules and forms. During the three months ended August 31, 2010, the Company did not make any changes to its internal controls over financial reporting that would have materially affected, or would likely materially affect, such controls. The Chief Executive Officer and Chief Financial Officer have evaluated the Company's disclosure controls and procedures as of August 31, 2010 and concluded that the Company's current disclosure controls and procedures are effective.

Convergence with International Financial Reporting Standards ("IFRS")

As described in the MD&A for the year ended February 28, 2010, the Company has designated March 1, 2011, as the date upon which it will adopt IFRS, and is presently engaged on a three-phase project during the current fiscal year to assess the impact that the transition to IFRS will have on the Company's systems, financial reporting controls and procedures and business activities. The Company is still engaged in the First Phase of this project (Initial impact assessment and scoping phase). Management is not yet able to assess with any precision which currently applicable Canadian GAAP Policies will be changed so as to comply with IFRS policies other than in general terms. Management will continue the IFRS Project throughout fiscal 2011 in order to effect the adoption of IFRS at the designated date.

Risks & Uncertainties

Although not exhaustive, the following list summarizes some of the key risks the Company faces, as well as, strategies the Company employs to manage these risks:

Market, Operating and Competitive Risks

The market opportunity for ESI's products is dependent upon external factors such as the continued growth in the use of the Internet, the growth of consumers' disposable income, consumer interest in gaming and regulatory and legislative matters. As well, the Company has larger competitors who have larger customer bases and more significant financial and operating resources, which may make it more difficult for ESI to compete in the marketplace. If ESI were not able to grow its customer base, ESI's business would be materially negatively impacted. To manage this risk, ESI has invested significant resources in product development, sales, marketing and customer service to ensure that it delivers products and services that are competitive and valuable to its customers and that are attractive to potential new customers. It also mitigates some of the market risk by aiming at a diversified customer base in different markets.

Technology Risks

ESI has invested significant resources in its products to ensure that they provide customers with a competitive offering relative to other suppliers in its industry. If ESI has not protected its intellectual property adequately or if it infringes third party intellectual property rights, it may lose its competitive advantage and incur significant costs and loss of reputation that could materially negatively impact its business. To manage this risk, ESI has invested significant resources in product development and professional assistance to protect its intellectual property and avoid to the extent possible infringement of third party intellectual property rights.

Financial Risk

ESI is undertaking an expansion strategy to capture new customers and provide its services in new jurisdictions. This strategy requires significant capital to achieve its long term strategic plan. If the

Company is unable fund its strategic plan through operating cash flow, debt and equity financing, its future prospects would be materially negatively impacted. In order to mitigate this risk, the Company has employed a disciplined budgeting approach to manage its expenditures relative to the achievement of its strategic plan so that appropriate measures can be put in place to reduce the Company's exposure to financial risk.

Regulatory Risk

The Company is subject to anti-money laundering ("AML") legislation in jurisdictions in which it operates or has operated in. Management has implemented controls and procedures that it believes makes the Company compliant with all applicable AML rules and regulations. It is possible that regulatory authorities may audit the Company systems and processes and assess monetary penalties for non-compliance which could be material.

Foreign currency risk

A significant component of the Company's transactions, particularly revenues, is undertaken in US dollars, Euros, and other foreign currencies. The Company maintains significant deposits in foreign currencies denominated accounts. Fluctuations in exchange rates between those foreign currencies could have a material effect on the business, results of operations and financial condition of the Company. The Company does not use hedging instruments to manage its exposure to foreign currency exchange risk.

Key Personnel Risk

The future success of ESI is heavily dependent upon the Company's ability to retain, recruit and train senior management, technical, sales and managerial personnel. Competition for qualified employees is intense and it may be possible that the Company is unable to retain and recruit qualified personnel in the future. If this were to occur, this would have a material negative impact on the Company. To manage this risk, the Company has implemented employee training programs, recognition programs and competitive compensation.

For further information please refer to the unaudited financial statements for the three and six months ending August 31, 2010, the audited year end financial statements as at February 28, 2010 and February 28, 2009 and the Management's Discussion and Analysis as at February 28, 2010. All information presented here is filed by the company on SEDAR, (System for Electronic Document Analysis and Retrieval) and can be viewed at www.sedar.com.

These unaudited financial statements have not been reviewed by the Company's auditors.

Dated : October 29, 2010