

ESI Entertainment Systems Inc.
Consolidated Financial Statements

(expressed in Canadian dollars)

For the Six Months Ended August 31, 2009 and 2008

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

ESI Entertainment Systems Inc.

Consolidated Balance Sheets

(expressed in Canadian dollars)
(unaudited)

	August 31, 2009 (unaudited)	February 28, 2009 (audited)
Assets		
Cash and cash equivalents	\$ 134,954	\$ 909,785
Accounts receivable	536,220	1,100,023
Prepays	171,793	106,513
	<u>842,967</u>	<u>2,116,321</u>
Citadel processing accounts (Note 3)	5,596,527	2,958,565
Property and equipment (Note 4)	144,021	280,725
Deferred contract costs	632,790	696,234
	<u>\$ 7,216,305</u>	<u>\$ 6,051,845</u>
Liabilities		
Accounts payable and accrued liabilities (Note 8)	\$ 1,079,162	\$ 1,049,700
Loan Payable (Note 9)	2,209,108	2,564,704
Capital lease obligations	4,515	30,684
Deferred revenue	700,697	535,667
	<u>3,993,482</u>	<u>4,180,755</u>
Citadel processing liabilities (Note 3)	5,596,527	2,958,565
Deferred revenue	1,095,963	1,324,392
	<u>10,685,972</u>	<u>8,463,712</u>
Shareholders' Equity		
Capital stock (Note 5)	9,957,959	9,957,959
Contributed surplus	4,328,885	4,328,885
Deficit	(17,756,511)	(16,698,711)
	<u>(3,469,667)</u>	<u>(2,411,867)</u>
	<u>\$ 7,216,305</u>	<u>\$ 6,051,845</u>

On behalf of the Board

"Tony Greening" Director
Tony Greening

"Michael Meeks" Director
Michael Meeks

See accompanying notes to the consolidated financial statements.

2

ESI Entertainment Systems Inc.

Consolidated Statements of Operations and Comprehensive Income (Deficit) and Retained Earnings

(expressed in Canadian dollars)

(unaudited)	Three Months Ended August 31,		Six Months Ended August 31,	
	2009	2008	2009	2008
Revenues (Note 4)	\$ 952,271	\$ 742,294	\$ 1,786,262	\$ 1,611,682
Direct costs	<u>597,289</u>	<u>801,870</u>	<u>1,271,526</u>	<u>1,509,562</u>
Gross profit	<u>354,982</u>	<u>(59,576)</u>	<u>514,736</u>	<u>102,120</u>
Operating expenses				
Product development	59,580	91,129	122,888	207,778
Sales, marketing and customer service	37,954	211,243	78,279	476,843
General and administrative	594,803	1,047,170	1,270,538	1,972,218
Amortization of property and equipment	<u>59,276</u>	<u>124,742</u>	<u>131,502</u>	<u>294,127</u>
	<u>751,613</u>	<u>1,474,284</u>	<u>1,603,207</u>	<u>2,950,966</u>
(Loss) Earnings before under noted items	(396,631)	(1,533,860)	(1,088,471)	(2,848,846)
Other expenses (income)				
Foreign exchange loss (gain)	118,671	123	(96,674)	5,883
Interest income	(19,510)	(13,254)	(20,200)	(28,205)
Interest expense	<u>39,885</u>	<u>24,301</u>	<u>86,203</u>	<u>30,866</u>
(Loss) Earnings before income taxes and non-controlling interest	<u>(535,677)</u>	<u>(1,545,030)</u>	<u>(1,057,800)</u>	<u>(2,857,390)</u>
Provision for income taxes				
Current	<u>-</u>	<u>1,707</u>	<u>-</u>	<u>1,707</u>
	<u>-</u>	<u>1,707</u>	<u>-</u>	<u>1,707</u>
Net (Loss) Earnings and comprehensive (Loss) Earnings	<u>\$ (535,677)</u>	<u>\$ (1,546,737)</u>	<u>\$ (1,057,800)</u>	<u>\$ (2,859,097)</u>
(Loss) Earnings per share (Note 7)				
Basic	\$ (0.04)	\$ (0.08)	\$ (0.07)	\$ (0.15)
Retained earnings (deficit), beginning of period	\$ (17,220,834)	\$ (12,942,545)	\$ (16,698,711)	\$ (11,630,185)
Net (Loss) Earnings	<u>(535,677)</u>	<u>(1,546,737)</u>	<u>(1,057,800)</u>	<u>(2,859,097)</u>
Retained earnings (deficit), end of period	<u>\$ (17,756,511)</u>	<u>\$ (14,489,282)</u>	<u>\$ (17,756,511)</u>	<u>\$ (14,489,282)</u>

See accompanying notes to the consolidated financial statements.

