



**MANAGEMENT'S DISCUSSION & ANALYSIS  
FOR THE SECOND QUARTER ENDED JUNE 30, 2006**

## **Introduction**

This following Management's Discussion and Analysis ("MD&A") for the three-month period ending June 30, 2006, compared with the three-month period ending June 30, 2005, provides an overview of the operations of Synergex Corporation ("Synergex") and a more detailed explanation of its financial statements. This MD&A provides information that management of Synergex believes is important to assess and understand the results of operations and financial condition of Synergex for the three-month period from April 1, 2006 to June 30, 2006.

Our objective is to present readers with a view of Synergex through the eyes of management by interpreting the material trends and uncertainties that affect the operating results, liquidity and financial position of Synergex. This discussion and analysis should be read in conjunction with Synergex' Interim Consolidated Financial Statements and accompanying notes thereto for the six month period ended June 30, 2006, Consolidated Financial Statements and accompanying notes thereto for the twelve month period ended December 31, 2005. The Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. All monetary amounts, unless otherwise indicated, are expressed in Canadian dollars.

## **About Synergex Corporation**

Synergex Corporation is a leading provider of business solutions. Synergex' objective is to deepen our involvement in markets we service in profitable and sustainable ways. We provide a variety of services and technology solutions from a deep base of management experience and success that allow our customers to optimize their business processes, improve customer satisfaction, achieve quality assurance goals, and reduce costs. Our strategy has enabled us to deliver continuing growth and good financial performance since the roots of our organization were established 19 years ago. We will continue to build a stronger platform for future profitability.

Across all Synergex businesses, we are steadily generating more business while also investing for long-term growth. The balance of the decade will be an exciting time of growth for Synergex. We will pursue a unified vision in all of our businesses: to be a premier, multi-industry company emphasizing the use of special skills and emerging technologies to provide an expanding breadth of solutions to our customers' business objectives.

The following is a current snapshot of Synergex' businesses as at June 30, 2006:

- 1) Synergex Commercial Gateway is one of Canada's leading providers of video game products. Commercial Gateway delivers value-added supply chain management and distribution solutions to its customers, which include some of the world's leading computer entertainment publishers and a variety of mid-sized manufacturers, including Sony Computer Entertainment America, Namco Bandai Entertainment Inc., LucasArts Entertainment Company LLC and Midway Home Entertainment Inc. Its wide range of complementary services generates multiple revenue streams for Synergex.
- 2) Synergex Technology designs, implements, and supports a variety of information technology based solutions, including Radio Frequency Identification ("RFID") technology. Management believes this workgroup will be an important growth platform

in the future. We are confident that our Workforce Automation Solutions using RFID will be a revolutionizing technology, allowing workers and organizations to partner together in satisfying their customers in ways not previously achievable. Synergex is also a leader in RFID implementation and systems integration in industrial control automation.

3) Synergex Digital Media is developing online marketing technologies, including its innovative SmartCatalogue technology, and performs commercial graphic and print layout design, web site development, language translation, digital signage solutions, and on-demand printing.

4) Synergex Business Information provides trade credit risk evaluation and reporting services, legal resource services, accounts receivable management, debt collection services, pre-employment background checking, and paralegal services through Lumbermen's Credit Bureau and Canada Bonded Attorney. Lumbermen's Credit Bureau is a leading credit reporting service to the construction industry in Ontario, and is strengthening its presence in Alberta. Canada Bonded Attorney runs our accounts receivable management and debt collection business.

## **Overview**

Results during the quarter were in line with management's expectations for both sales and earnings as we completed a seasonally low quarter and prepare for the peak season, which begins in October. We are approaching this busy season in an excellent position to supply customers with high-quality services. As part of our commitment of ongoing and rapid innovation, we developed and implemented a number of important innovations in internal processes. Traditionally we use this time of year to optimize workflow and train staff in advance of the high-volume season.

In Q3 Synergex will be consolidating its three Mississauga locations in to one larger facility and upgrading its IT and communications infrastructure. Synergex is better positioned due to these sustaining investments in infrastructure, making valuable improvements to our supply chain technology and the strength of our information systems. Through these investments, we continually enhance our ability to support greater business volume, achieve operating efficiencies and maintain a fast-paced innovation in our corporate culture.

