



## **CHARTWELL TECHNOLOGY INC.**

**Management's Discussion and Analysis of Financial Condition and Results of Operations  
for the three and six months ended April 30, 2006 and 2005.**

**June 13, 2006**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with Chartwell Technology Inc.'s ("Chartwell" or the "Company") audited consolidated financial statements and the accompanying notes for the year ended October 31, 2005, which have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com) under Chartwell Technology Inc. and on the Company's website at [www.chartwelltechnology.com](http://www.chartwelltechnology.com).

### **Special Note Regarding Forward-Looking Statements**

This MD&A contains certain forward-looking statements which reflect Management's expectations regarding the Company's growth, results of operations, performance and business prospects and opportunities.

Statements about the Company's future plans and intentions, results, levels of activity, performance or achievements or other future events constitute forward-looking statements. Whenever possible, words such as "anticipate", "estimate", "may", "will", "should", "could", "expect", "plan", "intend", "believe", "estimate", or "potential" or similar words, have been used to identify these forward-looking statements.

Forward-looking statements involve significant risk, uncertainties and assumptions. Many factors could cause actual results to differ materially from the results discussed or implied in the forward-looking statements. These factors should be considered carefully and readers should not place undue reliance on the forward-looking statements.

Factors which could cause results or events to differ from current expectations include, among other things: the impact of government legislation; the impact of price competition; the ability of the Company to retain and attract qualified professionals; the impact of rapid technological and market change; loss of business or credit risk with current and prospective major customers; general industry and market conditions and growth rates; currency rate fluctuations and the impact of consolidations in the on-line gaming industry. Chartwell disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. No assurance can be given that actual results, performance or achievement expressed in, or implied by, forward-looking statements within this disclosure will occur, or if they do, that any benefits may be derived from them.

Past performance has been considered in drawing conclusions with respect to forward-looking statements contained in this MD&A.

EBITDA is defined as earnings before interest, taxes, depreciation and amortization. EBITDA is not a recognized measure under Canadian generally accepted accounting principles. Management believes however that EBITDA is a useful supplementary measure as it provides indication of the results of Chartwell's business operations without regard to how these activities were financed or how these results were taxed. Chartwell's method of calculating EBITDA may differ from that of other companies, and accordingly, EBITDA may not be directly comparable to measures used by other companies.

## **OVERVIEW**

Chartwell develops, markets, licenses, implements and supports gaming applications and entertainment content for the internet and wireless platforms. Chartwell's JAVA and Flash based software products and games are designed for deployment in gaming, entertainment and promotional applications. Chartwell does not operate a gaming site nor do we operate our clients' gaming sites.

### **Business Plan**

The Company's business plan and objectives through fiscal 2006 are to continue to increase our market share in the traditional internet casino market, with a continued emphasis on the European market, further develop the liquidity of our poker community, establish liquidity in our bingo community, commercially release our Flash poker product and further develop poker variants and establish market share in these new market areas. We will continue to focus on product development and diversification of our products, customers and revenues.

### **Business Model**

The majority of Chartwell's revenue is in the form of software license fees. License fees, including fees from master license agreements, most of which are contingent upon customer usage, are recognized on an accrual basis as earned over the life of the contract. Licensees pay an ongoing fee for the licensing and support of the Company's software under a software licensing agreement, which typically has a three to five year term. The license fee is calculated as a percentage of each licensee's level of activity. Additional sales revenue is derived from software setup-fees and software development fees. Software set-up fees are one time fees for new customer development and installations. The Company's contractual agreements with licensees provide for the provision of graphics, web design, software implementation services, licensing of the software and provision of software upgrades over the fixed term of the contract. Set-up fee revenue and related costs are recognized ratably over the term of the contract. Software development fees are fees that the Company charges for software development services relating to software programming services. These fees are recognized on a percentage-of-completion basis and reported in other revenue.

Expenses are classified into six categories, software development and support; sales and marketing; general and administrative ("G&A"); depreciation and amortization, stock-based compensation expense and foreign currency gains or losses. Software development and support consists of personnel and related costs associated with the design and development of new products, support of existing products, customer implementation and quality assurance. Sales and marketing expenses consist of personnel and related costs associated with the Company's sales, marketing and business development activities. G&A expenses include the costs of all administrative, financial and IT personnel, investor relations and professional fees relating to our public company listing. Stock-based compensation expense consists of the estimated fair value of options granted to employees and consultants during the year. Depreciation and amortization expenses are based on the estimated useful life of our assets and include the amortization of deferred software development costs and intangible assets acquired in the acquisition of Micropower Corporation Limited ("Micropower"). The Company operates internationally with 100% of its revenue derived from non-Canadian sources. Under the Company's licensing agreements, the majority of the Company's revenue is received in Euros and U.S. dollars. Consequently, the Company is exposed to currency fluctuations, which result in foreign currency gains or losses, which are reported in this expense category.

