1986
Annual Report

SHL Systemhouse Inc.

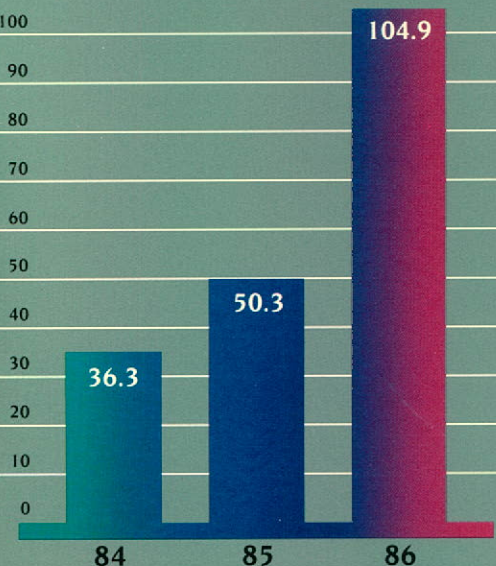
Table of Contents

Systemhouse
designs, develops and integrates
computer-based information
systems

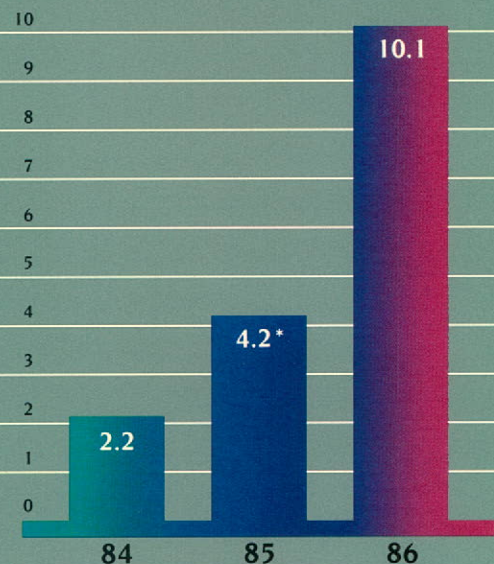
All financial information in this annual report is expressed in Canadian dollars unless otherwise stated.

Financial Highlights

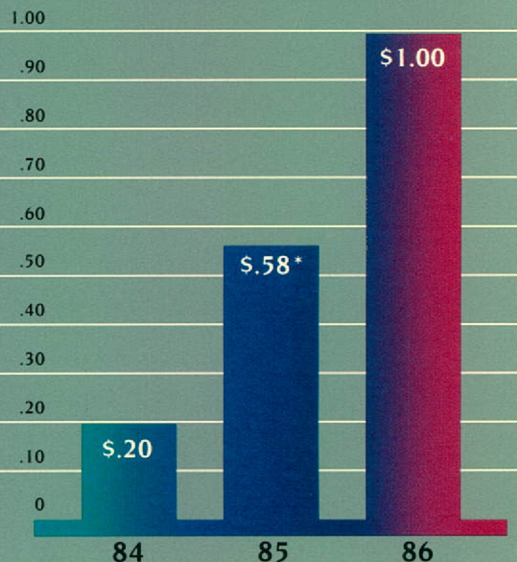
From Continuing Operations



Revenue
(in millions)

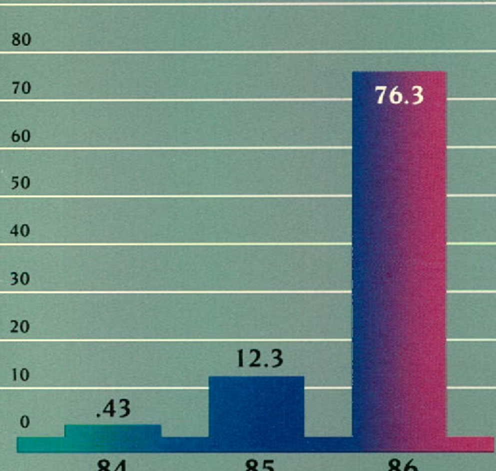


Net Income
(in millions)

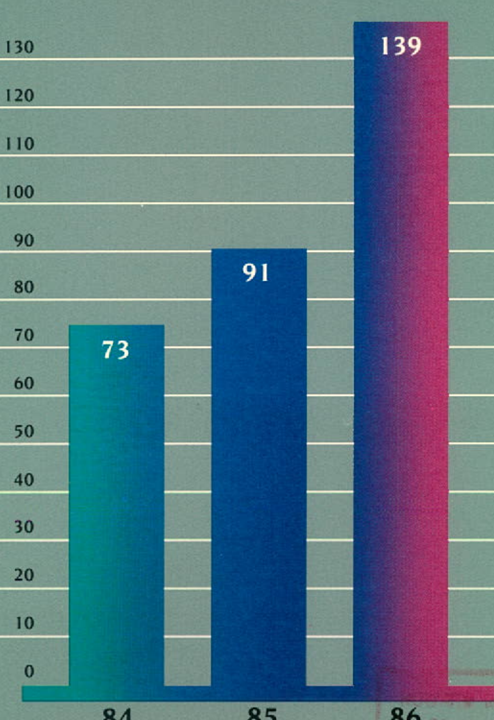


Earnings Per Share

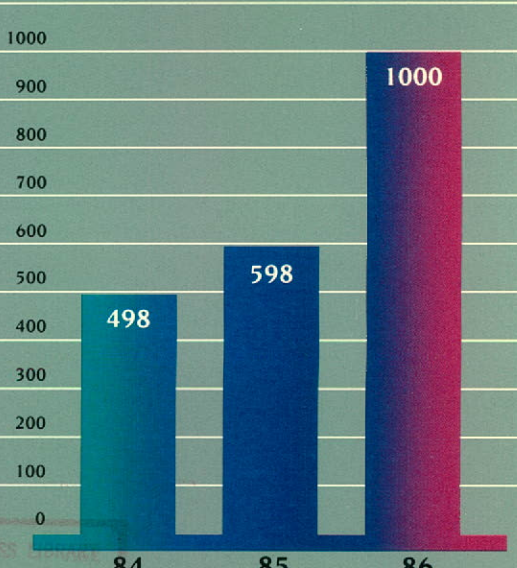
*Excludes gain of $4.8 million from sale of discontinued operations.



Tangible Net Worth
(in millions)



Revenue Per Employee
(in thousands)



Employees

Message to Shareholders

1986 was a year of growth and change for Systemhouse. It was also the year that our business, systems integration, emerged as a strategic segment of the computer services industry.

In each major operational element, Systemhouse experienced significant growth compared to 1985: total revenues – $104.9 million vs. $50.3 million; income – $10.1 million vs. $4.2 million; earnings per share – $1.00 vs. $.58; net income as a percentage of total revenue – 9.6% vs. 8.3%; employees at year-end – 1,000 vs. 598; revenue per employee – $139 thousand vs. $91 thousand; order backlog – $147 million vs. $24 million; shareholders' equity – $86.9 million vs. $12.3 million; working capital – $68.9 million vs. $8.4 million.

These results were achieved from an industry segment still in its infancy. Of over $200 billion of computer hardware, software and professional service components sold annually in North America, less than 10% flows to the customer as an integrated system from a supplier that takes full responsibility to deliver the system. However, the expansion in the power and complexity of computer systems technology is driving the demand by customers for systems solutions rather than components.

The current growth of the systems integration marketplace does not depend upon growth in sales of system components, but, rather, upon the share of those sales that flow through the systems integration channel. During 1986, there was a continued increase in the demand of customers to use this channel, thereby providing strong sales opportunities for Systemhouse in spite of a relatively sluggish growth in demand for the individual components.

In 1986, Systemhouse continued to expand its business in Canada, where it is well established in every region of the country. Our newly established International Systems Branch achieved profitability in its first year of operation and will be a strong contributor to growth in 1987 and beyond. Revenues from Canada and overseas were $52.2 million, up from $37 million last year, and backlog increased from $19.7 million to $25.5 million.

The principal focus of growth for 1986, however, was in the United States. During 1986, revenues in the United States were $52.7 million, a four times increase over 1985; backlog at year-end increased to $121 million from $4 million. This growth process was the result of strong performance by the established branches plus the acquisition and merger of Capital Systems, Inc. of Alexandria, Virginia. Capital Systems brought to Systemhouse excellent people, and a solid reputation among its customers.

Financial resources to support this growth and to continue expansion through 1987 were provided through two share offerings, one in November and one in June, for net proceeds of $59.2 million.

In 1987, Systemhouse is committed to maintaining our extraordinary reputation for delivering high quality results to our customers. We will continue to focus our internal efforts on ensuring that our own systems and processes keep pace with our growth. We are committed to quality results and technology leadership. Every one of our employees shares this commitment. We, in turn, are committed to creating the most exciting and challenging career opportunities in the industry.

We offer a special thank you to our customers, our employees and our shareholders. It is because of them that there is every reason to be enthusiastic about the opportunities that lie ahead.