ESI Entertainment Systems Inc.

Consolidated Statements of Cash Flows

(expressed in Canadian dollars)

(unaudited)	Three Months Ended August 31,		Six Months Ended August 31,	
	2009	2008	2009	2008
Cash flows provided by (used in)				
Operating activities				
Net (Loss) Earnings	\$ (535,677)	\$ (1,546,737)	\$ (1,057,800)	\$ (2,859,098)
Items not affecting cash:				
Amortization of property and equipment	59,276	124,742	131,502	294,127
Impairment of intangibles and other assets	-	(34,746)	-	(34,746)
Future income taxes	-	1,707	-	1,707
Net changes in non-cash operating items:				
Accounts receivable	852,300	72,514	563,803	294,462
Prepays	(89,828)	(96,219)	(65,280)	(228,835)
Allowance for bad debts	-	-	-	(310,608)
Accounts payable and accrued liabilities	(194,807)	(38,730)	29,462	(103,107)
Deferred revenue	(80,058)	(12,430)	(63,399)	33,425
Deferred contract costs	55,636	34,775	63,444	(60,796)
	<u>66,842</u>	<u>(1,495,124)</u>	<u>(398,268)</u>	<u>(2,973,469)</u>
Investing activities				
Acquisition of property and equipment	<u>12,854</u>	<u>-</u>	<u>5,202</u>	<u>-</u>
	<u>12,854</u>	<u>-</u>	<u>5,202</u>	<u>-</u>
Financing activities				
Loan payable	(24,992)	2,068,480	(355,596)	2,068,480
Capital lease payments	<u>(13,279)</u>	<u>(55,044)</u>	<u>(26,169)</u>	<u>(148,931)</u>
	<u>(38,271)</u>	<u>2,013,436</u>	<u>(381,765)</u>	<u>1,919,549</u>
Increase (decrease) in cash and cash equivalents	41,425	518,311	(774,831)	(1,053,920)
Cash and cash equivalents, beginning of period	<u>93,529</u>	<u>1,470,232</u>	<u>909,785</u>	<u>3,042,463</u>
Cash and cash equivalents, end of period	<u>\$ 134,954</u>	<u>\$ 1,988,543</u>	<u>\$ 134,954</u>	<u>\$ 1,988,543</u>
Supplemental information				
Interest received	\$ 19,510	\$ 13,254	\$ 20,200	\$ 28,204
Interest paid	39,885	24,301	86,203	30,515

See accompanying notes to the consolidated financial statements.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three and Six Months Ended August 31, 2009 and 2008

1. Nature and continuance of operations

ESI Entertainment Systems Inc. ("the Company") was incorporated as e-Success Inc. on December 9, 1999 under the *Canada Business Corporations Act*. On February 27, 2006, the Company was continued as a British Columbia corporation and changed its name to ESI Entertainment Systems Inc.

ESI Corporate

ESI Entertainment Systems Inc is a software development company with 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.

ESI Integrity

ESI Integrity provides real time auditing, fraud control and risk management systems to government lotteries and pari-mutuel (horse track) organizations. Integrity enters into 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. 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 the term of each contract. The growth in revenue is dependent on the number of contracts executed in a given year, which may vary substantially from year to year.

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.

Integrity continued to steadily grow its business throughout the three and six month periods to August 31, 2009 and surpassed its goals both in revenue and cash flow.

Citadel

Citadel's focus during the three and six month periods to August 31, 2009 has been on closing new business for the new online banking services offered as a part of its on-line payment processing services. At the same time Citadel has greatly reduced its expenses by cutting costs wherever possible including retaining only one consultant in Costa Rica, one person in the UK and reducing its Vancouver personnel to a core group.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three and Six Months Ended August 31, 2009 and 2008

1. Nature and continuance of operations

Citadel's services 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 and its existing infrastructure and personnel have the capability to process substantially larger volumes.

The Bank Transfer services use a software product that electronically scans Citadel bank accounts and notifies merchants when consumer funds are received. The Instant services use 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. 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 Credit.

