



## **CHARTWELL TECHNOLOGY INC.**

**Management's Discussion and Analysis of Financial Condition and Results of Operations  
for the three and nine months ended July 31, 2008 and 2007.**

**September 10, 2008**

## **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) unaudited Consolidated Financial Statements for the three and nine months ended July 31, 2008. It should also be read in conjunction with the audited Consolidated Financial Statements and the accompanying notes for the year ended October 31, 2007, 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 consolidation 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 securities legislation. 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 remote platforms. Chartwell's JAVA and Flash based software products and games are designed for deployment in gaming, entertainment and promotional applications.

### **Business Plan**

The Company's business plan and objectives through fiscal 2008 are to continue to increase our market share in the traditional internet Casino market with a continued emphasis on the European market; endeavour to license our software to the larger European operators; further develop the liquidity of our Poker community; penetrate new markets including Asia; launch a Linked Progressive Jackpot (LPJ) and seek out potential gaming operators who have large consumer databases.

Overall we intend to expand the range of products and services we provide through in-house development and through selected acquisitions and joint ventures. In order to grow and remain a leading software provider in a competitive market, we must continue to offer an expanding variety of new and innovative products and services that enhance the gaming experience in order to help our customers attract, and retain players.

### **Business Model**

The majority of Chartwell's revenue is in the form of software license fees most of which are contingent upon customer usage and are recognized on an accrual basis as earned over the life of the contract. 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. 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.

Software set-up fee revenue and the related costs for the initial design, construction and implementation of the gaming software are recognized ratably over the initial term of the contract.

Service revenue is generated from a variety of activities including custom software development, network administration, hosting and fully managed services. Software development fees are fees that the Company charges for custom software development and are recognized on a percentage of completion basis. The Company provides network administration services for fixed monthly rates and these fees are reported along with service fees on an accrual basis during the period of service. Following the acquisition of Elite Club Management N.V. (ECM), the Company includes hosting and fully managed services revenue in its consolidated service revenue. Hosting fees are fixed monthly fees and are recorded in service revenue on an accrual basis. Fully managed services are offered to software licensees whereby the Company provides varying levels of management support services. The fully managed services fees are based on the participants' level of activity and are recognized on an accrual basis. Prior to the ECM acquisition, and following the Poker Community Management Business acquisition in February of 2007, the company recognized Poker community management service revenue. This revenue was for the management of the Poker community for the benefit of ECM sub-licensees which following the acquisition of ECM, is no longer recognized on a consolidated basis.

Expenses are classified into eight categories, namely: software development and support; sales and marketing; general and administrative; amortization of deferred software development costs; stock-based compensation expense; depreciation and amortization; amortization of intangible assets; 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, first level support for fully managed services customers of the Poker community, second level support for both casino and poker products, hosting costs for the Poker, Bingo and LPJ communities paid to hosting providers, 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. General and administrative expenses include the costs of all administrative, financial and information technology

(IT) support 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. Depreciation and amortization charges are based on the estimated useful life of the respective assets and include the amortization of deferred software development costs and intangible assets. The Company operates internationally with all of its revenue derived from non-Canadian licensees. Under the Company's licensing agreements, the majority of the Company's revenue is received in UK Pounds Sterling and Euros. Consequently, the Company is exposed to currency fluctuations, which result in foreign currency gains or losses, which are reported in that expense category.

## **HIGHLIGHTS**

Total revenue for the three and nine months ended July 31, 2008 was \$6.1 and \$18.9 million compared to \$5.3 and \$16.3 million for the same periods a year earlier. Net income was \$0.6 and \$2.6 million for the three and nine months ended July 31, 2008 as compared to \$0.4 and \$1.0 million for the same period in the prior year with basic earnings per share of \$0.04 and diluted earnings per share of \$0.03 in the third quarter and \$0.14 of basic earnings per share and \$0.13 of diluted earnings per share for the first three quarters of 2008. This compares to \$0.02 in the third quarter of 2007 and \$0.05 for the nine months ended July 31, 2007 for both basic and diluted earnings per share.

Total expenses increased by 11.8% in the third quarter as compared to the third quarter of 2007. The majority of this increase is the result of hiring additional staff to broaden the Company's product base, the expense of operating the additional services following the ECM acquisition, and additional expense to improve the overall service that our clients receive. Specifically, we've added several new staff to introduce a Bingo product, as well as to continue to deliver on our aggressive Casino product roadmap.

In the third quarter, the Company announced that it had received both its Remote and Non-Remote Gaming License from the Gambling Commission in the UK. Chartwell was the first on-line gaming software provider to receive such licenses, which demonstrates our commitment to be at the forefront of remote gaming regulation.

Chartwell maintains a strong balance sheet. At July 31, 2008 the Company had cash and short-term investments of \$21.7 million, working capital (defined as current assets less current liabilities) of \$22.9 million and no debt.

## 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.

	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007	Q4 2006
<b>Revenue</b>								
Software license fees	\$5,695	\$6,459	\$5,582	\$4,651	\$5,019	\$5,334	\$5,289	\$4,367
Software set-up fees	19	43	25	45	81	55	55	111
Service fees	276	340	29	74	61	53	6	-
Interest and other	151	142	139	122	109	120	147	224
	<u>6,141</u>	<u>6,984</u>	<u>5,775</u>	<u>4,892</u>	<u>5,270</u>	<u>5,562</u>	<u>5,498</u>	<u>4,702</u>
<b>Expenses</b>								
Software development and support	3,084	2,833	2,305	2,182	2,439	2,357	2,470	2,394
Sales and marketing	573	603	745	663	740	716	924	618
General and administrative	874	989	788	1,124	775	1,292	1,021	1,502
Amortization of deferred software development costs	288	288	288	238	248	284	172	58
Impairment of deferred software development costs	-	-	-	543	-	-	-	-
Stock-based compensation	144	371	139	108	(149)	139	133	139
Depreciation and amortization	215	211	173	224	201	187	115	117
Amortization of intangible assets	122	122	122	171	245	205	123	124
Impairment of intangible assets	-	-	-	872	-	-	-	-
Foreign currency loss (gain)	(5)	(104)	(67)	439	237	298	(273)	48
	<u>5,295</u>	<u>5,313</u>	<u>4,492</u>	<u>6,564</u>	<u>4,736</u>	<u>5,478</u>	<u>4,685</u>	<u>5,000</u>
<b>Net income (loss) before taxes</b>	846	1,671	1,283	(1,672)	534	84	813	(298)
Income tax expense (recovery)	265	621	353	(578)	130	(23)	318	(77)
<b>Net income (loss)</b>	<u>\$581</u>	<u>\$1,050</u>	<u>\$930</u>	<u>(\$1,094)</u>	<u>\$404</u>	<u>\$107</u>	<u>\$495</u>	<u>(\$221)</u>
<b>Basic earnings per share</b>	\$0.04	\$0.05	\$0.05	(\$0.07)	\$0.02	\$0.01	\$0.03	(\$0.01)
<b>Diluted earnings per share</b>	\$0.03	\$0.05	\$0.05	(\$0.07)	\$0.02	\$0.01	\$0.03	(\$0.01)

## **QUARTERLY RESULTS**

### **FOR THE THREE AND NINE MONTHS ENDED JULY 31, 2008 COMPARED TO THE THREE AND NINE MONTHS ENDED JULY 31, 2007**

#### ***Revenue***

In the three and nine months ended July 31, 2008, total revenue increased by 16.5% and 15.7% to \$6.1 million and \$18.9 million compared to \$5.3 million and \$16.3 million in the same periods of 2007. The increase in total revenue in both periods was due to an increase in software license fees and an increase in services revenue following the ECM acquisition.

Software license fees increased by 13.5% and 13.4% to \$5.7 million and \$17.7 million in the three and nine months ending July 31, 2008 over the comparable periods in 2007. Licensing from our Casino product grew by 9.9% and 8.2%, while licensing from our Poker product grew by 52.0% and 76.7% in the three and nine months ended July 31, 2008 compared to the same period in 2007. Poker represented 11.4% and 11.8% of total software license fees in the three and nine months ended July 31, 2008, as compared to 8.5% and 7.6% in the same periods in 2007. The quarter over quarter increase in software license revenue is due to organic growth from existing customers despite the loss of revenue from one significant licensee in the quarter. Organic growth in the quarter was supported by the Euro 2008 football tournament and the increased traffic this generated on our clients' sports betting operations, which our casino products benefitted from. Poker license revenue has grown substantially from prior years, however the Company's Poker community, PokerNexus, is affected by the same market conditions that affect other European Poker networks. In this market, there is a saturation of Poker operators, some of whom finance their growth in Europe with revenue generated from US players. Chartwell prohibits the participants of PokerNexus from accepting US players.

Software set-up fees decreased by 76.3% and 54.0% to \$19,000 and \$81,000 from \$81,000 and \$191,000 for the three and nine months ended July 31, 2008 and 2007, respectively. The decrease is due to the initial contract term expiring for customers for whom set-up fees were being recognized.

Service fee revenue now includes the Fully Managed Services (FMS) and hosting revenue following the ECM acquisition. Additional services revenue from consolidating ECM was \$274,000 and \$244,000 in the second and third quarter of 2008, respectively.

Interest and other income increased by 25.0% and 1.1% to \$151,000 and \$202,000 in the three and nine months ended July 31, 2008. The increase is due to additional interest from a higher balance of short term investments following the Company's strong positive cash flow.

#### ***Expenses***

Total expenses other than income tax expense increased by 11.8% and 1.4% to \$5.3 and \$15.1 million for the three and nine months ended July 31, 2008 compared to \$4.7 and \$14.9 million for the same periods of 2007. The increased expense in the most recent quarter is the result of increased software development and support expense as the Company continues to invest in new products and improving the support it provides to existing licensees. The Company also had higher stock based compensation expense offset by a foreign exchange gain (versus a foreign exchange loss) and lower amortization of intangible assets in the third quarter as compared to the same quarter in 2007.