Roderick M. Bryden
Chairman & Chief Executive Officer

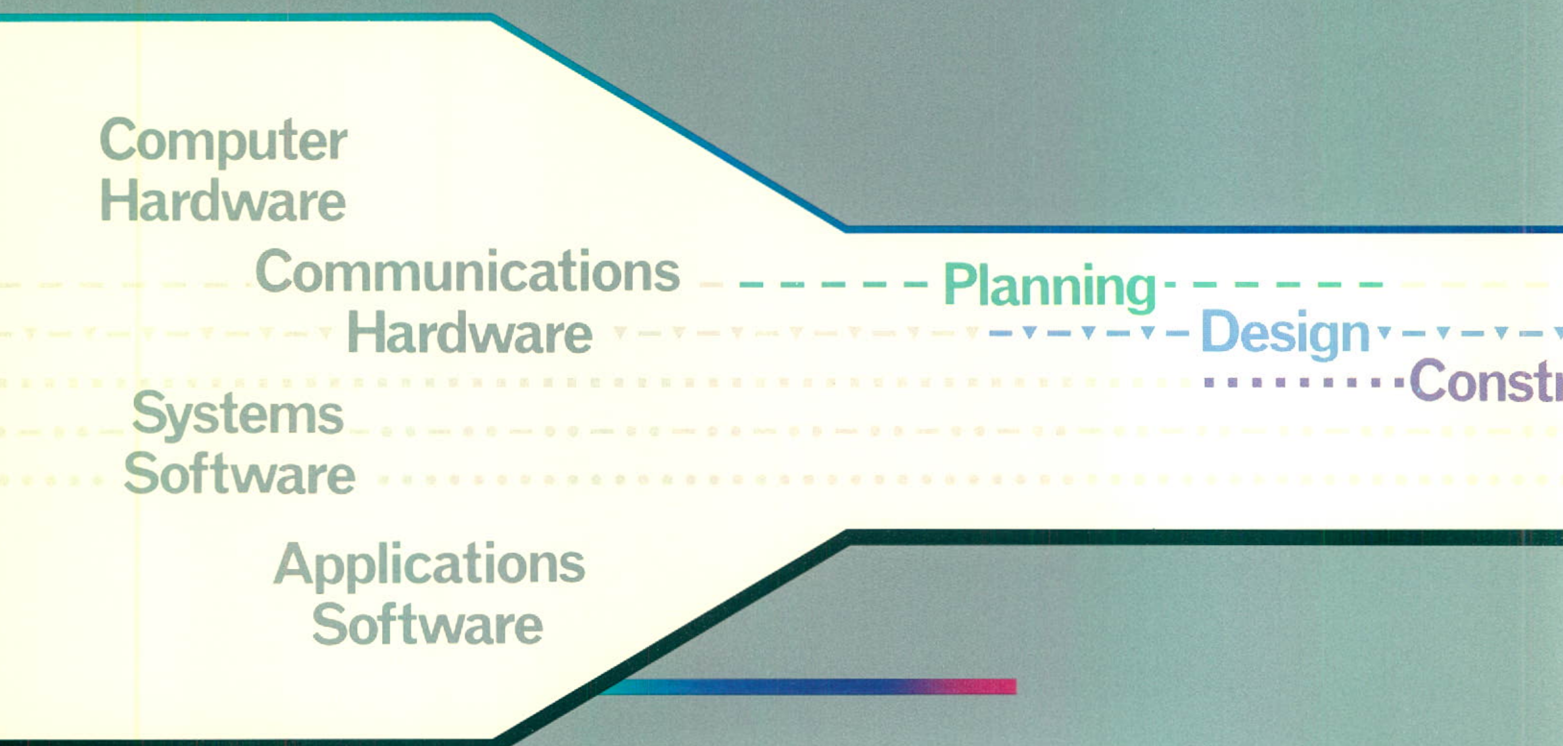
Peter A. Sandiford
President & Chief Operating Officer

Business of the Company

Systemhouse designs, develops and integrates computer-based information systems. Since its founding in 1974, the Company has focussed on the application of evolving hardware and software technology to meet the specific needs of customers. This business, systems integration, is rapidly emerging as a strategic segment of the computer industry.

Computer systems integration is the process of delivering a complete systems solution to meet specific operational and management needs of an organization. Systems typically comprise computer and communications hardware, systems and application software, often combining both custom and packaged software, and a range of implementation services. Increasingly, ongoing operation of the systems under a facilities management agreement has become part of the complete solution organizations are seeking.

Through many years of activity focussed on this objective, Systemhouse has accumulated all of the ingredients to deliver large, complex systems — on time and for a fixed cost — to meet the ultimate needs of the end user. Our detailed proprietary methodology and tools, our management processes, and our over 1,000 professional staff all contribute to this unique capability. Underlying every activity in the Company is a commitment to quality and results. Our unbroken record of customer satisfaction attests to this commitment.



Systems Integration

Systems integration can be represented as a channel. Product technologies, in the form of computer and communications hardware as well as systems and application software products, flow through the Systemhouse channel to meet the needs of our customers. We execute systems integration in system life cycle phases — planning, design, construction, implementation, and operation — with the aid of our comprehensive proprietary methodology covering each phase of the process. In this process, we deal with the organization's data, applications, and technology, both separately and as they must work together to create an integrated systems solution. Systemhouse works with its clients in all phases to help them achieve maximum benefit from the explosive advances in computer and communications-based technology.

Planning

As information technology becomes more pervasive, integrated planning for data, applications and supporting technology is increasingly critical to an organization's long term success. Planning is fundamental to every aspect of our work, whether it is directed at long term strategic uses of data or focussed on the successful implementation of new application software or hardware. Our approach encompasses a wide range of planning activities, including:

"Integrated planning for data, applications and supporting technology is increasingly critical to an organization's long term success."

- understanding the customer's business objectives, corporate strategies, and organizational philosophies together with the business and regulatory environment in which they exist;
- providing executive-level assistance in identifying strategic opportunities for the use of technology;
- performing data analysis and preparing data models which represent the information resources of the organization;
- analyzing business transactions and information flows;
- assessing the customer's current technical environment and charting a course for its evolution;
- preparing specific hardware architectures and communication network plans, and selecting appropriate database tools, methodologies, compilers and programming languages;
- recommending improved organizational structures and management processes;
- preparing detailed project plans in accordance with functional needs and application systems priorities;
- site planning, including space, power, lighting, and communications; and
- conducting workshops, seminars, interviews, executive briefings.

Planning for integrated systems is all of the above and more. It is the result of years of accumulated experience of expert staff, captured in our proprietary methodology.

Planned and implemented by Systemhouse, WAVES (Worker and Visitor Entrance System) will help control visitor access to the White House and the Old and New Executive Office Buildings.

Systemhouse planned the Arizona Technical Eligibility Computer System (AZTECS) to support human services program delivery through 56 State Department of Economic Security field offices and a 1000-terminal network.

Design

The success of any system lies in the quality of its design. Our design considers the total context of the systems we create or enhance. Nothing is considered in isolation from the whole. During the design stage, we engineer and specify a complete solution, blending individual components to provide optimal value to our clients.

"We engineer and specify a complete solution, blending individual system components to provide optimal value to our clients."

Integrating components from a variety of vendors is necessary to take full advantage of available technologies. Complex systems typically require the networking of a number of unique products, often from different manufacturers, ultimately linked with a host mainframe computer. We connect them with software and physical links through a variety of communications equipment and carriers — all carefully selected to meet the unique requirements of each customer.

We design the databases, the screens, the reports, the procedures, the communications networks as well as the physical facilities in which the system will eventually operate. We have the people, the methodology, the tools and the experience to create a system which meets the ultimate needs of the user.

System design determines system performance. Proven predictive models for performance design ensure the ability of the system to handle the anticipated transaction volumes and data uses.

Systemhouse designed the PARIS System for Shell Canada to track and control the production and movement of natural gas, gas products, and crude oil from the wellhead through processing plants to the pipelines.

The Company designed the Warrant System for the Los Angeles County Sheriff's Department that will produce 600,000 warrants annually and interface with 50 law enforcement agencies.

Construction

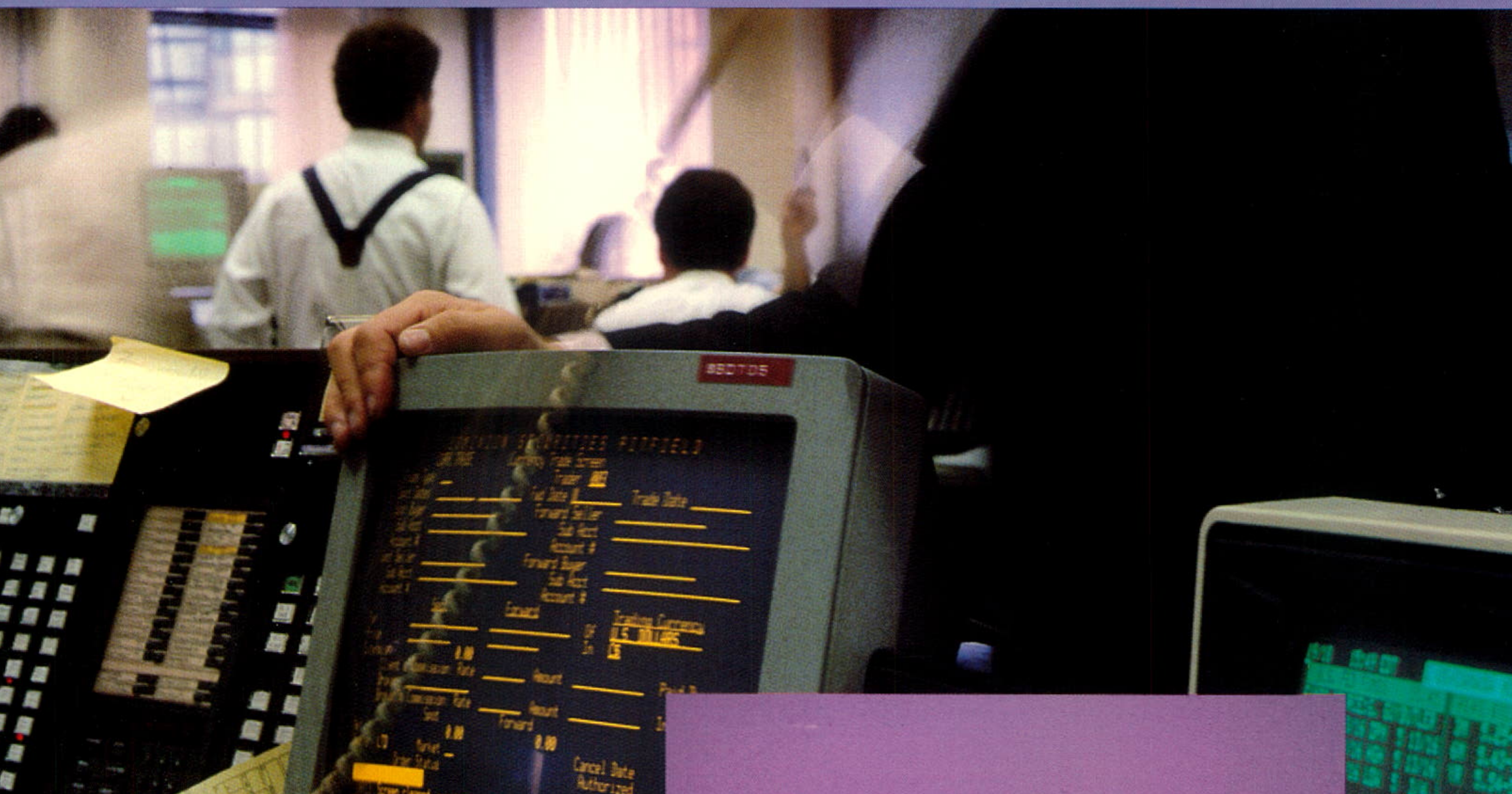
The construction of the system is where the planning, design, and components come together through the expertise of the integrator. It is often the most complex step in creating systems and typically consumes the bulk of the budget. The effective use of advanced tools and techniques now play an important role in controlling the risks and costs of system construction. Systemhouse is an industry leader in this area — a competitive advantage we intend to maintain.

