



## **BRIDGEWATER SYSTEMS CORPORATION**

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

**DATED: February 26, 2010**

*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 consolidated financial statements for the year ended December 31, 2009. The financial statements have been prepared in accordance with Canadian generally accepted accounting principals ("GAAP") and are reported in Canadian dollars. The information contained herein is dated as of February 26, 2010 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**

This MD&A contains certain information that may constitute "forward-looking information" and "forward-looking statements" within the meaning of applicable Canadian securities laws. All forward looking information and forward-looking statements are necessarily based on a number of estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies. All statements other than statements which are reporting results as well as statements of historical fact set forth herein are forward-looking statements that may involve a number of known and unknown risks, uncertainties and other factors, many of which are beyond our ability to control or predict. Known and unknown factors could cause actual results to differ materially from those projected in the forward-looking statements. Forward-looking statements include, without limitation, statements regarding strategic plans, future production, sales and revenue estimates, cost estimates and anticipated financial results. These statements relate to analysis and other information that are based on forecasts of future results, estimates of amounts not yet determinable and assumptions of management. These statements reflect current assumptions and expectations regarding future events and operating performance and speak only as of the date of this document. Material factors and assumptions used to develop such estimates include:

- Bridgewater's ability to maintain its relationships and contracts with Tier 1 customers;
- Bridgewater's visibility into the deployment plans of its major customers;
- Bridgewater's ability to maintain and grow its installed customer base in existing and emerging markets; and
- Bridgewater's expectations regarding long-term industry trends in growth in mobile data services and applications.

Forward-looking statements are generally identifiable by use of the words "may", "will", "expect", "continue", "believe", "plan", "intend", "would", "could", "should", "anticipate" or the negative of these words or other variations on these words or comparable terminology. These statements are provided to enable external stakeholders to understand our expectations as of the date hereof and may not be appropriate for other purposes. 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 risks identified under "Risks", which include the following:

- Bridgewater operates in highly competitive and continually evolving markets, and if it is not able to compete effectively, it may not be able to continue to expand its business as expected;
- Bridgewater relies on a limited number of customers for a large percentage of its revenue, and the loss of, or significant shortfall in business from, a key customer could significantly reduce its revenue;
- Bridgewater must continue to evolve its business models and platforms for delivery of products and services to respond to transaction capacity needs of its customers;
- Bridgewater's engagements with its customers involve complex arrangements and the size, timing and contractual terms of orders for Bridgewater's products may affect when revenue is recognized;
- Bridgewater has a lengthy and variable sales cycle; and
- Bridgewater may engage in future acquisitions that could disrupt its business and affect its financial condition and operating results.

Although we have attempted to identify important factors that could cause our actual results to differ materially from expectations, intentions, estimates or forecasts, there may be other factors that could cause our results to differ from what we currently anticipate, estimate or intend. Recent unprecedented events in global financial and credit markets have resulted in high market price volatility and contraction in credit markets. These on-going events could impact forward-looking statements contained in this MD&A in an unpredictable and possibly detrimental manner. In light of these risks, uncertainties and assumptions, the forward-looking events described in this MD&A might not occur or might not occur when stated. To develop a better understanding of the business risk factors that could cause our actual results to differ materially from expectations either expressed or implied please refer to our other publicly filed documents, including our Annual Information Form dated March 31, 2009, copies of which are available on SEDAR at [www.sedar.com](http://www.sedar.com).

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 Operations Information

	Three months ended December 31,		Fiscal year ended December 31,		
	2009	2008	2009	2008	2007
	(unaudited)				
	<i>(in thousands of dollars, except per share amounts and number of shares)</i>				
Revenue					
Product revenue.....	\$ 15,405	\$ 8,919	\$ 49,372	\$ 28,587	\$ 29,842
Service and support revenue.....	5,324	4,604	17,304	15,591	9,375
	<u>20,729</u>	<u>13,523</u>	<u>66,676</u>	<u>44,178</u>	<u>39,217</u>
Cost of sales.....	7,908	3,617	20,952	10,227	6,077
Gross margin.....	<u>12,821</u>	<u>9,906</u>	<u>45,724</u>	<u>33,951</u>	<u>33,140</u>
Expenses					
Sales and marketing.....	4,257	3,547	13,881	13,372	13,502
Research and development.....	4,673	3,335	15,718	14,935	13,808
General and administration.....	1,224	1,053	5,429	3,920	2,861
Investment tax credit carryforwards recognized.....	(2,000)	-	(2,000)	-	-
Bad debt expense (recovery).....	106	1,125	(158)	1,183	-
Stock-based compensation.....	100	66	369	235	202
	<u>8,360</u>	<u>9,126</u>	<u>33,239</u>	<u>33,645</u>	<u>30,373</u>
Earnings before undemoted items.....	4,461	780	12,485	306	2,767
Foreign exchange (loss) gain.....	(59)	868	(190)	1,496	(1,161)
Loss on disposal of property, equipment and intangible assets..	(131)	(118)	(131)	(118)	-
Interest and other income.....	71	274	544	1,261	666
Earnings before income taxes.....	4,342	1,804	12,708	2,945	2,272
Current income tax expense.....	2,000	-	2,000	-	-
Future income tax (recovery) expense.....	(183)	100	(496)	180	(470)
Net earnings.....	<u>\$ 2,525</u>	<u>\$ 1,704</u>	<u>\$ 11,204</u>	<u>\$ 2,765</u>	<u>\$ 2,742</u>
Earnings per share - basic.....	\$ 0.10	\$ 0.07	\$ 0.46	\$ 0.12	\$ 0.15
Earnings per share - diluted.....	\$ 0.10	\$ 0.07	\$ 0.44	\$ 0.11	\$ 0.13
Weighted average number of shares outstanding - basic.....	24,358,261	22,968,340	24,179,224	22,653,503	18,644,430
Weighted average number of shares outstanding - diluted.....	25,459,579	24,285,756	25,248,147	24,183,094	21,024,278

### Consolidated Balance Sheet Information

	Fiscal year ended December 31,		
	2009	2008	2007
	<i>(in thousands of dollars)</i>		
Cash and cash equivalents.....	\$ 53,829	\$ 50,364	\$ 38,571 <sup>(1)</sup>
Short-term investments.....	13,459	-	-
Accounts receivable.....	24,879	13,424	10,929
Working capital <sup>(2)</sup> .....	60,289	41,247	41,694
Total assets.....	121,503	87,207	69,486
Deferred revenue.....	44,288	24,013	14,244
Shareholders' equity.....	67,597	55,888	52,018

<sup>(1)</sup> Cash and cash equivalents at December 31, 2007 includes a note receivable of \$10,000,000

<sup>(2)</sup> Working capital is calculated as current assets less current liabilities

## Overview

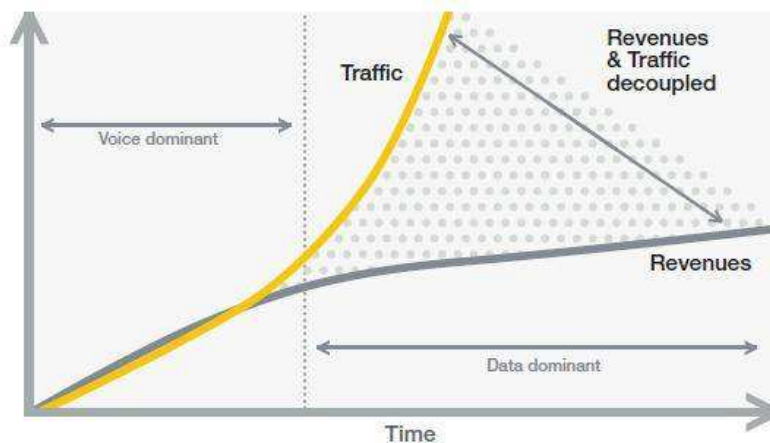
Bridgewater Systems Corporation (“Bridgewater” or the “Company”) is a market leading provider of mobile personalization products and services that enable global service providers to manage and profit from mobile data services, content and commerce. More than 140 service providers in 30 countries use our products and services to manage billions of mobile transactions per month. We have 13 years of experience helping our customers meet growing consumer and enterprise demand for mobile data and broadband wireline services.