## HIGHLIGHTS

Chartwell realized its fifteenth consecutive quarter of profitability in the three months ended April 30, 2006.

Total revenue increased to \$4,757K and \$9,197K for the three and six months ended April 30, 2006 compared to \$3,877K and \$8,692K for the three and six months ended April 30, 2005; net income decreased to \$101K and \$604K for the three and six months ended April 30, 2006 compared to \$934K and \$2,420K for the comparative period of 2005 with diluted earnings per share of \$0.01 and \$0.03 for the three and six months ended April 30, 2006 compared to \$0.05 and \$0.12 for the comparative period of 2005. Net earnings were negatively affected by a provision for a doubtful account, relating to one customer, in the amount of \$1,007K. The Company did not record any revenue from this customer in the three months ended April 30, 2006. This provision had the effect of reducing earnings per share (diluted) by \$0.03. Had the provision not been made, earnings per share (diluted) would have been \$0.04.

License fees for the three months ended April 30, 2006 grew 4.1% over the prior quarter, reflecting the positive impact of new client revenue and the growth of the poker community.

In fiscal 2006, the Company continues to invest in key areas of its business specifically related to product development and support and sales and marketing. To sustain and build for long term growth it is expected that the Company will maintain its current level of expenditures throughout the remainder of the fiscal 2006.

Chartwell maintains a strong balance sheet. At April 30, 2006, the Company had cash and short-term investments of \$15,636K, working capital (defined as current assets less current liabilities) of \$19,436K and no debt.

Chartwell's internal control systems continue to evolve as the Company grows. We believe these systems are sufficient to execute our business plan and to provide meaningful information upon which to manage our business.

## SUMMARY OF FINANCIAL RESULTS

### Comparative Quarterly Operating Results (in thousands, except share data)

The following table sets out selected unaudited financial information of the Company on a consolidated basis for the last eight quarters.

	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004	Q3 2004
<b>Revenue</b>								
Software license fees	\$ 4,449	\$ 4,275	\$ 4,113	\$ 4,028	\$ 3,630	\$ 4,622	\$ 3,237	\$ 3,393
Software set-up fees	65	51	69	348	125	115	208	184
Interest & other	243	115	467	132	122	78	44	21
	<u>4,757</u>	<u>4,441</u>	<u>4,649</u>	<u>4,508</u>	<u>3,877</u>	<u>4,815</u>	<u>3,489</u>	<u>3,598</u>
<b>Expenses</b>								
Software development & support	1,740	1,795	1,639	1,754	1,319	1,325	1,238	1,172
Sales & marketing	545	580	555	488	551	650	303	437
General & administrative	1,650	548	522	418	227	408	657	327
Amortization of intangible assets	123	123	86	19	-	-	-	-
Amortization of deferred software development costs	59	59	58	59	59	59	59	39
Stock-based compensation	171	224	230	198	91	118	103	-
Depreciation & amortization	100	95	102	54	68	36	53	103
Foreign currency loss (gain)	45	132	72	338	(15)	(20)	247	105
	<u>4,433</u>	<u>3,555</u>	<u>3,264</u>	<u>3,328</u>	<u>2,300</u>	<u>2,576</u>	<u>2,660</u>	<u>2,183</u>
<b>Net income before taxes</b>	324	886	1,384	1,180	1,577	2,239	829	1,415
Income taxes	223	382	534	452	643	753	(631)	204
<b>Net Income</b>	<u>101</u>	<u>\$ 504</u>	<u>\$ 850</u>	<u>\$ 728</u>	<u>\$ 934</u>	<u>\$ 1,486</u>	<u>\$ 1,460</u>	<u>\$ 1,211</u>
<b>Basic earnings per share</b>	0.01	\$ 0.03	\$ 0.04	\$ 0.04	\$ 0.05	\$ 0.09	\$ 0.10	\$ 0.08
<b>Diluted earnings per share</b>	0.01	\$ 0.03	\$ 0.04	\$ 0.04	\$ 0.05	\$ 0.08	\$ 0.08	\$ 0.07

## **QUARTERLY RESULTS**

### **FOR THE THREE AND SIX MONTHS ENDED APRIL 30, 2006 COMPARED TO THE THREE AND SIX MONTHS ENDED APRIL 30, 2005.**

#### **REVENUE**

In the three and six months ended April 30, 2006, total revenue increased by 22.7% and 5.8% to \$4,757K and \$9,197K compared to \$3,877K and \$8,692K in the same period of 2005. The year over year increase in total revenue was attributable to an increase in license fees and interest income.