"We develop custom software, modify existing software, integrate off-the-shelf software or hardware, and tailor the interfaces between the various components to create a working system."

During the construction phase, we develop custom software, modify existing software, integrate off-the-shelf software or hardware, and tailor the interfaces between the various components to create a working system.

Often, during construction, we work closely with end-users to build prototype systems. This approach reduces technological uncertainty and possible incompatibilities between products from different vendors. For other customers, there may be little or none of this uncertainty, in which case a tightly structured process, building module by module to very precise specifications, is appropriate.

Whether integrating the hard technologies to create distributed networks, or developing application software systems to run on these networks, Systemhouse's success depends ultimately on its project management principles, processes, systems and top-to-bottom commitment to quality.



The Automated Trading and Clearing System (ATAC) will accommodate Dominion Securities' trading volume in currencies and money market securities averaging $1 billion daily.

The status of Canada's commercial air traffic control and radar systems will be monitored by a real-time system developed by the Company.

Implementation

The effort expended in system planning, design and construction is only of value if the system can be implemented efficiently and the customer can make the smooth transition to effective operations.

Our implementation activities include hardware and software installation, user training, data conversion, acceptance testing, and live-run coaching. The keys to success are advance planning and user involvement.

> **"Systemhouse co-ordinates the multitude of concurrent tasks carried out by clients, suppliers, and our own staff to bring the system into effective operation."**

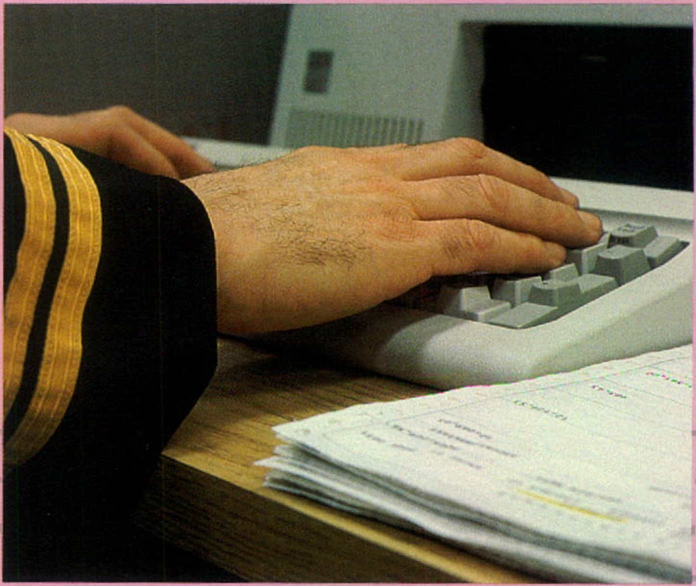
Implementation involves consultants, engineers and other specialists in the integration of the system into the operational life of the enterprise. Sites are prepared by providing power, cooling, furniture and space. Equipment is ordered, scheduled, delivered, and tested. Staff are briefed and provided with group and individual training as appropriate. Data from existing files and records are converted and loaded into files. Contingency back-up procedures are established to provide a final level of insurance to continued successful system operation.

During implementation, Systemhouse co-ordinates the multitude of concurrent tasks carried out by clients, suppliers, and our own staff to bring the system into effective operation. The Systemhouse Project Manager, being a central point of liaison between vendors and their parties, ensures that all links and interfaces work and bring maximum benefit with minimum complexity for the customer.

Implementation ends when the system is tested and accepted by the customer and is handed over to the customer's own staff for use in their day-to-day work.

For Safeway, the Oakland-based food retail chain, Systemhouse implemented key customer service and management information systems servicing 695 Safeway stores.

Systemhouse brought together 17 vendors as the Company delivered and installed the Department of National Defence's Financial Information System microcomputer network, linking 175 processing sites in 4 countries.



Operation

New breakthroughs in information technology make it increasingly complex to select, configure and maintain cost-effective computer facilities. As corporate managers focus their efforts on running their mainstream business and, at the same time, seek greater value from money invested, many find that retaining in-house data processing employees and facilities is not cost-effective. As a result, they are increasingly asking Systemhouse to acquire, operate and maintain their systems. Systemhouse responds to the demand of these customers by assuming full facilities management responsibility for the systems we create. Facilities management not only ensures that systems are available and fully functional, but also includes:

> **"By utilizing Systemhouse's facilities management services, many customers have found that valuable management time is focussed on managing the business rather than spent managing the technology."**

- the control and maintenance of system resources;
- performance analysis and system tuning;
- integration of vendors' upgrades and new software releases, thereby taking advantage of current technology;
- data communications network management;
- monitoring of transaction flows and volumes to ensure adequate capacity for growth in business;
- trouble-shooting and problem diagnosis;
- system backup; and
- contingency planning and disaster recovery.

By utilizing Systemhouse's facilities management services, many customers have found that valuable management time is focussed on managing the business rather than spent managing the technology.

Systemhouse is providing facilities management services to the U.S. Treasury Department for human resource-related programs, including the payroll for some 55,000 Treasury employees.

For the Real Estate division of Canada Trust/Le Permanent du Québec, Systemhouse manages the computerized production of their residential and commercial property guide from data entry to publishing 100,000 copies.

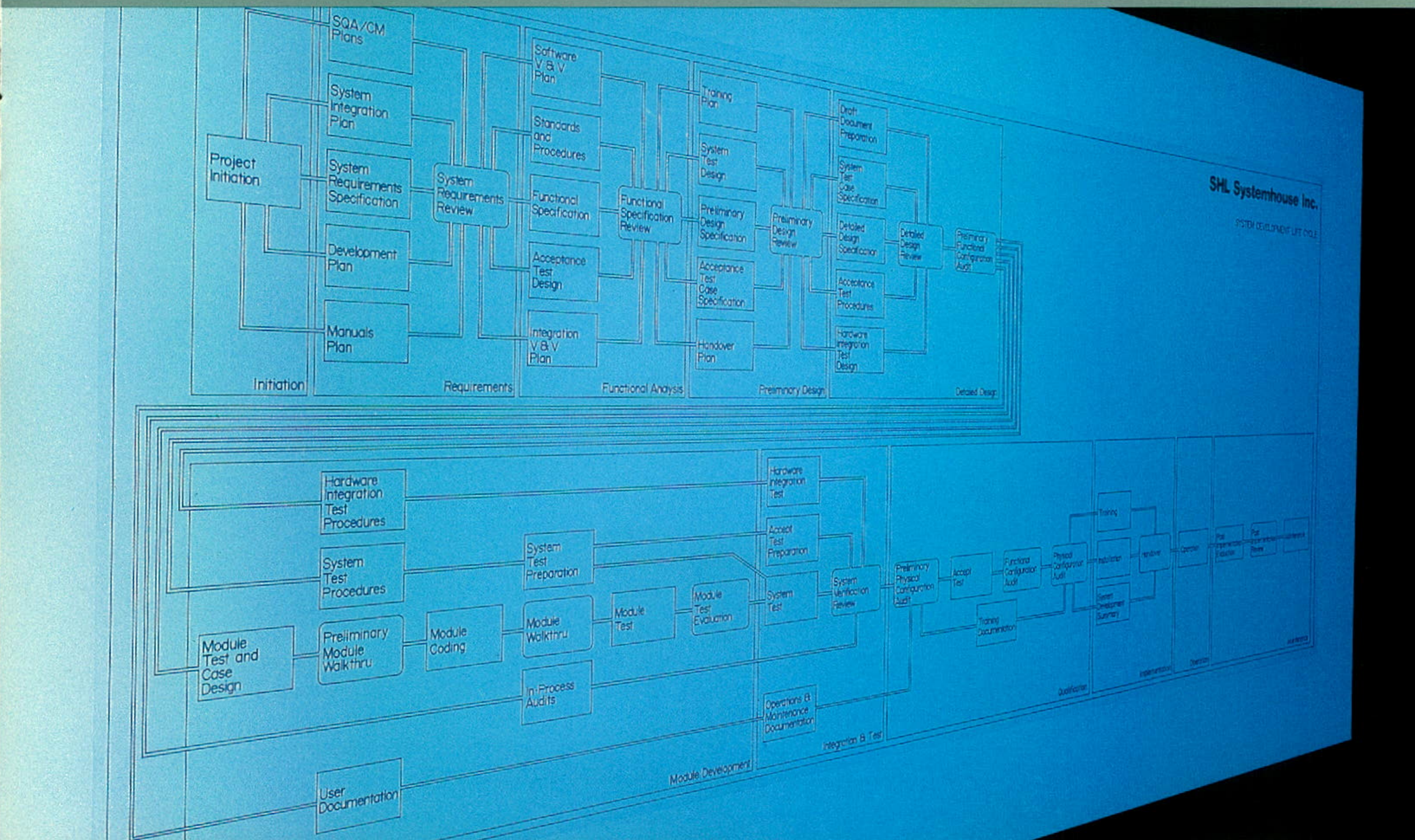
Methodology

The mainstay of our business and the vehicle by which we transfer information technology to customers is the Systemhouse Systems Integration Methodology. This methodology has been tested and repeatedly proven to be an effective way of delivering integrated systems to our customers. It combines successful management principles with state-of-the-art systems engineering techniques. It has been developed to support all phases of the information systems life cycle, from strategic data planning, through to the integration and operation of data centers. Role guides are provided for System Planners, Project Managers, Systems Engineers, Software Engineers, Analysts, Designers, Programmers and many other participants involved in the delivery and use of computer systems.

"The Systemhouse Methodology allows us to plan effectively the systems integration effort and to predict accurately implementation costs, operational costs and the operational performance of the system."

Whether the object of the customer's requirements is data, technology, applications, or a combination of all three, the process is defined by the Methodology. Planning, design, construction, implementation and operations make up the phases of this cycle. Depending on the combination of phase and object, the Methodology provides a consistent set of techniques and tools to guide professional staff undertaking the assignment.

