



**BRIDGEWATER SYSTEMS CORPORATION**  
**MANAGEMENTS'S DISCUSSION AND ANALYSIS**

**DATED: May 14, 2008**

*The following discussion and analysis provides management's discussion and analysis ("MD&A") of Bridgewater Systems Corporation's consolidated results of operations and financial condition. This discussion should be read in conjunction with the Company's unaudited consolidated financial statements for the three month period ended March 31, 2008. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and are reported in Canadian dollars. The information contained herein is dated as of May 14, 2008 and is current to that date, unless otherwise stated. Additional information relating to the Company may also be found on SEDAR at [www.sedar.com](http://www.sedar.com)*

*The Company's fiscal year commences January 1 of each year and ends on December 31.*

**FORWARD-LOOKING STATEMENTS**

Certain statements in this document may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this document, such statements use such words as "may", "will", "expect", "continue", "believe", "plan", "intend", "would", "could", "should", "anticipate" and other similar terminology. These statements reflect current assumptions and expectations regarding future events and operating performance and speak only as of the date of this document. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. A number of factors could cause actual results to vary significantly from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under "Risk Factors". Although the forward-looking statements contained in this document are based upon what we believe are reasonable assumptions, we cannot assure investors that our actual results will be consistent with these forward-looking statements. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances, except as required by securities law.

## SELECTED CONSOLIDATED FINANCIAL INFORMATION

### Consolidated Statements of Operation Information

	Three months ended March 31,	
	2008	2007
	(unaudited)	
	<i>(in thousands of dollars, except per share amounts and number of shares)</i>	
Revenue		
Product revenue.....	\$ 6,548	\$ 6,592
Service and support revenue.....	2,018	1,973
	<u>8,566</u>	<u>8,565</u>
Cost of sales.....	1,776	1,333
Gross margin.....	<u>6,790</u>	<u>7,232</u>
Expenses		
Sales and marketing.....	3,289	3,564
Research and development.....	4,344	2,811
General and administration.....	997	570
Stock-based compensation expense.....	41	50
	<u>8,671</u>	<u>6,995</u>
(Loss) earnings before undernoted items.....	<u>(1,881)</u>	<u>237</u>
Foreign exchange gain (loss).....	808	(123)
Interest income.....	390	159
(Loss) earnings before income taxes.....	<u>(683)</u>	<u>273</u>
Future income tax recovery.....	-	-
Net (loss) earnings for the period.....	<u>\$ (683)</u>	<u>\$ 273</u>
(Loss) earnings per share - basic and diluted.....	\$ (0.03)	\$ 0.01
Weighted average number of shares outstanding - basic.....	22,303,427	18,429,132
Weighted average number of shares outstanding - diluted.....	22,303,427	20,687,196

### Consolidated Balance Sheet Information

	As at	As at
	March 31, 2008	December 31, 2007
	(unaudited)	
	<i>(in thousands of dollars)</i>	
Cash and cash equivalents.....	\$ 42,225	\$ 38,571 (1)
Accounts receivable.....	7,512	10,929
Working capital.....	41,504	41,694
Total assets.....	68,572	69,486
Deferred revenue.....	13,255	14,244
Shareholders' equity.....	51,584	52,018

(1) Cash and cash equivalents as at December 31, 2007 includes a note receivable of \$10,000,000.

## **Overview**

Bridgewater Systems Corporation (“Bridgewater”, “we” or the “Company”) is a leading provider of real-time subscriber management and service control solutions for broadband network service providers. Our solutions are deployed in over 100 service-provider networks worldwide, including leading wireless, wireline and converged service providers. Service providers implement our solutions to ensure secure access to their networks and to increase revenue through the rapid deployment of new applications and charging arrangements. For example, service providers have deployed our solutions to manage access to 2G / 3G data services and third-party multi-media content, support data roaming, manage access to IPTV platforms and services, and provide on-demand and modular service offerings. Bridgewater solutions enable service providers to accelerate the convergence of their networks and service platforms; they also provide operational efficiencies through centralized subscriber-management and service-control.

The core of Bridgewater’s solutions is real-time, high performance software. Our software provides a centralized data repository for critical subscriber information, including service entitlements, subscriber preferences and billing profiles. Based on this information, our software establishes policies to control how subscribers access networks and applications and ensure appropriate quality of service. Our software and solutions were first deployed in 1998. To help our service provider customers meet the growing consumer and enterprise demands for wireless data and broadband wireline services, we leverage our ten years of experience to include delivery of value-added integration and implementation services.

## **The Market**

Bridgewater markets its products globally to broadband service providers with a primary focus on operators of CDMA2000, GSM, WiMAX and wireline networks as well as operators pursuing fixed mobile convergence strategies. The Company benefits directly from growth in these core markets as the number of operators continues to increase, as the number of subscribers rises and as subscribers use advanced broadband applications and services such as streaming mobile video, ring-tone and music downloads and VoIP.

There are a number of trends driving demand for Bridgewater’s solutions.

Service providers are seeking solutions that better and more efficiently enable them to merchandise their network as they act to harness the increase in demand for broadband services and applications, while simultaneously investing to remain relevant in a highly competitive marketplace. Bridgewater products enable service providers to reduce their operating expenditures by consolidating their network and applications access control infrastructure, while at the same time allowing more targeted and personalized delivery of on and off-network content and services.

