



Trusted Software for Gaming

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News Release

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ESI Entertainment announces Fiscal 2007 Financial Results

BURNABY, B.C. May 25, 2007- ESI Entertainment Systems Inc. ("ESI" or the "Company") (TSX: ESY) reported today its financial and operational results for the fiscal year ended February 28, 2007 ("fiscal 2007"). All amounts are in Canadian dollars unless otherwise stated.

Fiscal 2007 Financial Highlights

- The Company recorded a non-cash impairment of deferred start-up costs, capitalized development costs for Citadel and Playline and capital assets for Playline in the aggregate amount of \$6.2 million
- 19% increase in consolidated revenues to \$22.0 million for fiscal 2007 from \$18.5 million for fiscal 2006
- 41% increase in consolidated gross profit to \$13.5 million for fiscal 2007 from \$9.6 million for fiscal 2006
- 363% decrease in consolidated net earnings before income taxes and non-controlling interest to a loss of \$5.0 million for fiscal 2007 from earnings of \$1.9 million for fiscal 2006 (accounted for by the write-off of Deferred Start-up costs and Deferred Development Costs discussed elsewhere)
- 33% decrease in cash generated from consolidated operating activities to \$2.6 million for fiscal 2007 from \$3.9 million for fiscal 2006

"These results before the write-off of the deferred assets truly demonstrate the strength of ESI's business model. Revenues had grown substantially over the prior year and net income had increased even while considerable investments were made in infrastructure and in expanding the Company's employee base. The Company looks to expand in Europe and other e-commerce markets."

"The Company is focused on expanding its market reach into new geographic regions and e-commerce markets and on delivering new products and services that offer compelling value to its customers"

Fiscal 2007 Business Highlights

Fiscal 2007 was a year of significant decline in ESI's North American payment processing business for non-domestic internet merchants for U.S. consumers. ESI's strategy during the year was focused on expanding its market in North America before the enactment of the *Unlawful Internet Gambling Enforcement Act (the "UIGEA")* which led to the cessation of the payment processing business for non-domestic internet gaming merchants for U.S. consumers. ESI's strategy also included investing in new products, and sourcing investment to fund future growth plans.

The Company has delivered on all of these strategic objectives as follows:

- **Expanding the North American market.** North American consolidated revenues increased 19% compared to the prior fiscal year. A significant portion of this growth was driven by Citadel Commerce Corp.'s payment processing business from on-line gaming merchants. The Company ceased this part of the business late in the year due to uncertainty created by the actions taken by the U.S. authorities against other payment processors.
- **Investing in new products.** ESI's product marketing and engineering teams have focused on developing new products for new markets. Two such products are SecureSwipe and Citadel Switch. Secure Swipe is a proprietary pin pad device that allows consumers to conduct immediate, secure payments from their home computers over the Internet using debit and credit cards. Citadel Switch is a software product that electronically scans Citadel bank accounts and notifies merchants when consumer funds are received.
- **Obtained an e-money license from the UK Financial Services Authority.** This allows us to launch our products in Europe.
- **Sourcing investment for growth.** The Company raised \$10 million through an Initial Public Offering of its shares which listed on the Toronto Stock Exchange, on March 30, 2006.

Fiscal 2007 Financial Review

Results of Operations

Consolidated Revenues

The following table provides a breakdown of the Company's revenues from its three subsidiaries for the reported periods:

(\$ 000)	Year ended		% change
	Feb 28 2007	Feb 28 2006	
Citadel	19,976	14,726	36%
Integrity	2,036	3,648	(44%)
Other	11	170	(94%)
Total revenue	22,023	18,544	19%

Total revenue increased by 19% to \$22.0 million from \$18.5 million for fiscal 2007. This increase was mainly due to the growth in Citadel revenues, which increased 36% during the fiscal year. This increase arose as a result of growth in revenues from existing gaming merchants, new merchant growth and new revenue generated from NSF fees. During fiscal 2007, a majority of the revenues from Citadel Checks were earned from the growth in existing merchant accounts.