Typically, companies with a narrower focus — hardware vendors, management consultants, software firms, contract programming companies — focus on performing some part of the systems integration life cycle. Systemhouse performs all phases. The Systemhouse Methodology allows us to plan effectively the systems integration effort and to predict accurately implementation costs, operational costs and the operational performance of the system.



The Systemhouse Methodology is the logical, proven process of creating and delivering information systems on schedule and on budget.

PC-based tools are used in all aspects of delivery, including systems configuration, data flow and project management.

People and Technology

We are a service business and ultimately depend on the commitment and expertise of our people. It is crucial to our future that top calibre people find the Company an appealing place to pursue their professional goals.

"Systemhouse management philosophy encourages a high level of involvement by all employees in the operation of the business through networking rather than traditional corporate hierarchy."

Systemhouse management philosophy encourages a high level of involvement by all employees in the operation of the business through networking rather than traditional corporate hierarchy. In addition to challenging projects, attractive working conditions and competitive compensation packages, Systemhouse operates two such innovative network programs known as the Career and Education Management (CEM) Program and the Technology Network Program.

The CEM program ensures the involvement of all levels of staff in the human resources management process. Every employee is assigned a CEM Manager, in addition to and separate from that employee's line manager. The CEM Manager is a link between the company and each employee's career aspirations, capabilities and achievements. In this way, a relatively large company is personalized for each employee.

It is also the responsibility of CEM Managers to assess employees' strengths and then define with each employee the type and extent of experience and continuing education beyond the core curriculum for all Systemhouse employees which best augments their abilities and interests.

The Technology Network provides a process to identify, absorb and apply throughout Systemhouse the emerging technologies upon which integration of current and future systems is based.

The Technology Network Program provides a consistent framework for monitoring technological innovation and critically evaluating developments and trends. Systemhouse experts examine noteworthy developments and then filter out those which, in our view, lack cost-effectiveness, or are limited in their application or technical merit. With those technologies judged valuable and significant, the Network provides a vehicle through which employees work with and learn about these new products and techniques and their application.

The end product is the identification, absorption and dissemination of emerging technologies which meet the high standards required to satisfy the demands of industry and government for more and better information.

In every branch in the Company, participants in the Network form part of a dynamic process of absorbing and disseminating technological expertise. They draw to their individual branches information and techniques originating from other parts of the Company — and promote to the Company technological advances they have experienced in the field or in which they have specialized knowledge and interest.

The Company's Technology Network is the vehicle which permits our employees, and through them our customers, to remain leaders in technological innovation.

Systemhouse Career and Education Management (CEM) Program ensures individual attention to employee professional development.

Locations

Corporate Office — Canada
99 Bank Street
3rd Floor
Ottawa, Ontario
K1P 6B9
(613) 236-9734

Branch Offices

1500 West Georgia Street
Suite 750
Vancouver, British Columbia
V6G 3B8
(604) 681-9441
David Miller
General Manager

9942–108th Street
Suite 950
Edmonton, Alberta
T5K 2J5
(403) 423-4730
David Hall
General Manager

330 St. Mary Avenue
11th Floor
Winnipeg, Manitoba
R3C 3Z5
(204) 944-9166
Tom Hiebert
General Manager

99 Bank Street
3rd Floor
Ottawa, Ontario
K1P 6B9
(613) 236-9734
Don Lundgren
Vice President and
General Manager

1660 Hollis Street
Penthouse Suite
Halifax, Nova Scotia
B3J 1V7
(902) 429-0690
Yolande MacDonald
Branch Manager

Suite 860
Bow Valley Square I
202 – 6th Avenue, S.W.
Calgary, Alberta
T2P 2R9
(403) 266-2266
Ralph Gardiner
General Manager

2500 Victoria Avenue
Suite 1204
Regina, Saskatchewan
S4P 3X2
(306) 525-6105
Ken Penner
General Manager

146 Front Street West
Suite 700
Toronto, Ontario
M5J 1G5
(416) 595-9666
Dennis Maloney
Vice President and General
Manager

740 Notre Dame Ouest
Suite 860
Montreal, Quebec
H3C 3X6
(514) 866-2891
Serge Bujold
General Manager

99 Bank Street
3rd Floor
Ottawa, Ontario
K1P 6B9
(613) 236-9734
Don Pickard
General Manager,
International Systems

Corporate Office — United States
1010 North Glebe Road
Arlington, Virginia
22201
(703) 276-0500

Branch Offices

1900 South Norfolk Street
Suite 224
San Mateo, California
94403
(415) 572-2970
Brahm Levin
General Manager

1010 North Glebe Road
Arlington, Virginia
22201
(703) 276-0500
Robert B. Laurence
Vice President and
General Manager

7115 Ambassador Street
Baltimore, Maryland
21207
(301) 597-9040
Donald Rottman
General Manager

8600 West Bryn Mawr Avenue
Suite 820, South Tower
Chicago, Illinois
60631
(312) 693-0250
Ted Keys
General Manager

1010 North Glebe Road
Arlington, Virginia
22201
(703) 276-0500
Andy Bart
General Manager
National Systems

Auditors' Report

To the Shareholders of SHL Systemhouse Inc.:

We have examined the consolidated balance sheets of SHL Systemhouse Inc. as at August 31, 1986 and 1985 and the consolidated statements of operations, retained earnings and changes in financial position for each of the years in the three year period ended August 31, 1986. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at August 31, 1986 and 1985 and the results of its operations and the changes in its financial position for each of the years in the three year period ended August 31, 1986 in accordance with accounting principles generally accepted in Canada applied on a consistent basis during the period.

Clarkson Gordon

Clarkson Gordon
Chartered Accountants
A member of Arthur Young International

Ottawa, Canada,
October 10, 1986.

Consolidated Balance Sheets

(in thousands of Canadian dollars)

	August 31	
Assets	**1986**	**1985**
Current:		
Cash and short term deposits	$ 51,150	$ 136
Accounts receivable	25,719	9,790
Work in process	16,782	3,059
Prepaid expenses	2,396	1,074
Due from parent company (note 10(a))		2,207
	96,047	16,266
Long term receivables	1,220	710
Fixed assets (note 3)	7,222	4,788
Goodwill (note 2)	10,626	
	$115,115	**$21,764**
Liabilities and Shareholders' Equity		
Current:		
Accounts payable and accrued liabilities	$ 20,490	$ 4,115
Accrued employee costs	3,531	1,905
Current portion of long term debt	2,147	1,505
Deferred revenue	961	344
	27,129	7,869
Long term debt (note 5)	1,088	1,623
Shareholders' equity (note 6):		
Common shares		
Issued – 12,029,799 (1985 – 7,478,047)	76,158	5,920
Retained earnings, after a capital reduction of $31,071 during 1983 and a further $33,473 during 1985	10,740	6,352
	86,898	12,272
	$115,115	**$21,764**

On behalf of the Board:

Director

Director

(See accompanying notes to the consolidated financial statements)

Consolidated Statements of Operations

(in thousands of Canadian dollars, except per share amounts)

	Year ended August 31						
	1986	1985			1984		
		Continuing Operations	Net Gain on Sale of Discontinued Operations	Total	Continuing Operations	Discontinued Operations	Total
Gross revenue	$102,080	$48,744		$48,744	$36,174	$21,095	$57,269
Other income	2,846	1,545		1,545	164		164
Total revenue	104,926	50,289		50,289	36,338	21,095	57,433
Less cost of hardware and licensed software sold	45,940	13,597		13,597	9,973	10,450	20,423
Operating revenue	58,986	36,692		36,692	26,365	10,645	37,010
Expenses:							
Operating and administration	46,385	29,760		29,760	22,938	18,422	41,360
Depreciation and amortization	1,970	1,280		1,280	744	994	1,738
Interest on long term debt	406	646		646	454	638	1,092
Interest on short term debt	146	819		819		813	813
	48,907	32,505		32,505	24,136	20,867	45,003
Income (loss) before the following	10,079	4,187		4,187	2,229	(10,222)	(7,993)
Net gain on sale of discontinued operations (note 9)			$4,795	4,795			
Income (loss) before the following	10,079	4,187	4,795	8,982	2,229	(10,222)	(7,993)
Provision for income tax (note 8)	5,241	2,000	1,200	3,200			
Income (loss) before benefit of loss carry forward	4,838	2,187	3,595	5,782	2,229	(10,222)	(7,993)
Benefit of loss carry forward (note 8)	5,241	2,000	1,200	3,200			
Net income (loss)	**$ 10,079**	**$ 4,187**	**$4,795**	**$ 8,982**	**$ 2,229**	**$(10,222)**	**$ (7,993)**
Basic earnings per Common Share (note 11):							
Income (loss) before benefit of loss carry forward	**$ 0.48**	**$ 0.30**	**$ 0.50**	**$ 0.80**	**$ 0.20**	**$ (2.90)**	**$ (2.70)**
Net income (loss)	**$ 1.00**	**$ 0.58**	**$ 0.67**	**$ 1.25**	**$ 0.20**	**$ (2.90)**	**$ (2.70)**
Fully diluted earnings per Common Share (note 11):							
Income before benefit of loss carry forward	**$ 0.48**	**$ 0.29**	**$ 0.47**	**$ 0.76**			
Net income	**$ 0.99**	**$ 0.55**	**$ 0.62**	**$ 1.17**			

(See accompanying notes to the consolidated financial statements)

Consolidated Statements of Retained Earnings

(in thousands of Canadian dollars)	Year ended August 31		
	1986	1985	1984
Retained earnings (deficit), beginning of year	$ 6,352	$(34,543)	$(26,550)
Net income (loss)	10,079	8,982	(7,993)
	16,431	(25,561)	(34,543)
Capital reduction (note 6(c))		33,473	
Stock dividend on First Preference Shares		(820)	
Cost of shares issued and other related items	(5,691)	(634)	
Excess of cost of Common Shares purchased over proceeds		(106)	
Retained earnings (deficit), end of year	**$10,740**	**$ 6,352**	**$(34,543)**

(See accompanying notes to the consolidated financial statements)