Service providers are moving to embrace open access business models. Adopting Bridgewater solutions enable them to retain subscriber ownership while concurrently monetizing network assets such as subscriber location, device type or demographic profile by delivering this highly valuable information to off-network content or service partners in real-time.

Globally, the evolution from 3G to 4G, such as WiMAX and LTE is creating demand for proven, carrier grade, subscriber data management, access control and policy solutions that individually and collectively are required functional components of the network. Bridgewater’s current products and services address transition from 3G to 4G. Bridgewater is actively addressing the WiMAX market and its solutions have been selected by two Tier 1 North American WiMAX service providers to date along with other leading WiMAX service providers in Brazil, Russia and Angola.

## **Our Products and Solutions**

Bridgewater delivers software products and solutions to address network access control, entitlement control and subscriber management for IP networks. Our software solutions are highly scalable, robust, carrier-grade and modular. The products address service provider needs to enable a single view of the subscriber and launch new data applications such as Video on Demand, IPTV, and multi-media services.

Our solutions are focused on the subscriber experience, as opposed to other solutions that are device, application or network specific. Our subscriber-centric policy management solutions address the following elements:

- network access control — authenticates subscribers and gets them on the network quickly;
- entitlement control — ensures subscribers have access to the appropriate applications and content at the appropriate quality of service; and
- subscriber management — centralizes subscriber identity, profile, policy and state.

For example, one of our Tier 1 customers has created a comprehensive mobile portal to deliver content, games and streaming media to millions of subscribers. Our products authenticate the subscriber's network access, verify that the content selected by the subscriber is appropriate to the subscriber's profile, ensure that the network and the subscriber's device are able to deliver and receive the content, and finally, check that the subscriber is able to pay for the content in pre- or post-paid billing models.

In addition to software products, our knowledge of our customers' networks and requirements provides the opportunity to deliver professional services to support specific customer features, integrate solutions to other hardware or software platforms in the network and provide training.

We are planning to introduce an integrated system that will provide hardware, software and services. This new product will enable more rapid deployment of our software solutions in the network by providing a single integrated platform to our customers. Our current plan is to start building the internal infrastructure to support the introduction of this product in late 2008 to selected customers, with broad market deployments beginning in 2009.

### **Sales and Marketing**

We sell and distribute our products and services through direct and indirect sales channels. Whether sales are direct or indirect, an important part of our strategy involves dealing directly with service providers to understand and identify their market and service requirements. Our direct sales force addresses Tier 1 and selected Tier 2 service providers, and is established geographically in North America, Europe, Middle East and Africa (EMEA), and Asia Pacific (APAC). We have organized our sales teams for both large account management and relationships, with dedicated sales management and sales engineering teams, and for geographic/regional support of service providers. Our global indirect channel partners are focused on delivering turnkey networks or network subsystems in which our products are bundled and sold with complete network solutions. We also have established regional resellers to provide geographic coverage of specific network technologies.

### **Growth Strategy/Business Model**

Bridgewater intends to continue to expand its solutions and services to existing customers by investing in marketing, pre-sales and sales capability, with a focus on extending the Company's professional services capacity and capabilities to drive increased adoption. In addition, we will continue to invest in research and development to expand our product portfolio.

One growth opportunity is to deliver our products in an integrated system that will optimize performance, scalability and ease of management. We are reviewing this integrated system with key customers and anticipate an introduction in the fourth quarter of 2008.

We also intend to focus on extending our product and professional service offerings into new and adjacent technologies to deliver solutions that enable service providers to migrate from 3G to 4G technologies, such as WiMAX and LTE, through additional sales capabilities and product and corporate marketing programs.

Our business model involves maintaining a focus on expanding our products and services to our customers, growing our customer base and developing our channel model, while maintaining profitability. We have been successful with this strategy, and will continue to leverage our current investment in product development and sales and marketing to strive for incremental profitability.

In providing forward looking statements in this MD&A, we have relied on a number of key assumptions which include, but are not limited to, the following:

- Our research and development, sales and marketing expenses and investments will be directed to meet targeted growth in revenue;
- Through continued revenue growth and a disciplined focus on cost management, we are targeting an annual operating margin of 8-12% ;
- New channel development will provide access to customers and revenue to achieve expected revenue targets and will not impact the Company's gross margin;
- We will continue to expand our revenue from existing customers by selling additional products and services, as well as incremental license revenue as they increase subscribers in their networks;
- Introduction of an integrated solution will create a reduction in the gross margin, but will provide an incremental net income contribution;
- The US\$ will remain at par with the Canadian \$.

## **OVERALL PERFORMANCE**

### **Revenue and Expenses**

We generate revenue from licensing our software products and providing related services, including maintenance, support and professional services. Licensed products are sold under either a perpetual license model or an annual right-to-use model. Additional revenue for development of new features and applications on core product or other technical services can be part of the initial engagement or as a follow-on sale. Customers generally enter into annual maintenance and support contracts which provide the customer with 7/24 support, product updates and release upgrades.

We sell our products and services through direct sales teams and through indirect global sales channels and OEM partners. Direct sales typically are with Tier 1 and Tier 2 carriers. Our indirect sales are through global reseller arrangements as well as regional resellers to support specific sales engagements.