Bridgewater’s products and services enable service providers to:

- Generate revenue and improve the customer experience through:
  - Leveraging our smart application policy which provides authorization of revenue generating applications and content;
  - Seamlessly authenticate and provide transparency as subscribers migrate across different network technologies;
  - Enable new service models; and
  - Provide the ability for special offers and branding on smart phones with myPolicy.
- Manage broadband network traffic growth with products and solutions that provide:
  - The transformation to 4G technologies with a comprehensive control plane solution for either WiMAX or LTE networks;
  - Optimization of existing 3G networks (EVDO, HSPA) through a comprehensive and intelligent policy control capability across the IP core, Radio Access Network (RAN) and device; and
  - Data Offload and On-load solutions to effectively and seamlessly transition a customer experience from one network to another.

## Market Overview

The mobile data industry has evolved rapidly over the past two years, with the impact of growing 3G penetration, lower cost smart phones and USB laptop dongles, the popularity of mobile applications, and flat-rate data plans. This has resulted in huge growth in data traversing service providers’ mobile networks. The implications of this data growth are dramatic for service providers and consumers alike. In particular, service providers face challenges in delivering increasing bandwidth requirements without a corresponding increase in data revenue sources. Increases in the cost of delivering data threatens to far exceed comparative growth in data revenues; a ‘revenue gap’ that no commercial service provider can ignore. The capital and operating expenditures associated with this increase in data usage threaten service providers’ profitability and therefore the industry’s ability to meet the demand for mobile data services sustainably. Meanwhile, the risk to user experience from congested networks is significant. For example, dropped data sessions and slow network speeds can lead to an increase in consumer churn, which is one of the largest costs service providers face, especially in mature markets.



Source: [www.wirelesshabitat.eu](http://www.wirelesshabitat.eu)

Effectively dealing with this network resource management problem in an era of huge mobile data growth is vital to service providers’ long-term success and profitability. Faced with rising mobile data costs and the potential for

consumer churn, service providers are now introducing four main strategies to manage network congestion. These strategies will reduce costs by balancing traffic requirements across networks and implementing usage controls. Policy control, data traffic offload, evolution to 3G and 4G infrastructure, and network optimization are expected to incrementally reduce mobile data delivery costs by up to 60 per cent over the next three years. Policy control - how, when and under which circumstances subscribers can access networks, applications and services - will contribute annual cost savings of over 10 per cent, equating to over \$15 billion in annual cost reduction by 2013 in the US market alone (*Chetan Sharma Consulting, 2009*).

Cost reduction is only one side of the equation; service providers are also creating flexible, dynamic, and personalized customer pricing models that move away from unsustainable flat-rate plans, towards tiered and usage-based pricing underpinned by subscriber, service, and policy control. These new pricing models will better align data revenues with network costs.

### **Key Trends**

Bridgewater's products and services enable mobile operators to address these challenges and better align data revenues with network costs. There are a number of trends driving demand for Bridgewater's solutions including:

**Mobile data traffic growth.** Growth in mobile data traffic is being driven by the increase in mobile subscribers, the popularity of smart phones, the proliferation of mobile data applications such as social networking and mobile videos, unlimited flat-rate plans, and laptop data cards. The Company benefits directly from this growth by providing solutions that help service providers manage subscriber access to applications and network resources (e.g. bandwidth), alleviate network congestion by offloading data traffic to WiFi or femtocells, and migrating to 3G and 4G.

**Migration to 3G and 4G broadband wireless networks.** Evolving broadband wireless technologies such as EVDO, HSPA, WiMAX and LTE significantly increase network bandwidth and allow service providers to deliver more sophisticated multimedia services to their subscribers. Service providers that have invested in building a 3G infrastructure are now focusing on investment to drive revenue and ensure efficient utilization of this infrastructure. This is creating demand for Bridgewater's proven, carrier-grade, subscriber data management, service and policy control products that help service providers transition services to 3G and 4G networks. Many service providers are implementing 4G networks to achieve greater spectrum efficiency and provide higher bandwidth services.

**Service model innovation.** As the market becomes more competitive, service providers are attracting and retaining subscribers by expanding their traditional prepaid, postpaid and flat-rate service plans to new innovative service models such as casual and flexible usage, on-demand access to applications, and tiered services. Service providers are also delivering new services that are paid for by mobile advertising and revenue sharing with third-party application providers. Bridgewater's products incorporate flexible policy controls, real-time subscriber information, and dynamic metering capabilities that allow service providers to develop and support a variety of service models.

**Open access and applications.** As the mobile internet becomes a reality, service providers are opening their networks to third-party devices and applications, creating new service opportunities. For example, service providers can enhance internet-based social networking applications with real-time context such as the subscriber's location. At the same time, open access creates new business model options such as revenue-sharing and advertising. Bridgewater's products enable service providers to generate new revenue streams from third-party devices and applications by leveraging real-time subscriber information, making it easy to provision new services 'over the air', and implementing policies that control application usage and protect the network.

## Our Products and Services

Bridgewater's market leading, high performance products and services are being used by over 140 service providers in 30 countries and are managing billions of mobile transactions per month. Our products are network agnostic and support all major 2G (CDMA, GSM), 3G (EVDO, HSPA) and 4G (LTE, WiMAX) access technologies as well as fixed mobile convergence technologies such as WiFi and femtocells.

Bridgewater Systems offers a modular portfolio of mobile personalization products serving more than 150 million subscribers worldwide. Proven in the most demanding Tier 1 service provider networks, Bridgewater products provide carrier-grade performance and scalability - handling more than 20 billion transactions in a single month for one customer, and scaling from 5,000 to over 80 million subscribers. The product portfolio includes:

The **Bridgewater® Service Controller** provides authentication, authorization and accounting ("AAA"); real-time session management to enable mobility, roaming, security, mobile data offload, and usage tracking; and prepaid and postpaid charging functions.

The **Bridgewater® Policy Controller** provides real-time network, application, and subscriber policies that allow service providers to manage mobile data growth and deliver personalized services. It is unique in the industry in leveraging multiple types of policy that work together to deliver a superior mobile experience. Network policies are implemented by the Policy and Charging Rules Function ("PCRF") in the Policy Controller. These policies enable service providers to manage mobile data traffic by applying real-time bandwidth controls that adapt to changing network conditions and subscriber context. The Policy Controller also supports application policies that allow service providers to rapidly provision new applications and apply policies to determine what, where, and under which circumstances subscribers can access applications. Bridgewater's new myPolicy™ solution for the Apple® iPhone and Research in Motion's Blackberry® enables service providers to give subscribers direct policy control over their own mobile usage including: tracking real-time data, SMS, and applications usage; setting personalized limits and notifications; and receiving special offers.

The **Bridgewater® Home Subscriber Server ("HSS")** is a standards-compliant, carrier-grade master repository that contains subscriber and device profile and state information, and manages subscriber identities, service profiles, authentication, authorization, and quality of service for next generation networks.

The portfolio is anchored by Bridgewater's **Subscriber Data Broker™**, a sophisticated, carrier-grade, subscriber data management capability integrated into our products. It creates a real-time, unified view of the subscriber based on profile (identity, demographics, service plan), usage (behaviors, application patterns, billing) and dynamic state data (location, context, presence), and provides the sophisticated tools to provide this data to systems and applications to deliver personalized mobile services.

Bridgewater's Subscriber Data Broker features a comprehensive toolset including:

- A flexible, dynamic business rules engine that determines how subscribers can access services;
- Governance rules for brokering subscriber data to third-party applications while protecting subscriber identity and privacy;
- Policy control to provide subscriber access to and authorization for new applications; and
- Standards-based interfaces to federate subscriber data from multiple legacy systems and to integrate with third-party applications.