Software license fees increased by 22.6% and 5.7% to \$4,449K and \$8,724K for the three and six months ended April 30, 2006 from \$3,630K and \$8,251K in the same period of 2005. The increase in license fees reflects the impact of revenue from clients that began generating revenue in Q4FY05 and Q1FY06 and the increased volumes in the poker community. Sequentially, software license fees increased by 4.1.0 % over the first quarter of 2006.

Software set-up fees decreased by 48.1% and 51.9% to \$65K and \$115K from \$125K and \$240K for the three and six months ended April 30, 2006 and 2005, respectively. Software set-up fees, as a percentage of total sales revenue, decreased to 1.3% and 1.2% from 3.2% and 2.8% for the three and six months ended April 30, 2006 and 2005. This is due to smaller set-up fees from new clients. We expect that software set-up fees will continue to represent a very small percentage of the Company's sales revenue as we continue to build our license fee component of revenue.

Interest and other income increased by 98.7% and 78.0% to \$243K and \$358K in the three and six months ended April 30, 2006 compared to \$122K and \$201K for the same period of 2005. The increase is attributable to the Company having higher cash and investment balances earning higher interest at April 30, 2006, resulting in higher interest income.

#### ***Operating Expenses***

Total operating expenses, including foreign exchange gains and losses and net of deferred software development costs, increased by 92.8% and 63.8% to \$4,433K and \$7,988K for the three and six months ended April 30, 2006 compared to \$2,300K and \$4,876K for the same periods of 2005. The increase in operating expenses is reflective of the Company's growth in personnel and supporting infrastructure. In addition to higher expenses relating to software development and support, the Company incurred significantly higher expenses in the areas of stock-based compensation as well as depreciation and amortization resulting from the intangible assets acquired in the acquisition of Micropower. Increases in general and administration costs resulting from the Company's increased size and administrative requirements also contributed to the increased operating expenses. In addition, an allowance for a doubtful account of \$1,007K was recorded to general and administrative expenses causing an abnormal increase in the quarter. As at April 30, 2006 there were 129 employees and consultants compared to 94 employees and consultants at April 30, 2005.

### *SOFTWARE DEVELOPMENT & SUPPORT*

Software development and support expenses, net of deferred software development costs, increased by 31.9% and 33.7% to \$1,740K and \$3,535K for the three and six months ended April 30, 2006 compared to \$1,320K and \$2,645K for the same period of 2005. Salaries and consulting fees continue to represent the largest expenditure area and accounted for 68.9% and 72.4% of total software development and support costs for the three and six months ended April 30, 2006. The increased salary expenses reflect the increased headcount over the comparative period of the prior year. In addition, given increased traffic and revenues within the poker community, hosting costs for the community have increased over the comparative periods of the prior year. Other increases are due to increased travel costs, placement costs, rent, telecommunications, etc. Software development and support costs are net of deferred development costs on the poker community which were \$417K and \$883K for the three and six months ended April 30, 2006. In the three months ended April 30, 2006, Chartwell deferred \$181K in development costs on the Company's mobile product given that the criteria for deferring said costs were met in the quarter. Given that there were no such associated deferrals in the comparative periods of 2005, the magnitude of the increase to software development and support costs is lower than anticipated.

As a percentage of revenue, software development and support expenses, net of deferred software development costs, were 35.0% and 37.6% for the three and six months ended April 30, 2006 and 2005. These percentages have increased over the comparative periods of 2005, which were 34.0% and 30.4%, but remain consistent with Q1 2006. Software development and support expenses are increasing in line with increased revenues and are consistent with the Company's growth strategies.

