



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

For the Fiscal Year 2010

For the Three and Six Months Ended August 31, 2009

October 29, 2009

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TO OUR SHAREHOLDERS
For the Quarter Ended August 31, 2009

Dear Shareholder:

We are pleased to present our results for the second quarter ended August 31, 2009.

Gross revenues for the quarter increased by 28% to \$952,000 from \$742,000 during the same period last year. Gross profit also increased to \$355,000 (37% gross margin) from a negative Gross profit of \$60,000 during the same period last year. Operating expenses decreased by 49% to \$752,000 from \$1,474,000 during the same period last year. Net loss after tax was \$536,000 compared to net loss after tax of \$1.5 million in the same period last year, a decrease of 65%.

During the second quarter of fiscal 2010 we maintained a steady growth while holding our costs to a minimum and building our customer base to allow us to work for future accelerated growth. Our team of employees and our Board continued to work well together with skill and dedication and many have accepted additional workloads to accommodate the growing business while holding down our costs.

Our second quarter occurs during the off-peak summer season and we traditionally can experience a slowing of revenues. However both subsidiaries have improved their performance over the previous year and both have invested in future opportunities that we will work to fulfill during the coming months.

"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 month periods ended August 31, 2009. The MD&A should be read in conjunction with the Company's February 28, 2009 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 Annual Information Form ("AIF") and MD&A and audited consolidated financial statements for the financial year ended February 28, 2009 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

The Company has two independently operated and controlled subsidiaries: Citadel Commerce Corp. and ESI Integrity Inc. A third subsidiary, PlayLine Inc., is presently dormant. The two active subsidiaries are co-located but are operated autonomously with completely separate management and personnel.

ESI has approximately 13 Citadel employees and 22 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 to businesses requiring high levels of security, integrity, and trust, including government regulated lotteries and pari-mutuel (horse track) betting.

Citadel provides on-line payment processing services including Bank Transfer, Instant Credit (an instant form of Bank Transfer), 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.

A detailed overview of ESI's business, including a summary of our core business, vision and strategy is provided in our MD&A and AIF for the financial year ended February 28, 2009.

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, 2009.

Additionally, the preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles 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, 2009, have been prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP) on a basis consistent with those followed in the most recent audited annual financial statements for the year ended February 28, 2009. 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, 2009.

Financial Highlights for the Three and Six Months ended August 31, 2009

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

- Revenue for the three months to August 31, 2009, increased from \$742,294 to \$952,271, 28% increase over the comparative period in the prior year;
- Revenue for the six months to August 31, 2009 increased from \$1,611,682 to \$1,786,262, 11% increase over the comparative period in the prior year;
- Gross profit for the three months to August 31, 2009 increased from (\$59,576) to \$354,982, 695% increase over the comparative period in the prior year;
- Gross profit for the six months to August 31, 2009, increased from \$102,120 to \$514,736, 404% increase over the comparative period in the prior year;
- Net loss for the three months to August 31, 2009 decreased by 65% to \$535,677 from \$1,546,737 in the comparative period in the prior year;
- Net loss for the six months to August 31, 2009 decreased by 63% to \$1,057,800 from \$2,859,097 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		
	2009	2008	% Change	2009	2008	% Change
Integrity	706	616	14.6%	1,286	1,365	(5.7%)
Citadel	246	126	95.2%	500	246	103.3%
Total Revenue	952	742	28.3%	1,786	1,611	10.8%

Approximately 74% of ESI's revenues were generated by ESI Integrity during the three months ended August 31, 2009 compared to 83% for the same period in the prior year.

Total revenue increased by 28% to \$952,000 for the three months ended August 31, 2009 from \$742,000 for the three months ended August 31, 2008.

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 track) betting.

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.

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 two online banking services: Bank Transfer, and Instant Credit (an instant form of Bank Transfer). All of Citadel's services are based on a fee per transaction charged to its merchants.

Consolidated Gross Profit

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

	Three months ended Aug 31		Six months ended Aug 31	
(\$ 000)	2009	2008	2009	2008
Revenues	952	742	1,786	1,611
Direct Costs	597	802	1,271	1,509
Gross profit	355	(60)	515	102
Gross profit margin (%)	37%	(8%)	29%	6%

Product Development

Product development expenses were \$59,580 and \$122,888 during the three and six months ended August 31, 2009 respectively, a decrease of 34% and 41% respectively compared to \$91,129 and \$207,778 for the three and six months ended August 31, 2008.

Sales, Marketing and Customer Service

Sales, marketing and customer service expenses were \$37,954 and \$78,279 during the three and six months ended August 31, 2009 respectively, a decrease of 82% and 84% respectively compared to \$211,243 and \$476,843 for the three and six months ended August 31, 2008.