These financial statements have been prepared on a going concern basis which includes the assumption that the Company will be able to realize its assets and settle its liabilities in the normal course of business. For the six month period ended August 31, 2009 the Company incurred a loss from operations of \$1,057,800 and an increase in 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. There can be no guarantee that adequate funds will be available on acceptable terms as and when required by the Company. Failure to obtain ongoing support of its shareholders and creditors may make the going concern basis of accounting inappropriate, in which case the Company's assets and liabilities would need to be recognized at their liquidation values. These financial statements do not include any adjustment due to this going concern uncertainty.

Geopolitical risk and impact of legislation in the USA as it pertains to Citadel

Significant new legislation regarding on-line gambling was introduced and enacted in the USA during fiscal 2007. There has been no risk or impact of legislation in the USA to ESI Integrity. However the new legislation has considerably affected the Citadel Commerce business and the following notes deal solely with the impact on Citadel.

While Citadel does not operate a gaming business itself, its products and services were used by companies operating in the on-line gaming industry. Citadel had on-line gaming customers in Canada and the United States which have now been discontinued. Citadel is now expanding its customer base by processing for payments processors and for merchants outside the USA and Canada. The governments of each country approach the issue of online gaming quite differently.

In Canada, corporate counsel asserts that most on-line gaming is likely prohibited activity under the federal Criminal Code ("the Code"). However the issue is not addressed directly in the Code, nor is there Canadian case law that provides a definitive answer one way or the other. Therefore it is possible that the provision of on-line gaming services, such as those supplied by users of Citadel's products and services could constitute the carrying on of a prohibited activity in Canada. The prohibitions in the Code, together with the possibility that

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)

Three and Six Months Ended August 31, 2009 and 2008

1. Nature and continuance of operations as it pertains to Citadel (Continued)

Citadel's activities could theoretically be found to constitute aiding and abetting in the commission of an offence, create risk for Citadel. However, as noted, there is little Canadian legislation or case law directly on point and so it is difficult if not impossible to accurately measure the level of such a risk. In fiscal 2008, the Company ceased processing payments directly for on-line gaming merchants in Canada, but continues to provide processing services to other third party processors

In the United States, President Bush signed the *Unlawful Internet Gambling Enforcement Act of 2006* (the "UIGEA") into force on October 13, 2006. The UIGEA represents an attempt by the U.S. government to stop non-domestic online gaming in the United States by cutting off the cash flow between U.S. online gamblers and non-domestic online gaming websites. This will be accomplished by developing policies and procedures for identifying and blocking all such transactions, and by requiring financial institutions (including companies such as Citadel) to adopt and follow those policies and procedures. Although the Company intended to comply with the policies and procedures once they are issued and known, the Company ceased its payment processing business for USA consumers on January 17, 2007 due to actions taken by Department of Justice against other financial processors' executives. The closure of this business segment has had a material impact on Citadel's business as approximately 95% of its fiscal 2007 revenues were derived from those merchants. This closure has not been treated as a discontinued operation as the Company cannot make realistic estimates of costs associated with these operations.

During March, 2007 the USA Department of Justice (DOJ) obtained a court order instructing Citadel's United States bank to freeze funds held in that bank. Subsequently, the DOJ compelled that same bank to disgorge all such funds to the DOJ.

During fiscal 2008 the Company was engaged in negotiations with the US District Attorney's Office for the Southern District of New York ("USDA") over its involvement, prior to January 17, 2007, as a financial processor to internet based gaming merchants providing services to US consumers. Those negotiations led to approval by the Court in New York of a Deferred Prosecution Agreement ("DPA") with a duration of 18 months which was finalized in June 2008. At the completion of the 18 month period, and subject to compliance with the terms of the DPA, the USDA will inform the court that it is dismissing the information previously filed with the court; there will be no prosecution of ESI and the case will be dismissed.

During fiscal 2008 the Company retained a firm of independent forensic accountants who determined that the funds seized by the DOJ included \$1,866,634 of Citadel's own funds (\$1,100,903 reported in fiscal 2007).