## **Financial Overview**

Taking into account the seasonality of the industry we are pleased with our results for the period ended June 30, 2006.

Total sales increased in Q2 by 28.2% relative to the same period in the prior year primarily due to obtaining new customers, and providing them with a wider range of diversified products. Total sales decreased in the six months ended June 30, 2006, relative to the same period in the prior year primarily due to the timing of large launches of new products in the prior year.

Computer entertainment software sales traditionally provide higher margins than hardware and have continued to drive gross profit growth. New product launches and continuing sales of hardware and peripheral devices generate trailing software sales growth as consumers purchase software products. The launch of Sony Computer

Entertainment America's PlayStation 3 expected in Q4 should benefit both sales and gross profit and further enhance software sales growth.

Computer entertainment software sales, one of our core revenue streams, continued to grow year over year. This continued software sales growth and increase in our gross profit as a percentage of sales, has positively impacted our overall gross profit.

The Company's innovations and efficient use of available resources resulted in net income for the second quarter of 2006 to increase by 105.2% compared the same period in the prior year. Despite the decrease in revenue, net income for the six-month period ended June 30, 2006, surpassed the net income in the same period from the prior year.

Highlights of the Company's consolidated financial results for the three months ended, June 30, 2006, compared to the three months ended June 30, 2005 were as follows:

- Sales increased to approximately \$26.3 million, or 28.2 percent above the \$20.6 million in sales recorded in the same period from the prior year;
- Gross profit increased to \$4.4 million (16.6% of sales) from \$3.1 million (14.9% of sales) or 42.7% above the same period in the prior year;
- Income before income taxes increased to approximately \$1.2 million from approximately \$0.6 million in the same period in the prior year;
- Net income doubled in the second quarter to approximately \$0.8 million from \$0.4 million in the same period of the prior year; and
- EBITDA increased 61.9% to approximately \$1.3 million compared to \$0.8 million in the same period in the prior year.

For the six months ended, June 30, 2006, compared to the six months ended June 30, 2005:

- Sales decreased to approximately \$55.2 million, or 14.3 percent below the \$64.4 million in sales recorded in the same period from the prior year;
- Gross profit increased to \$8.6 million (15.6% of sales) from \$7.7 million (11.9% of sales) or 12.4% above the same period in the prior year;
- Income before income taxes was approximately \$2.4 million in both periods;
- Net income for the six months ended, increased to approximately \$1.5 million from \$1.4 million in the same period of the prior year; and
- EBITDA remained relatively flat, decreasing 4.3% to approximately \$2.6 million compared to \$2.8 million in the same period in the prior year.

## **Results of Operations**

The results of operations for the three and six months ended June 30, 2006 compared to June 30, 2005 are summarized as follows:

Summary of Operations (in thousands of dollars, except earnings per share)	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Sales	\$26,336	\$20,550	\$55,205	\$64,386
Gross Profit	4,384	3,071	8,636	7,682
Expenses				
General and administration	2,794	2,036	5,160	4,169
Sales expense	266	176	839	529
Interest and bank charges	47	57	84	104
Interest income	(121)	(42)	(203)	(74)
Amortization of equipment	187	167	358	326
Amortization of customer list	24	24	48	48
Employee termination costs	0	9	0	20
Business combination costs	0	32	0	210
Income before income taxes	1,187	612	2,350	2,351
Provision for income taxes	369	213	816	924
Net income for the period	818	399	1,534	1,427
Earnings Per Share:	\$0.01	\$0.00	\$0.01	\$0.01
Basic and Fully diluted				

### Seasonality

The Commercial Gateway business is a diversified suite of disciplines. We manage complementary business processes for our customers, which at the present time primarily involves comprehensive supply chain management and sale of video game products to retailers and sub-distributors in Canada. Other value-added services include freight forwarding, and pick-and-pack services, technology management, invoicing, collections, reconciling of customer debits, flow through of debits between retailers and publishers, digital media creation and printing services. Retail activity is traditionally at its highest from October through January.

Sales generated from credit reporting and evaluation services are predominantly generated from contracts, with the sales amortized over the life of the contract.