### *GENERAL AND ADMINISTRATIVE*

G&A expenses increased by 627.7% and 220.7% to \$1,650K and \$2,197K from \$227K and \$685K for the three and six months ended April 30, 2006 compared to the same period of 2005. Contributing to this increase is additional infrastructure costs required to support the growth in personnel including increased facility costs, increased administrative staff costs, higher legal fees related to the acquisition of Micropower, professional fees relating to quarterly reviews, and increased investor relations activities. The largest increase is due to a \$1,007K expense related to an allowance for a doubtful account recorded in the second quarter of 2006 versus a bad debt expense recovery of \$132K recorded in the second quarter of 2005.

As a percentage of revenue, G&A expenses increased to 34.7% and 23.9% for the three and six months ended April 30, 2006 from 5.9% and 7.9% for the same periods of 2005. This percentage increased due to the one-time provision for doubtful accounts made in the quarter. This percentage is expected to decrease accordingly for the remainder of the year.

### *SALES AND MARKETING*

Sales and marketing expenses decreased by 1.2% and 2.3% to \$545K and \$1,125K for the three and six months ended April 30, 2006 from \$551K and \$1,151K for the same period of 2005. The decrease is primarily attributable to lower trade show and travel costs in the second quarter of 2006 compared to the second quarter of 2005. This decrease is partially offset by an increase in promotional costs related to promotions within the poker community in order to stimulate poker business. Chartwell will continue to invest in promotion of the poker community throughout fiscal 2006.

As a percentage of revenue, sales and marketing expenses decreased to 11.0% and 12.0% from 14.2% and 13.2% for the three months and six months ended April 30, 2006 and 2005, respectively.

#### *AMORTIZATION OF INTANGIBLE ASSETS*

Amortization of intangible assets is related to amortization charged against the customer contracts and intellectual property acquired in the acquisition of Micropower. The expenses for the three and six months ended April 30, 2006 are \$123K and \$246K, with no comparative expenses in 2005. The value recorded for customer contracts is being amortized over the contract period for each acquired contract (i.e. as cash flows are being generated for Chartwell). The value recorded for intellectual property is being amortized over five years, which is Management's best estimate of the time period that the acquired intellectual property will provide future value to Chartwell.

#### *AMORTIZATION OF DEFERRED SOFTWARE DEVELOPMENT COSTS*

Amortization of deferred software development costs for the three and six months ended April 30, 2006 were \$59K and \$118K, respectively, compared to \$59K and \$118K for 2005. In fiscal 2003 and fiscal 2004 the Company deferred \$531K and \$175K, respectively, of software development costs relating to the development of the Company's Community Poker product. Management has estimated that the appropriate amortization period would be three years. The Company began amortizing these costs on a straight line basis in the third quarter of fiscal 2004. In fiscal 2005 and the first two quarters of fiscal 2006, the Company deferred an additional \$1,545K of software development costs related to the development of version 2.0 of the Company's community poker product, which builds on the intellectual property acquired in the acquisition of Micropower. In the second quarter of 2006, the Company deferred \$181K of software development costs related to the development of the Company's mobile product. The costs for the community poker and mobile products have not been amortized to date, given that these versions of the products have not yet been launched.

#### *STOCK-BASED COMPENSATION*

The Company recorded \$171K and \$395K of stock-based compensation expense for the three and six months ended April 30, 2006 compared to \$91K and \$208K for the three and six months ended April 30, 2005. Stock-based compensation expense relates to the amortization of the fair value of stock options granted to employees, directors and consultants. Expenses are amortized over the vesting period of three to five years. The year over year increase in this expense is due to issuance of options throughout 2005 which have a cumulative impact on expenses in the current period.

#### *DEPRECIATION & AMORTIZATION*

Depreciation and amortization expenses increased by 47.4% and 87.5% to \$100K and \$195K for the three and six months ended April 30, 2006 versus \$68K and \$104K for the same period of 2005. This increased depreciation expense is due to increased net book values of property and equipment at April 30, 2006 versus April 30, 2005. Significant hardware additions were required in the fourth quarter of 2005 and the first quarter of 2006 to integrate the Micropower staff into the Chartwell environment and to build up their infrastructure. In the second quarter of 2006, additional investments were made in computer equipment including additions to servers to handle additional volumes as well as office furniture to continue to accommodate the Company's growth. It is expected that continued investment in computer hardware and software will be required as the Company continues to grow.