Before Citadel ceased processing entirely in the USA, it was determined the UIGEA would likely adversely impact the Company's Citadel business unit. In fiscal 2007 the Company undertook a review of its accounting treatment of assets including deferred start-up costs, capitalized development costs, inventory and property and equipment. The Company could not forecast with any certainty that it would recover the capitalized costs related to these assets and recorded an impairment charge in that year. In addition, the Company carried in prepaids, a balance for software that had been partially installed in fiscal 2007, and as it could not be determined with any certainty whether that software will be used in the future, it has recorded an impairment charge in fiscal 2008.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)

Three and Six Months Ended August 31, 2009 and 2008

1. Nature and continuance of operations as it pertains to Citadel (Continued)

Pursuant to the terms of the Company's agreements with its merchants, the merchants are obligated to indemnify the Company where the merchants' actions cause losses or damages to the Company. The Company has obtained a legal opinion that their merchants' actions were the cause of the DOJ seizure and as such, certain costs incurred by the Company are eligible for indemnification under the contractual terms of these merchant agreements. In management's opinion, costs eligible for indemnification include:

- previously written off development costs related to the Citadel business segment;
- costs associated with its software code license;
- certain general and administrative expenses; and
- the \$1,866,634 of the Company's own funds seized by the DOJ.

In aggregate, these costs totaled approximately \$7.6 million and were incurred in fiscal 2007 (\$6.4 million) and fiscal 2008 (\$1.2 million). Since merchant funds held by the Company and available to be used as indemnification totaled only \$2,055,430, this amount has been recorded as a cost recovery in the prior fiscal year with the balance included in expenses.

The Company is actively seeking to increase the volume of business it does with customers operating in jurisdictions where non-domestic online gaming is clearly legal, including the United Kingdom which announced legislation to license and regulate the on-line gaming industry. During the 2007 fiscal year, Citadel Commerce UK was authorized by the UK Financial Services Authority (FSA) as an ELMI (Electronic Money Issuer) and currently is classified as a Small e-Money Issuer (SMI). The Company also obtained similar status throughout the European Union through the Passporting rules.

2. Basis of consolidation and financial statement preparation:

These unaudited interim Consolidated Financial Statements 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. These 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.

3. Citadel processing

Citadel Processing Accounts represents the bank accounts maintained by the Company for the strict purpose of payment processing for Citadel merchants and clients. These accounts are separate from the Company's operating bank accounts.

Citadel processing liabilities represent balances due to myCitadel clients, merchants and their clients from funds held in trust and accounts receivable, pending transaction cancellation periods. These amounts consist of:

	<u>August 31,</u> <u>2009</u>	<u>February 28,</u> <u>2009</u>
Merchant processing funds	\$ 5,300,707	\$ 2,403,348
Merchant reserves	16,071	56,690
Merchant payout funds	254,990	450,398
myCitadel consumer funds	<u>24,759</u>	<u>48,129</u>
	<u>\$ 5,596,527</u>	<u>\$ 2,958,565</u>

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three and Six Months Ended August 31, 2009 and 2008

3. Citadel processing (Continued)

Merchant processing funds are funds held with Citadel for its merchants, these are available on demand.

Merchant reserves represent 10% of certain processed transactions accumulated on a six month rolling period for certain merchants.

Merchant payout funds relate to cash designated by merchants to fund player winnings.

myCitadel consumer funds represent the funds held by clients to be used in e-commerce activities.

4. Segmented information

The Company operates two main operating segments – ESI Integrity and Citadel.

The ESI Integrity segment 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-mutual (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.

The segmented information for each business segment is as follows:

Gross Profit:

Three months ended, August 31, 2009

	ESI Integrity	Citadel	Total
Segment gross profit			
Revenue	\$ 706,095	\$ 246,176	\$ 952,271
Cost of goods sold	<u>311,004</u>	<u>286,285</u>	<u>597,289</u>
Gross profit	<u>395,091</u>	<u>(40,109)</u>	<u>354,982</u>
Acquisition of property and equipment	\$ <u>12,854</u>	\$ <u>-</u>	\$ <u>12,854</u>

Three months ended, August 31, 2008

	ESI Integrity	Citadel	Total
Segment gross profit			
Revenue	\$ 616,454	\$ 125,840	\$ 742,294
Cost of goods sold	<u>563,259</u>	<u>238,611</u>	<u>801,870</u>
Gross profit	<u>53,195</u>	<u>(112,771)</u>	<u>(59,576)</u>
Acquisition of property and equipment	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three and Six Months Ended August 31, 2009 and 2008