Delivery of Bridgewater's products can be as a software solution, as an integrated system or as a WideSpan® system. Products delivered as a software solution are typically licensed based on subscribers or transactions. In these deployments, the service provider purchases hardware and some third-party services separately and takes responsibility for integration of the solution. Integrated system deployments provide a system-level product, packaging Bridgewater software with third-party hardware and software. These deployments are licensed on a rated-transaction load, growing as the transaction capacity requirements grow. WideSpan is an integrated system that enables service providers to bring new mobile services to market faster by using a single vendor solution, and better predict and manage subscriber growth. Anchored by Subscriber Data Broker, it integrates the Service Controller, Policy Controller and Home Subscriber Service products, plus third party hardware and software, in a

highly-scalable, carrier-class blade server environment. The system is pre-packaged and pre-configured with certified transaction throughput to manage rapid mobile transaction growth.

Bridgewater offers professional services to provide comprehensive consulting, planning, implementation, integration and management services for every stage of network development. The Company's professional services help service providers optimize network investments, maximize revenue generation, contain costs, and shorten time to market for new services.

### **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 the Americas, Europe, Middle East and Africa ("EMEA"), and Asia Pacific ("APAC"). We have organized our sales teams for major account management, with dedicated sales management and sales engineering teams, and for geographic/regional support of service providers. Our global channel partners deliver our products to support turnkey networks or network subsystems in complete network solutions. We also have established regional resellers to provide geographic coverage of specific network technologies.

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

Our business strategy is focused on expanding the breadth and depth of solutions that we deliver to our existing customers and expanding our customer base and developing our channel model, while maintaining profitability. Our long term strategy will continue to leverage our current investment in product development and sales and marketing to deliver increasing profitability and shareholder value. Our growth strategy is focused on three dimensions:

1. **Penetration of 3G/4G markets.** We are extending delivery of our products and services to 3G HSPA and 4G service providers. We have nine regional HSPA installations and two combined EVDO/HSPA installations. We have focused strategies to extend our products to support the broadband expansion in the 3G HSPA market. We are extending our products into new and adjacent technologies to deliver solutions that enable service providers to migrate from 3G to 4G technologies, such as WiMAX and LTE. Since Bridgewater's products support all major wireless access technologies, we bring strong value to interoperability and to support migration, interworking, and data offloading across mixed 3G/4G and WiFi networks. In the fourth quarter of 2009, we announced our first major LTE win with MetroPCS for our Home Subscriber Server and Policy Controller.
2. **Expansion of Product & Solution Portfolio.** Extension of our product portfolio is a key element of our growth strategy. We expect our policy control and subscriber data management products to take on increasing importance to enable service providers to personalize services. In the second quarter of 2009, we introduced Bridgewater's myPolicy™ solution for the Apple® iPhone and Research in Motion's Blackberry®. This innovative solution enables subscribers to personalize and manage mobile data usage, set limits and notifications, receive special offers, and prevent bill shock. In the third quarter of 2009, we unveiled our LTE product suite including the Bridgewater Home Subscriber Server and Policy Controller which are both anchored by Bridgewater's Subscriber Data Broker and are fully compliant with the Third Generation Partnership Project ("3GPP") Release 8 and Release 9 Standards for LTE.
3. **Continue to Expand New Delivery Models.** Our flexible delivery models that service providers to purchase and deploy our products as standalone software solutions or system-level products provides for additional penetration of our products in direct and channel engagements. Service providers are looking for delivery models that can match capacity requirements and identify and clarify total cost of ownership for new service models such as Widespan. WideSpan provides a delivery system that will optimize performance, scalability and ease of management.
4. **Geographic Expansion.** We are continuing to expand our business outside North America by increasing our investment in establishing service delivery capabilities in key markets, development and support of channel partners and system integrators, with a focus on expansion in key markets in EMEA, APAC and South America.

## **Components of Revenue and Expenses**

We generate revenue from licensing our software products and providing related hardware and services, including maintenance, support and professional services. Licensed products are sold primarily under a perpetual license model or subscription model. Additional revenue is realized through (i) incremental license sales due to growth in the customer environment, (ii) development of new features and applications on core product, (iii) other professional services such as capacity planning, interface and network planning, which can be part of the initial engagement or as a follow-on sale and (iv) annual maintenance and support contracts which provide the customer with 24/7 support, product updates and release upgrades.

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

The majority of our revenue is denominated in US dollars, whereas our expenses are predominately in Canadian dollars. As a result, our revenue and net earnings are impacted by the fluctuation in the exchange rate. We enter into foreign exchange contracts to reduce the impact of foreign exchange fluctuations.

Cost of sales consists of the cost of third party hardware and 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 expenses and costs for regional offices. Research and development expenses include personnel and related costs for product management and development programs, product documentation and technology infrastructure. Periodically we will engage external contractors to support specific research and development programs, and professional services engagements. General and administrative expenses include personnel and related compensation, professional fees, legal, accounting, and insurance costs. Bad debt expense includes any provisions for accounts receivables for which collectability is not reasonably assured.

## **Critical Accounting Policies and Estimates**

### *Revenue Recognition*

Our revenue is derived from the sale of software licenses, hardware integrated with licensed software, professional services and maintenance and support. Product revenue includes licensed software, hardware integrated with licensed software and feature development on standard products. Services and support revenue includes installation, training and integration, maintenance, software support, updates and the right to receive product upgrades on a when and if available basis. Software is sold through a perpetual license or, in limited cases, a subscription with a customer support and maintenance contract and may be integrated with hardware or include feature development and professional services.

We recognize revenue when there is a legally binding arrangement with a customer, delivery has occurred such that title and risk of loss have been transferred to the customer or services have been rendered, the fee is fixed or determinable and collectability is reasonably assured.

Customer acceptance provisions included in an arrangement are based on our product specifications. Revenue is recognized when we have demonstrated compliance with the specifications or have had a history of customer acceptance that provides no uncertainty of acceptance upon delivery of the product that would defer revenue recognition.

Arrangements may be comprised of multiple product and service elements. The majority of our software license arrangements include customer support and maintenance services. Customer support and maintenance services consist of 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. We also offer professional services consisting of network design and optimization, installation, training, deployment planning, interoperability

testing for customers and partners, and customer and partner training for network planners, engineers, system operators and solution sales engineers.

Revenue for customer support and maintenance services, feature development and professional services included in a multiple element arrangement are unbundled from the total fee for the arrangement based on reliable objective evidence of their fair value and the residual amount is allocated to the initial products delivered. We annually review our renewal pricing realized for customer support and maintenance services and our professional service rates achieved by customer group, to ensure that the appropriate amount of revenue, based on reliable objective evidence of fair value, is unbundled and deferred. Where reliable objective evidence of fair value for an element does not exist, revenue is deferred until such evidence exists for the remaining deliverables or only one element remains to be delivered. Where software is sold as a perpetual license, revenue is recognized on each element of the arrangement when all revenue recognition criteria have been met. Customer support and maintenance services, which include upgrades only on a when and if available basis, are recognized ratably over the service period. Professional services revenue is generally recognized on a proportional performance basis taking into consideration the hours completed to date in relation to the total expected hours to complete the deliverable. Where software is sold on a subscription basis, revenue for the entire arrangement is recognized on a ratable basis over the term of the subscription. Where an arrangement is comprised of multiple deliverables of the same or similar products and related services over time, revenue is allocated proportionately based on fair value to each product deliverable and recognized for the delivered product and related services when all revenue recognition criteria have been met.

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 feature development 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. If the development is considered critical to the functionality of the delivered product, the product revenue is included with the feature development revenue. Revenue for feature development is recognized as effort is incurred. 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. 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. When total cost estimates exceed revenues, we will accrue for the estimated losses immediately using cost estimates that are based upon an average fully burdened rate applicable to the individuals performing the feature development.

Our reseller arrangements do not provide for return rights with the exception of one reseller. We have had no returns from this reseller. We recognize revenue upon delivery to our resellers, provided that all other revenue recognition criteria have been met, and we estimate a return provision based on our historical experience.