#### ***SOFTWARE DEVELOPMENT AND SUPPORT***

Software development and support expense increased by 26.4% and 13.2% to \$3.1 million and \$8.2 million for the three and nine months ended July 31, 2008 compared to \$2.4 million and \$7.3 million for the same periods of 2007. No software development expenses were deferred in 2008, compared to \$487,000 deferred in the first three quarters of 2007. Comparing software development and support expense before the deferred software development in the prior year, there was an increase of 21.7%, or \$530,000 in the third quarter of 2008, and an increase of 6.5%, or \$469,000, in the first three quarters of 2008 as compared to the same periods in the prior year. The increase in

software development and support expenses in the third quarter is the result of the increased expense in providing the FMS line of business following the acquisition of ECM, as well as additional staffing for the integration and quality assurance of the Bingo product and community.

As a percentage of revenue, software development and support expenses were 50.2% and 43.5% for the three and nine months ended July 31, 2008 compared to 46.3% and 44.5% for the same periods in 2007, respectively.

#### *SALES AND MARKETING*

For the three and nine months ended July 31, 2008, sales and marketing expenses decreased by 22.5% and 19.3% to \$573,000 and \$1.9 million from \$740,000 and \$2.4 million in the same periods of 2007. The decrease is due to reduced salary expense as well as reduced rent and overall operating costs as the Company focused its sales and marketing efforts out of Malta to be closer to the majority of our customers.

As a percentage of revenue, sales and marketing expenses decreased to 9.3% and 10.2% from 14.0% and 14.6% for the three and nine months ended July 31, 2008 from the same periods in 2007, respectively.

#### *GENERAL AND ADMINISTRATIVE*

For the three months ended July 31, 2008, general and administrative expenses increased by 12.7% from \$775,000 to \$874,000. The increase in the third quarter is the result of increased professional fees from managing numerous corporate initiatives that included establishing the legal framework for the LPJ and Bingo communities, and several engagements focused on managing the Company's tax compliance. In the nine months ended July 31, 2008, general and administrative expenses decreased by \$437,000, or 14.2% from \$3.1 million to \$2.7 million. The nine month period was effected by the above conditions as well as benefited from overall reduced salary expense despite the addition of administrative staff with the ECM acquisition, reduced consulting fees for accounting services, and the fact that the prior year period included a non-recurring charge for the revaluation of a note receivable.

As a percentage of revenue, general and administrative expenses increased slightly to 14.2% from 14.0% in the three months ended July 31, 2007 as compared to the comparable period in 2007. For the nine months ended July 31, 2008, general and administrative expense as a percentage of revenue decreased to 14.7% from 18.9%.

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

Amortization of deferred software development costs for the three and nine months ended July 31, 2008 was \$288,000 and \$865,000 compared to \$248,000 and \$704,000 for the comparable periods in 2007. The increase in amortization reflects the amortization of deferred software development costs of version 2.0 of the Poker product. All of the deferred software development relates to version 2.0 of the Poker product, which builds on the intellectual property acquired in the acquisition of Micropower Corporation (Micropower). Management has estimated the appropriate amortization period to be three years. While the Company continues to invest in developing the Poker, Casino and other products, it has not deferred any costs related to this development in fiscal 2008.

#### *STOCK-BASED COMPENSATION*

The Company recorded \$144,000 and \$654,000 of stock-based compensation expense for the three and nine months ended July 31, 2008 compared to a recovery of \$149,000 and an expense of \$123,000 for the comparable periods in 2007. 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 expense recovery in the comparable period in 2007 was the result of forfeited stock options, in addition, the year over year increase is due to additional options granted late in 2007 as well as the revaluation of options that were granted and unexercised to contractors that are revalued at quarter end where the share price was higher than in previous quarters.

#### *DEPRECIATION AND AMORTIZATION*

Depreciation and amortization expenses increased by 7.3% and 19.2% to \$215,000 and \$599,000 for the three and nine months ended July 31, 2008 as compared to \$201,000 and \$503,000 in the similar periods of 2007. This increased depreciation is due to the assets acquired for the LPJ and Bingo communities as well as the assets acquired along with the acquisition of ECM. It is expected that continued investment in computer hardware and software will be required as the Company continues to grow.

#### *AMORTIZATION OF INTANGIBLE ASSETS*

Amortization of intangible assets relates to the customer contracts and intellectual property acquired in the acquisition of Micropower and the Poker Community Management business. The expense for the three and nine months ended July 31, 2008 decreased to \$122,000 and \$366,000 from \$245,000 and \$573,000 for the same periods in 2007. The decrease in fiscal 2008 is the result of the Company eliminating the remaining balance of intangible assets resulting from the Micropower acquisition late in fiscal 2007. 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 the Company). The value recorded for intellectual property acquired from the Poker Community Management business is being amortized over three years, which is Management's best estimate of the time period that the acquired intellectual property will provide future value to the Company.

#### *FOREIGN CURRENCY GAIN*

The Company recognized a foreign currency gain of \$5,000 and \$177,000 in the three and nine months ended July 31, 2008 as compared to a foreign currency loss of \$237,000 and \$263,000 for the comparable periods of 2007. The foreign currency gains experienced in 2008 reflect foreign denominated amounts receivable translated into Canadian dollar equivalents at higher foreign exchange rates than in the past, as well as gains in the value of cash balances of foreign currencies as the Canadian dollar weakened against foreign currencies. The Company began actively hedging some of the foreign currency risk at the start of fiscal 2008.

#### *PROVISION FOR INCOME TAXES*

Income tax expense for the three and nine months ended July 31, 2008 was \$265,000 and \$1.2 million, as compared to \$130,000 and \$425,000 in the comparable periods of 2007. The increase in tax expense is attributable to higher pre-tax income in the three and nine months ended July 31, 2008 compared to the similar periods of 2007.

#### *EBITDA*

EBITDA (defined as net income less interest, plus taxes, depreciation and amortization) increased by 18.0% and 84.5% to \$1.3 million and \$5.2 million in the three and nine months ended July 31, 2008 from \$1.1 million and \$2.8 million for the comparable period of 2007. The increase in the EBITDA is due to the same factors affecting net income, for reasons which are noted above.

EBITDA is reconciled to net income as follows:

*in thousands of Canadian dollars*

	Three months ended July 31,		Nine months ended July 31,	
	2008	2007	2008	2007
Net income	\$581	\$404	\$2,562	\$1,006
Interest	(151)	(109)	(390)	(370)
Amortization of deferred software development	288	248	865	704
Depreciation and amortization	215	201	599	503
Amortization of intangible assets	122	245	366	573
Income tax	265	130	1,239	425
<b>EBITDA</b>	<b>\$1,320</b>	<b>\$1,119</b>	<b>\$5,241</b>	<b>\$2,841</b>

### ***Net Income***

Net income increased by 43.9% and 154.6% to \$581,000 and \$2.6 million for the three and nine months ended July 31, 2008 versus \$404,000 and \$1.0 million for the three and nine months ended July 31, 2007. The increased net income is the result of increases in total revenue outpacing total expense growth. In the most recent quarter, the Company's commitment to producing more games, increasing the breadth of the product line and supplementing the service delivery capability has resulted in increased software development and support expense as well as higher depreciation and amortization charges.

Basic earnings per share was \$0.04 and diluted earnings per share were \$0.03 for the three months ended July 31, 2008. For the nine months ended July 31, 2008, basic earnings per share was \$0.14 and diluted earnings per share were \$0.13. In the three and nine months ended July 31, 2007, basic and diluted earnings per share were both \$0.02 and \$0.05. The increase in earnings per share over the comparable periods in the prior year is the result of higher net income.

### **Liquidity and Capital Resources**

#### ***Operating Activities***

Operating cash flow for the three and nine months ended July 31, 2008 was \$3.2 and \$8.3 million compared to \$590,000 and \$3.8 million for the same periods in 2007. Before adjustments due to working capital, and before an adjustment for restricted cash, cash flow from operations increased in both periods to \$1.3 and \$4.8 million from \$1.0 and \$2.4 million. The increase reflects the higher net income compared with the same periods in 2007.

#### ***Financing Activities***

Cash flows used in financing activities were \$nil and \$442,000 for the three and nine months ended July 31, 2008 compared to cash flows from financing activities of \$34,000 and \$200,000 for the same periods of 2007. The Company used cash in financing activities in 2008 as it commenced a Normal Course Issuer Bid and repurchased shares for cancellation. The Company did not repurchase any shares in the comparable period in 2007.

#### ***Investing Activities***

Cash flows used in investing activities were \$4.4 and \$9.9 million in the three and nine months ended July 31, 2008 and \$940,000 and \$2.1 million for the comparable periods of 2007. The Company's investing activities in the first three quarters of 2008 consisted mainly of the purchase of short term investments following the positive cash flow from operations, as well as the purchase of ECM and property and equipment. The Company did not defer any software development expense in 2008 as compared to deferring a total of \$487,000 in the nine months ended July 31, 2007.

### **Contractual Obligations**

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

2008	\$263,000
2009	\$950,000
2010	\$185,000
2011	\$ 63,000
2012	\$ 56,000
Thereafter	\$ 93,000

## **Related Party Transactions**

For the three and nine months ended July 31, 2008, the Company incurred legal fees to a firm which a certain director of the Company is a partner in the normal course of business of \$12,000 and \$54,000 as compared to \$nil and \$312,000 in each of the comparable periods of 2007. The Company incurred sales and marketing consultancy fees to a certain director and officer of \$31,000 and \$93,000 as compared to the \$31,000 and \$93,000 in the respective periods of 2007. In addition, general and administrative consulting fees of \$10,000 and \$31,000 to a certain director and officer as compared to \$10,000 and \$61,000 to a certain director and officer as well as a former officer in the respective periods in 2007. These transactions were measured at the exchange amount which approximate fair value and are recorded in software development, sales and marketing, and general administrative expenses. As at July 31, 2008, all amounts have been paid.

## **Normal Course Issuer Bid**

On January 25, 2008, the Company announced that it has filed with the Toronto Stock Exchange (the TSX) a notice of its intention to make a normal course issuer bid (the NCIB) for its Common Shares through the facilities of the TSX (the Notice).