We have focused our efforts since 2006 on expanding our geographic diversity. For fiscal 2007, we derived 29% of our revenue from customer deployments outside of the United States compared to 22% in fiscal 2006. For the three month period ended March 31, 2008, 34% of our revenue was from outside of the United States. Revenue from customer deployments and licensing outside of the United States is a result of our channel sales activity as well as the development of our sales organization with specific geographic mandates. We will continue to develop our sales channels and sales organization to be positioned to grow revenue in both APAC and EMEA.

The majority of our revenue is denominated in U.S. dollars, whereas our expenses are predominately in Canadian dollars. As a result, our revenue and net income is impacted by the fluctuation in the exchange rate. We have historically entered into foreign exchange contracts to minimize the impact of foreign exchange fluctuations.

Cost of sales consists of the cost of third party embedded licensed software and internal expenses attributed to installation, support and professional services to our customers. Costs for product and feature development are included in research and development expense.

Sales and marketing expenses include all personnel and related compensation expenses for direct and channel sales teams and marketing personnel, advertising, trade shows, communications expense and cost for regional offices. Research and development expenses include personnel and related costs for product management and development programs, technology infrastructure and product documentation. Periodically we will engage external contractors to support specific research and development programs. General and administrative expenses include all personnel and related compensation, professional fees, legal, stock-based compensation, accounting and insurance costs.

Prior to our initial public offering, we had historically qualified for Canadian federal investment tax credits (ITCs) and Ontario Innovation Tax Credits (OTICs) for qualifying research and development activities. When we were a Canadian controlled private corporation (CCPC), we claimed and received cash refunds based on related research and development programs. The cash refundable amount was estimated by management each year and reflected in the consolidated financial statement as a reduction to expenses. Following the completion of our public offering, we are no longer considered a CCPC, and thus the ITCs earned will no longer be available as cash refunds; however, we will continue to earn ITCs at a reduced rate which will reduce future cash taxes payable.

## **Critical Accounting Policies and Estimates**

### *Revenue Recognition*

Our revenue is derived from the sale of software product licenses, professional services and maintenance and support. Product revenue includes licensed product and feature development on standard products. Services revenue includes installation, training and integration services. Maintenance and support revenue includes software support, updates and the right to receive product upgrades on a when and if available basis.

Our software product licenses are sold on a perpetual basis and, in very limited cases, a subscription basis. We recognize the license fee revenue from the sale of perpetual licenses when: (1) we enter into a legally binding arrangement with a customer for the license of software; (2) we deliver the products; (3) customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is probable. In the very limited cases where our software products are sold on a subscription basis, the license fee revenue is recognized on a ratable basis over the term of the subscription provided that (1) there is a legally binding arrangement with a customer for the license of software; (2) the products have been delivered; (3) customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is probable.

The majority of our software license arrangements include customer support and maintenance services. Customer support and maintenance services consist of a tiered 24/7 help desk support to service providers and indirect channel partners, technical support and updates to our products only on a when and if available basis. Substantially all of our customers purchase product support and maintenance services when they acquire new software licenses. In addition, substantially all of our customers renew their product support and maintenance contracts annually. Revenue for customer support and maintenance services is deferred and recognized ratably over the service period. We annually review our renewal rate for customer support and maintenance services in multiple-element arrangements, by customer group, to ensure that the appropriate amount of revenue, based on vendor specific objective evidence of fair value, is unbundled and deferred. Our renewal rate depends on a number of factors including: whether the sale is to a reseller or end-user, customer size (volume of business that is being supported); customer location; customer network (decentralized or centralized affects the demand on support); the tier of support being purchased and finally the number and type of solutions installed (the more robust the installation the higher the cost of support).

We also offer professional services consisting of network design and optimization, deployment planning, interoperability testing for customers and partners, and customer and partner training for network planners, engineers, system operators and solution sales engineers. Revenue from these services is included with service revenue and is recorded as the services are performed in the same manner as feature development, described below.

Our solutions are highly scalable, with each solution interconnecting with other solutions in our portfolio allowing service providers the ability to add features on an incremental, as-needed basis. As a result, many of our software arrangements include feature development either sold on a stand-alone basis or as a part of a multiple element arrangement. Revenue from this is classified as product revenue as we retain the intellectual property rights and typically offer the feature in our product portfolio. Development comprised of feature and functionality enhancements requested by a customer are treated as a separate element in a multiple element arrangement as they are not considered critical to the functionality of the software products and the total price would vary where these features are excluded or included. Revenue is recognized as effort is incurred. If the feature development is considered critical to the functionality of the delivered software, the development effort is considered together with the license revenue and recognized together upon delivery of the customized license, provided that all other revenue recognition requirements have been met.

If there is a significant uncertainty about the project completion or receipt of payment, revenue is deferred until the uncertainty is sufficiently resolved. We estimate the proportional performance on contracts with fixed or “not to exceed” fees on a monthly basis utilizing hours incurred to date as a percentage of total estimated hours to complete the project. When total cost estimates exceed revenue, we accrue for the estimated losses immediately using cost estimates that are based upon an average fully burdened rate applicable to the individuals performing the development. The complexity of the estimation process results from assumptions, risks and uncertainties inherent with the application of the proportional performance method of accounting. A number of internal and external factors can affect our estimates, including labour rates, utilization and changes in estimates of hours required to complete the project. The fair value of development revenue is determined by estimated total number of hours of effort and our daily per diem rate that is applicable for development services sold on a stand-alone basis.