#### *FOREIGN CURRENCY LOSS*

The Company incurred foreign currency losses of \$45K and \$177K for the three and six months ended April 30, 2006 compared to foreign currency gains of \$15K and \$35K for the comparative periods of 2005. The increased foreign currency losses experienced in the first quarter of 2006 were due to larger accounts receivable balances subject to foreign exchange rate fluctuations and declining foreign exchange rates in the first two quarters of 2006 compared to the same period of 2005. The Company does not utilize hedges or forward contracts to mitigate foreign currency risk.

### *PROVISION FOR INCOME TAXES*

Income taxes for the three and six months ended April 30, 2006 decreased to \$223K and \$606K compared to \$643K and \$1,396K for the comparative period of 2005. The reduction in tax expense is attributable to the lower level of pre-tax income in the first two quarters of 2006 compared to the first two quarters of 2005 due to the growth of the company and increases in expense levels in 2006, including a one-time provision for doubtful accounts recorded in the second quarter of 2006.

### *EBITDA*

EBITDA (defined as net income less interest, plus taxes, depreciation and amortization) decreased by 61.3% to \$363K from \$938K for the three months ended April 30, 2006 and 2005 respectively. The change in EBITDA between the two periods is due to increased revenues and higher depreciation charges factored into net income, offset by higher expenditures in 2006 including a one-time provision for doubtful accounts recorded in the second quarter of 2006. EBITDA decreased by 63.2% to \$1,410K from \$3,836K for the six months ended April 30, 2006 and 2005 respectively. The decrease in EBITDA is due to higher lower net income for the six months ended April 30, 2006 in comparison to the same period of 2005.

### *Net Income*

Net income decreased by 89.2% and 75.0% to \$101K and \$604K for the three months ended April 30, 2006 versus \$934K and \$2,420K for the three and six months ended April 30, 2005. The decrease in net income for the first two quarters of 2006 compared to the similar period of 2005 is due to increased expenses, including a significant provision for doubtful receivables and additional amortization charges due to the growth of the Company.

Diluted earnings per share were \$0.01 and \$0.03 for the three and six month periods ended April 30, 2006 compared to \$0.05 and \$0.12 in the same periods of 2005. The decrease in the diluted earnings per share reflects the decreased net income in the second quarter and which was primarily attributable to the \$1,007K provision for a doubtful account.

### *Liquidity and Capital Resources*

#### *Operating Activities*

Operating cash flow for the three and six months ended April 30, 2006 was \$903K and \$109K compared to \$1,728K and \$2,948K for the three and six months ended April 30, 2005. The decrease is mainly attributable to a decrease in net income and a smaller reduction in the change in working capital. The change in working capital was due to a decrease in the balance of income taxes payable, decrease in accounts payable, a smaller decrease to accounts receivable, and increased prepaid expenses.

#### *Financing Activities*

Cash flows used in financing activities were (\$838K) and (\$2,090K) for the three and six months ended April 30, 2006 versus cash flows provided by financing activities of \$349K and \$10,821K for the three and six months ended April 30, 2005. The Company's financing activities in the second quarter of 2006 consisted primarily of the issuance of shares for cash resulting from the exercise of stock options, offset by cash used to repurchase 325,600 shares under the Normal Course Issuer Bid ("NCIB") in the three months ending April 30, 2006. The Company has repurchased a total of 681,000 shares under the NCIB. In addition to these activities, in the six months ended April 30, 2006 there was cash used to repay the amount Due to Honeycomb Holdings Limited which was recorded on the acquisition of Micropower. The variance from the six months ended April 30, 2005 was due to the private placement financing completed in Q1 2005 for net cash proceeds of \$10,476K. As well, the Normal Course Issuer Bid was not in effect in 2005 therefore there were no comparative cash payments.

### ***Investing Activities***

Cash flows provided by investing activities were \$589K and \$2,457K for the three and six months ended April 30, 2006 versus cash flows used in investing activities of (\$6,328) and (\$16,801) for the three and six months ended April 30, 2005. The Company's investing activities in the three and six months ended April 30, 2006 consisted mainly of the redemption of short term investments, the increase in deferred development costs and the purchase of property and equipment which include computers and software for internal use and furniture and fixtures. The variance from the three and six months ended April 30, 2005 was due to the purchase of \$10,366K of short term investments in Q1 2005 and an additional \$5,106K in Q2 2005 in order to invest cash received from the private placement. Also, a deposit was paid on the Micropower acquisition in the first quarter of 2005, with no comparative payment in 2006.