### Consolidated Sales

Consolidated sales for the three-month period ended June 30, 2006 totaled \$26,335,807, an increase of \$5,785,369 or 28.2% from \$20,550,438 for the same period last year. Consolidated sales for the six months ended June 30, 2006 totaled \$55,204,722, a decrease of \$9,181,737 or 14.3% from \$64,386,459 from the same period last year.

Sales vary from quarter to quarter due to the increasing number of customers we serve, seasonality, the timing of product introductions, and the pricing strategy of our suppliers and customers. Sales increased in the second quarter relative to the prior year primarily due to obtaining new customers, and providing them with a wider range of diversified products. Sales for the six months ended June 30, 2006, decreased due to the timing of large launches of new products in the prior year.

In Q2 gross profit increased to 16.6% of sales in 2006 compared to 15.9% of sales in the same period in 2005. For the six months ended June 30, gross profit increased to 15.6% of sales in 2006 compared to 12.4% of sales in the same period in 2005.

Consolidated sales for the last ten quarters are summarized in the table below:

**Sales (in thousands of dollars)**

	2006	2005	2004
First Quarter	\$ 28,869	\$ 43,836	\$ 16,259
Second Quarter	26,336	20,550	20,912
Third Quarter		29,801	23,320
Fourth Quarter		57,080	53,232
<b>Total Sales</b>	<b>\$55,205*</b>	<b>\$151,267</b>	<b>\$113,723</b>

*\*year-to-date sales*

**Gross Profit**

Consolidated gross profit for three months ended June 30, 2006 was \$4,383,645 or 16.6% of sales, an increase of \$1,312,183 or 42.7% compared to \$3,071,462 or 14.9% of sales in the same period last year. Consolidated gross profit for the six months ended June 30, 2006 totaled \$8,636,008 or 15.6% of sales, an increase of \$953,560 or 12.4% compared to \$7,682,448 or 11.9% of sales in the same period from the prior year.

The percentage increase was due primarily to the product mix sold, economies of scale achieved in transportation and labour costs, and a favourable trend in international currency exchange rates.

**Operating Expenses**

Operating expenses for the three months ended June 30, 2006, including general and administrative expenses, sales expense, interest and bank charges, interest income, amortization expenses, employee termination costs, and business combination costs totaled approximately \$3.2 million, an increase of approximately \$737,000, or 30.0%, from \$2.5 million in the second quarter of last year. Operating expenses for the six months ended June 30, 2006 totaled approximately \$6.3 million, an increase of approximately \$954,000, or 11.9%, from \$5.3 million in the same period from the prior year.

The increase in costs pertains primarily to the addition of resources including: programmers, sales staff and ancillary costs in 2006 to assist with the implementation of new technology business platforms.

**Income before Income Taxes**

Income before income taxes for the second quarter was \$1,186,910, an increase of \$575,325 or 105.2% compared to \$611,585 in the second quarter of the prior year. Year to date income before taxes was \$2,350,246, a decrease of \$894 compared to \$2,351,140 from the same period in the prior year. The reasons for the difference between quarters include the following:

- Increased sales and gross profit in Q2 due to product sales mix from increased computer entertainment software sales;

- Increased sales expense;
- Increased interest income, and decreased bank charges; and
- The elimination of employee termination costs and business combination costs.

Net income after taxes for the second quarter of 2006 was \$817,910 or approximately \$0.01 per share (basic and fully diluted) compared to \$398,585 or approximately \$0.00 per share (basic and fully diluted) in the same quarter a year ago. Year to date, net income after taxes for 2006 was \$1,534,246 or approximately \$0.01 per share (basic and fully diluted) compared to \$1,427,140 or approximately \$0.01 per share (basic and fully diluted) in the same period a year ago.

## **EBITDA**

References in these materials to “EBITDA” are to net income before interest expense, interest income, income taxes, loss (gain) on sale of equipment, and depreciation and amortization. EBITDA is not a recognized measure under Canadian GAAP. Investors are cautioned that EBITDA should not be construed as an alternative to net earnings or cash flows from operating activities (determined in accordance with GAAP) as a performance indicator, or to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows. Synergex’ method of calculating EBITDA may differ from other issuers and, accordingly, EBITDA may not be comparable to similar measures presented by other issuers. EBITDA performance is presented herein because management believes that, in addition to net income, EBITDA is a useful supplemental measure of Synergex’ financial performance.

