

ESI Entertainment Systems Inc.
Consolidated Financial Statements

(expressed in Canadian dollars)

For the Three Months Ended May 31, 2010 and 2009

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

ESI Entertainment Systems Inc.

Consolidated Balance Sheets

(expressed in Canadian dollars)

	May 31, 2010 (unaudited)	February 28, 2010 (audited)
Assets		
Cash and cash equivalents	\$ 175,776	\$ 89,208
Accounts receivable	1,125,154	1,073,580
Prepays	97,876	65,658
Citadel processing accounts	3,755,558	4,937,401
	<u>5,154,364</u>	<u>6,165,847</u>
Capitalized development costs	85,307	47,532
Property and equipment (Note 4)	156,524	170,499
Deferred contract costs	520,577	550,362
	<u>\$ 5,916,772</u>	<u>\$ 6,934,240</u>
Liabilities		
Accounts payable and accrued liabilities	\$ 2,684,546	\$ 2,227,935
Loan Payable (Note 8)	2,175,700	2,174,733
Citadel processing liabilities	4,614,603	5,649,239
Deferred revenue	573,392	582,667
	<u>10,048,241</u>	<u>10,634,137</u>
Deferred revenue	896,843	913,605
	<u>10,945,084</u>	<u>11,547,742</u>
Shareholders' Deficit		
Capital stock (Note 5)	9,957,959	9,957,959
Contributed surplus	4,467,539	4,467,539
(Deficit)	(19,453,810)	(19,039,010)
	<u>(5,028,312)</u>	<u>(4,613,502)</u>
	<u>\$ 5,916,772</u>	<u>\$ 6,934,240</u>

On behalf of the Board

"Tony Greening" Director
Tony Greening

"Michael Meeks" Director
Michael Meeks

See accompanying notes to the consolidated financial statements.

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ESI Entertainment Systems Inc.

Consolidated Statements of Operations and Comprehensive Loss and Deficit

(expressed in Canadian dollars)
(unaudited)

	Three Months Ended May 31,	
	2010	2009
Revenues (Note 4)	\$ 743,265	\$ 833,991
Direct costs	497,413	674,237
Gross profit	245,852	159,754
Operating expenses		
Product development	-	63,308
Sales, marketing and customer service	31,384	40,325
General and administrative	659,039	675,735
Amortization of property and equipment	13,975	72,226
	704,398	851,594
(Loss) Earnings before under noted items	(458,546)	(691,840)
Other expenses (income)		
Foreign exchange (gain) loss	(92,409)	(215,345)
Interest income	(44)	(690)
Interest expense	48,707	46,318
Net (loss) earnings	\$ (414,800)	\$ (522,123)
(Loss) Earnings per share (Note 7)		
Basic	\$ (0.03)	\$ (0.04)
Diluted	(0.03)	(0.04)
Retained earnings (deficit), beginning of period	\$ (19,039,010)	\$ (16,698,711)
Net (loss) earnings	(414,800)	(522,123)
(Deficit) retained earnings, end of period	\$ (19,453,810)	\$ (17,220,834)

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 May 31,
2010 2009

Cash flows provided by (used in)

Operating activities

Net (loss) earnings	\$	(414,800)	\$	(522,123)
Items not affecting cash:				
Amortization of property and equipment		13,975		72,226
Net changes in non-cash operating items				
Accounts receivable		(51,574)		(288,497)
Prepays		(32,218)		24,548
Accounts payable and accrued liabilities		514,396		224,268
Deferred revenue		26,037		16,658
Deferred contract costs		29,785		7,809

85,601 (465,111)

Investing activities

Acquisition of property and equipment		-		(7,652)
		-		(7,652)

Financing activities

Capital lease payments		-		(12,890)
Loan Payable		967		(330,603)
		967		(343,493)

Increase (decrease) in cash and cash equivalents

86,568 (816,256)

Cash and cash equivalents, beginning of period

89,208 909,785

Cash and cash equivalents, end of period

\$ 175,776 \$ 93,529

Supplemental information

Interest received	\$	44	\$	690
Interest paid		48,707		46,318

See accompanying notes to the consolidated financial statements.

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ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three Months Ended May 31, 2010 and 2009

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 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

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 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 a contract's respective term.

Citadel

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.

Going Concern

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 period ended May 31, 2010 the Company incurred a loss from operations of \$414,800 and an increase in operating cash flow of \$86,568. 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. 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.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three Months Ended May 31, 2010 and 2009

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, 2010. 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, 2010.

3. Citadel processing:

Citadel Processing Accounts represent the bank accounts maintained by the Company for the purpose of payment processing for Citadel merchants and clients. These accounts are recorded separately 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, pending transaction cancellation periods and processing times. These amounts consist of:

	<u>May 31,</u> <u>2010</u>	<u>February 28,</u> <u>2010</u>
Merchant processing funds	\$ 4,572,758	\$ 5,581,442
Merchant reserves	29,860	58,101
myCitadel consumer funds	<u>11,985</u>	<u>9,696</u>
	<u>\$ 4,614,603</u>	<u>\$ 5,659,239</u>

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.

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-mutuel (horse tracks) betting.