Consolidated Statements of Changes in Financial Position

(in thousands of Canadian dollars)	Year ended August 31		
	1986	1985	1984
Changes in components of working capital:			
Increase (decrease) in current assets —			
Cash and short term deposits	$51,014	$ 136	$ (1,199)
Accounts receivable	15,929	1,420	(2,636)
Work in process	13,723	(2,757)	(59)
Prepaid expenses	1,322	(767)	(1,579)
Other balances with affiliated companies	(2,207)	(2,979)	5,186
Assets segregated for disposition		(708)	708
	79,781	(5,655)	421
Decrease (increase) in current liabilities —			
Bank indebtedness		6,659	(3,547)
Accounts payable and accrued liabilities	(16,375)	3,515	2,263
Accrued employee costs	(1,626)	83	(239)
Current portion of long term debt	(642)	(307)	(24)
Deferred revenue	(617)	405	136
Part VIII tax liability		3,759	(3,759)
	(19,260)	14,114	(5,170)
Increase (decrease) in working capital	60,521	8,459	(4,749)
Working capital, beginning of year	8,397	(62)	4,687
Working capital, end of year	**$68,918**	**$ 8,397**	**$ (62)**

(See accompanying notes to the consolidated financial statements)

(in thousands of Canadian dollars)	Year ended August 31		
	1986	1985	1984
Working capital provided by:			
Operations:			
Income before benefit of loss carry forward	$ 4,838	$ 5,782	
Provision for deferred income tax	5,241	3,200	
Add other items not involving working capital	1,826	670	
Working capital from operations	11,905	9,652	
Issues of shares for cash (net)	60,083	3,963	$ 72
Less: Conversion of debentures		(3,600)	
Stock dividends on First Preference Shares		(820)	
Proceeds from issue of research and development debentures (net)			3,204
Current maturities on long term receivables		558	
Proceeds from disposal of fixed assets	36	1,163	382
Fixed and other assets for disposition			2,322
	72,024	10,916	5,980
Working capital applied to:			
Operations:			
Net loss			7,993
Less items not involving working capital			(2,124)
			5,869
Working capital deficiency of Capital Systems, Inc. (note 2)	6,922		
Increase in long term receivables (net)	120		315
Purchase of fixed assets (net)	2,047	1,223	3,269
Current maturities of long term debt	2,414	1,234	1,276
	11,503	2,457	10,729
Increase (decrease) in working capital	**$60,521**	**$ 8,459**	**$ (4,749)**

(See accompanying notes to the consolidated financial statements)

Notes to the Consolidated Financial Statements

1. Summary of Significant Accounting Policies

The consolidated financial statements include the accounts of SHL Systemhouse Inc. and its wholly-owned United States subsidiary, Systemhouse Inc. The accounts of Systemhouse Inc. include the accounts of its wholly-owned United States subsidiary, Capital Systems, Inc. from the date of acquisition on April 30, 1986 (see note 2).

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada consistently applied. These principles also conform in all material respects with accounting principles generally accepted in the United States except as described in note 7. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period necessarily involves the use of estimates and approximations which have been made using careful judgement. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

a) Revenue recognition

Revenue is recognized on a percentage of completion basis whereby revenue and work in process are recorded at the estimated realizable value of work completed to date. Deferred revenue is recorded to the extent that billings to clients are in excess of revenue recognized to date.

b) Fixed assets

Fixed assets are initially recorded at cost. Assets under capital lease are initially recorded at the present value of minimum future lease payments.

Depreciation and amortization are provided as set out below:

	RATE	BASIS
Furniture	10%	Declining Balance
Office equipment	20%	Declining Balance
Computer equipment	30%	Declining Balance
Leasehold improvements	Term of Lease	Straight Line

c) Goodwill

Goodwill arising on the acquisition of Capital Systems, Inc. is being amortized on a straight line basis over 20 years.

d) Income taxes

The Company follows the tax allocation method of accounting for income taxes. The Company accounts for investment tax credits using the cost reduction method, whereby tax credits related to qualifying expenditures are accrued and applied to reduce such expenditures in the year in which they are incurred, provided there is reasonable assurance of realization.

During the year, the Company recorded $296,000 of investment tax credits as a reduction of operating and administration expenses (1985 — $422,000; 1984 — Nil).

2. Acquisition of Capital Systems, Inc.

On April 30, 1986, the Company acquired all the outstanding shares of Capital Systems, Inc. ("CSI") for 360,000 Common Shares of the Company. CSI was a private corporation engaged in the computer systems integration business. The acquisition of CSI has been accounted for using the purchase method. The net assets acquired and assigned values were:

	(000's)
Ascribed value of Common Shares issued	$ 4,464
Net liabilities acquired:	
Working capital deficiency, including costs of acquisition of $896,000	6,922
Fixed assets	(2,344)
Long term debt	1,719
	6,297
Goodwill	**$10,761**

Pursuant to the purchase agreement, the selling shareholders agreed to indemnify the Company against certain claims. At closing, the selling shareholders deposited in escrow 176,400 of the Common Shares issued to them to secure these claims including any claim which the Company may have as a result of the consolidated tangible net worth of CSI as at February 28, 1986, as determined by the Company prior to December 31, 1986, being less than negative U.S. $400,000. The Company anticipates that any subsequent adjustment to the carrying value of the CSI assets and goodwill will not have a material effect upon the consolidated financial position and operating results of the Company.

The following unaudited pro forma financial information for the years ended August 31, 1986 and August 31, 1985 gives effect to the CSI purchase as if it had been consummated on September 1, 1985 and September 1, 1984 respectively.

	(000's except per share amounts) Year ended August 31	
	1986	1985
	(unaudited)	
Total revenue	$131,838	$83,624
Income before benefit of loss carry forward	2,032	1,346
Net income	4,360	3,346
Earnings per Common Share:		
Income before benefit of loss carry forward	$ 0.20	$ 0.18
Net income	$ 0.42	$ 0.44

The pro forma financial information for the year ended August 31, 1985 includes the Company's continuing operations only.

3. Fixed Assets

	(000's) August 31			
	1986			1985
	Cost	Accumulated depreciation	Net	Net
Furniture and office equipment	$ 1,563	$ 663	$ 900	$ 522
Computer equipment	6,306	2,183	4,123	1,975
Leasehold improvements	1,230	792	438	229
Assets under capital lease:				
Furniture and office equipment	1,672	855	817	1,004
Computer equipment	1,752	808	944	1,058
	$12,523	**$5,301**	**$7,222**	**$4,788**

4. Part VIII Tax Liability

During the year ended August 31, 1984, the Company recognized funding from the sale of tax credits related to research and development expenditures. The sale of tax credits related to research and development expenditures gives rise to a refundable tax liability which is extinguished at the rate of one dollar for each two dollars of expenditures on qualified scientific research. A company may also discharge this liability by purchasing tax credits relating to other companies' eligible expenditures.

To August 31, 1984, the Company had claimed $9.7 million of scientific research expenditures, thereby discharging $4.85 million of Part VIII tax liability and recognized a net benefit of $3.9 million, of which $3.6 million relates to discontinued operations. The net benefit has been recorded as a reduction of operating and administration expenses.

The remaining $3.8 million of tax liability of the continuing operations at August 31, 1984 was settled through the purchase of scientific research tax credits during the fiscal year ended August 31, 1985, resulting in a gain of approximately $475,000. Such gain has been recorded as a reduction of operating and administration expenses. The qualified scientific research expenditures, the purchase of scientific research tax credits and the resulting Part VIII tax recovery are subject to review by Revenue Canada, Taxation. While Revenue Canada, Taxation has neither formally accepted nor reviewed in detail the eligible expenditures claimed by the Company, the Company has discussed with Revenue Canada the principles applied in administering its research and development program and believes that its obligations have been fully discharged.

5. Long Term Debt

	(000's) August 31	
	1986	1985
Capital lease obligations bearing interest at rates varying from 11% to 21.5%	$ 2,266	$ 2,864
Other office lease obligations	64	185
Leasehold improvement financing	58	79
Notes payable bearing interest at rates varying from 10% to 17%	847	
	3,235	3,128
Less current portion	(2,147)	(1,505)
	$ 1,088	**$ 1,623**

During the year ended August 31, 1986, the Company incurred operating lease expenses of approximately $3,068,000 (1985 — $2,506,000; 1984 — $3,639,000).

The Company is committed to make future minimum payments as follows:

	(000's) August 31, 1986		
	Capital Leases	Notes Payable	Operating Leases
1987	$ 1,886	$ 441	$ 2,961
1988	382	138	2,707
1989	191	108	1,877
1990	139	83	1,654
1991	27	77	1,414
	2,625	**$ 847**	**$10,613**
Less interest	(359)		
	$ 2,266		

6. Capital Stock

The Company's authorized share capital consists of an unlimited number of Common Shares without nominal or par value and an unlimited number of First Preference Shares issuable in series.

A summary of the changes during the period August 31, 1983 to August 31, 1986, in issued and fully paid First Preference Shares, Class A Common Shares, and Common Shares is as follows:

(000's except share amounts)

	First Preference Shares		Class A Common Shares		Common Shares	
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount
Balance, August 31, 1983	5,380,505	$26,903	17,521,231	$7,998		
Employee Stock Purchase Plan			64,284	90		
Redemption of shares			(2,500)	(19)		
Stock options exercised			533	1		
Conversion of First Preference Shares to Class A Common Shares	(23,351)	(117)	58,377	117		
Balance, August 31, 1984	5,357,154	26,786	17,641,925	8,187		
Conversion of Debentures into Class A Common Shares (a)			3,130,434	3,600		
Change of First Preference Shares into Class A Common Shares (b)	(5,357,154)	(26,786)	16,071,462	26,786		
Capital reduction (c)				(33,473)		
Payment of stock dividend to Kinburn Corporation in Class A Common Shares (d)			546,631	820		
Change in Class A Common Shares to Common Shares (e)			(37,390,452)	(5,920)	**7,478,047**	**$ 5,920**
Balance, August 31, 1985	—	$ —	—	$ —	**7,478,047**	**5,920**
Issued in public offerings (f)					**4,100,000**	**64,875**
Employee Stock Purchase Plan					**19,317**	**259**
Stock options exercised					**42,470**	**430**
Bank warrants exercised (g)					**30,000**	**210**
Issued to acquire Capital Systems, Inc. (note 2)					**360,000**	**4,464**
Payments in lieu of fractional shares on conversion of First Preference Shares and Class A Common Shares to Common Shares					**(35)**	
Balance, August 31, 1986					**12,029,799**	**$76,158**

(a) Upon payment by the Company of $180,000 during January, 1985 to the holders of outstanding debentures, these debentures were converted into 3,130,434 Class A Common Shares.