ESI Integrity revenues declined by 44% in fiscal 2007. The decrease in ESI Integrity revenues mainly related to one time significant computer hardware sale to a United States based lottery organization in the previous year.

Citadel Revenues

As approximately 91% of ESI's revenues were generated by Citadel, the Company has provided a more comprehensive breakdown of these revenues as follows:

The majority of Citadel's revenues were generated from Citadel Checks, an electronic cheque service. Approximately 90% of the revenues were generated from fees charged to gaming merchants for processing consumer funds on behalf of the merchants. Citadel does not charge the consumer a fee for this service.

(\$ 000)	Years ended		% change
	Feb 28 2007	Feb 28 2006	
Citadel Checks	18,157	13,288	37%
Citadel Payouts	1,627	1,438	13%
myCitadel	192	-	N/A
Total Citadel Revenues	19,976	14,726	36%

Included in Citadel Checks revenues were fees generated from merchants (i) when consumers who were authenticated by Citadel's risk assessment process did not pass this process, and (ii) from NSF fees, a new revenue stream in fiscal 2006, where Citadel charged fees to consumers who initially had insufficient funds in their chequing accounts when transactions were being processed.

In addition to Citadel Checks revenues, additional fees were generated from payout transactions. Fees were charged to merchants when funds from merchants were transferred to their consumers.

myCitadel, a business unit within Citadel, is developing enhancements to Citadel's electronic wallet. myCitadel was in its start-up phase and all its revenues were being capitalized until November 30, 2006 at which time the Company wrote off the deferred start-up costs given the uncertainties created by the passing of the UIGEA. Subsequent to November 30, 2006, the Company is expensing all costs as they are incurred and is also recognizing revenues as they are earned. During fiscal 2007 the Company obtained authorization from the UK Financial Services Authority (FSA) to operate as a regulated e-money issuer. The Company is launching its myCitadel electronic wallet to consumers in Europe.

Citadel Checks offers two payment processing programs to its merchants, a non-guarantee program and a guarantee program. The table below reports the allocation of Citadel Checks revenues for each of these programs.

(\$ 000)	Years ended		% change
	Feb 28 2007	Feb 28 2006	
Non-guarantee program	14,514	9,387	55%
% of total revenue	80%	71%	
Guarantee program	3,643	3,901	-7%
% of total revenue	20%	29%	
Total Citadel Checks Revenues	18,157	13,288	37%

Under the non-guarantee program, Citadel charges merchants a fixed fee for processing consumer transactions and it does not accept any chargeback risk. Under the guarantee program, merchants are charged a fee that is a percentage of the value of the transaction processed because Citadel assumes the chargeback risk for the transactions it guarantees. Thus, the guarantee fee charged to merchants is typically higher than for a non-guarantee transaction. The guarantee program was established in fiscal 2006.

During fiscal 2006 and 2007 all Citadel revenues were generated in North America. As noted above the Company ceased its financial processing business for non-domestic internet gaming merchants for US consumers which accounted for all of its revenues for the Citadel business unit. The Company is now focused on expanding its European and Asian presence over the next few years.

Consolidated Gross Profit

The following table provides a summary of the Company's gross profit for the reported periods:

(\$ 000)	Years ended	
	Feb 28 2007	Feb 28 2006
Revenues	22,023	18,544
Direct costs	8,479	8,935
Gross profit	13,544	9,609
Gross profit margin (%)	61%	52%

The increase in gross profit margin in fiscal 2007 was due to direct costs not growing at the same rate as revenues and was mainly attributable to Citadel. In the previous fiscal year due to the rapid growth in Citadel's revenues, management hired additional merchant support and operational personnel to handle the increased activity. Citadel also incurred costs related to its newly launched guarantee program in fiscal 2006. All of these costs were recorded as direct costs of revenues generated by Citadel.

ESI Integrity's gross profit as a percentage of revenue was also higher during fiscal 2007 relative to the prior fiscal year due to the one-time, low margin sale of computer hardware to a United States lottery customer in fiscal 2006.