General and Administrative

General and administrative expenses were \$594,803 and \$1,270,538 during the three and six months ended August 31, 2009 respectively, representing a decrease of 43% and 36% compared to \$1,047,170 and \$1,972,218 for the three months and six months ended August 31, 2008. This reduction is due to the Company's ongoing efforts to minimize its operating expenses.

Amortization of Property and Equipment

Amortization expenses were \$59,276 and \$131,502 during the three month and six month periods ended August 31, 2009, respectively, a decrease of 52% and 55% compared to \$124,742 and \$294,127 for the corresponding periods ended August 31, 2008. 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, 2009 was \$535,677 (\$0.04 net loss per share) and \$1,057,800 (\$0.07 net loss per share), respectively, compared to net loss of \$1,546,737 (\$0.08 net loss per share) and \$2,859,097 (\$0.15 net loss per share) for the prior comparative periods.

Citadel Processing Accounts and Liabilities

Citadel processing accounts as at August 31, 2009 totaled \$5.6 million compared to \$2.9 million as at February 28, 2009. 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, 2009 derived from unaudited statements prepared by Management.

<i>(\$000)</i>	31-Aug	31-May	28-Feb	30-Nov	31-Aug	31-May	29-Feb	30-Nov
<i>except for per share data</i>	2009	2009	2009	2008	2008	2008	2008	2007
Consolidated Revenue	952	834	1,147	1,196	742	869	1,029	762
Consolidated Gross Profit	355	160	251	619	(60)	161	145	64
% of revenues	37%	19%	22%	52%	-8%	19%	14%	8%
Total Operating Expenses	752	851	1,297	1,313	1,474	1,476	2,042	2,513
% of revenues	78%	102%	113%	110%	198%	170%	198%	330%
Consolidated Net Income (loss)	(535)	(522)	(1,103)	(1,106)	(1,547)	(1,312)	225	(2,251)
% of revenues	-56%	-63%	-96%	-92%	-208%	-151%	22%	-295%
Earnings per share								
Basic	(\$0.04)	(\$0.04)	(\$0.09)	(\$0.07)	(\$0.08)	(\$0.07)	(\$0.02)	(\$0.13)

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, 2009, cash provided in operating activities was \$66,842 and during the six months ended August 31, 2009, cash used in operating activities was \$398,268, compared to cash used in operating activities of \$1,495,124 and \$2,973,469 during the comparative periods ended August 31, 2008, respectively.

Cash used in financing activities totaled \$38,271 and \$381,765 during the three months and six months ended August 31, 2009 respectively. These activities related to the funding of capital lease obligations and by the loan payable. Cash provide by financing activities for the comparative periods for the three and six months ending August 31, 2008, were \$2,013,436 and \$1,919,549 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, 2009, the total amount of the deferred salaries is \$614,487.

Upon and subject to the closing of the sale of shares of ESI Integrity Inc., the Loan Payable will be significantly reduced.

As at August 31, 2009, the Company had cash and cash equivalents of \$134,954, compared to \$1,988,543 on August 31, 2008.

For the three month period ending August 31, 2009 the Company incurred a loss from operations of \$535,677 with an increase of operating cash flow of \$41,425. In addition, the Company has incurred significant operating losses and net utilization of cash in operations in all 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, 2009. (August 31, 2008 – nil)

Outstanding Share Data

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

	Aug 31/09	Aug 31/08	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 six month period ended August 31, 2009, 50,000 options were granted and a total of 29,000 were forfeited or expired unexercised. (August 31, 2008, nil, nil and 34,250 respectively).

As at August 31, 2009, there were 1,937,000 options outstanding (August 31, 2008 – 1,916,000), and as at the date of this report, there were 2,079,500 options outstanding, exercisable at a Weighted Average Price of \$ 0.64 (August 31, 2008 - \$0.82).

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 month and six months ended August 31, 2009, the Company did not make any changes to its internal control 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, 2009 and concluded that the Company's current disclosure controls and procedures are effective.

Risks & Uncertainties

A detailed explanation of risk factors which ESI faces is provided in its Annual Information Form listed on www.sedar.com. 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. Additionally, ESI also has very few customers for Citadel business since cessation of the financial processing business for non-domestic internet gaming merchants. 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 new markets and new geography. 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 six months ending August 31, 2009, the audited year end financial statements as at February 28, 2009 and February 29, 2008, the Management's Discussion and Analysis as at February 28, 2009 and the Annual Information Form for February 28, 2009. 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.

Dated October 29, 2009.