The Notice provides that Chartwell may, during the twelve-month period commencing February 1, 2008, purchase on the TSX up to 1,725,000 Common Shares, being approximately 10% of the "public float" (as defined in the policies of the TSX) as at the date of filing the Notice with the TSX. As at January 15, 2008, Chartwell had 18,845,089 issued and outstanding Common Shares. The price that Chartwell will pay for any such Common Shares will be the market price at the time of acquisition and any Common Shares purchased under the NCIB will be cancelled. The actual number of Common Shares that may be purchased and the timing of any such purchases will be determined by Chartwell. Chartwell's previous NCIB expired on September 25, 2006; accordingly, no Common Shares had been repurchased by the Corporation prior to February 1, 2008.

The average daily trading volume of Chartwell over the previous six months (July to December, 2007) was 20,976 Common Shares (the "ADTV"). Under TSX rules, Chartwell may purchase up to 25% of the ADTV per trading day. Accordingly, daily purchases will be limited to a maximum of 5,244 Common Shares, other than purchases pursuant to block purchase exceptions.

As of September 10, 2008, the Company has purchased 401,500 shares at an average cost of \$1.58 which it either has or intends to cancel.

A copy of the Notice may be obtained by any shareholder of Chartwell, without charge, by contacting Chartwell's head office and will be available for reviewing on the SEDAR website at [www.sedar.com](http://www.sedar.com).

## **Changes in accounting policies including initial adoption**

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, 2007.

On November 1, 2007, Company adopted the new CICA Handbook Section 3862, "Financial Instruments – Disclosures" and Section 3863, "Financial Instruments - Presentation", and Section 1535, "Capital Disclosures" on a prospective basis.

Section 3862 requires disclosures in the financial statements that will enable users to evaluate: the significance of financial instruments for a Company's financial position and performance; and the nature and extent of risks arising from financial instruments to which a Company is exposed during the period and at the balance sheet date, and how a Company manages those risks. This accounting standard is effective for fiscal years beginning after October 1, 2007.

Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. This section compliments the existing CICA Handbook Section 3861 - Financial Instruments - Disclosure and Presentation and is effective for fiscal years beginning on or after October 1, 2007.

Section 1535 establishes standards for disclosing information about a Company's capital and how it is managed to enable users of the financial statements to evaluate the Company's objectives, policies and procedures for managing capital. This section is effective for the fiscal years beginning on or after October 1, 2007.

The adoption of these new accounting standards did not impact the amounts in the Company's financial statements as they primarily relate to disclosure.

The CICA implemented revisions to standards dealing with Intangible Assets effective for fiscal years beginning on or after October 1, 2008. The revisions are intended to align the definition of an Intangible Asset in Canadian GAAP with that in IFRS and U.S. GAAP. Section 1000 - Financial Statement Concepts was revised to remove material that permitted the recognition of assets that might not otherwise meet the definition of an asset and to add guidance from the IASB's Framework for the Preparation and Presentation of Financial Statements that will help distinguish assets from expenses. Section 3064 - Goodwill and Intangible Assets, which replaced Section 3062 - Goodwill and Other Intangible Assets, gives guidance on the recognition of intangible assets as well as the recognition and measurement of internally developed intangible assets. Section 3450 - Research and Development Costs will be withdrawn from the Handbook. The Company does not expect these changes to have a material effect on its financial statements.

With the Canadian Accounting Standards Board's recent announcement that January 1, 2011 as the date International Financial Reporting Standards ("IFRS") will replace current Canadian GAAP for publicly accountable enterprises, the Company has been carefully evaluating its own implementation plan and assessing the impact the numerous accounting changes will have on the organization. As the final implementation date approaches, the Company will continue to monitor developments.

## **Risks and Uncertainties**

Important risk factors that could cause actual results, performance or achievements to be materially different than past performance or those implied by forward looking statements include:

- Uncertainty as to the degree of new and continuing market acceptance of our products
- Our products could contain defects that lead to costs, damage of reputation or litigation
- Our dependence on customer performance
- Uncertainty regarding future profitability
- Uncertainty regarding the pricing, reporting and collection of accounts
- Risk associated with sales in foreign countries and government policy and regulation therein
- Our ability to diligently ensure that our customers operate in accordance with the terms of our license agreements that require observation of the laws of Canada and foreign countries
- Our ability to attract and retain key personnel

For further information on the Company's risks and uncertainties, see the Company's 2007 Annual Information Form available at [www.sedar.com](http://www.sedar.com).

## **Proposed Transactions**

There is no proposed asset or business acquisition or disposition transactions pending as at July 31, 2008.

## **Off Balance Sheet Arrangements**

As at July 31, 2008, the Company has not entered into any off balance sheet arrangements

## **Financial Instruments and Other Instruments**

The Company's financial instruments consist of cash, short term investments, accounts receivable, accounts payable and accrued liabilities, and income taxes receivable or payable. The fair values of these financial instruments approximate their carrying values. It is management's opinion that the Company is not exposed to significant interest rate risk. The Company's credit risk lies in its accounts receivable where the balances due reflect a concentration among a relatively small number of accounts. The Company's short term investments consist primarily of investments in low risk corporate and government obligations.

Most of the Company's revenue is earned in foreign currencies and is exposed to currency fluctuations. The Company will engage from time to time in foreign exchange collars. As of July 31, 2008, the Company had entered into several Euro denominated foreign exchange collars.

## **Other MD&A Requirements**

The Company evaluated the effectiveness and design of its disclosure controls and procedures for the period ended July 31, 2008, and based on this evaluation (which included testing of the key controls by examining evidence demonstrating their existence on a test basis) have determined these controls to be effective.

The Corporation's financial reporting procedures and practices have enabled the certification of Chartwell Technology Inc.'s annual and interim filings in compliance with Multilateral Instrument 52-109 "Certification of Disclosure in Issuers' Annual and Interim Filings". Management has designed such internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements and other annual and interim filings in accordance with Canadian Generally Accepted Accounting Principles, except as noted below.

Given the size of the Company, the evaluation of the design of internal controls over financial reporting for the Company resulted in the identification of the following weaknesses:

Management is aware that due to its relatively small scale of operations there is a lack of segregation of duties due to a limited number of employees dealing with accounting and financial matters. However, management has concluded that considering the employees involved and the control procedures in place, including management and Audit Committee oversight, risks associated with such lack of segregation are not significant enough to justify the expense associated with adding employees to clearly segregate duties.

Management is aware that in-house expertise to deal with complex taxation, accounting and reporting issues may not be sufficient. The Company requires outside assistance and advice on new accounting pronouncements and complex accounting and reporting issues, which is common with companies of a similar size.

There have been no significant changes to the Company's internal control over financial reporting that occurred during the most recent period that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company has 18,595,723 Common Shares outstanding at September 10, 2008. If all of the Company's options were exercised, the Company would have 20,701,723 Common Shares outstanding.

The Company's 2007 Annual Information Form is available on [www.sedar.com](http://www.sedar.com).



## **CHARTWELL TECHNOLOGY INC.**

**Management's Discussion and Analysis of Financial Condition and Results of Operations  
for the three and nine months ended July 31, 2008 and 2007.**

**September 10, 2008**

## **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) unaudited Consolidated Financial Statements for the three and nine months ended July 31, 2008. It should also be read in conjunction with the audited Consolidated Financial Statements and the accompanying notes for the year ended October 31, 2007, 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 consolidation 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 securities legislation. 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 remote platforms. Chartwell's JAVA and Flash based software products and games are designed for deployment in gaming, entertainment and promotional applications.

### **Business Plan**

The Company's business plan and objectives through fiscal 2008 are to continue to increase our market share in the traditional internet Casino market with a continued emphasis on the European market; endeavour to license our software to the larger European operators; further develop the liquidity of our Poker community; penetrate new markets including Asia; launch a Linked Progressive Jackpot (LPJ) and seek out potential gaming operators who have large consumer databases.

Overall we intend to expand the range of products and services we provide through in-house development and through selected acquisitions and joint ventures. In order to grow and remain a leading software provider in a competitive market, we must continue to offer an expanding variety of new and innovative products and services that enhance the gaming experience in order to help our customers attract, and retain players.

### **Business Model**

The majority of Chartwell's revenue is in the form of software license fees most of which are contingent upon customer usage and are recognized on an accrual basis as earned over the life of the contract. 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. 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.

Software set-up fee revenue and the related costs for the initial design, construction and implementation of the gaming software are recognized ratably over the initial term of the contract.

Service revenue is generated from a variety of activities including custom software development, network administration, hosting and fully managed services. Software development fees are fees that the Company charges for custom software development and are recognized on a percentage of completion basis. The Company provides network administration services for fixed monthly rates and these fees are reported along with service fees on an accrual basis during the period of service. Following the acquisition of Elite Club Management N.V. (ECM), the Company includes hosting and fully managed services revenue in its consolidated service revenue. Hosting fees are fixed monthly fees and are recorded in service revenue on an accrual basis. Fully managed services are offered to software licensees whereby the Company provides varying levels of management support services. The fully managed services fees are based on the participants' level of activity and are recognized on an accrual basis. Prior to the ECM acquisition, and following the Poker Community Management Business acquisition in February of 2007, the company recognized Poker community management service revenue. This revenue was for the management of the Poker community for the benefit of ECM sub-licensees which following the acquisition of ECM, is no longer recognized on a consolidated basis.

Expenses are classified into eight categories, namely: software development and support; sales and marketing; general and administrative; amortization of deferred software development costs; stock-based compensation expense; depreciation and amortization; amortization of intangible assets; 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, first level support for fully managed services customers of the Poker community, second level support for both casino and poker products, hosting costs for the Poker, Bingo and LPJ communities paid to hosting providers, 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. General and administrative expenses include the costs of all administrative, financial and information technology

(IT) support 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. Depreciation and amortization charges are based on the estimated useful life of the respective assets and include the amortization of deferred software development costs and intangible assets. The Company operates internationally with all of its revenue derived from non-Canadian licensees. Under the Company's licensing agreements, the majority of the Company's revenue is received in UK Pounds Sterling and Euros. Consequently, the Company is exposed to currency fluctuations, which result in foreign currency gains or losses, which are reported in that expense category.