We recognize revenue when the product is delivered or over the period in which the service is performed, in accordance with our revenue recognition policy for each element. If we cannot objectively determine the fair value of any undelivered element included in bundled software and service arrangements, we defer revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. When the fair value of a delivered element has not been established, we use the residual method to record revenue if the fair value of all undelivered elements is determinable. Under the residual method, the fair value of the undelivered element is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

Our reseller arrangements do not provide for return rights with the exception of one reseller. We have had no returns from this reseller and have no business practice of accepting any returns from any other resellers. As a result, we are able to recognize revenue upon delivery to the reseller network, provided that other conditions stipulated above have been met, and we estimate a return provision based on our historical experience.

We assess whether fees are fixed or determinable at the time of sale and recognize revenue if all other revenue recognition requirements are met. Our standard payment terms are generally net 30-45 days; however, terms may vary based on the country in which the agreement is executed. Where payment terms are considered not to be fixed and determinable, revenue is recognized as payments become due and when all conditions related to revenue recognition have been met.

Unbilled receivables arise when services are performed or products and features are delivered prior to our ability to invoice in accordance with contract terms.

#### *Stock-Based Compensation*

We have stock option plans for employees, officers and directors. As a result, we report a compensation expense based on CICA Handbook Section 3870 – Stock-Based Compensation and Other Stock-Based Payments, which establishes the standards for recognition, measurement and disclosure of stock-based compensation for all awards granted on or after January 1, 2003. The fair value of the stock options is determined using the Black-Scholes option pricing model and judgments to estimate the term of the stock options, the volatility of our stock and future dividends. In addition, judgment is required in estimating the amount of the stock option awards that are expected to be forfeited. If actual results differ significantly from these estimates, stock based compensation expense and our operating results could be materially impacted.

#### *Impairment of Long-Lived Assets*

We monitor events and change in circumstances that may require assessment of the recoverability of our long-lived assets. If required, the impairment loss is recognized when their carrying value exceeds the total undiscounted future operating cash flows. If the carrying value of the asset is not recoverable, an impairment loss is recognized comparing the carrying amount of the asset to its fair value.

#### *Valuation of Future Income Taxes and Income Tax Expense*

We have accumulated significant non-capital tax losses at the end of fiscal 2007. In fiscal 2004 and subsequent periods, we have generated taxable income but have not paid income tax as we have had available significant historical tax losses and unclaimed research and development expenses to reduce our tax liability and offset any current tax liability. In preparing the consolidated financial statements, we are required to estimate our income tax obligations. The process involves estimating the actual tax exposure together with assessing the temporary

differences resulting from differing treatment of items for tax and accounting purposes. The temporary differences plus the net operating loss carry forwards from operations, result in future income tax assets and liabilities, which are recorded on the balance sheet.

Judgment is required in determining the amounts of future income tax assets and liabilities and the related valuation allowance recorded against the net future income tax assets. In assessing the potential realization of future income tax assets, we have considered whether it is "more likely than not" that some portion or all of the future income tax assets will be realized. Management assesses the likelihood that future income tax assets will be recovered from future taxable income and whether a valuation allowance is required to reflect any uncertainty.

As of March 31, 2008, we have a future tax asset of \$8.5 million. We will continue to reassess our estimates as to future profitability and make a determination related to the recognition of any potential future income tax asset. This determination will require judgment and estimates and analysis of future events, which by their nature, may or may not occur.

As at March 31, 2008, the Company had approximately \$26.8 million of unused research and development expenditures for Canadian income tax purposes, and \$6.8 million of unrecognized investment tax credits which may be applied against future Canadian income taxes otherwise payable. The Company also had approximately US\$3.5 million of losses for U.S. income tax purposes.

#### *Impact of Recently Issued Accounting Standards*

Effective January 1, 2008, we have adopted two new CICA standards, Sections 3863 "*Financial Instruments Disclosure*" and Section 3863 "*Financial Instruments Presentation*", which will replace Section 3861 "*Financial Instruments Disclosure and Presentation*". The new presentation standard carries forward the former presentation requirements and increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. This new standard does not have a material effect on our consolidated financial statements.

Effective January 1, 2008, we have adopted the new CICA standard, Section 1535 "*Capital Disclosures*". This section establishes standards for disclosing information about a company's capital and how it is managed in order that a user of the financial statements may evaluate the company's objectives, policies and processes for managing capital. This new standard does not have a material effect on our consolidated financial statements.

**RESULTS OF OPERATIONS**

	Three months ended March 31,	
	2008	2007
	(unaudited)	
Revenue	\$ 8,566	\$ 8,565
Product revenue.....	76.4%	77.0%
Service and support revenue.....	23.6%	23.0%
Gross margin.....	6,790	7,232
% of Revenue.....	79.3%	84.4%
Sales and marketing.....	3,289	3,564
% of Revenue.....	38.4%	41.6%
Research and development.....	4,344	2,811
% of Revenue.....	50.7%	32.8%
General and administration.....	997	570
% of Revenue.....	11.6%	6.7%
Stock-based compensation expense.....	41	50
% of Revenue.....	0.5%	0.6%
Total operating expenses.....	\$ 8,671	\$ 6,995
% of Revenue.....	101.2%	81.7%
(Loss) earnings before undernoted items.....	\$ (1,881)	\$ 237
% of Revenue.....	-22.0%	2.8%
Foreign exchange gain (loss).....	808	(123)
% of Revenue.....	9.4%	-1.4%
Interest income.....	390	159
% of Revenue.....	4.6%	1.9%
Net (loss) earnings for the period.....	\$ (683)	\$ 273
% of Revenue.....	-8.0%	3.2%

**Revenue**

For the first quarter of 2008, the Company's total revenue was \$8.6 million, compared to \$8.6 million for the same period last year. Revenue growth in common currency was \$1.4 million or 18% for first quarter fiscal 2008 compared to the same period for 2007 related to new customer deployments, license upgrades and professional services engagements.