### **Contractual Obligations**

The Company's future minimum annual payments under operating and capital leases are the following:

2006	\$454,368
2007	\$562,099
2008	\$512,898
2009	\$ 85,498
Thereafter	\$ NIL

### **Related Party Transactions**

Software development and support expenses for the three months ended April 30, 2006 include legal fees of \$15K and consulting fees of \$41K paid to certain officers of the Company in the normal course of business. Amounts due from related parties of \$163K consist of amounts due from certain Company officers and directors. The balance bears 6% interest, is secured by 189 thousand common shares of the Company and has no set terms of repayment.

### **Accounting Policies and Estimates**

Critical accounting policies and methods used in the preparation of the Company's financial statements are described in note 1 to the consolidated financial statements of the Company for the year ended October 31, 2005. There have been no changes to critical accounting policies in the three month period ended January 31, 2006.

### **Risks and Uncertainties**

#### ***General***

The Company and its subsidiaries operate in a rapidly changing environment that involves numerous risks and uncertainties, many of which are beyond our control and which could have a material effect on our business, revenue, operating results and financial condition. The following highlights some of these risks and uncertainties.

### ***Government Regulation***

The Company and our software licensees are subject to applicable laws in the jurisdictions in which they operate, such as Belize, Malta, Gibraltar, Netherlands Antilles and others. Some jurisdictions have introduced legislation and rules attempting to restrict or prohibit online gaming, while other jurisdictions have taken the position that online gaming is legal and have adopted (or are in the process of considering) legislation to regulate online gaming.

The UK intends to establish a regulated market for online gaming. The Isle of Man and Alderney, both in the British Isles, are already regulated environments for Internet gaming, based on standards consistent with land-based gaming. The British government has enacted legislation to create a regulated and licensed jurisdiction for Internet gaming. Compliance with that legislation may result in increased costs that could have a material adverse effect on the Company's revenue, results of operations and financial condition.

Existing legislation in some jurisdictions, including US federal and state statutes, has been and could continue to be construed to prohibit or restrict gaming through the use of the Internet and there is a risk that governmental authorities may view the Company and/or our licensees as having violated such statutes. Therefore, there is a risk that legal proceedings could be initiated against us, our licensees, Internet Service Providers ("ISPs") and others involved in the Internet gaming industry. This could potentially result in our incurring substantial litigation and legal expenses, penalties, fines, injunctions or other remedies or restrictions being imposed upon us or our licensees while diverting the attention of Management. Such proceedings could have a material adverse effect on the Company's revenue, results of operations and financial condition.

As companies and consumers involved in online gaming, including our licensees and their players, are located in different jurisdictions around the world, there is uncertainty regarding the future regulatory framework for online gaming. There is a risk that proposed legislation supporting online gaming may not be passed and that existing legislation supporting online gaming may be changed. Changes to the regulatory framework could have a material adverse effect on the Company's revenue, results of operations and financial condition.

### ***E-Commerce Law***

In addition to laws pertaining specifically to online gaming, Chartwell may become subject to any number of laws and regulations that may be adopted with respect to the Internet and electronic commerce. As well, current laws, which predate or are incompatible with Internet commerce, may be enforced in a manner that restricts the electronic commerce market. The application of such pre-existing Canadian, US and international laws regulating communications or commerce in the context of the Internet and electronic commerce is uncertain.

Moreover, it may take years to determine the extent to which existing laws relating to issues such as intellectual property ownership and infringement, libel and personal privacy are applicable to the Internet.

New laws and regulations that address issues such as user privacy, pricing, online content regulation, taxation, advertising, intellectual property, information security, and the characteristics and quality of online products and services may be enacted.

The adoption of new laws or regulations relating to the Internet, or particular applications or interpretations of existing laws, could decrease the growth in the use of the Internet, decrease the demand for our products and services, increase our cost of doing business or could otherwise have a material adverse effect on the Company's revenue, results of operations and financial condition.

### ***Payment Processing***

Commencing in December 2001, certain financial institutions in the US ceased to accept online gaming transactions through their credit cards due to the uncertainty regarding the legality of Internet gaming in the US. This event negatively impacted the online gaming industry as a whole, our licensees and Chartwell. If other financial institutions or credit card issuers in the US or other countries implement similar or additional restrictions, this would have a material adverse effect on the Company's revenue, results of operations and financial condition. This risk has been partially mitigated, however, with Chartwell's ongoing focus on the European market.