## **HIGHLIGHTS**

Total revenue for the three and nine months ended July 31, 2008 was \$6.1 and \$18.9 million compared to \$5.3 and \$16.3 million for the same periods a year earlier. Net income was \$0.6 and \$2.6 million for the three and nine months ended July 31, 2008 as compared to \$0.4 and \$1.0 million for the same period in the prior year with basic earnings per share of \$0.04 and diluted earnings per share of \$0.03 in the third quarter and \$0.14 of basic earnings per share and \$0.13 of diluted earnings per share for the first three quarters of 2008. This compares to \$0.02 in the third quarter of 2007 and \$0.05 for the nine months ended July 31, 2007 for both basic and diluted earnings per share.

Total expenses increased by 11.8% in the third quarter as compared to the third quarter of 2007. The majority of this increase is the result of hiring additional staff to broaden the Company's product base, the expense of operating the additional services following the ECM acquisition, and additional expense to improve the overall service that our clients receive. Specifically, we've added several new staff to introduce a Bingo product, as well as to continue to deliver on our aggressive Casino product roadmap.

In the third quarter, the Company announced that it had received both its Remote and Non-Remote Gaming License from the Gambling Commission in the UK. Chartwell was the first on-line gaming software provider to receive such licenses, which demonstrates our commitment to be at the forefront of remote gaming regulation.

Chartwell maintains a strong balance sheet. At July 31, 2008 the Company had cash and short-term investments of \$21.7 million, working capital (defined as current assets less current liabilities) of \$22.9 million and no debt.

## 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.

	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007	Q4 2006
<b>Revenue</b>								
Software license fees	\$5,695	\$6,459	\$5,582	\$4,651	\$5,019	\$5,334	\$5,289	\$4,367
Software set-up fees	19	43	25	45	81	55	55	111
Service fees	276	340	29	74	61	53	6	-
Interest and other	151	142	139	122	109	120	147	224
	<u>6,141</u>	<u>6,984</u>	<u>5,775</u>	<u>4,892</u>	<u>5,270</u>	<u>5,562</u>	<u>5,498</u>	<u>4,702</u>
<b>Expenses</b>								
Software development and support	3,084	2,833	2,305	2,182	2,439	2,357	2,470	2,394
Sales and marketing	573	603	745	663	740	716	924	618
General and administrative	874	989	788	1,124	775	1,292	1,021	1,502
Amortization of deferred software development costs	288	288	288	238	248	284	172	58
Impairment of deferred software development costs	-	-	-	543	-	-	-	-
Stock-based compensation	144	371	139	108	(149)	139	133	139
Depreciation and amortization	215	211	173	224	201	187	115	117
Amortization of intangible assets	122	122	122	171	245	205	123	124
Impairment of intangible assets	-	-	-	872	-	-	-	-
Foreign currency loss (gain)	(5)	(104)	(67)	439	237	298	(273)	48
	<u>5,295</u>	<u>5,313</u>	<u>4,492</u>	<u>6,564</u>	<u>4,736</u>	<u>5,478</u>	<u>4,685</u>	<u>5,000</u>
<b>Net income (loss) before taxes</b>	846	1,671	1,283	(1,672)	534	84	813	(298)
Income tax expense (recovery)	265	621	353	(578)	130	(23)	318	(77)
<b>Net income (loss)</b>	<u>\$581</u>	<u>\$1,050</u>	<u>\$930</u>	<u>(\$1,094)</u>	<u>\$404</u>	<u>\$107</u>	<u>\$495</u>	<u>(\$221)</u>
<b>Basic earnings per share</b>	\$0.04	\$0.05	\$0.05	(\$0.07)	\$0.02	\$0.01	\$0.03	(\$0.01)
<b>Diluted earnings per share</b>	\$0.03	\$0.05	\$0.05	(\$0.07)	\$0.02	\$0.01	\$0.03	(\$0.01)

## QUARTERLY RESULTS

### FOR THE THREE AND NINE MONTHS ENDED JULY 31, 2008 COMPARED TO THE THREE AND NINE MONTHS ENDED JULY 31, 2007

#### *Revenue*

In the three and nine months ended July 31, 2008, total revenue increased by 16.5% and 15.7% to \$6.1 million and \$18.9 million compared to \$5.3 million and \$16.3 million in the same periods of 2007. The increase in total revenue in both periods was due to an increase in software license fees and an increase in services revenue following the ECM acquisition.

Software license fees increased by 13.5% and 13.4% to \$5.7 million and \$17.7 million in the three and nine months ending July 31, 2008 over the comparable periods in 2007. Licensing from our Casino product grew by 9.9% and 8.2%, while licensing from our Poker product grew by 52.0% and 76.7% in the three and nine months ended July 31, 2008 compared to the same period in 2007. Poker represented 11.4% and 11.8% of total software license fees in the three and nine months ended July 31, 2008, as compared to 8.5% and 7.6% in the same periods in 2007. The quarter over quarter increase in software license revenue is due to organic growth from existing customers despite the loss of revenue from one significant licensee in the quarter. Organic growth in the quarter was supported by the Euro 2008 football tournament and the increased traffic this generated on our clients' sports betting operations, which our casino products benefitted from. Poker license revenue has grown substantially from prior years, however the Company's Poker community, PokerNexus, is affected by the same market conditions that affect other European Poker networks. In this market, there is a saturation of Poker operators, some of whom finance their growth in Europe with revenue generated from US players. Chartwell prohibits the participants of PokerNexus from accepting US players.

Software set-up fees decreased by 76.3% and 54.0% to \$19,000 and \$81,000 from \$81,000 and \$191,000 for the three and nine months ended July 31, 2008 and 2007, respectively. The decrease is due to the initial contract term expiring for customers for whom set-up fees were being recognized.

Service fee revenue now includes the Fully Managed Services (FMS) and hosting revenue following the ECM acquisition. Additional services revenue from consolidating ECM was \$274,000 and \$244,000 in the second and third quarter of 2008, respectively.

Interest and other income increased by 25.0% and 1.1% to \$151,000 and \$202,000 in the three and nine months ended July 31, 2008. The increase is due to additional interest from a higher balance of short term investments following the Company's strong positive cash flow.

#### *Expenses*

Total expenses other than income tax expense increased by 11.8% and 1.4% to \$5.3 and \$15.1 million for the three and nine months ended July 31, 2008 compared to \$4.7 and \$14.9 million for the same periods of 2007. The increased expense in the most recent quarter is the result of increased software development and support expense as the Company continues to invest in new products and improving the support it provides to existing licensees. The Company also had higher stock based compensation expense offset by a foreign exchange gain (versus a foreign exchange loss) and lower amortization of intangible assets in the third quarter as compared to the same quarter in 2007.

#### *SOFTWARE DEVELOPMENT AND SUPPORT*

Software development and support expense increased by 26.4% and 13.2% to \$3.1 million and \$8.2 million for the three and nine months ended July 31, 2008 compared to \$2.4 million and \$7.3 million for the same periods of 2007. No software development expenses were deferred in 2008, compared to \$487,000 deferred in the first three quarters of 2007. Comparing software development and support expense before the deferred software development in the prior year, there was an increase of 21.7%, or \$530,000 in the third quarter of 2008, and an increase of 6.5%, or \$469,000, in the first three quarters of 2008 as compared to the same periods in the prior year. The increase in

software development and support expenses in the third quarter is the result of the increased expense in providing the FMS line of business following the acquisition of ECM, as well as additional staffing for the integration and quality assurance of the Bingo product and community.

As a percentage of revenue, software development and support expenses were 50.2% and 43.5% for the three and nine months ended July 31, 2008 compared to 46.3% and 44.5% for the same periods in 2007, respectively.

#### *SALES AND MARKETING*

For the three and nine months ended July 31, 2008, sales and marketing expenses decreased by 22.5% and 19.3% to \$573,000 and \$1.9 million from \$740,000 and \$2.4 million in the same periods of 2007. The decrease is due to reduced salary expense as well as reduced rent and overall operating costs as the Company focused its sales and marketing efforts out of Malta to be closer to the majority of our customers.

As a percentage of revenue, sales and marketing expenses decreased to 9.3% and 10.2% from 14.0% and 14.6% for the three and nine months ended July 31, 2008 from the same periods in 2007, respectively.

#### *GENERAL AND ADMINISTRATIVE*

For the three months ended July 31, 2008, general and administrative expenses increased by 12.7% from \$775,000 to \$874,000. The increase in the third quarter is the result of increased professional fees from managing numerous corporate initiatives that included establishing the legal framework for the LPJ and Bingo communities, and several engagements focused on managing the Company's tax compliance. In the nine months ended July 31, 2008, general and administrative expenses decreased by \$437,000, or 14.2% from \$3.1 million to \$2.7 million. The nine month period was effected by the above conditions as well as benefited from overall reduced salary expense despite the addition of administrative staff with the ECM acquisition, reduced consulting fees for accounting services, and the fact that the prior year period included a non-recurring charge for the revaluation of a note receivable.

As a percentage of revenue, general and administrative expenses increased slightly to 14.2% from 14.0% in the three months ended July 31, 2007 as compared to the comparable period in 2007. For the nine months ended July 31, 2008, general and administrative expense as a percentage of revenue decreased to 14.7% from 18.9%.

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

Amortization of deferred software development costs for the three and nine months ended July 31, 2008 was \$288,000 and \$865,000 compared to \$248,000 and \$704,000 for the comparable periods in 2007. The increase in amortization reflects the amortization of deferred software development costs of version 2.0 of the Poker product. All of the deferred software development relates to version 2.0 of the Poker product, which builds on the intellectual property acquired in the acquisition of Micropower Corporation (Micropower). Management has estimated the appropriate amortization period to be three years. While the Company continues to invest in developing the Poker, Casino and other products, it has not deferred any costs related to this development in fiscal 2008.

#### *STOCK-BASED COMPENSATION*

The Company recorded \$144,000 and \$654,000 of stock-based compensation expense for the three and nine months ended July 31, 2008 compared to a recovery of \$149,000 and an expense of \$123,000 for the comparable periods in 2007. 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 expense recovery in the comparable period in 2007 was the result of forfeited stock options, in addition, the year over year increase is due to additional options granted late in 2007 as well as the revaluation of options that were granted and unexercised to contractors that are revalued at quarter end where the share price was higher than in previous quarters.