The gross profit margin by dollar and as a percentage of revenues for each subsidiary is listed below:

(\$ 000)	Years ended			
	Feb 28 2007		Feb 28 2006	
		<u>GP%</u>		<u>GP %</u>
Citadel	12,853	64%	8,578	58%
Integrity	686	34%	976	27%
Other	5	45%	55	32%
Total gross profit	13,544	61%	9,609	52%

Citadel's gross profit margin during fiscal 2007 was 64%. Gross profit margin for Citadel increased by 6% from previous year mainly due ramping costs incurred in the previous year from which benefit was derived in the current year. Integrity gross profit also increased by 7% because last year's gross profit included a one time sale of hardware with low gross profit.

Product Development

Product development expenses were \$1.3 million in fiscal 2007, an increase of 147% compared to \$505,346 for the prior period. The increase is mainly related to additional software development work on myCitadel since the Company no longer capitalizes those costs.

Sales, Marketing and Customer Service

Sales, marketing and customer service expenses were \$3.2 million for fiscal 2007, an increase of 10% compared to \$2.9 million for the prior period. The increase primarily related to the expansion of Citadel's sales and marketing forces, increased travel, additional marketing activities relating to trade shows and increased promotional activities to attract new customers.

General and Administrative

General and administrative expenses were \$7.6 million for fiscal 2007, an increase of 105% compared to \$3.7 million for the prior period. This increase resulted from new hires in the financial, human resources and information systems departments to manage the increased activity within the ESI group of companies. In addition, ESI expanded its rental space, incurred additional professional fees and other general corporate expenses as the headcount and activity levels of the Company increased in fiscal 2007 before the cessation of the financial processing business for non-domestic internet gaming merchants for US consumers. Furthermore, public company expenses including investor relations fees, public filings fees, directors' and officers' liability insurance and other expenses incurred during the fiscal 2007 were not incurred during fiscal 2006. The Company also recorded a provision for bad debts totaling \$0.8 million for fiscal 2007 compared to nil for fiscal 2006 related to actions taken by the DoJ against the on-line gaming payment processing industry in the U.S.

Included in general and administrative expenses was non-cash stock compensation expense of approximately \$272,874 for fiscal 2007 and approximately \$20,353 for fiscal 2006. Stock compensation expense is expected to increase during the next fiscal year as a result of additional stock grants to the Company's expanded employee base and the increased volatility factor used in the calculation of stock compensation expense by virtue of ESI's new public company status.

Amortization of Property and Equipment

Amortization expenses were \$887,783 for fiscal 2007, an increase of 36% compared to \$653,972 for the prior period. The increase relates to the purchase of additional computer hardware and software, furniture and fixtures and leasehold improvements to accommodate the Company's expanded employee base. Additionally, specific leasehold improvements were made to expand Citadel's call centre and new equipment was purchased to upgrade Citadel's data centre toward the end of fiscal 2006.

Other Income

Other income was \$665,715 for fiscal 2007, compared to \$65,549 for the prior period. This increase is mainly accounted for by interest earned on the funds from the IPO and foreign exchange gains.

Provision for Income Taxes

Provision for income tax expense was \$46,550 for fiscal 2007 compared to \$670,500 for the prior period. This decrease resulted from a net loss before income taxes in fiscal 2007 compared to net earnings before income taxes in fiscal 2006.

Net (loss) Earnings

Net loss for fiscal 2007 was \$5.0 million (\$0.27 loss per share – basic and diluted) compared to net earnings of \$1.3 million (\$0.11 earnings per share- basic; \$0.08 earnings per share diluted). This decrease was largely driven by the write-off of capitalized start-up and capitalized development costs in fiscal 2007.

Capital Expenditures

Capital expenditures for fiscal 2007 were \$506,914 compared to \$1.6 million for fiscal 2006. The decrease in capital expenditures was primarily the result of an expansion in physical infrastructure in the prior year to meet growing sales and employee numbers. The expansion included computer hardware and software purchases (including upgrades to Citadel's data centre) and leasehold improvements (including expansion of Citadel's call centre).