Product revenue for the first quarter of 2008 was \$6.5 million, or 76% of total revenue, compared to \$6.6 million, or 77% of total revenue, for same period in 2007. Our top five customers in the first quarter of 2008 represented 79% of revenue compared to 81% of revenue for first quarter of 2007. The contribution from our top five customers is related to the increase in products and subscriber licenses associated with growth in customer networks, demonstrating that as new applications and services are deployed, revenue from existing customers will continue to grow.

First quarter 2008 services revenue from maintenance and support contracts and other services was \$2.0 million, or 24% of total revenue, compared to \$2.0 million, or 23% of total revenue, for same period in 2007. Growth in services revenue is directly related to growth in our customer base, an increase in the number of renewal of maintenance and support contracts, as well as growth in requirements for our professional services. As we further develop our services offering, this component of revenue is expected to increase.

The development of channel partner relationships is a key growth strategy and provides opportunities for deployment to a broader set of customers as part of an integrated solution. For the first quarter of 2008, indirect revenue contributed 16% of total revenue compared to 20% for the first quarter of 2007, due to transition of the Alcatel-Lucent relationship from an indirect/OEM relationship in 2007 to a direct relationship in the first quarter of 2008. Bridgewater continues to have active channel engagements for CDMA, WiMAX and GSM networks through eight channel partners operating in various geographies.

	<b>Three months ended</b>		<b>Three months ended</b>	
	<b>March 31, 2008</b>		<b>March 31, 2007</b>	
	<b>\$</b>	<b>%</b>	<b>\$</b>	<b>%</b>
Direct	7,218	84%	6,890	80%
Indirect	1,347	16%	1,675	20%
<b>Total</b>	<b>8,565</b>	<b>100%</b>	<b>8,565</b>	<b>100%</b>

Historically, our customers have been predominantly CDMA service providers; however, in fiscal 2007, we began providing products and services to two GSM customers in Asia, and have active WiMAX engagements with major providers in North America and several providers in EMEA and APAC. These developments will contribute to both revenue and customer diversification in 2008.

Although revenue from CDMA continues to represent the majority of our revenue, revenue derived from the migration of 3G to 4G networks contributed 8% of revenue in the first quarter of 2008 as a result of deployment of products to support WiMAX and GSM policy deployments in North America and through channel partners in the rest of the world. Wireline revenue of \$2.7 million, or 32% of revenue in the first quarter of 2008, was primarily derived from revenue recognized from the Alcatel-Lucent Source Code License Agreement.

### Gross Margin

Gross margin for the first quarter of 2008 was 79%, compared to 84% for the first quarter of 2007, and 83% for the fourth quarter 2007. Cost of goods sold consists of direct product costs, operations support expenses to support installed customer deployments and professional services engagements. Cost of goods sold was \$1.8 million for first quarter 2008, a decrease of \$0.3 million from the fourth quarter 2007 due to lower direct cost of sales and an increase of \$0.5 million from the first quarter of 2007 due to an increase in support personnel to address the rise in customer deployments.

We have extended our professional services offering in 2008 to provide value added services, such as network and capacity management in support of product deployments. The cost of the professional services practice, both internal and subcontracting costs, is carried in cost of sales. With the expected expansion of professional services and the delivery of the integrated solution comprised of both hardware and services, we expect our gross margin will be lower in future periods as we ramp-up these activities in support of new customer deployments.

### Operating Expenses

#### Sales and Marketing

Sales and marketing expenses were \$3.3 million for the first quarter of 2008, a decrease of \$0.3 million or 8% over the first quarter of 2007. The decrease is due to lower salaries and related staff costs resulting from a net decrease in headcount of four from the first quarter of 2007 to the same period in 2008. Sales and marketing spend increased \$0.1 million from the fourth quarter of 2007 to the first quarter of 2008 due to additional headcount and marketing programs in support of trade show activity in first quarter of 2008.

## **Research and Development**

Research and development (R&D) expenses, excluding the refundable R&D tax credits (ITC's), increased 38% or \$1.2 million to \$4.3 million from \$3.1 million for the first quarter of 2007. The rise in R&D expense was driven by the increase in headcount and higher contract costs which were incurred to accelerate new product introduction and support incremental patent submissions. Our R&D headcount increased to 115 from 105 in the first quarter of 2007. Growth in R&D headcount was related to investment in design and development of our policy products. There were no refundable ITC's in the first quarter of 2008 whereas in the first quarter of 2007 we recorded refundable ITC's of \$0.3 million. As a result, R&D expenses, net of refundable ITC's, were \$4.3 million in the first quarter of 2008 compared to \$2.8 million for the same period in 2007.