EBITDA for the second quarter of 2006 was \$1,324,218 compared to EBITDA of \$818,061 in the same period a year ago. Year to date EBITDA for the first half of 2006 was \$2,636,503 compared to EBITDA of \$2,754,560 in the same period a year ago.

## **Liquidity and Cash Resources**

Synergex’ primary sources of cash are cash flow from operations. Cash has been used for the purchase of equipment, investment in technology, and general working capital uses, specifically managing levels of accounts payable, accounts receivable, and inventory.

As of June 30, 2006, Synergex had a net cash position of \$7,876,822 compared to \$6,378,456 as at December 31, 2005.

Year to date, Synergex generated \$2,641,808 in cash from operations compared to \$1,294,872 in the same period in the prior year.

Synergex’ net cash position varies with income earned, the timing of cash receipts from customers, the timing of payments to suppliers, investment in fixed assets and other capital transactions. Working capital as at June 30, 2006 totaled \$12,340,791 compared to \$7,814,740 as at June 30, 2005.

Synergex maintains un-utilized credit facilities with a Canadian chartered bank in the event that short-term financing is required. Synergex has nominal long-term financial debt. Maintaining liquidity is a key factor in management’s funding strategy, and ensures our ability to satisfy the needs of customers and suppliers.

Our policy is to have sufficient cash and cash equivalents and to have access to credit facilities in order to provide liquidity for all of our foreseeable funding requirements. Management expects that Synergex' positive working capital position will be maintained and believes that its working capital is sufficient to support its current operations and foreseeable obligations. As the business expands some external financing may be required.

### Consolidated Financial Position

Total consolidated assets increased to \$31,502,781 at June 30, 2006 from \$22,851,352 as at June 30, 2005.

Total Shareholders' Equity increased to \$14,671,960 at June 30, 2006 from \$10,215,243 as at June 30, 2005.

### Summary of 2006, 2005 and 2004 Quarterly Results

Fiscal 2006 (thousands of dollars)				
	Q1	Q2		
Sales in the quarter	\$28,869	\$26,336		
Gross Profit	4,252	4,384		
General and administration	2,368	2,793		
Sales expense	573	266		
Interest income	(84)	(121)		
Interest expense	37	48		
Amortization of equipment	171	187		
Amortization of customer list	24	24		
Provision for income taxes	447	369		
<i>Net income in the Quarter</i>	\$ 716	818		
<b><i>EBITDA, 2006, in the quarter</i></b>	<b>\$1,312</b>	<b>1,324</b>		

Fiscal 2005 (thousands of dollars)				
	Q1	Q2	Q3	Q4
Sales in the quarter	\$43,836	\$20,550	\$29,801	\$57,080
Gross Profit	4,611	3,071	4,156	9,462
General and administration	2,133	2,036	2,464	2,952
Sales expense	353	176	331	2,931
Interest income	(32)	(42)	(42)	(81)
Interest expense	47	57	34	75
Amortization of equipment	159	167	170	216
Amortization of customer list	24	24	24	24
Employee termination costs	12	9	2	19
Loss (gain) on disposal of equipment	-	-	-	(16)
Business combination costs	177	32	4	(125)
Provision for income taxes	711	213	461	1,219
<i>Net income in the Quarter</i>	\$1,029	\$399	\$708	\$2,248
<b><i>EBITDA, 2005, in the quarter</i></b>	<b>\$1,937</b>	<b>\$818</b>	<b>\$1,355</b>	<b>\$3,685</b>

<b>Fiscal 2004 (thousands of dollars)</b>				
	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>
Sales in the quarter	\$16,259	\$20,912	\$23,320	\$53,232
Gross Profit	2,636	2,683	2,723	5,085
Gross Profit General and administration	1,783	1,894	1,858	2,555
Sales expense	205	164	220	624
Interest income	(36)	(30)	(25)	(38)
Interest expense	69	84	28	54
Amortization of equipment	159	160	157	178
Amortization of customer list	-	-	-	56
Loss (gain) on disposal of equipment	-	-	311	(3)
Employee termination costs	-	50	39	8
Lease termination costs	-	-	57	-
Business combination costs	-	-	-	147
Provision for income taxes	190	125	250	82
<i>Net income(loss) in the Quarter</i>	\$266	\$236	\$(172)	\$1,422
<b>EBITDA, 2004, in the quarter</b>	\$648	\$575	\$549	\$1,752