#### *DEPRECIATION AND AMORTIZATION*

Depreciation and amortization expenses increased by 7.3% and 19.2% to \$215,000 and \$599,000 for the three and nine months ended July 31, 2008 as compared to \$201,000 and \$503,000 in the similar periods of 2007. This increased depreciation is due to the assets acquired for the LPJ and Bingo communities as well as the assets acquired along with the acquisition of ECM. It is expected that continued investment in computer hardware and software will be required as the Company continues to grow.

#### *AMORTIZATION OF INTANGIBLE ASSETS*

Amortization of intangible assets relates to the customer contracts and intellectual property acquired in the acquisition of Micropower and the Poker Community Management business. The expense for the three and nine months ended July 31, 2008 decreased to \$122,000 and \$366,000 from \$245,000 and \$573,000 for the same periods in 2007. The decrease in fiscal 2008 is the result of the Company eliminating the remaining balance of intangible assets resulting from the Micropower acquisition late in fiscal 2007. 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 the Company). The value recorded for intellectual property acquired from the Poker Community Management business is being amortized over three years, which is Management's best estimate of the time period that the acquired intellectual property will provide future value to the Company.

#### *FOREIGN CURRENCY GAIN*

The Company recognized a foreign currency gain of \$5,000 and \$177,000 in the three and nine months ended July 31, 2008 as compared to a foreign currency loss of \$237,000 and \$263,000 for the comparable periods of 2007. The foreign currency gains experienced in 2008 reflect foreign denominated amounts receivable translated into Canadian dollar equivalents at higher foreign exchange rates than in the past, as well as gains in the value of cash balances of foreign currencies as the Canadian dollar weakened against foreign currencies. The Company began actively hedging some of the foreign currency risk at the start of fiscal 2008.

#### *PROVISION FOR INCOME TAXES*

Income tax expense for the three and nine months ended July 31, 2008 was \$265,000 and \$1.2 million, as compared to \$130,000 and \$425,000 in the comparable periods of 2007. The increase in tax expense is attributable to higher pre-tax income in the three and nine months ended July 31, 2008 compared to the similar periods of 2007.

#### *EBITDA*

EBITDA (defined as net income less interest, plus taxes, depreciation and amortization) increased by 18.0% and 84.5% to \$1.3 million and \$5.2 million in the three and nine months ended July 31, 2008 from \$1.1 million and \$2.8 million for the comparable period of 2007. The increase in the EBITDA is due to the same factors affecting net income, for reasons which are noted above.

EBITDA is reconciled to net income as follows:

*in thousands of Canadian dollars*

	Three months ended July 31,		Nine months ended July 31,	
	2008	2007	2008	2007
Net income	\$581	\$404	\$2,562	\$1,006
Interest	(151)	(109)	(390)	(370)
Amortization of deferred software development	288	248	865	704
Depreciation and amortization	215	201	599	503
Amortization of intangible assets	122	245	366	573
Income tax	265	130	1,239	425
<b>EBITDA</b>	<b>\$1,320</b>	<b>\$1,119</b>	<b>\$5,241</b>	<b>\$2,841</b>

### ***Net Income***

Net income increased by 43.9% and 154.6% to \$581,000 and \$2.6 million for the three and nine months ended July 31, 2008 versus \$404,000 and \$1.0 million for the three and nine months ended July 31, 2007. The increased net income is the result of increases in total revenue outpacing total expense growth. In the most recent quarter, the Company's commitment to producing more games, increasing the breadth of the product line and supplementing the service delivery capability has resulted in increased software development and support expense as well as higher depreciation and amortization charges.

Basic earnings per share was \$0.04 and diluted earnings per share were \$0.03 for the three months ended July 31, 2008. For the nine months ended July 31, 2008, basic earnings per share was \$0.14 and diluted earnings per share were \$0.13. In the three and nine months ended July 31, 2007, basic and diluted earnings per share were both \$0.02 and \$0.05. The increase in earnings per share over the comparable periods in the prior year is the result of higher net income.

### **Liquidity and Capital Resources**

#### ***Operating Activities***

Operating cash flow for the three and nine months ended July 31, 2008 was \$3.2 and \$8.3 million compared to \$590,000 and \$3.8 million for the same periods in 2007. Before adjustments due to working capital, and before an adjustment for restricted cash, cash flow from operations increased in both periods to \$1.3 and \$4.8 million from \$1.0 and \$2.4 million. The increase reflects the higher net income compared with the same periods in 2007.

#### ***Financing Activities***

Cash flows used in financing activities were \$nil and \$442,000 for the three and nine months ended July 31, 2008 compared to cash flows from financing activities of \$34,000 and \$200,000 for the same periods of 2007. The Company used cash in financing activities in 2008 as it commenced a Normal Course Issuer Bid and repurchased shares for cancellation. The Company did not repurchase any shares in the comparable period in 2007.

#### ***Investing Activities***

Cash flows used in investing activities were \$4.4 and \$9.9 million in the three and nine months ended July 31, 2008 and \$940,000 and \$2.1 million for the comparable periods of 2007. The Company's investing activities in the first three quarters of 2008 consisted mainly of the purchase of short term investments following the positive cash flow from operations, as well as the purchase of ECM and property and equipment. The Company did not defer any software development expense in 2008 as compared to deferring a total of \$487,000 in the nine months ended July 31, 2007.

### **Contractual Obligations**

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

2008	\$263,000
2009	\$950,000
2010	\$185,000
2011	\$ 63,000
2012	\$ 56,000
Thereafter	\$ 93,000

## **Related Party Transactions**

For the three and nine months ended July 31, 2008, the Company incurred legal fees to a firm which a certain director of the Company is a partner in the normal course of business of \$12,000 and \$54,000 as compared to \$nil and \$312,000 in each of the comparable periods of 2007. The Company incurred sales and marketing consultancy fees to a certain director and officer of \$31,000 and \$93,000 as compared to the \$31,000 and \$93,000 in the respective periods of 2007. In addition, general and administrative consulting fees of \$10,000 and \$31,000 to a certain director and officer as compared to \$10,000 and \$61,000 to a certain director and officer as well as a former officer in the respective periods in 2007. These transactions were measured at the exchange amount which approximate fair value and are recorded in software development, sales and marketing, and general administrative expenses. As at July 31, 2008, all amounts have been paid.

## **Normal Course Issuer Bid**

On January 25, 2008, the Company announced that it has filed with the Toronto Stock Exchange (the TSX) a notice of its intention to make a normal course issuer bid (the NCIB) for its Common Shares through the facilities of the TSX (the Notice).

The Notice provides that Chartwell may, during the twelve-month period commencing February 1, 2008, purchase on the TSX up to 1,725,000 Common Shares, being approximately 10% of the "public float" (as defined in the policies of the TSX) as at the date of filing the Notice with the TSX. As at January 15, 2008, Chartwell had 18,845,089 issued and outstanding Common Shares. The price that Chartwell will pay for any such Common Shares will be the market price at the time of acquisition and any Common Shares purchased under the NCIB will be cancelled. The actual number of Common Shares that may be purchased and the timing of any such purchases will be determined by Chartwell. Chartwell's previous NCIB expired on September 25, 2006; accordingly, no Common Shares had been repurchased by the Corporation prior to February 1, 2008.

The average daily trading volume of Chartwell over the previous six months (July to December, 2007) was 20,976 Common Shares (the "ADTV"). Under TSX rules, Chartwell may purchase up to 25% of the ADTV per trading day. Accordingly, daily purchases will be limited to a maximum of 5,244 Common Shares, other than purchases pursuant to block purchase exceptions.

As of September 10, 2008, the Company has purchased 401,500 shares at an average cost of \$1.58 which it either has or intends to cancel.

A copy of the Notice may be obtained by any shareholder of Chartwell, without charge, by contacting Chartwell's head office and will be available for reviewing on the SEDAR website at [www.sedar.com](http://www.sedar.com).

## **Changes in accounting policies including initial adoption**

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, 2007.

On November 1, 2007, Company adopted the new CICA Handbook Section 3862, "Financial Instruments – Disclosures" and Section 3863, "Financial Instruments - Presentation", and Section 1535, "Capital Disclosures" on a prospective basis.

Section 3862 requires disclosures in the financial statements that will enable users to evaluate: the significance of financial instruments for a Company's financial position and performance; and the nature and extent of risks arising from financial instruments to which a Company is exposed during the period and at the balance sheet date, and how a Company manages those risks. This accounting standard is effective for fiscal years beginning after October 1, 2007.

Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. This section compliments the existing CICA Handbook Section 3861 - Financial Instruments - Disclosure and Presentation and is effective for fiscal years beginning on or after October 1, 2007.

Section 1535 establishes standards for disclosing information about a Company's capital and how it is managed to enable users of the financial statements to evaluate the Company's objectives, policies and procedures for managing capital. This section is effective for the fiscal years beginning on or after October 1, 2007.

The adoption of these new accounting standards did not impact the amounts in the Company's financial statements as they primarily relate to disclosure.

The CICA implemented revisions to standards dealing with Intangible Assets effective for fiscal years beginning on or after October 1, 2008. The revisions are intended to align the definition of an Intangible Asset in Canadian GAAP with that in IFRS and U.S. GAAP. Section 1000 - Financial Statement Concepts was revised to remove material that permitted the recognition of assets that might not otherwise meet the definition of an asset and to add guidance from the IASB's Framework for the Preparation and Presentation of Financial Statements that will help distinguish assets from expenses. Section 3064 - Goodwill and Intangible Assets, which replaced Section 3062 - Goodwill and Other Intangible Assets, gives guidance on the recognition of intangible assets as well as the recognition and measurement of internally developed intangible assets. Section 3450 - Research and Development Costs will be withdrawn from the Handbook. The Company does not expect these changes to have a material effect on its financial statements.

With the Canadian Accounting Standards Board's recent announcement that January 1, 2011 as the date International Financial Reporting Standards ("IFRS") will replace current Canadian GAAP for publicly accountable enterprises, the Company has been carefully evaluating its own implementation plan and assessing the impact the numerous accounting changes will have on the organization. As the final implementation date approaches, the Company will continue to monitor developments.