Prior to the completion of our initial public offering in fourth the quarter of 2007, we had historically qualified for Canadian federal investment tax credits (ITCs) and Ontario Innovation Tax Credits (OTICs) for qualifying research and development activities. When we were a Canadian controlled private corporation (CCPC), we claimed and received cash refunds based on related research and development programs. The cash refundable amount was estimated by management each year and reflected in the consolidated financial statement as a reduction to expenses. Since the completion of our public offering, we are no longer considered a CCPC, and thus the ITCs earned will no longer be available as cash refunds; however, we will continue to earn ITCs at a reduced rate which will reduce future cash taxes payable.

## **General and Administrative**

For the first quarter of 2008, general and administrative expenses were \$1.0 million compared to \$0.6 million for same period for 2007. The increase is attributed to a rise in professional fees associated with the increase in the number of commercial engagements, an increase in audit fees and a headcount increase of four.

Stock based compensation expense for the first quarter of 2008 was \$0.04 million compared to \$0.05 million for the same period in 2007.

## **Foreign Exchange**

We conduct a significant portion of our business activities in U.S. dollars. We translate our accounts for our U.S. subsidiary into Canadian dollars using the temporal method of foreign exchange translation, which translates monetary assets and liabilities at the rate of exchange in effect at period end. Non-monetary items are translated at the rates in effect on the dates of the transactions. Revenue and expenses are translated at the average rate for the period. The resulting translation adjustments are included in the determination of the net income.

The Company realized a \$0.8 million foreign exchange gain for the first quarter of 2008 compared to a \$0.1 million foreign exchange loss for the same period in 2007. The foreign exchange gain in the first quarter of 2008 was due to the impact of a decline in the Canadian dollar relative to the U.S. dollar on our working capital balances.

## **Interest and Other Income**

In the first quarter of 2008, we earned interest income of \$0.4 million compared to \$0.2 million for same period in 2007. The increase in interest income is due to higher cash and cash equivalent balances due to increased cash from our initial public offering and from operations.

## **Income Tax Expense (Recovery)**

As at March 31, 2008, the Company has accumulated \$26.8 million of unused R&D expenditures for income tax purposes, and \$6.8 million of unrecognized investment tax credits which may be applied against future Canadian income taxes otherwise payable. The Company also had US\$3.5 million of losses for U.S. income tax purposes.

Judgment is required in determining the amounts of future income tax assets and liabilities and the related valuation allowance recorded against the net future income tax assets. In assessing the potential realization of future income tax assets, we have considered whether it is "more likely than not" that some portion or all of the future income tax assets will be realized. Management assesses the likelihood that future income tax assets will be recovered from future taxable income, and whether a valuation allowance is required to reflect any

uncertainty. Based on this review, we determined that no adjustment was required for the first quarter of 2008. As of March 31, 2008 our future tax asset was \$8.5 million. We will continue to evaluate our tax position quarterly and record any adjustment necessary in that period.

### Net (Loss) Income

Net loss for the first quarter of 2008 was \$0.7 million, or 8.0% of revenue, compared to net income of \$0.3 million, or 3.2% of revenue for the same period last year. Loss per share was \$0.03 for the first quarter of 2008 compared to earnings per share of \$0.01 for same period in 2007.

### LIQUIDITY and CAPITAL RESOURCES

We have funded our operations from the placement of equity securities and profits from operations since our inception in 1997. While we expect to continue to execute the business profitably, we do expect from time to time to use cash to fund our operating working capital needs. Our future liquidity is primarily dependent on cash flows generated from our operations.

The table below outlines selected balance sheet accounts, key ratios and a summary of cash inflows and outflows by activity.

(in thousands except for ratios)

	Three months ended March 31,	
	2008	2007
	(unaudited)	
	<i>(in thousands of dollars, except ratios)</i>	
Cash inflows and (outflows) by activity		
Operating activities.....	\$ 3,239	\$ (3,282)
Investing activities, excluding note receivable.....	(53)	(341)
Financing activities.....	208	45
Net cash inflows (outflows) .....	\$ 13,654	\$ (15,665)
Key balance sheet accounts and ratios		
Cash and cash equivalents (1).....	\$ 42,225	\$ 17,529
Working capital.....	(722)	4,045
Long term assets.....	10,079	9,790
Long term liabilities.....	-	-
Working capital ratio (2).....	1.0	1.5
Current ratio (3).....	3.4	3.5

(1) Cash and cash equivalents as at March 31, 2007 includes a note receivable of \$12,000,000.

(2) Working capital ratio is calculated as the ratio of current assets less cash and cash equivalents to current liabilities

(3) Current ratio is calculated as the ratio of current assets to current liabilities

### Cash and Cash Equivalents

#### *Operating Activities*

There was a net cash inflow from operations of \$3.2 million for the fiscal three month period ended March 31, 2008 primarily due to a decrease in working capital of \$3.8 million, net of an operating loss of \$0.7 million.

Our net working capital decreased \$3.8 million during the first quarter of 2008. Accounts receivable decreased by \$3.4 million due to the collection of billings for major contract awards in the first quarter of 2008 and unbilled revenue decreased by \$0.2 million due to the timing of billings driven by the terms in the specific contracts. Investment tax credits receivable decreased by \$1.5 million on the collection of cash refunds. Prepaid expenses and other assets increased by \$0.8 million from the fourth quarter of 2007 due to annual renewals of third party support contracts and prepaid commissions on major contracts. Accounts payable increased \$0.5 million due to an increase in payroll accrual relative to the timing of payment and vacation accruals.