Citadel provides on-line payment processing services including internet bank transfers, electronic cheque 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 Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three Months Ended May 31, 2010 and 2009

4. Segmented information (Continued)

The segmented information for each business segment is as follows:

Gross Profit

Three months ended, May 31, 2010

	ESI Integrity	Citadel	Total
Revenue	\$ 433,853	\$ 309,411	\$ 743,265
Cost of goods sold	<u>228,399</u>	<u>269,014</u>	<u>497,413</u>
Gross profit	<u>205,455</u>	<u>40,397</u>	<u>\$ 245,852</u>

Acquisition of property and equipment	\$ <u>NIL</u>	\$ <u>NIL</u>	\$ <u>NIL</u>
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Three months ended, May 31, 2009

	ESI Integrity	Citadel	Total
Revenue	\$ 580,508	\$ 253,483	\$ 833,991
Cost of goods sold	<u>386,296</u>	<u>287,941</u>	<u>674,237</u>
Gross profit	<u>194,212</u>	<u>(34,458)</u>	<u>159,754</u>

Acquisition of property and equipment	\$ <u>NIL</u>	\$ <u>(7,652)</u>	\$ <u>(7,652)</u>
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Property and Equipment

As at May 31, 2010	ESI Integrity	Citadel	ESI Corp	Total
Property and equipment, net	\$ <u>66,527</u>	\$ <u>56,698</u>	\$ <u>33,299</u>	\$ <u>156,524</u>
As at Feb 28, 2010	ESI Integrity	Citadel	ESI Corp	Total
Property and equipment, net	\$ <u>72,596</u>	\$ <u>61,784</u>	\$ <u>36,119</u>	\$ <u>170,499</u>

Net Earnings

Three months ended, May 31

	2010	2009
Gross profit	\$ 245,852	\$ 159,754
Operating expenses		
Product development	-	63,308
Sales, marketing and customer service	31,384	40,325
General and administrative	659,039	675,735
Amortization of property and equipment	13,975	72,226
Foreign exchange loss (gain)	(92,409)	(215,345)
Interest income	(44)	(690)
Interest expense	<u>48,707</u>	<u>46,318</u>
Net earnings	\$ <u>(414,800)</u>	\$ <u>(522,123)</u>

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(unaudited, expressed in Canadian dollars)
Three Months Ended May 31, 2010 and 2009

4. Segmented information (Continued)

Total Assets

As at the period ending:	<u>May 31, 2010</u>	<u>Feb 28, 2010</u>
Property and Equipment	\$ 156,524	\$ 170,499
Cash and cash equivalents	175,776	89,208
Accounts receivable	1,125,154	1,073,580
Prepays	97,876	65,658
Citadel processing accounts	3,755,558	4,937,401
Capitalized development costs	85,307	47,532
Deferred contract costs	<u>520,577</u>	<u>550,362</u>
	<u>\$ 5,916,772</u>	<u>\$ 6,934,240</u>

Revenues earned by geographic location

Three months ended, May 31	<u>2010</u>	<u>2009</u>
United States	\$ 82,363	\$ 221,628
Canada	77,894	80,935
International	<u>583,008</u>	<u>531,428</u>
	<u>\$ 743,265</u>	<u>\$ 833,991</u>

As at May 31, 2010, 79% of the Company's fixed assets were situated in Canada and 21% were located internationally.

Economic dependence

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

Three months ended, May 31	<u>2010</u>	<u>2009</u>
Customer A	24%	20%
Customer B	14%	16%
Customer C	11%	15%

5. Capital stock

Authorized:

Unlimited voting common shares without par value

	Number of Common Shares	Amount
Issued and outstanding - common shares		
Balance, February 28, 2010	# 14,234,726	\$ 9,957,959
Balance, May 31, 2010	<u># 14,234,726</u>	<u>\$ 9,957,959</u>

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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 period ended May 31, 2010, no stock options were granted and a total of 30,750 were forfeited or expired unexercised. (May 31, 2009, nil, nil and 34,250 respectively).

As at May 31, 2010, there were 1,896,000 options outstanding (May 31, 2009 – 1,916,000), exercisable at a Weighted Average Price of \$0.61 (May 31, 2009 - \$0.64). As at the date of these Interim Financial Statements there are 145,000 options outstanding, consequence upon the voluntary cancellation by employees and directors, 1,751,000 options without compensation after May 31, 2010.

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 period ending May 31, 2010, no stock based compensation expense was recorded (May 31, 2009 – nil).

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:

	Three Months Ended May 31,	
	2010	2009
Weighted average shares used in computation of basic earnings per share	# 14,234,726	# 14,234,726
Fully diluted weighted average number of common shares	# 14,234,726	# 14,234,726

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

8. Loan Payable

In June 2008, the Company secured a US\$ 2 million loan bearing interest at the rate of 6% per annum. 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. On January 28, 2010, the Company renegotiated the terms of the loan facility so that the loan is no longer repayable on a fixed date and is now repayable on demand. All other terms of the loan are unchanged.

9. International Financial Reporting Standards ("IFRS")

In February 2008, the Canadian Accounting Standards Board ("AcSB") announced that 2011 is the changeover date for publicly-listed companies to use International Financial Reporting Standards ("IFRS"), replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

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Three Months Ended May 31, 2010 and 2009

9. International Financial Reporting Standards ("IFRS") (Continued)

March 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended February 28, 2011. The Company is currently working to analyze the standards and while the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

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.

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.

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

Dated August 19, 2010