## **Risks and Uncertainties**

Important risk factors that could cause actual results, performance or achievements to be materially different than past performance or those implied by forward looking statements include:

- Uncertainty as to the degree of new and continuing market acceptance of our products
- Our products could contain defects that lead to costs, damage of reputation or litigation
- Our dependence on customer performance
- Uncertainty regarding future profitability
- Uncertainty regarding the pricing, reporting and collection of accounts
- Risk associated with sales in foreign countries and government policy and regulation therein
- Our ability to diligently ensure that our customers operate in accordance with the terms of our license agreements that require observation of the laws of Canada and foreign countries
- Our ability to attract and retain key personnel

For further information on the Company's risks and uncertainties, see the Company's 2007 Annual Information Form available at [www.sedar.com](http://www.sedar.com).

## **Proposed Transactions**

There is no proposed asset or business acquisition or disposition transactions pending as at July 31, 2008.

## **Off Balance Sheet Arrangements**

As at July 31, 2008, the Company has not entered into any off balance sheet arrangements

## **Financial Instruments and Other Instruments**

The Company's financial instruments consist of cash, short term investments, accounts receivable, accounts payable and accrued liabilities, and income taxes receivable or payable. The fair values of these financial instruments approximate their carrying values. It is management's opinion that the Company is not exposed to significant interest rate risk. The Company's credit risk lies in its accounts receivable where the balances due reflect a concentration among a relatively small number of accounts. The Company's short term investments consist primarily of investments in low risk corporate and government obligations.

Most of the Company's revenue is earned in foreign currencies and is exposed to currency fluctuations. The Company will engage from time to time in foreign exchange collars. As of July 31, 2008, the Company had entered into several Euro denominated foreign exchange collars.

## **Other MD&A Requirements**

The Company evaluated the effectiveness and design of its disclosure controls and procedures for the period ended July 31, 2008, and based on this evaluation (which included testing of the key controls by examining evidence demonstrating their existence on a test basis) have determined these controls to be effective.

The Corporation's financial reporting procedures and practices have enabled the certification of Chartwell Technology Inc.'s annual and interim filings in compliance with Multilateral Instrument 52-109 "Certification of Disclosure in Issuers' Annual and Interim Filings". Management has designed such internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements and other annual and interim filings in accordance with Canadian Generally Accepted Accounting Principles, except as noted below.

Given the size of the Company, the evaluation of the design of internal controls over financial reporting for the Company resulted in the identification of the following weaknesses:

Management is aware that due to its relatively small scale of operations there is a lack of segregation of duties due to a limited number of employees dealing with accounting and financial matters. However, management has concluded that considering the employees involved and the control procedures in place, including management and Audit Committee oversight, risks associated with such lack of segregation are not significant enough to justify the expense associated with adding employees to clearly segregate duties.

Management is aware that in-house expertise to deal with complex taxation, accounting and reporting issues may not be sufficient. The Company requires outside assistance and advice on new accounting pronouncements and complex accounting and reporting issues, which is common with companies of a similar size.

There have been no significant changes to the Company's internal control over financial reporting that occurred during the most recent period that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company has 18,595,723 Common Shares outstanding at September 10, 2008. If all of the Company's options were exercised, the Company would have 20,701,723 Common Shares outstanding.

The Company's 2007 Annual Information Form is available on [www.sedar.com](http://www.sedar.com).



## **CHARTWELL TECHNOLOGY INC.**

**Management's Discussion and Analysis of Financial Condition and Results of Operations  
for the three and nine months ended July 31, 2008 and 2007.**

**September 10, 2008**

## **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) unaudited Consolidated Financial Statements for the three and nine months ended July 31, 2008. It should also be read in conjunction with the audited Consolidated Financial Statements and the accompanying notes for the year ended October 31, 2007, 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 consolidation 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 securities legislation. 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 remote platforms. Chartwell's JAVA and Flash based software products and games are designed for deployment in gaming, entertainment and promotional applications.

### **Business Plan**

The Company's business plan and objectives through fiscal 2008 are to continue to increase our market share in the traditional internet Casino market with a continued emphasis on the European market; endeavour to license our software to the larger European operators; further develop the liquidity of our Poker community; penetrate new markets including Asia; launch a Linked Progressive Jackpot (LPJ) and seek out potential gaming operators who have large consumer databases.

Overall we intend to expand the range of products and services we provide through in-house development and through selected acquisitions and joint ventures. In order to grow and remain a leading software provider in a competitive market, we must continue to offer an expanding variety of new and innovative products and services that enhance the gaming experience in order to help our customers attract, and retain players.

### **Business Model**

The majority of Chartwell's revenue is in the form of software license fees most of which are contingent upon customer usage and are recognized on an accrual basis as earned over the life of the contract. 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. 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.

Software set-up fee revenue and the related costs for the initial design, construction and implementation of the gaming software are recognized ratably over the initial term of the contract.

Service revenue is generated from a variety of activities including custom software development, network administration, hosting and fully managed services. Software development fees are fees that the Company charges for custom software development and are recognized on a percentage of completion basis. The Company provides network administration services for fixed monthly rates and these fees are reported along with service fees on an accrual basis during the period of service. Following the acquisition of Elite Club Management N.V. (ECM), the Company includes hosting and fully managed services revenue in its consolidated service revenue. Hosting fees are fixed monthly fees and are recorded in service revenue on an accrual basis. Fully managed services are offered to software licensees whereby the Company provides varying levels of management support services. The fully managed services fees are based on the participants' level of activity and are recognized on an accrual basis. Prior to the ECM acquisition, and following the Poker Community Management Business acquisition in February of 2007, the company recognized Poker community management service revenue. This revenue was for the management of the Poker community for the benefit of ECM sub-licensees which following the acquisition of ECM, is no longer recognized on a consolidated basis.

Expenses are classified into eight categories, namely: software development and support; sales and marketing; general and administrative; amortization of deferred software development costs; stock-based compensation expense; depreciation and amortization; amortization of intangible assets; 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, first level support for fully managed services customers of the Poker community, second level support for both casino and poker products, hosting costs for the Poker, Bingo and LPJ communities paid to hosting providers, 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. General and administrative expenses include the costs of all administrative, financial and information technology

(IT) support 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. Depreciation and amortization charges are based on the estimated useful life of the respective assets and include the amortization of deferred software development costs and intangible assets. The Company operates internationally with all of its revenue derived from non-Canadian licensees. Under the Company's licensing agreements, the majority of the Company's revenue is received in UK Pounds Sterling and Euros. Consequently, the Company is exposed to currency fluctuations, which result in foreign currency gains or losses, which are reported in that expense category.

## **HIGHLIGHTS**

Total revenue for the three and nine months ended July 31, 2008 was \$6.1 and \$18.9 million compared to \$5.3 and \$16.3 million for the same periods a year earlier. Net income was \$0.6 and \$2.6 million for the three and nine months ended July 31, 2008 as compared to \$0.4 and \$1.0 million for the same period in the prior year with basic earnings per share of \$0.04 and diluted earnings per share of \$0.03 in the third quarter and \$0.14 of basic earnings per share and \$0.13 of diluted earnings per share for the first three quarters of 2008. This compares to \$0.02 in the third quarter of 2007 and \$0.05 for the nine months ended July 31, 2007 for both basic and diluted earnings per share.

Total expenses increased by 11.8% in the third quarter as compared to the third quarter of 2007. The majority of this increase is the result of hiring additional staff to broaden the Company's product base, the expense of operating the additional services following the ECM acquisition, and additional expense to improve the overall service that our clients receive. Specifically, we've added several new staff to introduce a Bingo product, as well as to continue to deliver on our aggressive Casino product roadmap.

In the third quarter, the Company announced that it had received both its Remote and Non-Remote Gaming License from the Gambling Commission in the UK. Chartwell was the first on-line gaming software provider to receive such licenses, which demonstrates our commitment to be at the forefront of remote gaming regulation.

Chartwell maintains a strong balance sheet. At July 31, 2008 the Company had cash and short-term investments of \$21.7 million, working capital (defined as current assets less current liabilities) of \$22.9 million and no debt.

## 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.

	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007	Q4 2006
<b>Revenue</b>								
Software license fees	\$5,695	\$6,459	\$5,582	\$4,651	\$5,019	\$5,334	\$5,289	\$4,367
Software set-up fees	19	43	25	45	81	55	55	111
Service fees	276	340	29	74	61	53	6	-
Interest and other	151	142	139	122	109	120	147	224
	<u>6,141</u>	<u>6,984</u>	<u>5,775</u>	<u>4,892</u>	<u>5,270</u>	<u>5,562</u>	<u>5,498</u>	<u>4,702</u>
<b>Expenses</b>								
Software development and support	3,084	2,833	2,305	2,182	2,439	2,357	2,470	2,394
Sales and marketing	573	603	745	663	740	716	924	618
General and administrative	874	989	788	1,124	775	1,292	1,021	1,502
Amortization of deferred software development costs	288	288	288	238	248	284	172	58
Impairment of deferred software development costs	-	-	-	543	-	-	-	-
Stock-based compensation	144	371	139	108	(149)	139	133	139
Depreciation and amortization	215	211	173	224	201	187	115	117
Amortization of intangible assets	122	122	122	171	245	205	123	124
Impairment of intangible assets	-	-	-	872	-	-	-	-
Foreign currency loss (gain)	(5)	(104)	(67)	439	237	298	(273)	48
	<u>5,295</u>	<u>5,313</u>	<u>4,492</u>	<u>6,564</u>	<u>4,736</u>	<u>5,478</u>	<u>4,685</u>	<u>5,000</u>
<b>Net income (loss) before taxes</b>	846	1,671	1,283	(1,672)	534	84	813	(298)
Income tax expense (recovery)	265	621	353	(578)	130	(23)	318	(77)
<b>Net income (loss)</b>	<u>\$581</u>	<u>\$1,050</u>	<u>\$930</u>	<u>(\$1,094)</u>	<u>\$404</u>	<u>\$107</u>	<u>\$495</u>	<u>(\$221)</u>
<b>Basic earnings per share</b>	\$0.04	\$0.05	\$0.05	(\$0.07)	\$0.02	\$0.01	\$0.03	(\$0.01)
<b>Diluted earnings per share</b>	\$0.03	\$0.05	\$0.05	(\$0.07)	\$0.02	\$0.01	\$0.03	(\$0.01)

## **QUARTERLY RESULTS**

### **FOR THE THREE AND NINE MONTHS ENDED JULY 31, 2008 COMPARED TO THE THREE AND NINE MONTHS ENDED JULY 31, 2007**

#### ***Revenue***

In the three and nine months ended July 31, 2008, total revenue increased by 16.5% and 15.7% to \$6.1 million and \$18.9 million compared to \$5.3 million and \$16.3 million in the same periods of 2007. The increase in total revenue in both periods was due to an increase in software license fees and an increase in services revenue following the ECM acquisition.