4. Segmented information (Continued)

Six months ended, August 31, 2009

	ESI Integrity	Citadel	Total
Segment gross profit			
Revenue	\$ 1,286,602	\$ 499,660	\$ 1,786,262
Cost of goods sold	<u>697,299</u>	<u>574,227</u>	<u>1,271,526</u>
Gross profit	<u>589,303</u>	<u>(74,567)</u>	<u>514,736</u>
Acquisition of property and equipment	\$ <u>5,202</u>	\$ <u>-</u>	\$ <u>5,202</u>

Six months ended, August 31, 2008

	ESI Integrity	Citadel	Total
Segment gross profit			
Revenue	\$ 1,365,451	\$ 246,231	\$ 1,611,682
Cost of goods sold	<u>1,017,691</u>	<u>491,871</u>	<u>1,509,562</u>
Gross profit	<u>347,760</u>	<u>(245,640)</u>	<u>102,120</u>
Acquisition of property and equipment	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>

Property and Equipment:

As at August 31, 2009

	ESI Integrity	Citadel	ESI Corp	Total
Segment assets				
Property and equipment, net	\$ <u>18,997</u>	\$ <u>83,532</u>	\$ <u>41,492</u>	\$ <u>144,021</u>

As at February 28, 2009

	ESI Integrity	Citadel	ESI Corp	Total
Segment assets				
Property and equipment, net	\$ <u>29,801</u>	\$ <u>163,199</u>	\$ <u>87,725</u>	\$ <u>280,725</u>

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three and Six Months Ended August 31, 2009 and 2008

4. Segmented information (Continued)

Net Loss:

	<u>Three months ended, August 31</u>		<u>Six months ended, August 31</u>	
	2009	2008	2009	2008
Segment gross profit	\$ 354,982	\$ (59,576)	\$ 514,736	\$ 102,120
Product development	59,580	91,129	122,888	207,778
Sales, marketing and customer service	37,954	211,243	78,279	476,843
General and administrative	594,803	1,047,170	1,270,538	1,972,218
Amortization of property and equipment	59,276	124,742	131,502	294,127
Foreign exchange loss (gain)	118,671	123	(96,674)	5,883
Interest income	(19,510)	(13,254)	(20,200)	(28,205)
Interest expense	39,885	24,301	86,203	30,866
Provision for income taxes	-	1,707	-	1,707
Net Loss	<u>\$ (535,677)</u>	<u>\$ (1,546,737)</u>	<u>\$ (1,057,800)</u>	<u>\$ (2,859,097)</u>

Total Assets:

	August 31, 2009	February 28, 2009
Property and Equipment	\$ 144,021	\$ 280,725
Cash and cash equivalents	134,954	909,785
Accounts receivable	536,220	1,100,023
Prepays	171,793	106,513
Citadel processing accounts	5,596,527	2,958,565
Deferred contract costs	632,790	696,234
	<u>\$ 7,216,305</u>	<u>\$ 6,051,845</u>

Revenues earned by geographic location:

	<u>Three months ended August 31</u>		<u>Six months ended August 31</u>	
	2009	2008	2009	2008
United States	\$ 277,023	\$ 312,849	\$ 498,651	\$ 614,721
Canada	75,324	123,142	156,259	293,445
International	599,942	306,303	1,131,352	703,516
	<u>\$ 952,289</u>	<u>\$ 742,294</u>	<u>\$ 1,786,262</u>	<u>\$ 1,611,682</u>

As at August 31, 2009, 72% of the Company's fixed assets were situated in Canada and 28% were located internationally.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three and Six Months Ended August 31, 2009 and 2008

4. Segmented information (Continued)

Economic dependence

The Citadel business unit revenue consists of transaction processing. Customer dependency for Citadel revenue is as follows:

	<u>Three months ended August 31</u>		<u>Six months ended August 31</u>	
	2009	2008	2009	2008
Customer A	22.3%	17.8%	21.6%	20.4%
Customer B	17.7%	16.2%	16.4%	17.8%
Customer C	16.5%	14.5%	15.8%	15.5%

5. Capital stock

Authorized:

Unlimited voting common shares without par value

	<u>Number of Common Shares</u>	<u>Amount</u>
Issued and outstanding - common shares		
Balance, February 28, 2009	14,234,726	\$ 9,957,959
Balance, August 31, 2009	<u>14,234,726</u>	<u>\$ 9,957,959</u>

6. Stock-based compensation plans

Under the company stock option plan and at the discretion of the board of directors, the Company may grant options to purchase up to 2,850,000 common shares of the Company to its directors, officers, employees and consultants. No one person is to be granted options equal to more than 5% of the total issued and outstanding common shares of the Company on a non-diluted basis. The maximum term of the options under this plan is ten years and the exercise price and vesting period will be determined by the board of directors at the time of granting.