### **Outstanding Share Data**

Set out below is our outstanding share data as at June 30, 2006. For additional information, refer to Note 8 to our 2005 Annual Audited Consolidated Financial Statements and to Note 5 to the Unaudited Interim Consolidated Financial Statements for the three and six months ended June 30, 2006.

Common Shares	111,592,785
Series A Preference Shares	6,574,219
Outstanding Options	979,000

### **Nature of Operations**

The natural result of Synergex' business relationships and market share in the computer entertainment sector in Canada is that a significant percentage of its sales and purchases are concentrated among a limited number of customers and suppliers. For the six months ended June 30, 2006, three customers each accounted for more than 10% of sales and four suppliers each accounted for more than 10% of purchases. In fiscal 2005, three customers each accounted for more than 10% of sales and three suppliers each accounted for more than 10% of purchases.

### **Related Party Transactions**

In the normal course of operations, the Company provides logistics services and recovers general and administrative costs from two companies owned by a director. For additional information, refer to Note 11 to our 2005 Annual Audited Consolidated Financial Statements and to Note 6 to the Unaudited Interim Consolidated Financial Statements for the three and six months ended June 30, 2006.

## **Forward Looking Statements**

Some statements contained in this MD&A are forward-looking statements relating to Synergex' current expectations regarding future events. These forward-looking statements are based on our current expectations. We caution that all forward-looking information is inherently uncertain and actual results may differ materially from the assumptions, estimates or expectations reflected or contained in the forward-looking information, and that actual future performance will be affected by a number of factors, including economic conditions, technological change, regulatory change, and competitive factors, many of which are beyond our control. Therefore, future events and results may vary significantly from what we currently foresee. For more information on the Company's risks and uncertainties relating to these forward looking statements, please refer to the risk factors section of this MD&A below.

## **Risk Factors**

Any investment in the securities of Synergex must be considered speculative, generally, because of the nature of its business and the general stage of its development. In addition to the usual risks associated with investment in a business, investors should carefully consider the following risk factors:

### ***Possible Volatility of Stock Price***

The market price of Synergex' common shares has been and may be subject to wide fluctuations in response to factors such as actual or anticipated variations in Synergex' consolidated results of operations, general market considerations, and other factors. Market fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations may adversely affect the market price of the common shares.

### ***Competition***

Synergex' competition is comprised of comprehensive logistics, supply chain management, distribution, international freight forwarding, digital media design and printing, information technology procurement, development and implementation, credit reporting, and third-party debt recovery businesses. These are highly competitive industries with many competitors, the size of which vary significantly from small, owner-managed businesses to large companies. This may present some opportunities for acquisitions.

### ***Risks Associated with Expansion Activities***

To successfully implement its corporate strategy, Synergex must be able to successfully integrate new assets and skills into an expanded suite of business disciplines. The consolidation and integration of functions procedures presents an ongoing management function. The failure to achieve such integration could have a material adverse effect on the results of operations of Synergex. As a result, although Synergex believes it can successfully integrate its acquisition activities into its operations, there can be no assurance that Synergex will achieve improved operating results in each successive period. Ongoing product development activities and investment in our staff and technology base are essential to a) ensure our leadership, b) strengthen our competitiveness, c) deepen our service capabilities, and d) continue to implement our corporate concept.

### ***Integration of Acquired Businesses and Growth***

As part of its long-term strategy, Synergex intends to acquire complementary businesses that are economically and strategically justified.

However, there can be no assurance that Synergex will be able to identify attractive acquisition candidates in the future or that it will necessarily succeed in effectively managing the integration of acquired businesses. If the expected synergies from those transactions do not materialize, or if it fails to successfully integrate acquired businesses there may be an adverse effect on the business.