### ***Competition***

Some of Chartwell's competitors have significantly greater financial, technical, marketing and sales resources and may be able to respond more quickly to changes in customer needs. Additionally, these competitors may be able to devote a greater number of resources to the enhancement, promotion and sale of their games and gaming systems. Our future success is dependent upon our ability to win our share of sales (in the form of new licensees) against these larger competitors. Failure to do so could result in a material adverse effect on the Company's revenue, results of operations and financial condition.

### ***Industry Consolidation***

Recently, there has been a significant amount of consolidation in the industry in which we operate. There exists the potential that such consolidation could shrink the list of prospective customers for our services through a rationalization of preferred software vendor suppliers. This factor could have a material adverse effect on the Company's business, revenues, results of operations and financial condition.

### ***Renewal of Software License Agreements***

The majority of the Company's revenue is in the form of software license fees. Licensees pay an ongoing fee for the licensing and support of the Company's software under a software licensing agreement, which typically has a three to five year term. The license fee, or royalty, is calculated as a percentage of each licensee's level of activity. There is no assurance that Chartwell will be able to renew agreements with existing clients or that the Company will be able to renew agreements under similar financial and other terms. The failure to renew agreements or the failure to renew agreements under similar financial and other terms could have a material adverse effect on the Company's revenue, results of operations and financial condition.

### ***Dependence on Market Growth***

The online gaming market has experienced and is expected to continue to experience significant growth. There can be no assurance that the market for the Company's gaming solutions will continue to grow, that consumers will continue to adapt Chartwell's solutions or that Chartwell will be successful in selling into new and existing markets. If the markets in which our products compete fail to grow, or if the business of the licensees who use our products fails to grow, or grows more slowly than Chartwell currently anticipates, the Company's business, results of operations and financial condition may be materially adversely affected.

### ***Risks Associated with Currency Fluctuations***

The majority of Chartwell's revenue is realized in foreign currencies, while the majority of the Company's expenses are incurred in Canadian Dollars. Fluctuations in the exchange rate between the Canadian Dollar and other currencies, particularly the US Dollar and the Euro, may have a material adverse effect on the Company's results of operations and financial condition.

### ***Chargebacks***

As a result of increased player deposit levels, our customers are subject to higher exposure to chargebacks, which may also result in possible penalties. Chargebacks are deposit transactions credited to an end user's account that is later reversed or repudiated. This factor could have a material adverse effect on the business of our licensees and accordingly, a material adverse effect on the Company's business, results of operations and financial condition.

### ***Lengthy Sales Cycle***

The Company's sales cycle (beginning with an interested customer and culminating in the entering into of a commercial agreement with a customer) typically ranges from six to twelve months and may be longer. This lengthy sales cycle limits Chartwell's ability to forecast the timing of new sales in a specific financial quarter. Any extension in the length of our sales cycle may have a material adverse effect on the Company's revenues and financial condition.

### ***Lengthy Collections Cycle***

The Company charges license fees to licensees based on their level of activity. Chartwell's licensees operate in a number of jurisdictions and currencies and are at various stages of maturity and liquidity in their business. As a result of these factors, collections cycles will vary between licensees. A lengthy collections cycle has the effect of increasing the Company's exposure to fluctuations in foreign exchange rates as well as drawing on operating cash flows. Any delay in collections could, therefore, have a material adverse effect on the Company's operating expenses, cash flow and financial condition. As well, the Company's management exercises judgment in making collectibility assumptions on a customer-by-customer basis in determining whether receivables are collectible. Any changes in circumstances may cause these assumptions to be incorrect and could have a material adverse effect on the Company's working capital, net income and financial condition.

### ***Internet Viability and System Infrastructure and Reliability***

The growth of Internet usage has caused interruptions and delays in processing and transmitting data over the Internet. There can be no assurance that the Internet infrastructure or the Company's own network systems will continue to be able to support the demands placed on us by the continued growth of the Internet, the overall online gaming industry or that of our customers.

The Internet's viability could be affected by delays in the development or adoption of new standards and protocols to handle increased levels of Internet activity or due to increased government regulation. If critical issues concerning the commercial use of the Internet are not favorably resolved (including security, reliability, cost, ease of use, accessibility and quality of service), if the necessary infrastructure is not sufficient, or if other technologies and technological devices eclipse the Internet as a viable channel, this may negatively affect Internet usage, and our business, revenues, financial condition and operating results will be materially adversely affected.