We assess whether fees are fixed or determinable and collectability is reasonably assured at the time of sale and recognize revenue if all other revenue recognition criteria 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 fees are considered not to be fixed or determinable, revenue is recognized as payments become due and when all other revenue recognition criteria have been met.

Under certain arrangements, we may be required to provide compensation to a customer if and when specified product performance or customer support levels are not met. Based on historical experience, we estimate the expected performance compensation to be incurred under these arrangements and defer the equivalent amount of revenue until the performance period has lapsed or sufficient evidence exists to support a change in the estimate.

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

Deferred revenue arises when payments are received from customers in advance of revenue recognition criteria being met.

### *Deferred Cost of Sales*

Our WideSpan system includes third party hardware and software costs recorded as deferred cost of sales until the related revenues are recognized. Deferred cost of sales is carried at the lower of cost and net realizable value.

### *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*. 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.

### *Valuation of Future Income Tax Assets and Future Income Tax (Recovery)*

As of December 31, 2009, we have a future tax asset of \$8.8 million, representing an increase of \$0.5 million from December 31, 2008. The increase is due to a decrease in the valuation allowance reflecting our current view of our anticipated tax position in future periods. We will continue to reassess our estimates as to our anticipated income tax position in future periods 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 December 31, 2009, we had accumulated \$27.7 million of unused R&D expenditures for income tax purposes, and \$7.7 million of unrecognized investment tax credits which may be applied against future Canadian income taxes otherwise payable. We also had approximately US\$2.7 million of losses for US 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 a future income tax recovery of \$0.2 million was required for the fourth quarter of 2009. We will continue to evaluate our future income tax position quarterly and record any adjustment necessary in that period.

### *Current Income Tax Expense*

On an ongoing basis, management reviews the estimated current tax position and the use of accumulated tax deductions.

Based on this review, we recognized \$2.0 million of non-refundable investment tax credit carryforwards as a component of operating expenses and current income tax expense of \$2.0 million. We will continue to evaluate our current tax position and record any adjustment necessary in that period.

### *Impact of Changes in Accounting Policies*

Effective January 1, 2009, we have adopted the new CICA standard, Section 3064, *Goodwill and Intangible Assets*, which replaced Handbook Section 3062, *Goodwill and Other Intangible Assets* and Handbook Section 3450, *Research and Development Costs*. This revision aligns Canadian GAAP with International Financial Reporting Standards and establishes standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard has not had a material effect on our consolidated financial statements.

In June 2009, the CICA amended Section 3862, *Financial Instruments – Disclosure*, which requires an entity to classify fair value measurements using a fair value hierarchy that reflects the significance of inputs used in making the measurements. The accounting standard establishes a fair value hierarchy based on the level of independent, objective evidence surrounding the inputs used to measure fair value. A financial instrument’s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair

value measurement. CICA Handbook Section 3862 prioritizes the inputs into three levels that may be used to measure fair value:

- a) Level 1 – Applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.
- b) Level 2 – Applies to assets or liabilities for which there are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly such as quoted prices for similar assets or liabilities in active markets or indirectly such as quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions.
- c) Level 3 – Applies to assets or liabilities for which there are not observable market data.

The Company's financial instruments consist principally of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities. Pursuant to CICA Handbook Section 3862, fair value of assets and liabilities measured on a recurring basis include cash and cash equivalents determined based on Level 1 and Level 2 inputs. The Company believes that the recorded values of all of the other financial instruments approximate their current fair values because of their nature and respective maturity dates or durations.

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

In January 2009, the CICA issued Handbook Section 1582, *Business Combinations*, which will replace Handbook Section 1581, *Business Combinations*. The new standard is effective for acquisitions in fiscal years beginning on or after January 1, 2011 but with earlier adoption permitted and provides the Canadian equivalent to International Financial Reporting Standard IFRS 3, *Business Combinations*. The new standard is not expected to have a material effect on our consolidated financial statements.

In January 2009, the CICA issued Handbook Sections 1601, *Consolidated Financial Statements*, and 1602, *Non-Controlling Interests*, which will replace Handbook Section 1600, *Consolidated Financial Statements*. These new standards are effective for interim and annual consolidated statements for fiscal years beginning on or after January 1, 2011 but with earlier adoption permitted and provide the Canadian equivalent to International Financial Reporting Standard IAS 27, *Consolidated and Separate Financial Statements*. The new standards are not expected to have a material effect on our consolidated financial statements.

In December 2009, the CICA issued Emerging Issues Committee EIC-175, *Multiple Deliverable Revenue Arrangements*. This new standard is applied to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011 but with earlier adoption permitted. The new standard requires a vendor to allocate arrangement consideration at the inception of an arrangement to all deliverables using the relative selling price method. It also changes the level of evidence of the standalone selling price required to separate deliverables when more objective evidence of the selling price is not available. It is the Company's intention to not early adopt the following standard and it is in the process of assessing the impact the standard may have on the Company's consolidated financial statements.

#### *Transition to International Financial Reporting Standards*

In January 2006, the Accounting Standards Board (the "AcSB") announced its decision to require all publicly accountable enterprises to report under International Financial Reporting Standards ("IFRS") for years beginning on or after January 1, 2011. On February 13, 2008, the AcSB confirmed that publicly accountable enterprises will be required to use IFRS, as issued by the International Accounting Standards Board, unless modifications or additions to the requirements of IFRS are issued by the AcSB. IFRS must be adopted for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, with restatement of comparative periods.

We are currently implementing our IFRS transition plan to achieve adoption of IFRS by January 1, 2011 which consists of three phases: diagnostic, analysis and implementation.

The diagnostic phase includes the identification of Canadian GAAP and IFRS differences relevant to the Company and the alternatives available upon adoption. During the third quarter of 2009, the Company completed the diagnostic phase and the key differences between Canadian GAAP and IFRS were identified as revenue recognition, stock-based compensation, income taxes and financial statement presentation and disclosure requirements. Additional differences may be identified in the future as a result of changes to the Company's business or as IFRS standards are further developed.

The analysis phase includes an evaluation and selection of accounting policies and alternatives available at initial adoption of IFRS. The analysis phase also includes an evaluation and assessment of our information systems, internal controls over financial reporting, financing agreements or compensation arrangements that may be impacted by the adoption of IFRS. The Company engaged external advisors to provide support in completing this phase. During the fourth quarter of 2009, the Company completed its analysis of key differences between Canadian GAAP and IFRS.

As a result of the analysis, we concluded that differences exist related to stock-based compensation which would have a material effect on the Company's accounting policies and consolidated financial statements. The Company grants stock options to employees, officers and directors which vest in equal installments over 48 months. Under Canadian GAAP, the Company elected to treat the stock option grant and the vesting installments as a pool and the fair value of the grant was determined using the average life of the instrument. The fair value was recognized as stock-based compensation expense on a straight-line basis over the average life of the instrument.

Under IFRS, each separate vesting installment must be treated as a separate award. The fair value is determined for each vesting installment and recognized as stock-based compensation over its vesting period.

The Company will change its accounting policy upon adoption of IFRS to conform to these standards and record an adjustment increasing the opening deficit for fiscal 2010. This adjustment reflects the difference in stock-based compensation expense that would have been recorded under IFRS compared to the expense recorded under Canadian GAAP for all unvested stock option grants outstanding at January 1, 2010. Furthermore, stock-based compensation expense calculated under IFRS for the year ended December 31, 2010 will be lower than will be recorded under Canadian GAAP for currently outstanding awards.

During the analysis phase, we did not identify any other material impacts to the financial results or significant changes to our procedures, systems or controls.

The implementation phase includes completion of all necessary changes to systems, process and controls and development of the financial statement presentation and disclosures required to convert to IFRS. This phase will be completed during fiscal 2010 to provide the comparative information required to report under IFRS and during the initial year of adoption in fiscal 2011.