Deferred Start-Up Costs

The Company established PlayLine early in fiscal 2006 and the myCitadel division in fiscal 2004. Direct costs associated with the start up of these operations were being deferred until each commenced commercial operations, at which time the accumulated start up costs were to be amortized over a period not to exceed five years. Direct costs associated with the start up of the business operations for myCitadel and PlayLine were deferred until November 30, 2006, at which time the accumulated start up costs were reviewed in light of the passing of the UIGEA on October 13, 2006. During fiscal 2007, sales, marketing, business development and other direct expenses in the amount of \$185,787 and \$1.1 million were capitalized for PlayLine and myCitadel, respectively. Before the impairment of the asset, as at November 30, 2006, Start-up Costs for PlayLine totaled \$813,698 and \$3,115,148 for myCitadel. With the enactment of the UIGEA, its impact on Citadel's market and the redeployment of resources from Playline to Citadel, management reassessed the carrying value of Deferred Start-up Costs. Management determined that the passing of the UIGEA and the redeployment of resources from Playline to Citadel will likely lead to reduced future revenue streams in the Citadel division. Management believes the Company can no longer reasonably expect to recover the accumulated capitalized start up costs and hence has written them off in the fiscal 2007. The Company will expense and recognize any revenues in future periods as these items occur.

Capitalized Development Costs

The Company has capitalized certain computer software production costs for PlayLine and myCitadel. Amortization of the software development costs would have commenced on reaching commercial operations using the straight line method over the useful life of the software. During fiscal 2007, software expenses in the amount of \$253,768 and \$354,024 were capitalized for PlayLine and myCitadel, respectively. Before the impairment of the asset, as at November 30, 2006 capitalized development costs for PlayLine totaled \$610,001 and \$1,266,415 for myCitadel.

As with Deferred Start-up Costs, with the enactment of the UIGEA, the redeployment of resources from Playline to Citadel, and its impact on Citadel's market, management reassessed the carrying value of Capitalized Development Costs. Management determined that the passing of the UIGEA and the redeployment of resources from Playline to Citadel will likely lead to reduced future revenue streams in the Citadel division. Management believes the Company can

no longer reasonably expect to recover the accumulated capitalized development costs and hence has written them off in the current fiscal year.

Citadel Processing Accounts and Liabilities

Citadel processing accounts as at February 28, 2007 totaled \$16.9 million compared to \$33.8 million as at February 28, 2006. The accounts are comprised of restricted cash, which are segregated bank funds arising from the processing of deposits and payments for Citadel merchants and consumers, and accounts receivable relating to Citadel processing accounts for funds in transit from merchants and consumers. The processing account balances are also recorded as a liability because these funds represent amounts due to consumers and merchants. The decline in Citadel processing accounts and Citadel processing liabilities is due to cessation of the financial processing business for non-domestic internet gaming merchant for US consumers during fiscal 2007. The Company also recorded an allowance for bad debts totaling \$0.8 million for 2007 compared to nil for 2006 for Citadel processing accounts due to the uncertainty created by actions taken by the DoJ against the on-line gaming payment processing industry in the U.S.

Subsequent to year end approximately US\$ 8.31 million Merchant Reserve Funds in the USA were seized by the U.S. Department of Justice (DoJ). The company is continuing to work with the DoJ through its legal counsel to resolve the situation. The Company has not made any allowances for these balances in these Financial Statements.

Liquidity and Capital Resources

ESI has historically financed its operations through the sale of equity and through cash generated by its operations.

During fiscal 2007, cash provided by operating activities was \$2.6 million compared to \$3.9 million during fiscal 2006, a decrease of \$1.3 million from the prior period. This decrease resulted from a \$585,211 increase in cash generated from operations and a \$1.9 million decrease in non-cash operating items during fiscal 2007. Cash from operations was higher during fiscal 2007 compared to fiscal 2006 because of higher cash based earnings mainly as a result of increased activity within Citadel. Non-cash operating items in fiscal 2007 were lower than fiscal 2006 as a result of paying down accounts payable and accrued liabilities and expenditures on SecureSwipe inventory.

