



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

For the Fiscal Year 2011

For the Three and Nine Months Ended November 30, 2010

January 28, 2011

ESI Entertainment Systems Inc.

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TO OUR SHAREHOLDERS

For the Quarter Ended November 30, 2010

Dear Shareholder:

We are pleased to present our results for our third quarter ended November 30, 2010.

Gross Revenues for the quarter increased by 13% to \$937,000 from \$832,000 during the same period last year. Gross profit increased 146% to \$488,000 from \$198,000 during the same period last year. Operating expenses decreased by 19% to \$664,000 from \$825,000 during the same period last year. Net earnings were \$250,000 compared to a net loss of \$525,000 in the same period last year.

Growing Citadel transaction processing resulted in our gross revenues increasing by 14% over last quarter; the increase in net earnings is due to a foreign exchange adjustment from prior periods.

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 improve our revenue and net earnings.

"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 nine months ended November 30, 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 15 Citadel employees and 9 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 November 30, 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 Nine Months ended November 30, 2010

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

- Revenue for the three months to November 30, 2010, increased from \$832,284 to \$936,842, 13% increase over the comparative period in the prior year;
- Revenue for the nine months to November 30, 2010 decreased from \$2,618,546 to \$2,502,136, 4% decrease over the comparative period in the prior year;
- Gross profit for the three months to November 30, 2010 increased from \$198,591 to \$488,257, 145% increase over the comparative period in the prior year;
- Gross profit for the nine months to November 30, 2010, increased from \$713,327 to \$1,073,539, 50% increase over the comparative period in the prior year;
- Operating expenses for the three months to November 30, 2010 decreased by 19% to \$664,282 from \$824,792 in the comparative period in the prior year;
- Operating expenses for the nine months to November 30, 2010 decreased by 14% to \$2,097,482 from \$2,427,999 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 November 30			Nine months ended November 30		
	2010	2009	% Change	2010	2009	% Change
Integrity	401	546	(27%)	1,275	1,832	(30%)
Citadel	536	286	87%	1,227	786	56%
Total Revenue	937	832	13%	2,502	2,618	(4%)

Total revenue increased by 13% to \$937,000 for the three months ended November 30, 2010 from \$832,000 for the three months ended November 30, 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 43% of ESI's revenues were generated by ESI Integrity during the three months ended November 30, 2010 compared to 66% 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 57% of ESI's revenues were generated by Citadel during the three months ended November 30, 2010 compared to 34% 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 Nov 30		Nine months ended Nov 30	
	2010	2009	2010	2009
Revenues	937	832	2,502	2,618
Direct Costs	449	634	1,428	1,905
Gross profit	488	198	1,074	713
Gross profit margin (%)	52%	24%	43%	27%

Product Development

All Product Development expenses are now being capitalized

Sales, Marketing and Customer Service

Sales, marketing and customer service expenses were \$50,496 and \$110,915 during the three and nine months ended November 30, 2010 respectively, an increase of 28% and a decrease of 6% respectively compared to \$39,423 and \$117,702 for the three and nine months ended November 30, 2009.

General and Administrative

General and administrative expenses were \$600,871 and \$1,947,307 during the three and nine months ended November 30, 2010 respectively, representing a decrease of 14% and 1% compared to \$699,865 and \$1,970,403 for the three months and nine months ended November 30, 2009.

Amortization of Property and Equipment

Amortization expenses were \$12,915 and \$39,260 during the three month and nine month periods ended November 30, 2010, respectively, a decrease of 55% and 75% compared to \$28,710 and \$160,212 for the corresponding periods ended November 30, 2009. The decrease in amortization expense mainly relates to very few new assets being purchased and amortization being reduced on older equipment.

Net Earnings (Loss)

Net earnings for the three and nine month periods ended November 30, 2010 was \$250,350 (\$0.02 net earnings per share) and (\$447,874), (\$0.03 net loss per share), respectively, compared to net earnings of (\$525,232), (\$0.04 net loss per share) and (\$1,583,032), (\$0.11 net loss per share) for the prior comparative periods. The net earnings reported during the three months ending November is due to a foreign exchange adjustment from prior periods.

Citadel Processing Accounts

Citadel processing accounts as at November 30, 2010 totaled \$5.653 million compared to \$5.649 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 November 30, 2010 derived from unaudited statements prepared by Management.

(\$000) except for per share data	30-Nov 2010	31-Aug 2010	31-May 2010	28-Feb 2010	30-Nov 2009	31-Aug 2009	31-May 2009	28-Feb 2009
Consolidated Revenue	936	822	743	963	832	952	834	1,147
Consolidated Gross Profit	488	339	57	253	198	355	160	251
% of revenues	52%	41%	8%	26%	24%	37%	19%	22%
Total Operating Expenses	664	729	704	682	825	752	851	1,297
% of revenues	71%	87%	95%	71%	99%	78%	102%	113%
Consolidated Net Income (loss)	250	(283)	(415)	(199)	(525)	(535)	(522)	(1,103)
% of revenues	26%	-34%	-56%	-21%	-63%	-56%	-63%	-96%
Earnings per share								
Basic	\$0.02	(\$0.02)	(\$0.04)	(\$0.02)	(\$0.04)	(\$0.04)	(\$0.04)	(\$0.09)
Diluted	\$0.02	(\$0.02)	(\$0.04)	(\$0.02)	(\$0.04)	(\$0.04)	(\$0.04)	(\$0.09)

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 November 30, 2010, cash provided in operating activities was \$94,413, during the nine months ended November 30, 2010, cash provided in operating activities was \$101,803, compared to cash provided in operating activities of \$32,262 and cash used of \$366,006 during the comparative periods ended November 30, 2009, respectively.

Cash used by financing activities totaled \$62,362 and \$10,853 during the three months and nine months ended November 30, 2010 respectively. These activities related mainly to the loan payable. Cash used by financing activities for the comparative periods for the three and nine months ending November 30, 2009, were \$51,987 and \$433,752 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 November 30, 2010, the total amount of the deferred salaries is \$1,319,389.

As at November 30, 2010, the Company had cash and cash equivalents of \$101,411, compared to \$105,544 on November 30, 2009.

For the three month period ending November 30, 2010 the Company recorded an income from operations of \$250,350 with an increase of operating cash flow of \$6,617; the income is due to a foreign exchange adjustment from prior periods. The Company has incurred significant operating losses and net utilization of cash in operations in prior periods. 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 nine month period ending November 30, 2010. (November 30, 2009 – nil)

Outstanding Share Data

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

	Nov 30/10	Nov 30/09	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 months ended November 30, 2010, 1,414,000 stock options were granted with none being forfeited or expired unexercised. (November 30, 2009 – 145,000 and 82,000 respectively).

As at November 30, 2010, and at the date of this report, there were 1,559,000 options outstanding, (November 30, 2009 – 2,000,000) exercisable at a Weighted Average Price of \$0.05 (November 30, 2009 - \$0.60).

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 November 30, 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 nine months ending November 30, 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 : January 28, 2011