## RESULTS OF OPERATIONS

	Three months ended December 31,		Fiscal year ended December 31,		
	2009	2008	2009	2008	2007
	(unaudited)				
	<i>(in thousands of dollars, except per share amounts and number of shares)</i>				
Revenue	\$ 20,729	\$ 13,523	\$ 66,676	\$ 44,178	\$ 39,217
Product revenue.....	74%	66%	74%	65%	76%
Service and support revenue.....	26%	34%	26%	35%	24%
Gross margin.....	12,821	9,906	45,724	33,951	33,140
% of Revenue.....	62%	73%	69%	77%	85%
Sales and marketing.....	4,257	3,547	13,881	13,372	13,502
% of Revenue.....	21%	26%	21%	30%	34%
Research and development.....	4,673	3,335	15,718	14,935	13,808
% of Revenue.....	23%	25%	24%	34%	35%
General and administration.....	1,224	1,053	5,429	3,920	2,861
% of Revenue.....	6%	8%	8%	9%	7%
Investment tax credit carryforwards recognized.....	(2,000)	-	(2,000)	-	-
% of Revenue.....	-10%	0%	-3%	0%	0%
Bad debt expense (recovery).....	106	1,125	(158)	1,183	-
% of Revenue.....	1%	8%	0%	3%	0%
Stock-based compensation.....	100	66	369	235	202
% of Revenue.....	0%	0%	1%	1%	1%
Total operating expenses.....	\$ 8,360	\$ 9,126	\$ 33,239	\$ 33,645	\$ 30,373
% of Revenue.....	40%	67%	50%	76%	77%
Earnings before undemoted items.....	\$ 4,461	\$ 780	\$ 12,485	\$ 306	\$ 2,767
% of Revenue.....	22%	6%	19%	1%	7%
Foreign exchange (loss) gain.....	(59)	868	(190)	1,496	(1,161)
% of Revenue.....	0%	6%	0%	3%	-3%
Loss on disposal of property, equipment and intangible assets.....	(131)	(118)	(131)	(118)	-
% of Revenue.....	-1%	-1%	0%	0%	0%
Interest and other income.....	71	274	544	1,261	666
% of Revenue.....	0%	2%	1%	3%	2%
Earnings before income taxes.....	\$ 4,342	\$ 1,804	\$ 12,708	\$ 2,945	\$ 2,272
% of Revenue.....	21%	13%	19%	7%	6%
Current income tax expense.....	(2,000)	-	(2,000)	-	-
% of Revenue.....	-10%	0%	-3%	0%	0%
Future income tax (recovery) expense.....	(183)	100	(496)	180	(470)
% of Revenue.....	-1%	1%	-1%	0%	-1%
Net earnings.....	\$ 2,525	\$ 1,704	\$ 11,204	\$ 2,765	\$ 2,742
% of Revenue.....	12%	13%	17%	6%	7%

### Revenue

For the fourth quarter of 2009, our total revenue was \$20.7 million, an increase of \$7.2 million or 53% compared to \$13.5 million for the fourth quarter of 2008. For the fiscal year ended December 31, 2009, our total revenue was \$66.7 million, an increase of \$22.5 million or 51% compared to \$44.2 million for the same period in 2008. Revenue growth when reported in US dollars for the three month and year ended December 31, 2009 was US\$8.2 million (72%) and US\$17.3 million (41%) compared to the same periods in 2008. The increase in revenue is primarily related to consistent growth in product revenue. During the fourth quarter of 2009 we added 9 new service provider customers, of which 4 were in APAC, 3 in EMEA, and 2 in North America.

Product revenue for the fourth quarter of 2009 was \$15.4 million, or 74% of total revenue, compared to \$8.9 million, or 66% of total revenue, for the same period in 2008. The increase is due to delivery of the Home Subscriber Server and Policy Controller solutions to Metro PCS, and the ongoing revenue associated with the deployment of the WideSpan systems with Verizon Wireless and Cricket Communications. Our top five customers in the fourth quarter of 2009 represented 82% of revenue compared to 86% of revenue for the same period in 2008.

For the fiscal year ended December 31, 2009, product revenue was \$49.4 million, or 74% of total revenue, compared to \$28.6 million, or 65% of total revenue, for same period in 2008. The increase is due to delivery of the Home Subscriber Server, Policy Controller and other solutions, license revenue from several significant projects, in addition to ongoing revenue associated with the deployment of the WideSpan systems. Our top five customers during the fiscal year ended December 31, 2009 represented 82% of revenue which is consistent with the same period in 2008. We expect to continue to develop our product offering, and to see additional growth in this component of revenue.

Fourth quarter 2009 service and support revenue, derived from professional services and maintenance and support contracts, was \$5.3 million, or 26% of total revenue, compared to \$4.6 million, or 34% of total revenue, for the same period in 2008. For the fiscal year ended December 31, 2009 service and support revenue was \$17.3 million, or 26% of total revenue, compared to \$15.6 million, or 35% of total revenue, for the same period in 2008. Growth in service revenue over the fiscal year is attributed to growth in the number of customers and in the requirements for value-added professional services. We expect to continue to develop our services offering, and to see additional growth in this component of revenue.

Bridgewater has active channel engagements for CDMA-EVDO, WiMAX, 3G GSM and LTE networks through channel partners operating in various geographies. For the fourth quarter of 2009, indirect revenue from our channel partners and resellers contributed 5% of total revenue compared to 18% for the same period in 2008 and 8% of revenue for the fiscal year ended December 31, 2009 compared to 15% for the same period in 2008.

The decrease in indirect revenue in the three month period and fiscal year ended December 31, 2009 compared to the same periods in 2008 is due to lower volumes from a reseller who filed for creditor protection on January 14, 2009. Continued development of existing channels and new channel relationships are expected to contribute to higher indirect revenue in 2010.

	Three months ended December 31,				Fiscal year ended December 31,			
	2009		2008		2009		2008	
	(unaudited)							
	<i>(in thousands of dollars, except percentages)</i>							
Direct	\$ 19,656	95%	\$ 11,134	82%	\$ 61,097	92%	\$ 37,768	85%
Indirect	1,073	5%	2,389	18%	5,579	8%	6,410	15%
Total	<u>\$ 20,729</u>	<u>100%</u>	<u>\$ 13,523</u>	<u>100%</u>	<u>\$ 66,676</u>	<u>100%</u>	<u>\$ 44,178</u>	<u>100%</u>

Historically, our customers have been predominantly CDMA-EVDO service providers; however, in recent years, we began providing products and services to supporting 3G GSM, WiMAX and LTE networks in the Americas, EMEA and APAC.

	Three months ended				Fiscal year ended December 31,			
	2009		2008		2009		2008	
	(unaudited)							
	<i>(in thousands of dollars, except percentages)</i>							
CDMA-EVDO	\$ 12,951	63%	\$ 7,820	58%	\$ 43,339	65%	\$ 23,900	54%
3G to 4G	5,191	25%	2,701	20%	11,604	17%	8,778	20%
Wireline	2,587	12%	3,002	22%	11,733	18%	11,500	26%
Total	<u>\$ 20,729</u>	<u>100%</u>	<u>\$ 13,523</u>	<u>100%</u>	<u>\$ 66,676</u>	<u>100%</u>	<u>\$ 44,178</u>	<u>100%</u>

For the fourth quarter of 2009, our CDMA-EVDO revenue was \$13.0 million, an increase of \$5.1 million or 66% compared to \$7.8 million for the fourth quarter of 2008. For the fiscal year ended December 31, 2009, our CDMA-EVDO revenue was \$42.3 million, an increase of \$19.4 million or 81% compared to \$23.9 million for the same period in 2008. The increase is due to the ongoing revenue associated with the deployment of the WideSpan systems with Verizon Wireless and Cricket Communications.