Deferred revenue decreased \$1.0 million due to the timing of the recognition of revenue which is based on the completion of product license deliveries, feature development and the recognition of our maintenance and service contracts. In the fourth quarter of 2007, we recorded an increase in deferred revenue related to an initial payment of \$5.0 million on our Alcatel-Lucent License Agreement. The revenue attributed to this initial payment and the balance of the License Agreement will be recognized ratably over the three year term of the agreement.

#### *Investing Activities*

Capital asset purchases for the first quarter of 2008 amounted to \$0.1 million compared to \$0.3 million for the first quarter of 2007. Capital purchases are comprised of desktop equipment, IT infrastructure, research and development, computer equipment and servers, and leasehold improvements.

#### *Financing Activities*

During the first quarter of 2008, we issued 214,982 common shares related to the exercise of stock options, with net proceeds from the exercise of options of \$0.2 million.

Currently we have 22,417,864 common shares outstanding and 3,594,987 common share options issued under our Stock Option Plan.

#### *Lease Obligations*

We rent premises in Canada, Singapore and Australia under operating leases which expire at varying dates up to February 2011. We also lease certain office equipment.

The following table sets forth our contractual obligations and commitments to make future payments under leases for office space and office equipment as at March 31, 2008.

Remainder 2008.....	\$ 678,000
2009 to 2011.....	1,938,000

#### **Off Balance Sheet Arrangements**

We do not have any off balance sheet arrangements other than those disclosed under “Lease Obligations” and “Financial Instruments”.

#### **Related Party Transactions and Material Contracts**

Our office in Kanata, Canada is leased from KRPC, a related party that is controlled by Terry Matthews, the Chairman of our Board of Directors. Terms of this lease were negotiated on normal commercial terms. The lease expires in February 2011. For the first quarter of 2008 we incurred rent expenses of \$0.2 million versus \$0.2 million for same period in 2007.

In October, 2007, we entered into a license agreement with Alcatel-Lucent (the “License Agreement”). Pursuant to the License Agreement, Alcatel-Lucent was granted a perpetual, royalty-free license to use, copy, modify, and create derivative works based on version 3.1 (and earlier versions) of the Subscriber Service Controller (SSC), and to distribute and grant sublicenses for such versions and derivative works in object code format. Alcatel-Lucent Canada was also granted a three-year, royalty-free license to reproduce, distribute and grant sublicense to use copies of version 1.0 of our Radius Engine software, a policy and profile engine based on our AAA Service Controller product, in object code format only. The licenses granted to Alcatel-Lucent Canada are non-exclusive and we retain ownership of the intellectual property associated with the SSC and Radius Engine software, including the ability to license copies of the SSC and Radius engine software to others, and to create new versions of both products. Alcatel-Lucent Canada will own any intellectual property associated with the modifications it makes to the SSC. Total consideration payable for the licenses granted is US\$23.0 million, with US\$5.0 million received in December 2007, and the remaining amount payable in equal quarterly installments over the next three years. In addition, the License Agreement contemplates the provision by us to Alcatel-Lucent Canada of an estimated US\$0.8 million to US\$3.0 million of support, engineering and other professional services over the next three years, depending on the level of services requested by Alcatel-Lucent Canada. At March 31, 2008, we had recognized \$2.7 million of revenue from all elements this agreement.

## Outlook

For the full year, we expect that our revenue growth will be consistent with growth in the prior fiscal year, as result of :

- i. sales of existing and new products in wireless, wireline and converged networks; and
- ii. increased license and maintenance fees from existing deployments as our customers grow and continue to add new subscribers and devices to their networks.

Over the next several quarters we will continue to transition some of our key customers to an integrated solution model. This new offering is expected to be a key growth driver over the long-term but is not expected to have a significant revenue impact for this fiscal year. As a result of incremental costs associated with the expansion of an integrated system and professional services engagements, we anticipate gross margin to decrease in future periods. However, we expect operating margins to increase towards 8-12% due to revenue growth and a disciplined focus on cost management.

In terms of operating expenses, R&D expenses are expected to continue to be an important focus as we invest in new product development. However, we are seeking lower-cost alternatives for product development and are working on increasing efficiencies from our existing operational staff. Accordingly, we expect R&D expenses to decline as a percentage of revenue in future periods. We anticipate that additional resources will be committed to sales and marketing with particular emphasis on further developing our distribution channels and our channel partners to support growth in WiMAX and GSM in EMEA, APAC and North America. General and administrative expenses are expected to increase as a result of additional costs associated with operating as a public company. We expect to continue to finance our operations internally.

In summary, we anticipate growth in our business to be derived from the following:

- Continued growth in our core market, CDMA, due to the expansion of broadband services such as “open access” and 4G deployments;
- Delivery of our software products through an integrated system that will provide hardware, software and services;
- Revenue from initial deployment of 4G technologies and as infrastructure of networks such as WiMAX and LTE are deployed, our products and services will provide an enabling tool for this conversion; and
- Extending our footprint into 4G with a GSM insertion point through our Fixed Mobile Convergence solution.