(b) During the year ended August 31, 1985, the Series I Convertible Redeemable First Preference Shares were changed into Class A Common Shares on a 3 for 1 basis.

(c) During the year ended August 31, 1985, the shareholders approved a reduction of $33,473,000 to stated capital and deficit.

(d) During the year ended August 31, 1985, the Company declared and paid a dividend of $820,000 on the 2,910,551 First Preference Shares owned by Kinburn Corporation relating to the period prior to April 15, 1983 during which time Kinburn's funds were invested in the Company. This dividend was paid through the issue of 546,631 Class A Common Shares.

(e) During the year ended August 31, 1985, there was a change of Class A Common Shares into Common Shares and a consolidation of the resulting Common Shares on the basis of one new share for five old shares. All share amounts in these financial statements reflect this consolidation.

(f) During the year ended August 31, 1986, the Company issued 4.1 million Common Shares from treasury for gross proceeds of $64.9 million in two separate public issues.

(g) Under a banking agreement the Company had granted the Company's banker warrants to purchase 30,000 Common Shares at $7.00 per share. During the year ended August 31, 1986, the bank exercised all these warrants.

Employee Share Plans

Pursuant to the Employee Stock Purchase Plan, designated employees are eligible to acquire Common Shares within certain limits from the Trustee. Under this plan, 19,982 shares are being held in trust for the employees until paid in full.

The Company has granted stock options to certain employees of the Company and its subsidiary to purchase Common Shares pursuant to stock option agreements. During the year ended August 31, 1986, the Company granted options to senior employees of the Company to purchase 114,700 Common Shares at $9.00 per share. These options may be exercised from September 1, 1988 to February 28, 1989.

In September 1986, the Company granted options to senior employees of the Company to purchase up to 153,400 Common Shares at $23.00 per share. These options may be exercised from September 1, 1989 to February 28, 1990.

A total of 481,900 options to purchase Common Shares are outstanding at prices ranging from $4.00 to $23.00 per share which are eligible to be exercised at various dates from September 1, 1987 to February 28, 1990.

7. United States Accounting Principles

The following table reconciles net income (loss) for the year as reported in the accompanying consolidated statements of operations to the net income (loss) that would have been reported had the financial statements been prepared in conformity with United States accounting principles ("U.S. GAAP"). Reconciling items relate to the effects of accounting for discontinued operations.

	(000's) Year ended August 31		
	1986	1985	1984
Income (loss) before income tax, as reported	$10,079	$ 8,982	$ (7,993)
Add (deduct):			
Loss of discontinued operations			10,222
Gain on disposal of discontinued operations		(4,795)	
	10,079	4,187	2,229
Provision for deferred income tax on continuing operations	5,241	2,000	1,150
Income before benefit of loss carry forward from continuing operations in conformity with U.S. GAAP	4,838	2,187	1,079
Benefit of loss carry forward	5,241	2,000	1,150
Income from continuing operations in conformity with U.S. GAAP	10,079	4,187	2,229
Loss from discontinued operations			(10,222)
Gain on disposal of discontinued operations (net of tax effects)		4,795	
Net income (loss) in conformity with U.S. GAAP	**$10,079**	**$ 8,982**	**$ (7,993)**

The following table sets forth earnings (loss) per share in conformity with United States accounting principles:

	Year ended August 31		
	1986	1985	1984
Primary earnings per share:			
Continuing operations:			
Before extraordinary item	$ 0.47	$ 0.30	$(0.11)(i)
After the benefit of loss carry forward	$ 0.98	$ 0.58	$ 0.21 (i)
Discontinued operations		$ 0.66	$(2.90)
Net income (loss)	$ 0.98	$ 1.24	$(2.69)(i)

Pro forma earnings per share for the year ended August 31, 1985, in conformity with U.S. GAAP would have been $1.20 had the debentures been converted into Common Shares on September 1, 1984.

	Year ended August 31		
	1986	1985	1984
Fully diluted earnings per share (iii):			
Continuing operations:			
Before extraordinary item	$ 0.47	$ 0.28(ii)	
After the benefit of loss carry forward	$ 0.98	$ 0.55(ii)	
Discontinued operations		$ 0.63(ii)	
Net income	$ 0.98	$ 1.18(ii)	

(i) after reflecting preference share entitlements of $0.43 in 1984
(ii) after reflecting the debentures as having been converted on September 1, 1984
(iii) fully diluted earnings per share information in 1984 is not presented as there is an antidilutive effect

The above primary, pro forma and fully diluted earnings per share reflect the application of the treasury stock method for outstanding options and warrants.

8. Income Tax Information

The provision for income tax reported differs from the amount computed by applying Canadian tax rates to income (loss) before taxes as follows:

	(000's) Year ended August 31		
	1986	**1985**	**1984**
Expected statutory tax rate	52%	51%	51%
Expected tax provision (recovery)	$5,241	$4,581	$(4,076)
Research and development expenditures not deductible (net)			2,958
Non taxable portion of capital gains		(1,381)	
Tax effect of losses not recognized			1,118
Provision for deferred tax reflected in the consolidated statements of operations	**$5,241**	**$3,200**	**$ —**

The Company has loss carry forwards as at August 31, 1986, for which no accounting benefit has been recognized, of approximately $49 million of which $11.5 million expires at various dates up to 1990 in Canada and $20.6 million expires at various dates up to 2001 in the United States. The balance relates to Canada and may be carried forward indefinitely. In addition, the Company has timing differences of approximately $7 million which also may be carried forward indefinitely, for which no accounting benefit has been recognized.

Income (loss) before tax attributable to the U.S. operation is as follows: August 31, 1986 — $3,689,000; 1985 — $11,000; 1984 — ($3,780,000).

9. Sale of Discontinued Operations

As of September 1, 1984, the Company sold all of its shares of Systemhouse Business Systems Ltd., Systemhouse Controls Ltd., Systemhouse Graphics Systems Ltd., XIOS Systems Corporation and Systemhouse (International) Ltd., all of which were wholly-owned Canadian Subsidiaries (the "Canadian Subsidiaries") engaged in the software products business.

These assets were sold to Kinburn Technology Corporation (formerly Kinburn Technology Group Inc.) a wholly-owned subsidiary of Kinburn Corporation (which owns approximately 32% of the shares of the Company as at August 31, 1986) for an aggregate sale price of $8 million cash. Upon the sale of the Canadian Subsidiaries to Kinburn Technology Corporation ("KTC"), the Company recorded a gain of approximately $4,795,000 net of fees and costs relating to the sale.

10. Related Party Transactions

(a) During January, 1985, the Company concluded the sale of its Canadian Subsidiaries to KTC (see note 9) effective as of September 1, 1984. At August 31, 1985, the Company had outstanding $2.2 million from KTC relating to disbursements totalling approximately $5.7 million made by the Company on behalf of the Canadian Subsidiaries between September 1, 1984 and January 31, 1985. Outstanding amounts, including intercompany balances included in (k) below, bear interest at bank prime plus 1%. Interest earned by the Company on these amounts for the year ended August 31, 1986 totalled approximately $400,000 (1985 — $548,000) and is included in other income in the consolidated statements of operations. The outstanding amount of $2.2 million was repaid prior to February 28, 1986.

(b) Systemhouse (International) Ltd. ("International") advanced $3.6 million to the Company during September 1984 without interest, which amount was repaid upon closing the sale of the Canadian Subsidiaries in January, 1985.

(c) The Company has entered into agreements with affiliated companies to undertake research and development work. During the year ended August 31, 1986, the Company earned revenue of approximately $5,959,000 (1985 — $2,755,000) resulting from the research and development services.

(d) The Company entered into licensing agreements with the same affiliates referred to in (c) above, under which the Company obtained the rights to the use of the results of the product development work. During the year ended August 31, 1986, the Company incurred $3,456,000 (1985 — $1,598,000) in royalty fees, such royalty fees being based on sub-license revenue earned by the Company.

(e) The Company received management services from an affiliated company during the year ended August 31, 1986, for a fee of $450,000 (1985 — $166,000; 1984 — $72,000). Of this total $310,000 relates to services provided in connection with the two public issues of Common Shares during the year.

(f) International agreed to bear the cost of interest on the Company's $3,759,000 Part VIII tax liability commencing September 1, 1984, as this cost relates to research and development financing. Such interest earned totalled approximately $492,000 for the year ended August 31, 1985, and is included in other income in the consolidated statement of operations.

(g) International agreed to bear the cost of interest on the debentures referred to in note 6(a) for the period September 1, 1984 to January 15, 1985 (the date the debentures were converted into Class A Common Shares of the Company). Such interest totalled approximately $175,000.

(h) During the year ended August 31, 1985, the Company realized a gain of $518,000 resulting from a purchase and sale and lease-back of office facilities with third parties. Under the leaseback, the Company leased such office facilities for a 10 year period expiring in 1995 at a total cost of $3.0 million. Such office facilities were sublet under similar terms to KTC. The lease and related sublease were cancelled in December, 1985.

(i) The Company provided certain administrative services to affiliated companies during the year ended August 31, 1986 for $128,000 (1985 — $115,000).

(j) As of September 1, 1984, the Company entered into agreements with affiliated companies to sublet certain office furniture and equipment for a two year term, after which ownership of the assets is to transfer to the affiliated companies. The net book value of these assets was $762,000 on September 1, 1984 and the initial value of the leases was $1.1 million. At August 31, 1986, the remaining balance of these capital leases was nil (1985 — $591,000). Interest earned on these capital leases during the year totalled approximately $49,000 (1985 — $117,000).

(k) At August 31, 1986, the Company had intercompany balances due from affiliated companies included in accounts receivable, other than those mentioned in (a) and (j) above, totalling $715,000 (1985 — $931,000). During the year ended August 31, 1984, the Company was advanced up to $2,390,000 by KTC and an associated company for which interest totalling $67,000 was incurred at the rate of bank prime plus 2%. During the year ended August 31, 1986, the Company advanced up to $1,700,000 to KTC for which interest totalling $45,000 was charged at the rate of bank prime plus 1%. These advances were repaid prior to March, 1986.

11. Earnings Per Share Information

The following table sets out the computation of basic and fully diluted earnings per Common Share.