Although revenue from CDMA-EVDO continues to represent the majority of our revenue, revenue derived from the migration of 3G to 4G (e.g. 3G GSM, WiMAX, femtocell) networks contributed 25% of revenue in the fourth quarter and 17% during the fiscal year ended December 31, 2009. For the fourth quarter and fiscal year ended December 31, 2009, our 3G to 4G revenue increased \$2.5 million or 92% and \$2.8 million or 32%, respectively, over the same periods in 2008. The increase in revenue is due to delivery of the Home Subscriber Server and Policy Controller solutions to Metro PCS and sales of products to support the WiMAX market and initial GSM policy deployments in emerging markets.

Wireline revenue of \$2.6 million (12% of revenue) in the fourth quarter of 2009 and \$11.7 million (18% of revenue) during the fiscal year ended December 31, 2009, was primarily derived from revenue from the Alcatel-Lucent Source Code License Agreement (“Alcatel Agreement”) which expires October 30, 2010 and resale of products and services through the Alcatel-Lucent reseller agreement. For the fourth quarter of 2009, our Wireline revenue decreased \$0.4 million or 14% over the same period in 2008. For the fiscal year ended December 31, 2009, our Wireline revenue increased \$0.2 million or 2% over the same period in 2008.

### **Gross Margin**

Gross margin for the fourth quarter of 2009 was 62%, compared to 73% for the fourth quarter of 2008, and 69% for the fiscal year ended December 31, 2009, compared to 77% during the same period in 2008. Cost of sales consists of direct product costs, operations support expenses to support customer deployments and professional services engagements. The decrease in gross margin percentage for the fourth quarter and fiscal year ended December 31, 2009 is due to an increase in direct product costs associated with the deployment of the WideSpan systems with Verizon Wireless and Cricket Communications and planned investments in operations support infrastructure for software product and WideSpan system deployments, as well as internal and subcontracting costs incurred to support the increase in professional services engagements.

### **Operating Expenses**

#### **Sales and Marketing**

Sales and marketing expenses were \$4.3 million for the fourth quarter of 2009, an increase of \$0.7 million or 20% over the three month period in 2008. The increase during the three month period is due to higher commission expenses, compensation and related staff costs, and travel expenses.

For the fiscal year ended December 31, 2009, sales and marketing expenses were \$13.9 million, an increase of \$0.5 million or 4% over the same period of 2008. The increase over the fiscal years is due to higher professional fees, higher direct marketing costs and commission expenses on higher revenue which were partially offset by lower compensation costs and related staff costs. Our sales and marketing headcount was 44 at December 31, 2009, compared to 35 at December 31, 2008.

#### **Research and Development**

For the fourth quarter of 2009, research and development (“R&D”) expenses increased 40% or \$1.3 million to \$4.7 million from \$3.3 million in the fourth quarter of 2008. For the fiscal year ended December 31, 2009, R&D expenses increased 5% or \$0.8 million to \$15.7 million from \$14.9 million. The increase in R&D expense for the three month period and fiscal year ended December 31, 2009 was driven by higher compensation costs, higher travel and higher contractor costs. Our R&D headcount was 103 at December 31, 2009 compared to 91 at December 31, 2008.

#### **General and Administrative**

For the fourth quarter of 2009, general and administrative expenses were \$1.2 million compared to \$1.1 million for same period for 2008. The increase in expenses is due to higher compensation costs, professional fees and compliance costs. For the fiscal year ended December 31, 2009, general and administrative expenses were \$5.4 million, compared to \$3.9 million for the same period in 2008. The increase in expenses was due to the

incremental costs of advisors to the Board of Directors and related committees incurred early in 2009 to respond to the request for a special shareholder meeting. Our general and administrative headcount was 18 at December 31, 2009 compared to 15 at December 31, 2008.

#### **Investment Tax Credit Carryforwards Recognized**

On an ongoing basis, management reviews the estimated current tax position and the use of accumulated tax deductions. Based on this review, \$2.0 million of non-refundable investment tax credit carryforwards were recognized.

#### **Bad Debt Expense (Recovery)**

For the fourth quarter of 2009, there was a bad debt expense of \$0.1 million compared to a \$1.1 million bad debt expense for same period in 2008.

For the fiscal year ended December 31, 2009, a bad debt recovery of \$0.2 million was recorded compared to a \$1.2 million bad debt expense for same period in 2008. The recovery during the fiscal year ended December 31, 2009 is attributed to the collection of accounts receivable which were previously recorded as doubtful accounts from one customer engaged as a reseller that filed for creditor protection on January 14, 2009, which was partially offset by additional bad debt expense recorded.

#### **Stock-Based Compensation**

Stock-based compensation expense for the fourth quarter of 2009 was \$0.1 million, which is comparable to the same period in 2008.

Stock-based compensation expense for the fiscal year ended December 31, 2009 was \$0.4 million compared to \$0.2 million for same period in 2008.

#### **Foreign Exchange**

We conduct a significant portion of our business activities in US dollars. We translate our accounts for our US 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 net earnings.

We realized a \$0.1 million foreign exchange loss for the fourth quarter of 2009 compared to a \$0.9 million foreign exchange gain for the same period in 2008. For the fiscal year ended December 31, 2009, a foreign exchange loss of \$0.2 million was realized in comparison to a \$1.5 million foreign exchange gain during the same period in 2008. The foreign exchange loss for the three month and fiscal year ended December 31, 2009 was due to the impact of an increase in the value of the Canadian dollar relative to the US dollar on our US dollar denominated working capital balances. At December 31, 2009, we had no forward contracts to purchase or sell US dollars.

#### **Loss on disposal of Property, Equipment and Intangible Assets**

In the fourth quarter of 2009, the Company incurred a loss of \$0.1 million on disposal of property, equipment and intangible assets which is comparable to the same period in 2008.

#### **Interest and Other Income**

In the fourth quarter of 2009, we earned interest income of \$0.1 million compared to \$0.3 million for the same period in 2008. Interest income for the fiscal year ended December 31, 2009 decreased to \$0.5 million from \$1.3 million during the same period last year. The decrease in interest income is due to lower interest rates earned on cash and cash equivalent balances and short-term investments.

#### **Current Income Tax Expense**

Based on the review of the estimated current tax position and the use of accumulated tax deductions, a \$2.0 million current income tax expense was recorded during the fourth quarter of 2009.

### **Future Income Tax (Recovery)**

As at December 31, 2009, we have accumulated \$27.7 million (December 31, 2008 - \$30.0 million) of unused R&D expenditures for income tax purposes, and \$7.7 million of unrecognized investment tax credits which may be applied against future Canadian income taxes otherwise payable. We also have US\$2.7 million of losses available for carry forward for US income tax purposes.

Based on management's assessment of the likelihood that future income tax assets will be recovered, we determined that a future income tax recovery of \$0.2 million was required for the fourth quarter of 2009. Total future income tax recovery for the fiscal year ended December 31, 2009 was \$0.5 million. As of December 31, 2009, our future income tax asset was \$8.8 million. We will continue to evaluate our tax position quarterly and record any adjustment necessary in that period.

### **Net Earnings**

Net earnings before income taxes for the fourth quarter of 2009 were \$4.3 million, or 21% of revenue, compared to \$1.8 million, or 13% of revenue, in the fourth quarter of 2008. Net earnings before income taxes for the fiscal year ended December 31, 2009 were \$12.7 million, or 19% of revenue, compared to \$2.9 million, or 7% of revenue, for the same period in 2008.

Net earnings for the fourth quarter of 2009 were \$2.5 million, or 12% of revenue, compared to \$1.7 million, or 13% of revenue, in the fourth quarter of 2008. Net earnings for the fiscal year ended December 31, 2009 were \$11.2 million, or 17% of revenue, compared to \$2.8 million, or 6% of revenue, for the same period in 2008.

Strong net earnings improvements in the fourth quarter and fiscal year ended December 31, 2009 are due to multiple new contract wins, customer and product expansion and, in part, to the timing and revenue contribution of large project deployments.

Basic earnings per share were \$0.10 for the fourth quarter of 2009 compared to earnings per share of \$0.07 for the same period in 2008. Basic earnings per share for the fiscal year ended December 31, 2009 were \$0.46 compared to earnings per share of \$0.12 for the same period in 2008.