### ***Dependence on International Trade and Continuing Trend to Outsource Logistics Services***

Synergex' principal businesses are directly related to the volume of international and domestic trade, in particular, cross-border trade between Canada and other countries. Such trade is influenced by many factors, including North American and overseas economic and political conditions, major work stoppages, wars, terrorist acts or security operations, currency fluctuations and Canadian and foreign laws relating to duties, trade restrictions, foreign investments and taxation. There can be no assurance that trade-related events beyond the control of Synergex, such as an increase in trade restrictions, will not have an adverse effect on Synergex' business.

### ***Dependence on Equipment and Qualified Personnel***

To maintain a competitive position in the industry, Synergex will continue to place an emphasis on providing high quality services to its customers. Synergex continues to provide its employees with on-going training and education, and utilizes reliable, up-to-date capital equipment, and computerized systems maintained through an in-house programming staff. However, there can be no assurance that Synergex will not experience employee turnover in the future or that Synergex' labour costs will not increase. There is no assurance that the Corporation will be able to continue to hire and retain a sufficient number of qualified personnel.

### ***Creating New Revenue Sources***

In addition to capturing a portion of the market by offering traditional services, Synergex' ability to grow revenue is based, in part, on its ability to sell additional value-added services to its existing and new clients, sometimes in nontraditional business models.

### ***Vulnerability to Economic Conditions***

Synergex is dependent on the economic environments in which it operates. Demand for Synergex' services could be adversely affected by economic conditions in the sectors in which Synergex' customers operates. Synergex' business has also experienced and is expected to experience fluctuations, and can be sensitive to external factors such as events which may adversely affect the economy and consumer spending. There can be no assurance that such factors may not have an adverse effect on Synergex' business.

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

The success of Synergex is dependent on the abilities, experience, and efforts of a number of members of senior management. The experience of these individuals, as well as new talent that we attract to our organization, will be an important factor contributing to Synergex' continued success and growth. While Synergex has entered into employment agreements with its senior management and with substantially all full-time employees, should these persons be unable or unwilling to continue his or her employment with Synergex, the loss of one or more of these individuals could have an

adverse effect on Synergex' operations and business prospects. Synergex does not carry "key man" insurance policies on any of its officers, directors, or employees.

***Seasonality***

Although Synergex' businesses are increasingly diversified across various product lines and is carried on with a variety of customers, portions of its business and that of some of its customers (particularly those driven by consumer spending) are subject to seasonality. Synergex' results of operations generally vary between quarterly periods as a result of such seasonality.

***Foreign Exchange***

Synergex conducts its business primarily in Canada and purchases a large percentage of the goods it sells in U.S. funds. Exchange rate fluctuations in the spot market are beyond Synergex' control and there can be no assurance that unmitigated exchange rate fluctuations would not have a material adverse effect on Synergex' business. Synergex continually analyzes the currency-related risks that it faces and may engage in mitigating transactions to limit its exposure to such risks, but there can be no assurance that any mitigating strategy will, if entered into, be successful.

***Contingencies***

In the normal course of operations, there are or may be claims or proceedings instituted against Synergex. Management does not expect that these claims or proceedings will have a material effect on the financial position of Synergex or its results of operations. Losses sustained, if any, will be recorded on the statements of operations at such time as the loss is determined.

## **Synergex Corporation's Management and Board of Directors**

David O. A. Aiello, CA  
President, CEO, and Director

Nick Blasutto, CA, CBV  
Chief Financial Officer

John L. Smith  
Senior Vice-President and Director

Matthew Reiter  
Senior Vice-President

Jean-Paul Rehr  
Vice-President

Eric So  
Vice-President and General Counsel

David A. Aello  
Chairman of the Board

Neil Fleshner, MD  
Director

Tom Davidson  
Director

Phil Walton  
Director

**AUDITORS:**  
Daurio & Franklin LLP

**LAWYERS:**  
Goodman and Carr LLP  
Fraser Milner Casgrain LLP  
Minden Gross Grafstein and Greenstein LLP

**INVESTOR RELATIONS:**  
BarnesMcInerney Inc.

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*For more information on the company and what Synergex can do for your business, please visit our website at: [www.syx.ca](http://www.syx.ca). Additional information regarding Synergex Corporation is available under its profile on SEDAR at [www.sedar.com](http://www.sedar.com).*