	(000's except share and per share amounts) Year ended August 31						
	1986	1985			1984(ii)		
		Continuing Operations	Net Gain on Sale of Discontinued Operations	Total	Continuing Operations	Discontinued Operations	Total
Basic							
Net income (loss)	$ 10,079	$ 4,187	$ 4,795	$ 8,982	$ 2,229	$ (10,222)	$ (7,993)
Preferred share entitlements					(1,515)		$ (1,515)
	$ 10,079	**$ 4,187**	**$ 4,795**	**$ 8,982**	**$ 714**	**$ (10,222)**	**$ (9,508)**
Weighted average number of Common Shares	10,071,615	7,200,518	7,200,518	7,200,518	3,521,481	3,521,481	3,521,481
Net income (loss) per Common Share	**$ 1.00**	**$ 0.58**	**$ 0.67**	**$ 1.25**	**$ 0.20**	**$ (2.90)**	**$ (2.70)**
Adjusted Basic (i)							
Net income per Common Share		**$ 0.56**	**$ 0.64**	**$ 1.20**			
Fully Diluted (ii)							
Net income	$ 10,079	$ 4,187	$ 4,795	$ 8,982			
Add imputed interest on options (net of tax)	269	99		99			
Adjusted net income	**$ 10,348**	**$ 4,286**	**$ 4,795**	**$ 9,081**			
Common Shares	10,071,615	7,478,047	7,478,047	7,478,047			
Share options	353,980	308,447	308,447	308,447			
Fully diluted number of Common Shares	**10,425,595**	**7,786,494**	**7,786,494**	**7,786,494**			
Fully diluted net income per Common Share	**$ 0.99**	**$ 0.55**	**$ 0.62**	**$ 1.17**			

(i) Adjusted basic net income per Common Share treats the debentures referred to in note 6(a) as having been converted on September 1, 1984.

(ii) Fully diluted net income per Common Share information in 1984 is not presented as there is an antidilutive result.

12. Segmented Information

In the opinion of management, the Company currently operates in a single industry segment, being the computer systems integration business. This business involves the design, development, integration and implementation of computer-based information systems. In 1984, operations consisted of the systems integration business, and the now discontinued software products business.

The Company carries on business primarily in two geographic segments: Canada and the United States. Canadian-based sales to customers in foreign countries are as follows: year ended August 31, 1986 — $4.0 million; 1985 — $1.7 million; 1984 — $1.9 million.

(000's)

	1986		1985		1984	
			Continuing Operations		Continuing Operations	
	Canada	U.S.	Canada	U.S.	Canada	U.S.
Total revenue	$52,203	$52,723	$37,035	$13,254	$24,598	$11,740
Net income	$ 6,390	$ 3,689	$ 4,176	$ 11	$ 1,271	$ 958
Depreciation and amortization	$ 1,296	$ 674	$ 1,142	$ 138	$ 605	$ 139
Total assets	$67,538	$47,577	$16,910	$ 4,854	$20,790	$ 7,514

Reported gross revenues in the consolidated statements of operations reflect sales by each business segment to parties outside the Systemhouse group. For the year ended August 31, 1984, the cost of intersegment services between the continuing operations and discontinued operations are reflected as expenses in the business segment for which the services were performed.

Revenues generated from U.S. government agencies in fiscal 1986 amounted to approximately $23.7 million (1985 – $3.0 million; 1984 – $3.9 million); from ministries and departments of the federal government of Canada, approximately $13.1 million (1985 — $8.0 million; 1984 — $7.6 million); and from Canadian federal crown corporations, approximately $2.2 million (1985 — $2.8 million; 1984 — $4.6 million).

Management's Discussion and Analysis of Financial Condition and Results of Operations

The Company's Consolidated Financial Statements are prepared in accordance with Canadian generally accepted accounting principles. For a reconciliation to U.S. generally accepted accounting principles, see note 7 of the Notes to the Consolidated Financial Statements.

Results of Operations For the three year period ended August 31, 1986

Total revenue for the Company for fiscal 1986 was $104.9 million, an increase of 109% from total revenue from continuing operations of $50.3 million in fiscal 1985, and an increase of 189% over total revenue from continuing operations of $36.3 million for fiscal 1984. Total revenue in fiscal 1986 included other income of $2.8 million. This consisted primarily of interest income from the investments held during the year. The increase in revenue in fiscal 1986 is primarily attributed to expanded business volume through normal growth as well as the purchase of Capital Systems, Inc.

The systems integration services provided by the Company may include procurement of computer hardware and software from suppliers at discounts. The increase in the cost of hardware and licensed software sold as a percentage of gross revenue reflects the increasing hardware content of the Company's systems integration contracts. Costs of hardware and licensed software sold was $45.9 million, or 45% of gross revenue in fiscal 1986, $13.6 million, or 28% of gross revenue from continuing operations in fiscal 1985 and $10.0 million or 28% of gross revenue from continuing operations in fiscal 1984.

Operating and administration expenses were $46.4 million, or 45% of gross revenue in fiscal 1986 compared with $29.8 million or 61% of gross revenue from continuing operations in fiscal 1985 and $22.9 million or 63% of gross revenue from continuing operations in fiscal 1984. The increase in total operating and administrative expenses in fiscal 1986 resulted primarily from increased employee costs attributable to an increase in the number of professional staff. Operating and administration expenses have decreased as a percentage of gross revenue from 63% in fiscal 1984 to 61% in fiscal 1985 and to 45% in fiscal 1986. This decrease is due largely to the increase in the portion of the Company's revenues resulting from fixed price systems integration contracts. Such contracts have higher revenue in relation to operating expenses, primarily because of the increase in the hardware and software components of such contracts, which require less significant operating and administration expenditures.

Depreciation and amortization expense increased 54% over fiscal 1985 and 165% over fiscal 1984. This increase reflects depreciation of computer equipment acquired during the year to service increased staff and customer requirements, as well as the increased assets acquired on the purchase of Capital Systems, Inc.

Net income for fiscal 1986 was $10.1 million, or 9.9% of gross revenue. Net income from continuing operations for fiscal 1985 was $4.2 million or 8.6% of gross revenue. Net income from continuing operations for fiscal 1984 was $2.2 million, or 6.2% of gross revenue.

Provisions for income tax were offset by equivalent benefits of losses carried forward from prior years. At the end of fiscal 1986, the Company had available tax loss carry forwards of approximately $49 million available to reduce taxable income in future years.

Geographic Segments

Total revenue generated in Canada in fiscal 1986 was $52.2 million, which represents 50% of the Company's total revenue in fiscal 1986 compared with $37.0 million from continuing operations in fiscal 1985, which represented 74% of total revenue and $24.6 million from continuing operations in fiscal 1984, which represented 68% of total revenue. The remainder of total revenue in each of the above years was generated in the United States. The increase in revenue in the United States in fiscal 1986 was due in part to the acquisition of Capital Systems, Inc. in April 1986 and in part to growth in the previously established branches.

The Company does not maintain permanent facilities outside North America but pursues non-North American systems integration project opportunities from its International branch located in Ottawa. For fiscal 1986, revenue for such international projects was $4.0 million, compared with $1.7 million in fiscal 1985 and $1.9 million in fiscal 1984. These revenues are included in Canadian revenues.

Liquidity and Capital Resources

At August 31, 1986, working capital was $68.9 million, compared with working capital of $8.4 million at August 31, 1985 and a deficiency of $62,000 at August 31, 1984. The increase in working capital during fiscal 1986 resulted from earnings from operations and two public offerings of Common Shares which generated $59.2 million of working capital.

Total receivables at August 31, 1986 were $25.7 million compared with $9.8 million at August 31, 1985 and $8.4 million from continuing operations at August 31, 1984. The number of days sales in accounts receivable at August 31, 1986 was 50 days, as compared with 59 days at August 31, 1985 and 78 days at August 31, 1984. The Company purchases equipment only after securing firm orders for systems requiring that equipment. Current inventory levels are considered immaterial and the amount of $276,000 as at August 31, 1986 (1985 – $205,000) has been grouped with prepaid expenses. Prepaid expenses have increased during fiscal 1986 primarily as a result of increased business activity.

The systems integration business is not capital intensive. Office premises are leased, and furnishings and equipment are financed through capital leases. The Company has no commitments to make any material capital expenditures in the 1987 fiscal year. Working capital is adequate for the Company's business through the next fiscal year and cash flow anticipated from operations in fiscal 1987 is expected to further improve the Company's liquidity.

In fiscal 1986, 1985 and 1984, the Company believes that inflation did not have a material impact on operating results. The Company's current practice of using separate contracts for each stage of a long term engagement provides protection against escalating employee related costs. Computer hardware costs have not been sensitive to inflationary pressures.

Quarterly Results

(000's except per share amounts)
(unaudited)

Fiscal 1986

	First Quarter	Second Quarter	(1) Third Quarter	(1) Fourth Quarter
Total revenue	$16,808	$19,846	$23,665	$44,607
Operating revenue	10,634	11,936	15,277	21,139
Expenses	9,424	10,021	12,574	16,888
Income before income taxes, and extraordinary items	1,210	1,915	2,703	4,251
Income taxes	617	977	1,399	2,248
Benefit of loss carry forward	617	977	1,399	2,248
Net income	1,210	1,915	2,703	4,251
Net income per Common Share:				
Cdn. GAAP	0.16	0.19	0.26	0.36
U.S. GAAP	0.16	0.18	0.25	0.35

(1) includes the results of Capital Systems, Inc. from May 1, 1986

Fiscal 1985

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenue	$10,352	$13,223	$13,088	$13,626
Operating revenue	8,106	8,553	9,918	10,115
Expenses	7,081	7,615	8,811	8,998
Income before income taxes, and extraordinary items	1,025	938	1,107	1,117
Net gain on sale of subsidiaries		4,795		
Income taxes	513	1,667	314	706
Benefit of loss carry forward	513	1,667	314	706
Net income	1,025	5,733	1,107	1,117
Net income per Common Share:				
Cdn. GAAP	0.13	0.74	0.15	0.15
U.S. GAAP	0.13	0.75	0.15	0.15
From continuing operations after the benefits of loss carry forward (U.S. GAAP)	0.13	0.12	0.15	0.15

Selected Financial Data

Selected Financial Data

The following table summarizes certain selected consolidated financial information and is qualified in its entirety by, and should be read in conjunction, with the more detailed Consolidated Financial Statements and related notes of the Company. The following table has been derived from the Company's Consolidated Financial Statements which have been prepared in accordance with generally accepted accounting principles as applied in Canada ("Cdn. GAAP").