End-users of our software depend on ISPs, online service providers, gaming site operators and our system infrastructure for access to the sites operated by our licensees. Many of these services have experienced service outages in the past and could experience service outages, delays and other difficulties due to system failures, instability and interruption. Our licensees may lose customers as a result of delays or interruption in service, including delays or interruptions relating to high volumes of traffic or technological problems. As a result, we may not be able to meet the level of service that we have contracted for, and we may be in breach of our contractual commitments, which could have a material adverse effect on the Company's business, revenues, results of operations and financial condition.

Also, the increasing presence of viruses and cyber attacks may affect the viability and infrastructure of the Internet and could materially adversely affect our business.

### ***Security***

The Company's Internet gaming software is reliant on technologies and network systems to securely handle transactions and user information over the Internet, which may be vulnerable to system intrusions, unauthorized access or manipulation. As users become increasingly sophisticated and devise new ways to commit fraud, our security and network systems may be tested and subject to attack. There is no assurance that such intrusions or attacks will or can be prevented in the future and any system intrusion or attack may cause a delay, interruption or financial loss, which could have a material adverse effect on our business, results of operations and financial condition.

### ***Reliance on Other Parties***

The Company's products rely on ISPs to allow our licensees' customers and servers to communicate with each other. If ISPs experience service interruptions, it would prevent communication over the Internet and would impair our ability to carry on our business.

The ability of our customers to process e-commerce transactions depends on banking processing and credit card systems. Any system failure, including network, software or hardware failure that causes a delay or interruption in e-commerce services could have a material adverse effect on the business of our licensees and accordingly, this could have a material adverse effect on the Company's business, results of operations and financial condition.

### ***Failure to Manage Growth Successfully***

The Company's business has grown rapidly in the last four years. The accelerated growth of our business places a strain on managerial and financial resources. This growth, our expansion and the acquisition of Micropower Corporation have resulted in substantial growth to the number of our employees, the scope of our infrastructure and the geographic area of our operations, resulting in increased responsibilities for existing and new management personnel. Our ability to successfully manage this growth depends, in large part, upon our ability to: retain and attract qualified management; retain and attract skilled technical personnel to continue to develop reliable solutions that respond to the evolving needs of our customers; and retain and attract sales and marketing personnel to create an expanding presence in the rapidly growing marketplace for our products. The inability to achieve any of these objectives could harm the Company's business, results of operations and financial condition.

### ***Dependence on Key Personnel***

The Company's success is largely dependant upon the performance of its key management, technical and sale personnel. Competition for highly skilled management, technical and sales personnel is intense. The inability to retain and keep employees and to attract and retain additional key employees who have the necessary skills may have a material adverse effect upon the Company's growth and profitability.

### ***Intellectual Property Protection***

The Company relies on a combination of laws and contractual provisions to establish and protect our rights in our software and proprietary technology. Our ability to protect our proprietary information is crucial to the success of our business. We do not currently possess any patent or copyright registrations in Canada, the United States or any other jurisdiction. There can be no assurance that the steps we have taken to protect our proprietary rights will be adequate to deter misappropriation of our technology. Any such misappropriation could have a material adverse effect on the Company's business, revenues, results of operations and financial condition.

Similarly, given the nature of the business environment in which we operate, other parties have threatened to issue legal proceedings against the Company based on alleged infringement of intellectual property rights. None of these threats has yet resulted in legal proceedings, however, there can be no assurance that such threats would never materialize into actual litigation or that the Company would prevail in such litigation. An adverse determination in legal proceedings, a costly litigation process or a costly settlement could have a material adverse effect on the Company's business, revenues, results of operation and financial condition.

### **Proposed Transactions**

There is no proposed asset or business acquisition or disposition transactions pending as at the date of this MD&A.

### **Off Balance Sheet Arrangements**

As at the date of this MD&A, the Company has not entered into any off balance sheet arrangements

**Financial Instruments and Other Instruments**

The Company does not use financial derivatives or “other financial instruments”.

**Other MD&A Requirements**

The Company has 18,884,889 common shares outstanding at June 13, 2006. If all of the Company’s options were exercised, the Company would have 20,184,227 common shares outstanding.

Management believes that the disclosure controls and procedures that are currently in place are effective.

The Company’s 2005 Annual Information Form is available on [www.sedar.com](http://www.sedar.com).