Software license fees increased by 13.5% and 13.4% to \$5.7 million and \$17.7 million in the three and nine months ending July 31, 2008 over the comparable periods in 2007. Licensing from our Casino product grew by 9.9% and 8.2%, while licensing from our Poker product grew by 52.0% and 76.7% in the three and nine months ended July 31, 2008 compared to the same period in 2007. Poker represented 11.4% and 11.8% of total software license fees in the three and nine months ended July 31, 2008, as compared to 8.5% and 7.6% in the same periods in 2007. The quarter over quarter increase in software license revenue is due to organic growth from existing customers despite the loss of revenue from one significant licensee in the quarter. Organic growth in the quarter was supported by the Euro 2008 football tournament and the increased traffic this generated on our clients' sports betting operations, which our casino products benefitted from. Poker license revenue has grown substantially from prior years, however the Company's Poker community, PokerNexus, is affected by the same market conditions that affect other European Poker networks. In this market, there is a saturation of Poker operators, some of whom finance their growth in Europe with revenue generated from US players. Chartwell prohibits the participants of PokerNexus from accepting US players.

Software set-up fees decreased by 76.3% and 54.0% to \$19,000 and \$81,000 from \$81,000 and \$191,000 for the three and nine months ended July 31, 2008 and 2007, respectively. The decrease is due to the initial contract term expiring for customers for whom set-up fees were being recognized.

Service fee revenue now includes the Fully Managed Services (FMS) and hosting revenue following the ECM acquisition. Additional services revenue from consolidating ECM was \$274,000 and \$244,000 in the second and third quarter of 2008, respectively.

Interest and other income increased by 25.0% and 1.1% to \$151,000 and \$202,000 in the three and nine months ended July 31, 2008. The increase is due to additional interest from a higher balance of short term investments following the Company's strong positive cash flow.

#### ***Expenses***

Total expenses other than income tax expense increased by 11.8% and 1.4% to \$5.3 and \$15.1 million for the three and nine months ended July 31, 2008 compared to \$4.7 and \$14.9 million for the same periods of 2007. The increased expense in the most recent quarter is the result of increased software development and support expense as the Company continues to invest in new products and improving the support it provides to existing licensees. The Company also had higher stock based compensation expense offset by a foreign exchange gain (versus a foreign exchange loss) and lower amortization of intangible assets in the third quarter as compared to the same quarter in 2007.

#### ***SOFTWARE DEVELOPMENT AND SUPPORT***

Software development and support expense increased by 26.4% and 13.2% to \$3.1 million and \$8.2 million for the three and nine months ended July 31, 2008 compared to \$2.4 million and \$7.3 million for the same periods of 2007. No software development expenses were deferred in 2008, compared to \$487,000 deferred in the first three quarters of 2007. Comparing software development and support expense before the deferred software development in the prior year, there was an increase of 21.7%, or \$530,000 in the third quarter of 2008, and an increase of 6.5%, or \$469,000, in the first three quarters of 2008 as compared to the same periods in the prior year. The increase in

software development and support expenses in the third quarter is the result of the increased expense in providing the FMS line of business following the acquisition of ECM, as well as additional staffing for the integration and quality assurance of the Bingo product and community.

As a percentage of revenue, software development and support expenses were 50.2% and 43.5% for the three and nine months ended July 31, 2008 compared to 46.3% and 44.5% for the same periods in 2007, respectively.

#### *SALES AND MARKETING*

For the three and nine months ended July 31, 2008, sales and marketing expenses decreased by 22.5% and 19.3% to \$573,000 and \$1.9 million from \$740,000 and \$2.4 million in the same periods of 2007. The decrease is due to reduced salary expense as well as reduced rent and overall operating costs as the Company focused its sales and marketing efforts out of Malta to be closer to the majority of our customers.

As a percentage of revenue, sales and marketing expenses decreased to 9.3% and 10.2% from 14.0% and 14.6% for the three and nine months ended July 31, 2008 from the same periods in 2007, respectively.

#### *GENERAL AND ADMINISTRATIVE*

For the three months ended July 31, 2008, general and administrative expenses increased by 12.7% from \$775,000 to \$874,000. The increase in the third quarter is the result of increased professional fees from managing numerous corporate initiatives that included establishing the legal framework for the LPJ and Bingo communities, and several engagements focused on managing the Company's tax compliance. In the nine months ended July 31, 2008, general and administrative expenses decreased by \$437,000, or 14.2% from \$3.1 million to \$2.7 million. The nine month period was effected by the above conditions as well as benefited from overall reduced salary expense despite the addition of administrative staff with the ECM acquisition, reduced consulting fees for accounting services, and the fact that the prior year period included a non-recurring charge for the revaluation of a note receivable.

As a percentage of revenue, general and administrative expenses increased slightly to 14.2% from 14.0% in the three months ended July 31, 2007 as compared to the comparable period in 2007. For the nine months ended July 31, 2008, general and administrative expense as a percentage of revenue decreased to 14.7% from 18.9%.

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

Amortization of deferred software development costs for the three and nine months ended July 31, 2008 was \$288,000 and \$865,000 compared to \$248,000 and \$704,000 for the comparable periods in 2007. The increase in amortization reflects the amortization of deferred software development costs of version 2.0 of the Poker product. All of the deferred software development relates to version 2.0 of the Poker product, which builds on the intellectual property acquired in the acquisition of Micropower Corporation (Micropower). Management has estimated the appropriate amortization period to be three years. While the Company continues to invest in developing the Poker, Casino and other products, it has not deferred any costs related to this development in fiscal 2008.

#### *STOCK-BASED COMPENSATION*

The Company recorded \$144,000 and \$654,000 of stock-based compensation expense for the three and nine months ended July 31, 2008 compared to a recovery of \$149,000 and an expense of \$123,000 for the comparable periods in 2007. 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 expense recovery in the comparable period in 2007 was the result of forfeited stock options, in addition, the year over year increase is due to additional options granted late in 2007 as well as the revaluation of options that were granted and unexercised to contractors that are revalued at quarter end where the share price was higher than in previous quarters.

#### *DEPRECIATION AND AMORTIZATION*

Depreciation and amortization expenses increased by 7.3% and 19.2% to \$215,000 and \$599,000 for the three and nine months ended July 31, 2008 as compared to \$201,000 and \$503,000 in the similar periods of 2007. This increased depreciation is due to the assets acquired for the LPJ and Bingo communities as well as the assets acquired along with the acquisition of ECM. It is expected that continued investment in computer hardware and software will be required as the Company continues to grow.

#### *AMORTIZATION OF INTANGIBLE ASSETS*

Amortization of intangible assets relates to the customer contracts and intellectual property acquired in the acquisition of Micropower and the Poker Community Management business. The expense for the three and nine months ended July 31, 2008 decreased to \$122,000 and \$366,000 from \$245,000 and \$573,000 for the same periods in 2007. The decrease in fiscal 2008 is the result of the Company eliminating the remaining balance of intangible assets resulting from the Micropower acquisition late in fiscal 2007. 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 the Company). The value recorded for intellectual property acquired from the Poker Community Management business is being amortized over three years, which is Management's best estimate of the time period that the acquired intellectual property will provide future value to the Company.

#### *FOREIGN CURRENCY GAIN*

The Company recognized a foreign currency gain of \$5,000 and \$177,000 in the three and nine months ended July 31, 2008 as compared to a foreign currency loss of \$237,000 and \$263,000 for the comparable periods of 2007. The foreign currency gains experienced in 2008 reflect foreign denominated amounts receivable translated into Canadian dollar equivalents at higher foreign exchange rates than in the past, as well as gains in the value of cash balances of foreign currencies as the Canadian dollar weakened against foreign currencies. The Company began actively hedging some of the foreign currency risk at the start of fiscal 2008.

#### *PROVISION FOR INCOME TAXES*

Income tax expense for the three and nine months ended July 31, 2008 was \$265,000 and \$1.2 million, as compared to \$130,000 and \$425,000 in the comparable periods of 2007. The increase in tax expense is attributable to higher pre-tax income in the three and nine months ended July 31, 2008 compared to the similar periods of 2007.

#### *EBITDA*

EBITDA (defined as net income less interest, plus taxes, depreciation and amortization) increased by 18.0% and 84.5% to \$1.3 million and \$5.2 million in the three and nine months ended July 31, 2008 from \$1.1 million and \$2.8 million for the comparable period of 2007. The increase in the EBITDA is due to the same factors affecting net income, for reasons which are noted above.

EBITDA is reconciled to net income as follows:

*in thousands of Canadian dollars*

	Three months ended July 31,		Nine months ended July 31,	
	2008	2007	2008	2007
Net income	\$581	\$404	\$2,562	\$1,006
Interest	(151)	(109)	(390)	(370)
Amortization of deferred software development	288	248	865	704
Depreciation and amortization	215	201	599	503
Amortization of intangible assets	122	245	366	573
Income tax	265	130	1,239	425
<b>EBITDA</b>	<b>\$1,320</b>	<b>\$1,119</b>	<b>\$5,241</b>	<b>\$2,841</b>

### ***Net Income***

Net income increased by 43.9% and 154.6% to \$581,000 and \$2.6 million for the three and nine months ended July 31, 2008 versus \$404,000 and \$1.0 million for the three and nine months ended July 31, 2007. The increased net income is the result of increases in total revenue outpacing total expense growth. In the most recent quarter, the Company's commitment to producing more games, increasing the breadth of the product line and supplementing the service delivery capability has resulted in increased software development and support expense as well as higher depreciation and amortization charges.