Diluted earnings per share were \$0.10 for the fourth quarter of 2009 and \$0.44 for the fiscal year ended December 31, 2009. Diluted earnings per share were \$0.07 for the fourth quarter of 2008 and \$0.11 for the fiscal year ended December 31, 2008.

### **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. Despite the current volatility in the economic environment, our liquidity and ability to meet our financial obligations have not been negatively impacted.

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

	Three months ended		Fiscal year ended	
	December 31,		December 31,	
	2009	2008	2009	2008
	(unaudited)			
	<i>(in thousands of dollars, except ratios)</i>			
Cash inflows and (outflows) by activity				
Operating activities .....	\$ 6,358	\$ 15,529	\$ 22,226	\$ 15,675
Investing activities <sup>(1)</sup> .....	4,362	(5,583)	(15,238)	(6,578)
Financing activities .....	247	3	135	869
Net cash inflows .....	10,502	\$ 11,454	\$ 3,465	\$ 21,793

	Fiscal year ended	
	December 31,	
	2009	2008
Key balance sheet accounts and ratios		
Cash and cash equivalents .....	\$ 53,829	\$ 50,364
Short-term investments .....	13,459	-
Non-cash working capital <sup>(2)</sup> .....	(6,999)	(9,116)
Long term assets .....	7,308	14,640
Long term liabilities .....	-	-
Non-cash working capital ratio <sup>(3)</sup> .....	0.9	0.7
Current ratio <sup>(4)</sup> .....	2.1	2.3

(1) Net of note receivable

(2) Non-cash working capital is calculated as current assets less cash and cash equivalents less short-term investments less current liabilities

(3) Non-cash working capital ratio is calculated as the ratio of current assets less cash and cash equivalents and short-term investments to current liabilities

(4) 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 \$6.4 million for the fourth quarter of 2009 primarily due to net earnings of \$2.5 million, a decrease in non-cash working capital of \$2.7 million and non-cash amortization of property, equipment and intangible assets of \$0.5 million.

For the fiscal year ended December 31, 2009, there was a net cash inflow of \$22.2 million, primarily due to net earnings of \$11.2 million, a foreign exchange loss of \$3.7 million on cash held in foreign currency, a decrease in non-cash working capital of \$5.5 million and non-cash amortization of property, equipment and intangible assets of \$1.5 million.

Our non-cash working capital balance decreased \$5.5 million through fiscal 2009. Accounts receivable increased by \$11.8 million net of allowance for doubtful accounts due to an increase in billings for major contract awards during the year. Unbilled receivables increased by \$0.4 million due to the timing of billings driven by the terms in specific contracts. Deferred cost of sales increased \$3.3 million due to additional direct costs incurred related to future deployments, net of amounts recognized in cost of sales related to the WideSpan deployments for Verizon and Cricket Communications. Prepaid expenses and other assets increased by \$1.5 million primarily due to cost of goods sold prepaid during the fiscal year which will have the expense recognized in future periods. Accounts payable and accrued liabilities increased \$2.2 million due to an increase in trade amounts outstanding and higher accrued liabilities for operating expenses at the end of fiscal year 2009.

Deferred revenue increased \$20.3 million primarily due to payments received in advance of the recognition of revenue on the Verizon Wireless WideSpan systems and other long term contracts. Deferred maintenance and support revenue decreased due to the timing of contract renewals.

	Fiscal year ended December 31,	
	2009	2008
	(unaudited)	
	<i>(in thousands of dollars)</i>	
Deferred revenue		
Product and service revenue.....	\$ 41,812	\$ 20,754
Maintenance and support revenue	2,476	3,259
	\$ 44,288	\$ 24,013

	Fiscal year ended December 31,	
	2009	2008
	<i>(in thousands of dollars)</i>	
Net change in non-cash working capital		
Accounts receivable, net of allowance for doubtful accounts...	\$ (11,788)	\$ (3,677)
Investment tax credits receivable.....	-	1,668
Unbilled receivables.....	(392)	4,353
Deferred cost of sales.....	(3,281)	(3,518)
Prepaid expenses and other assets.....	(1,494)	(1,057)
Accounts payable and accrued liabilities.....	2,211	4,082
Deferred revenue.....	20,275	9,769
Net decrease in non-cash working capital	\$ 5,531	\$ 11,620

#### *Investing Activities*

Net cash received from investing activities of \$4.4 million for the three month period ended December 31, 2009 was primarily due to the sale of short-term investments of \$4.7 million during the period.

Net cash used for investing activities of \$15.2 million for the fiscal year ended December 31, 2009 was primarily due to the purchase of short-term investments of \$13.5 million during the year.

Additional investing activities for the three month period and fiscal year ended December 31, 2009 included property, equipment and intangible asset purchases amounting to \$0.3 million and \$1.8 million, respectively, compared to \$0.1 and \$1.1 million for the same periods in 2008. Property, equipment and intangible asset purchases are comprised of desktop equipment, IT infrastructure, R&D equipment, computer equipment and servers, software and leasehold improvements.

#### *Financing Activities*

On March 12, 2009, the Toronto Stock Exchange (the "TSX") accepted the Company's notice of intention to repurchase up to 1,148,962 common shares (5 percent of the Company's issued and outstanding common shares) through a normal course issuer bid ("NCIB"). The NCIB was effective March 17, 2009 and will expire March 16, 2010. Daily purchases over the facilities of the TSX are limited to 9,545 shares, other than pursuant to block purchase exemptions. Except in the case of an exempt purchase, the prices that the Company will pay for the common shares purchased will be the market price of the shares at the time of acquisition.

During the fiscal year ended December 31, 2009, the Company acquired 528,485 common shares pursuant to the NCIB through an automatic share purchase plan. These shares were purchased for cancellation at an aggregate cost of \$2.5 million, all of which had been cancelled at December 31, 2009. No shares were repurchased pursuant to the NCIB purchase plan during the fourth quarter of 2009.

During the fourth quarter and fiscal year ended December 31, 2009, we received net proceeds of \$0.2 million and \$2.6 million from issuance of shares upon the exercise of stock options.

As at December 31, 2009, we have 24,432,468 common shares outstanding and 1,799,650 share options issued and outstanding under our Stock Option Plan.

#### *Lease Obligations*

We rent premises in Canada 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 December 31, 2009.

2010.....	\$ 1,379,000
2011.....	586,000
2012.....	318,000

#### **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**

We lease office premises from a company controlled by the Chairman of the Board of Directors under terms and conditions reflecting prevailing market conditions at the time of the lease. For the fourth quarter and fiscal year ended December 31, 2009, we incurred rent expenses of \$0.2 million and \$0.9 million, respectively, which is comparable for the same periods in 2008. In addition, the Company purchased leasehold improvements from a company controlled by the Chairman of the Board of Directors for \$0.1 million during fiscal 2009 versus a nominal amount in 2008.

For the fiscal year ended December 31, 2009 we purchased sales and development services from a company controlled by the Chairman of the Board in the amount of \$0.1 million. The services were recorded at the exchange amount. We have no current commitments related to these services.

No similar consulting services were purchased from a related party in 2008.

#### **Financial Instruments**

On September 8, 2008, we issued a letter of credit to Verizon Wireless for US\$3.0 million to secure certain performance obligations made within the supply agreement for support services for our WideSpan systems. The letter of credit is renewed on an annual basis.

#### **Outlook**

Bridgewater’s business growth is driven by key market trends in mobile data which continue to be favorable despite continued economic challenges in certain regions. The proliferation of smart devices is leading to significant growth in mobile data usage. Growth in the number of mobile data and mobile internet applications is increasing rapidly due to the use of new “smart” devices in the network and the continued evolution towards higher bandwidth. In order to accommodate high transaction growth and to facilitate the deployment of new applications, service providers are expanding bandwidth with the roll-out of broadband 3G networks and the introduction of 4G networks in addition to data offload solutions. These factors translate into substantial growth in data services evidenced by the increase in data revenue from leading wireless service providers.