These principles are also in conformity, in all material respects, with generally accepted accounting principles as applied in the United States ("U.S. GAAP") except with respect to (i) deferral of software product development costs, (ii) the presentation in the balance sheet of the First Preference Shares, and (iii) the presentation of the gain on disposal of discontinued operations. For the reconciliation of financial data to U.S. GAAP, see note 7 of the Notes to the Consolidated Financial Statements.

(000's except share and per share amounts)
Year ended August 31

	1986 (4)	1985			1984			1983(1)	1982(1)
		Continuing Operations	Net gain on sale of Discontinued Operations	Total	Continuing Operations	Discontinued Operations (1)	Total (1)	Total	Total
Income Statement Data:									
Total revenue	$104,926	$50,289		$50,289	$36,338	$21,095	$57,433	$ 49,815	$ 39,833
Operating revenue (2)	58,986	36,692		36,692	26,365	10,645	37,010	34,381	33,236
Expenses	48,907	32,505		32,505	24,136	20,867	45,003	48,353	62,982
Income (loss) before income taxes, unusual and extraordinary items	10,079	4,187		4,187	2,229	(10,222)	(7,993)	(13,972)	(29,746)
Net gain on sale of discontinued operations			$ 4,795	4,795					
Income taxes (recovery)	5,241	2,000	1,200	3,200					(214)
Benefit of loss carry forward (3)	(5,241)	(2,000)	(1,200)	(3,200)					
Removal of unamortized software development costs (5)								(14,800)	
Net income (loss)	**$ 10,079**	**$ 4,187**	**$ 4,795**	**$ 8,982**	**$ 2,229**	**$(10,222)**	**$ (7,993)**	**$(28,772)**	**$(29,532)**
Net income (loss) per Common Share (3):									
Cdn GAAP	$ 1.00	$ .58	$ .67	$ 1.25	$ 0.20	$ (2.90)	$ (2.70)	$ (10.40)	$ (12.55)
U.S. GAAP	0.98	.58	.66	1.24	0.21	(2.90)	(2.69)	(5.40)	(13.06)

(000's)
August 31

	1986 (4)	1985	1984(1)	1983(1)	1982(1)
Balance Sheet Data:					
Working capital	$ 68,918	$ 8,397	$ (62)	$ 4,687	$ 1,388
Total assets	115,115	21,764	28,304	28,559	41,175
Capital lease obligations	682	1,623	2,120	3,146	3,900
Other long term debt	406		3,772	249	19,612
Shareholders' equity	86,898	12,272	429(6)	8,351(6)	(221)

(1) Includes discontinued Software Product Business. It is not practicable to segregate the results of operations of discontinued operations for 1983 and 1982.
(2) Total revenue less cost of hardware and licenced software sold.
(3) Amounts charged to operations in fiscal 1982, 1983 and 1984 associated with product development, marketing and sales relating to the discontinued software product business contributed to losses of which approximately $49 million are available to the Company to reduce or eliminate income taxes otherwise payable on future earnings.
(4) Includes the results of Capital Systems, Inc. from May 1, 1986 (see note 2 of the Notes to the Consolidated Financial Statements).
(5) Pursuant to Cdn. GAAP, the Company deferred and amortized certain software development costs until 1983. Under U.S. GAAP such amounts would have been expensed as incurred and, consequently, net losses in conformity with U.S. GAAP in 1983 and 1982 were $14,518,000 and $30,749,000 respectively.
(6) Pursuant to U.S. GAAP, the Company's First Preference Shares would be considered to be Redeemable Preference Shares and, as such, are to be presented outside Shareholders' Equity. The amounts of First Preference Shares outstanding at August 31, 1984 and 1983 were $26,786,000 and $26,903,000 respectively.

Common Share Information

Principal Markets

The NASDAQ National Market System is the principal market on which the Company's shares are traded. The shares are also traded on The Toronto Stock Exchange and The Montreal Exchange. The Company's shares were first listed on The Toronto Stock Exchange on August 25, 1980 and included on NASDAQ on June 14, 1985. The stock symbol of the Company's shares on NASDAQ is SHKIF and on The Toronto Stock Exchange and The Montreal Exchange it is SHK.

The following table sets forth the high and low prices for the Common Shares for the periods shown below.

NASDAQ National Market System (U.S. Dollars)

	High Bid	Low Bid
1985		
Second Quarter (commencing June 14)	$ 7.38	$ 7.00
Third Quarter	7.75	6.50
Fourth Quarter	10.13	6.63
1986		
First Quarter	12.50	9.50
Second Quarter	20.00	11.13
Third Quarter	19.75	15.13
Fourth Quarter (through to October 20, 1986)	22.63	15.75

The NASDAQ quotations reflect inter-dealer prices, without retail mark-up, mark-down or commissions and may not necessarily represent actual transactions.

The Toronto Stock Exchange
(Canadian Dollars)

	High	Low
1984		
First Quarter	$ 8.70	$ 5.50
Second Quarter	7.00	4.50
Third Quarter	5.00	3.25
Fourth Quarter	7.65	3.50
1985		
First Quarter	9.25	6.50
Second Quarter	10.38	7.00
Third Quarter	10.63	9.00
Fourth Quarter	13.63	8.75
1986		
First Quarter	17.38	13.25
Second Quarter	28.00	15.50
Third Quarter	27.63	21.00
Fourth Quarter (through to October 20, 1986)	31.38	22.00

Shareholders
As at October 20, 1986, there were 1,741 shareholders of record.

Dividends
The Company has not declared or paid any dividends on its Common Shares since February 1982 and the Board of Directors anticipates that all available funds will be applied in the foreseeable future to finance growth.

Under the Income Tax Act, (Canada) (the "Act"), assuming that beneficial owners of the Common Shares are neither residents nor deemed to be residents of Canada and that they do not use or hold and are not deemed to use or hold the Common Shares in carrying on business in Canada, dividends paid by Systemhouse on its Common Shares will be subject to withholding tax at a maximum rate of 25% or such lower rate as may be provided for under the terms of an applicable bilateral tax treaty. Under the United States–Canada Tax Convention (1980), the rate of withholding tax on Systemhouse dividends paid or credited, or deemed paid or credited, to individuals residing in, or corporations organized under the laws of, the United States, and not having a "permanent establishment" or "fixed base" in Canada, is reduced to 15%. The rate of withholding tax on dividends is further reduced under the Convention to 10% if the beneficial owner is a corporation resident in the United States and not having a "permanent establishment" or "fixed base" in Canada which owns at least 10% of the voting stock of Systemhouse.

On the basis of the assumptions set forth above, no other Canadian income or capital gains tax is payable under the Act by a non-resident of Canada in respect of the Common Shares or the dividends thereon, or any gains realized upon the disposition thereof, except on and to the extent of the capital gain realized on the disposition of Common Shares by a beneficial owner where such Common Shares are "taxable Canadian property" as defined by the Act. An applicable bilateral tax treaty may however, reduce or eliminate such tax, if it is exigible under the Act.

Exchange Rates of the Canadian Dollar

The high and low rates (i.e., the highest and lowest rates at which Canadian dollars were sold), the average exchange rate (i.e., the average of the exchange rates on the last day of each month during the period) and the period end exchange rate of the Canadian dollar in exchange for U.S. currency for each of the five years ended December 31, 1985 and for the period January 1, 1986 through October 20, 1986, as reported by the Federal Reserve Bank of New York, were as follows:

	January 1, to October 20, 1986	1985	1984	1983	1982	1981
High	$0.7331	$0.7728	$0.8033	$0.8201	$0.8430	$0.8499
Low	0.6954	0.7130	0.7492	0.7993	0.7691	0.8048
Average	0.7180	0.7308	0.7713	0.8108	0.8083	0.8339
Period End	0.7185	0.7151	0.7566	0.8035	0.8132	0.8430

Directors of the Company

Roderick M. Bryden
Chairman & Chief Executive Officer
SHL Systemhouse Inc.

Peter A. Sandiford
President & Chief Operating Officer
SHL Systemhouse Inc.

W. Alan Macfarlane
Vice President & Secretary
Kinburn Corporation
Investment Holding Company

John G. Bryden
Corporate Director

Dr. Michael C.J. Cowpland
President, Corel Systems Corporation
Laser Publications Systems Manufacturer

John C. Hardy*
President
The Hendron Financial Group
Investment Holding Company

Charles E. O'Connor*
Chairman & Chief Executive Officer,
Kinburn Technology Corporation
Technology Management Company

Donald W. Paterson*
Vice President & Director
Wood Gundy Inc.
Investment Dealer

C. Ian Ross
President,
Paperboard Industries Corporation
Paperboard & Corrugated Products Manufacturer

*Member of the Audit Committee

Officers of the Company

Roderick M. Bryden
Chairman & Chief Executive Officer

Peter A. Sandiford
President & Chief Operating Officer

Stanley Udaskin
Vice President, Finance and Administration

Jean-Pierre Soublière
Executive Vice President,
Canadian Operations

Donald J. Lundgren
Vice President & General Manager,
Ottawa Branch

Dennis B. Maloney
Vice President & General Manager,
Toronto Branch

Robert B. Laurence
Vice President & General Manager,
Capital Systems Branch

Howard G. Ulep
Vice President, Marketing (U.S.)

W. Alan Macfarlane
Secretary

Corporate Information

Auditors
Clarkson Gordon
Ottawa, Ontario

Legal Counsel (Canada)
Gowling & Henderson
Barristers & Solicitors
Ottawa, Ontario

Legal Counsel (U.S.)
Milbank, Tweed, Hadley & McCloy
New York, New York

Stock Exchange Listings
NASDAQ National Market System
The Toronto Stock Exchange
The Montreal Exchange

Transfer Agents & Registrars
The Canada Trust Company
Toronto, Ontario

Morgan Shareholder Services
Trust Company
New York, New York

Banker
The Royal Bank of Canada

The Annual and Special Meeting of Shareholders of SHL Systemhouse Inc. will be held at 4:30 p.m., December 9, 1986, in the Auditorium of The Toronto Stock Exchange, 2 First Canadian Place, Toronto, Ontario, Canada.

A copy of the Company's annual report on Form 10-K filed with the U.S. Securities and Exchange Commission is available to shareholders without charge upon request to: Corporate Communications, SHL Systemhouse Inc., 99 Bank Street, 3rd Floor, Ottawa, Ontario, Canada, K1P 6B9.

Designed and produced by Wallace Kearney McGill Advertising
Printed in Canada