During the three months ended August 31, 2009, 50,000 stock options were granted and 29,000 were forfeited or expired unexercised. (August 31, 2008 - 800,000, nil and 56,000 respectively).

As at August 31, 2009, there were 1,937,000 options outstanding, (August 31, 2008 - 787,000) exercisable at a Weighted Average Price of \$0.62. (August 31, 2008 - \$0.64). As at the date of these Interim Financial Statements there are 2,079,500 options outstanding.

All options are exercisable at a price equal to the current trading price of common shares at the date of grant. When stock options are granted, the Company records a stock based compensation expense in the statement of operations. This amount is included in General and Administrative operating expenses. The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model. During the six month period ending August 31, 2009, no stock based compensation expense was recorded (August 31, 2008 - nil).

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three and Six Months Ended August 31, 2009 and 2008

7. Earnings (loss) per share

The following table sets the number of weighted average shares used in the computation of basic and diluted earnings per share:

	<u>Three Months Ended,</u> <u>August 31</u>		<u>Six Months Ended,</u> <u>August 31</u>	
	2009	2008	2009	2008
Weighted average shares used in computation of basic earnings per share	14,234,726	14,234,726	14,234,726	14,234,726
Fully diluted weighted average number of common shares	14,234,726	14,234,726	14,234,726	14,234,726

The fully diluted loss per share has not been computed, as the effect would be anti-dilutive.

8. Accounts Payable and accrued liabilities

As at August 31, 2009, of the \$1,079,162 balance in Accounts payable and accrued liabilities, \$614,487 is comprised of deferred salaries. Certain employees have voluntarily deferred part of their compensation. The unpaid deferred amounts are being accrued with interest and are payable upon termination or when the Company's economic conditions have strengthened to accommodate for the repayment.

9. Loan Payable

In June 2008, the Company secured a US\$ 2 million loan bearing interest at the rate of 6% per annum. In June 2009, the agreement was amended to reflect new repayment terms, which are: US\$ 1,500,000 repayable on October 11, 2009 and the balance plus accrued interest due on December 11, 2009. The loan is secured by first ranking fixed charges on the entire issued share capital of the Company's principal subsidiaries, ESI Integrity Inc., Citadel Commerce Corp and Citadel Commerce UK Limited.

10. Commitments and contingencies

The Company files separate tax returns for its Canadian subsidiaries. Management has recorded their best estimate of the Company's income tax obligation in the consolidated financial statements. The ultimate liability however is subject to final approval by taxation authorities. It is possible that the tax authorities may reassess the Company's filing position which could result in a material increase in the Company's liability for current and prior financial periods; however any such adjustment is indeterminate at this time.

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 put the Company in compliance with all applicable AML rules and regulations.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three and Six Months Ended August 31, 2009 and 2008

11. Financial instruments and concentration of risk

Fair values

The Company's financial instruments include cash and cash equivalents, accounts receivable, Citadel processing accounts, accounts payable and accrued liabilities, Citadel processing liabilities and capital lease. The fair values of these financial instruments approximate their carrying values.

Credit risk

The Company maintains substantially all of its cash and cash equivalents with major financial institutions internationally. Financial instruments that potentially subject the Company to concentration of credit risk are primarily accounts receivable. Management is of the opinion that any risk of loss is significantly reduced due to the financial strength of the Company's major customers.

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.

12. Subsequent Event

In October 2009, the company signed a Letter Agreement with Insight ID Inc of Mississauga, Ontario for the sale of its wholly owned subsidiary ESI Integrity Inc. Under the terms of the Letter Agreement, Insight ID Inc., will acquire all of the issued and outstanding shares in the capital of ESI Integrity Inc. for the sum of US\$ 2,250,000 on or about November 11, 2009. Closing of the transaction is subject to all relevant regulatory and other consents and approvals as well as satisfaction or waiver of conditions contained in the Letter Agreement.

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

Dated October 29, 2009