Our existing customers and new service providers in emerging markets may be facing financial challenges in the next 12 to 24 months and we acknowledge that this may have an impact on our business. However due to several key aspects of our business model, we believe we have a strong foundation to manage this uncertainty.

- Strong cash position;
- Long term contracts that provide a base of predictable and constant revenue streams; and
- Large installed base of customers in existing and emerging markets addressing high growth markets for mobile data services.

Taking into account the uncertainty around the macroeconomic climate and the near-term financial challenges that existing customers and new service providers in emerging markets may be facing, Bridgewater is currently forecasting revenue of approximately \$82 to \$92 million for fiscal 2010, as a result of:

- Significant contracts with Tier 1 customers;
- Sales of existing and new products in wireless, wireline and converged networks;
- Increased license and maintenance fees from existing deployments as our customers grow and continue to add new subscribers and devices to their networks; and
- Continued evolution of our business model for delivering products and services to address higher transaction capacity needs.

With continued emphasis on cost management while investing in key areas for future growth, we are forecasting net earnings of \$13 to \$16 million for 2010.

See “**Forward-Looking Statements**”.

#### **Risks**

Risks and uncertainties affecting the Company are described in more detail in Bridgewater’s Annual Information Form dated March 31, 2009 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:

*The Company is dependent upon the continued service and performance of the members of the Board of Directors and senior management team, who have significant experience in telecom software, financial markets and related industries. Significant changes to the Board and/or senior management team may adversely affect the Company's business prospects and ability to execute on its strategic growth plan.*

*Our quarterly revenues 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. The loss of, or a significant shortfall in orders from, or changes in contract terms with, key customers could significantly reduce our revenue.*

*Access to capital for new operators to expand services and data services may be limited, which could result in reduced deployment plans or delays in the sale of our products to support expanded data services.*

*A slow down in consumer spending on new devices could reduce service provider's revenue and as a result could impact decisions to implement new products and services.*

*A general global economic downturn may lead to the discontinuance of certain business lines and products of our customers and channel partners. Such events may decrease revenue and increase cost and may increase credit risk with our customers and impact our ability to collect accounts receivable.*

*Our current and future sales depend on our success in generating indirect sales through 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-EVDO market.*

*We derive a large portion of our revenue from our service control products and related products and services. Our engagements with customers may involve complex arrangements for large network deployments and failure to execute may result in delayed revenue recognition or commercial penalties.*

*Our future revenue growth will in part depend on the introduction of new products and services which have not yet been proven.*

*The introduction of our integrated systems products may have an impact on our business model and may require additional investment impacting operating margins in future periods due to the complexity of deployments and implementation timeframes.*

*We have a lengthy and variable sales cycle.*

*The Company may engage in future acquisitions that could disrupt its business, cause dilution to its shareholders and harm its financial condition and operating results.*

*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 operations 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 earnings.*

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

*Our engagements with our customers involve complex arrangements which may require interpretation of GAAP and may result in deferral of revenue recognition. In addition, changes to pronouncements on revenue recognition rules may impact our reported revenue in a given fiscal period, and may decrease the predictability of our revenue going forward.*

*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.*

*Our growth may be impacted by new market uncertainty and timing of deployment in new services.*

*We will require networking and system integrator partners to drive growth plans for 3G GSM and 4G markets.*

*As we expand our product and service offerings we may encounter increased competition from large Network Equipment Providers and System Integrators.*

*Timing of deployment of LTE to existing and new customers could impact revenue in future periods.*

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

*Economic and geopolitical uncertainty may affect decisions by our customers to purchase our products resulting in an impact to our 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 shares.*

## **Controls and Procedures**

### ***Disclosure Controls and Procedures***

The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining effective disclosure controls and procedures for the Company as defined in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*. The Company's Chief Executive Officer and the Chief Financial Officer have evaluated the Company's disclosure controls and procedures as of December 31, 2009 and have determined that such disclosure controls and procedures are effective.

### ***Internal Control over Financial Reporting***

The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining effective internal control over financial reporting as defined in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*. Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. The Company's Chief Executive Officer and the Chief Financial Officer have evaluated the Company's internal controls over financial reporting as of December 31, 2009 and have determined that such internal controls are effective.

There have not been any changes in the issuer's internal control over financial reporting that occurred during the period beginning on January 1, 2009 and ended on December 31, 2009 that has materially affected, or is reasonably likely to affect, the issuer's internal control over financial reporting.

### Selected Consolidated Quarterly Financial Information

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

	Quarters Ended							
	Dec 31, 2009	Sept 30, 2009	Jun 30, 2009	Mar 31, 2009	Dec 31, 2008	Sept 30, 2008	June 30, 2008	March 31, 2008
	<i>(in thousands of dollars, except for percentages, per share amounts and number of shares)</i>							
	<i>(unaudited)</i>							
Revenue	\$ 20,729	\$ 15,769	\$ 16,134	\$ 14,043	\$ 13,523	\$ 10,294	\$ 11,796	\$ 8,565
Gross margin	\$ 12,821	\$ 10,133	\$ 12,051	\$ 10,720	\$ 9,906	\$ 7,738	\$ 9,517	\$ 6,790
Gross margin %	62%	62%	75%	76%	73%	75%	81%	79%
Expenses	\$ 10,360	\$ 8,474	\$ 8,245	\$ 8,161	\$ 9,126	\$ 7,527	\$ 8,321	\$ 8,671
Net earnings (loss)	\$ 2,525	\$ 1,651	\$ 4,143	\$ 2,885	\$ 1,704	\$ 483	\$ 1,260	\$ (683)
Earnings (loss) per share - basic	\$ 0.10	\$ 0.07	\$ 0.17	\$ 0.12	\$ 0.07	\$ 0.02	\$ 0.06	\$ (0.03)
Earnings (loss) per share - diluted	\$ 0.10	\$ 0.07	\$ 0.17	\$ 0.12	\$ 0.07	\$ 0.02	\$ 0.05	\$ (0.03)
Weighted average number of shares outstanding - basic	24,358,261	24,359,491	24,483,296	23,107,823	22,968,340	22,758,098	22,574,790	22,303,427
Weighted average number of shares outstanding - diluted	25,459,579	25,237,721	25,033,020	24,401,989	24,285,756	24,208,862	24,093,597	22,303,427

### Volatility of Operating Results

Our quarterly operating results have fluctuated in the past and may fluctuate significantly in the future depending on factors such as demand for our products, the size and timing of orders, the number, timing and significance of new product announcements by us and our competitors, the ability to develop, introduce and market new and enhanced versions of products on a timely basis, the level of product and price competition, changes in operating expenses, changes in our sales incentive strategy, sales personnel changes, the mix of direct and indirect sales and general economic factors, among others.

A significant portion of our expenses are based on expectations of future revenue and, therefore, is relatively fixed in the short-term. Expenses have generally increased on a quarterly basis reflecting the investment in sales and marketing capabilities and product development activities over this time period. Quarterly gross margin has decreased relative to growth in revenue in the most recent quarters reflecting the direct costs and support resources required in delivery of our integrated systems products. Timing of revenue is impacted by our customers' requirements for capacity or technical solutions as well as their internal budget cycles and spending patterns. Accordingly, if revenue levels are below expectations, operating results are likely to be adversely affected. Operating results have been impacted by incremental costs of advisors to the Board of Directors and related committees to respond to the request for a shareholder meeting received from Crescendo Partners. The Company had a \$0.1 million bad debt expense in the quarter ended December 31, 2009, \$0.5 million of bad debt recovery in the quarter ended June 30, 2009, and incurred \$0.2 million of bad debt expense in the quarter ended March 31, 2009 in addition to a \$1.1 million of bad debt expense in the quarter ended December 31, 2008. We caution that period-to-period comparison of results of operations is not necessarily meaningful and should not be relied upon as any indication of future performance.