## Risks

Risks and uncertainties affecting the Company are described in more detail in Bridgewater’s Annual Information Form for the year ended December 31, 2007 dated March 27, 2008 which can be found at [www.sedar.com](http://www.sedar.com). Additional risks and uncertainties not presently known to us or those we currently consider immaterial also may impair our business and operations and cause the price of the common shares to decline. If any of the noted risks actually occur, our business may be harmed and the financial condition and results of operation may suffer significantly. In that event, the trading price of the common shares could decline, and shareholders may lose all or part of their investment.

The Company’s business performance, achievements and results may be impacted by risks and uncertainties related to our business. These risks and uncertainties include, but are not limited to the following:

*Our quarterly revenues and operating results may fluctuate, which may harm our results of operations.*

*We depend on a limited number of customers for a substantial portion of our revenue in any fiscal period, and the loss of, or a significant shortfall in orders from, key customers could significantly reduce our revenue.*

*Our current and future sales depend on our success in generating indirect sales to a limited number of channel partners, and any failure to do so would have a significant detrimental effect on our business.*

*We derive a large portion of our revenue from a single market, specifically the CDMA market.*

*We derive a large portion of our revenue from our network access control products and related products and services. Our future revenue growth will in part depend on the introduction of new products and services which have not yet been proven.*

*We have a lengthy and variable sales cycle.*

*The loss of key personnel or an inability to attract and retain additional personnel may impair our ability to grow our business.*

*Our products are highly technical and may contain undetected software or hardware errors, which could cause harm to our reputation and adversely affect our business.*

*Product liability claims could negatively impact sales and have a material adverse effect on our business, results of operation and financial condition.*

*Our ability to compete and the success of our business could be jeopardized if we are unable to protect our intellectual property adequately.*

*Claims by other parties that we infringe their proprietary technology could force us to redesign our products or to incur significant costs.*

*We use open source software in connection with our products which exposes us to uncertainty and potential liability.*

*We depend on sole sources for certain third party intellectual property embedded or used in our products, and our business would be harmed if the supply from our sole sources were disrupted.*

*Foreign exchange fluctuations could adversely impact our revenue and net income.*

*Our international sales and operations subject us to additional risks that can adversely affect our operating results.*

*Because our business depends on the continued strength of the telecommunications industry, our operating results will suffer if that industry experiences an economic downturn.*

*Our growth is dependent in part on the rate of adoption of new services.*

*Mergers or other strategic transactions by our existing and prospective customers could negatively impact sales and have a material adverse effect on our business, results of operation and financial condition.*

*Economic and geopolitical uncertainty may affect our business, financial conditions and results of operations.*

*Compliance with industry standards applicable to our products may be time consuming, difficult and costly, and if we fail to comply, our product sales will decrease.*

*If our products do not interoperate with our customers' existing networks and applications, the demand for our products will decrease and our operating results will be harmed.*

*We may require additional capital in the future and no assurance can be given that such capital will be available at all or available on terms acceptable to us and if it is available, may dilute your ownership of our Common Shares.*

## Controls and Procedures

### *Evaluation of disclosure controls and Internal Controls over Financial Reporting:*

The Company's CEO and CFO are responsible for establishing and evaluating disclosure controls and procedures for the Company. As of March 31, 2008, they have determined that such disclosure controls and procedures are in place.

## Selected Consolidated Quarterly Financial Information

The following table provides an analysis of our unaudited operating results for each of the quarters indicated:

	March 31, 2008	Dec. 31, 2007	Sept. 30, 2007	June 30, 2007	March 31, 2007	Dec. 31, 2006	Sept. 30, 2006	June 30, 2006
	<i>(in thousands of dollars, except for percentages, per share amounts and number of shares)</i>							
	<i>(unaudited)</i>							
Revenue	\$ 8,565	\$ 11,794	\$ 8,998	\$ 9,859	\$ 8,565	\$ 9,535	\$ 8,341	\$ 6,897
Gross margin	\$ 6,790	\$ 9,754	\$ 7,702	\$ 8,453	\$ 7,232	\$ 7,830	\$ 6,942	\$ 5,623
Gross margin %	79%	83%	86%	86%	84%	82%	83%	82%
Expenses	\$ 8,671	\$ 8,481	\$ 7,178	\$ 7,720	\$ 6,995	\$ 7,076	\$ 5,759	\$ 5,514
Net (loss) earnings	\$ (683)	\$ 1,869	\$ 250	\$ 351	\$ 273	\$ 9,176	\$ 1,239	\$ 68
 (Loss) earnings per share - basic	 (0.03)	 0.10	 0.01	 0.02	 0.01	 0.50	 0.07	 0.00
(Loss) earnings per share - diluted	(0.03)	0.09	0.01	0.02	0.01	0.45	0.06	0.00
 Weighted average number of shares outstanding - basic	 22,303,427	 19,214,956	 18,473,560	 18,445,252	 18,429,132	 18,397,531	 18,378,582	 18,343,913
Weighted average number of shares outstanding - diluted	22,303,427	21,788,915	20,953,134	20,679,734	20,687,196	20,183,016	19,591,022	19,558,399

Historically, our operating results will fluctuate on a quarterly basis and it is expected that they will continue to fluctuate in future periods. Fluctuations will be related to timing of revenue recognition associated with growth in our revenue and new customer contracts and timing of staffing and infrastructure expansion to support growth.