Basic earnings per share was \$0.04 and diluted earnings per share were \$0.03 for the three months ended July 31, 2008. For the nine months ended July 31, 2008, basic earnings per share was \$0.14 and diluted earnings per share were \$0.13. In the three and nine months ended July 31, 2007, basic and diluted earnings per share were both \$0.02 and \$0.05. The increase in earnings per share over the comparable periods in the prior year is the result of higher net income.

### **Liquidity and Capital Resources**

#### ***Operating Activities***

Operating cash flow for the three and nine months ended July 31, 2008 was \$3.2 and \$8.3 million compared to \$590,000 and \$3.8 million for the same periods in 2007. Before adjustments due to working capital, and before an adjustment for restricted cash, cash flow from operations increased in both periods to \$1.3 and \$4.8 million from \$1.0 and \$2.4 million. The increase reflects the higher net income compared with the same periods in 2007.

#### ***Financing Activities***

Cash flows used in financing activities were \$nil and \$442,000 for the three and nine months ended July 31, 2008 compared to cash flows from financing activities of \$34,000 and \$200,000 for the same periods of 2007. The Company used cash in financing activities in 2008 as it commenced a Normal Course Issuer Bid and repurchased shares for cancellation. The Company did not repurchase any shares in the comparable period in 2007.

#### ***Investing Activities***

Cash flows used in investing activities were \$4.4 and \$9.9 million in the three and nine months ended July 31, 2008 and \$940,000 and \$2.1 million for the comparable periods of 2007. The Company's investing activities in the first three quarters of 2008 consisted mainly of the purchase of short term investments following the positive cash flow from operations, as well as the purchase of ECM and property and equipment. The Company did not defer any software development expense in 2008 as compared to deferring a total of \$487,000 in the nine months ended July 31, 2007.

### **Contractual Obligations**

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

2008	\$263,000
2009	\$950,000
2010	\$185,000
2011	\$ 63,000
2012	\$ 56,000
Thereafter	\$ 93,000

## **Related Party Transactions**

For the three and nine months ended July 31, 2008, the Company incurred legal fees to a firm which a certain director of the Company is a partner in the normal course of business of \$12,000 and \$54,000 as compared to \$nil and \$312,000 in each of the comparable periods of 2007. The Company incurred sales and marketing consultancy fees to a certain director and officer of \$31,000 and \$93,000 as compared to the \$31,000 and \$93,000 in the respective periods of 2007. In addition, general and administrative consulting fees of \$10,000 and \$31,000 to a certain director and officer as compared to \$10,000 and \$61,000 to a certain director and officer as well as a former officer in the respective periods in 2007. These transactions were measured at the exchange amount which approximate fair value and are recorded in software development, sales and marketing, and general administrative expenses. As at July 31, 2008, all amounts have been paid.

## **Normal Course Issuer Bid**

On January 25, 2008, the Company announced that it has filed with the Toronto Stock Exchange (the TSX) a notice of its intention to make a normal course issuer bid (the NCIB) for its Common Shares through the facilities of the TSX (the Notice).

The Notice provides that Chartwell may, during the twelve-month period commencing February 1, 2008, purchase on the TSX up to 1,725,000 Common Shares, being approximately 10% of the "public float" (as defined in the policies of the TSX) as at the date of filing the Notice with the TSX. As at January 15, 2008, Chartwell had 18,845,089 issued and outstanding Common Shares. The price that Chartwell will pay for any such Common Shares will be the market price at the time of acquisition and any Common Shares purchased under the NCIB will be cancelled. The actual number of Common Shares that may be purchased and the timing of any such purchases will be determined by Chartwell. Chartwell's previous NCIB expired on September 25, 2006; accordingly, no Common Shares had been repurchased by the Corporation prior to February 1, 2008.

The average daily trading volume of Chartwell over the previous six months (July to December, 2007) was 20,976 Common Shares (the "ADTV"). Under TSX rules, Chartwell may purchase up to 25% of the ADTV per trading day. Accordingly, daily purchases will be limited to a maximum of 5,244 Common Shares, other than purchases pursuant to block purchase exceptions.

As of September 10, 2008, the Company has purchased 401,500 shares at an average cost of \$1.58 which it either has or intends to cancel.

A copy of the Notice may be obtained by any shareholder of Chartwell, without charge, by contacting Chartwell's head office and will be available for reviewing on the SEDAR website at [www.sedar.com](http://www.sedar.com).

## **Changes in accounting policies including initial adoption**

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, 2007.

On November 1, 2007, Company adopted the new CICA Handbook Section 3862, "Financial Instruments – Disclosures" and Section 3863, "Financial Instruments - Presentation", and Section 1535, "Capital Disclosures" on a prospective basis.

Section 3862 requires disclosures in the financial statements that will enable users to evaluate: the significance of financial instruments for a Company's financial position and performance; and the nature and extent of risks arising from financial instruments to which a Company is exposed during the period and at the balance sheet date, and how a Company manages those risks. This accounting standard is effective for fiscal years beginning after October 1, 2007.

Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. This section compliments the existing CICA Handbook Section 3861 - Financial Instruments - Disclosure and Presentation and is effective for fiscal years beginning on or after October 1, 2007.

Section 1535 establishes standards for disclosing information about a Company's capital and how it is managed to enable users of the financial statements to evaluate the Company's objectives, policies and procedures for managing capital. This section is effective for the fiscal years beginning on or after October 1, 2007.

The adoption of these new accounting standards did not impact the amounts in the Company's financial statements as they primarily relate to disclosure.

The CICA implemented revisions to standards dealing with Intangible Assets effective for fiscal years beginning on or after October 1, 2008. The revisions are intended to align the definition of an Intangible Asset in Canadian GAAP with that in IFRS and U.S. GAAP. Section 1000 - Financial Statement Concepts was revised to remove material that permitted the recognition of assets that might not otherwise meet the definition of an asset and to add guidance from the IASB's Framework for the Preparation and Presentation of Financial Statements that will help distinguish assets from expenses. Section 3064 - Goodwill and Intangible Assets, which replaced Section 3062 - Goodwill and Other Intangible Assets, gives guidance on the recognition of intangible assets as well as the recognition and measurement of internally developed intangible assets. Section 3450 - Research and Development Costs will be withdrawn from the Handbook. The Company does not expect these changes to have a material effect on its financial statements.

With the Canadian Accounting Standards Board's recent announcement that January 1, 2011 as the date International Financial Reporting Standards ("IFRS") will replace current Canadian GAAP for publicly accountable enterprises, the Company has been carefully evaluating its own implementation plan and assessing the impact the numerous accounting changes will have on the organization. As the final implementation date approaches, the Company will continue to monitor developments.

## **Risks and Uncertainties**

Important risk factors that could cause actual results, performance or achievements to be materially different than past performance or those implied by forward looking statements include:

- Uncertainty as to the degree of new and continuing market acceptance of our products
- Our products could contain defects that lead to costs, damage of reputation or litigation
- Our dependence on customer performance
- Uncertainty regarding future profitability
- Uncertainty regarding the pricing, reporting and collection of accounts
- Risk associated with sales in foreign countries and government policy and regulation therein
- Our ability to diligently ensure that our customers operate in accordance with the terms of our license agreements that require observation of the laws of Canada and foreign countries
- Our ability to attract and retain key personnel

For further information on the Company's risks and uncertainties, see the Company's 2007 Annual Information Form available at [www.sedar.com](http://www.sedar.com).

## **Proposed Transactions**

There is no proposed asset or business acquisition or disposition transactions pending as at July 31, 2008.

## **Off Balance Sheet Arrangements**

As at July 31, 2008, the Company has not entered into any off balance sheet arrangements

## **Financial Instruments and Other Instruments**

The Company's financial instruments consist of cash, short term investments, accounts receivable, accounts payable and accrued liabilities, and income taxes receivable or payable. The fair values of these financial instruments approximate their carrying values. It is management's opinion that the Company is not exposed to significant interest rate risk. The Company's credit risk lies in its accounts receivable where the balances due reflect a concentration among a relatively small number of accounts. The Company's short term investments consist primarily of investments in low risk corporate and government obligations.

Most of the Company's revenue is earned in foreign currencies and is exposed to currency fluctuations. The Company will engage from time to time in foreign exchange collars. As of July 31, 2008, the Company had entered into several Euro denominated foreign exchange collars.

## **Other MD&A Requirements**

The Company evaluated the effectiveness and design of its disclosure controls and procedures for the period ended July 31, 2008, and based on this evaluation (which included testing of the key controls by examining evidence demonstrating their existence on a test basis) have determined these controls to be effective.

The Corporation's financial reporting procedures and practices have enabled the certification of Chartwell Technology Inc.'s annual and interim filings in compliance with Multilateral Instrument 52-109 "Certification of Disclosure in Issuers' Annual and Interim Filings". Management has designed such internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements and other annual and interim filings in accordance with Canadian Generally Accepted Accounting Principles, except as noted below.

Given the size of the Company, the evaluation of the design of internal controls over financial reporting for the Company resulted in the identification of the following weaknesses:

Management is aware that due to its relatively small scale of operations there is a lack of segregation of duties due to a limited number of employees dealing with accounting and financial matters. However, management has concluded that considering the employees involved and the control procedures in place, including management and Audit Committee oversight, risks associated with such lack of segregation are not significant enough to justify the expense associated with adding employees to clearly segregate duties.

Management is aware that in-house expertise to deal with complex taxation, accounting and reporting issues may not be sufficient. The Company requires outside assistance and advice on new accounting pronouncements and complex accounting and reporting issues, which is common with companies of a similar size.

There have been no significant changes to the Company's internal control over financial reporting that occurred during the most recent period that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company has 18,595,723 Common Shares outstanding at September 10, 2008. If all of the Company's options were exercised, the Company would have 20,701,723 Common Shares outstanding.

The Company's 2007 Annual Information Form is available on [www.sedar.com](http://www.sedar.com).