Cash used in investing activities totaled approximately \$3.1 million during fiscal 2007. Investments consisted of the purchase of property and equipment (approximately \$0.4 million), funding of PlayLine and myCitadel development costs (approximately \$1.6 million), restricted cash seized subsequent to year-end by DoJ of approximately \$1.1 million.

Cash provided by financing activities totaled \$7.5 million during fiscal 2007. These activities related to the Company's IPO which raised \$8.9 million and payment of capital lease and license obligations of \$404,505.

Overall, the net cash provided was \$7.0 million in fiscal 2007 compared to a use of cash of \$0.4 million in fiscal 2006 mainly due to the IPO which raised cash of \$8.9 million net of offering costs.

Consolidated Financial Statements

NOTE TO READER: The following financial statements are extracted from the complete audited financial statements of the Company which have been filed together with the Management's Discussion and Analysis and Annual Information Form with the Company's documents on www.sedar.com to which the reader is referred.

Consolidated Balance Sheets

(expressed in Canadian dollars)

February 28

2007

2006

	2007	2006
Assets		
Current		
Cash and cash equivalents	\$ 9,453,701	\$ 2,498,268
Accounts receivable	558,291	717,324
Prepays	472,910	485,982
	<u>10,484,902</u>	<u>3,701,574</u>
Restricted cash	1,100,903	-
Citadel processing accounts	16,075,768	33,805,751
Property and equipment	1,391,764	1,973,586
Deferred contract costs	502,596	537,822
Deferred start-up costs	-	2,675,695
Capitalized development cost	-	1,477,731
Deferred share issue costs	-	936,987
	<u>\$ 29,555,933</u>	<u>\$ 45,109,146</u>
Liabilities		
Current		
Accounts payable and accrued liabilities	\$ 1,237,547	\$ 2,213,787
Capital lease obligations	348,671	258,631
Software license obligation	9,917	114,286
Deferred revenue	539,198	564,239
Loan payable	-	1,000,000
	<u>2,135,333</u>	<u>4,150,943</u>
Citadel processing liabilities	16,883,268	33,805,751
Deferred revenue	1,080,247	687,895
Capital lease obligations	245,399	486,058
Software license obligation	-	5,247
Future income tax liabilities	-	258,500
	<u>20,344,247</u>	<u>39,394,394</u>
Shareholders' Equity		
Capital stock	13,226,702	5,089,990
Warrants	84,634	5,926
Contributed surplus	330,134	57,779
(Deficit) retained earnings	(4,429,784)	561,057
	<u>9,211,686</u>	<u>5,714,752</u>
	<u>\$ 29,555,933</u>	<u>\$ 45,109,146</u>

Consolidated Statements of Operations and (Deficit) Retained Earnings

(expressed in Canadian dollars)
Years Ended February 28

	2007	2006
Revenues	\$ 22,023,110	\$ 18,544,167
Direct costs	<u>8,478,676</u>	<u>8,934,785</u>
Gross profit	<u>13,544,434</u>	<u>9,609,382</u>
Operating expenses		
Product development	1,250,584	505,346
Sales, marketing and customer service	3,164,733	2,925,280
General and administrative	7,639,875	3,661,088
Amortization of property and equipment	<u>887,783</u>	<u>653,972</u>
	<u>12,942,975</u>	<u>7,745,686</u>
Earnings before under noted items	601,459	1,863,696
Other expenses (income)		
Impairment of intangibles and other assets	6,211,465	-
Foreign exchange (gain) loss	(272,973)	38,096
Interest income	(527,564)	(183,351)
Interest expense	<u>134,822</u>	<u>79,706</u>
(Loss) Earnings before income taxes and non-controlling interest	<u>(4,944,291)</u>	<u>1,929,245</u>
Provision for income taxes		
Current	46,550	-
Future	<u>-</u>	<u>670,500</u>
	<u>46,550</u>	<u>670,500</u>
(Loss) Earnings before non-controlling interest	<u>(4,990,841)</u>	<u>1,258,745</u>
Non-controlling interest	<u>-</u>	<u>(4,762)</u>
Net (loss) earnings	<u>\$ (4,990,841)</u>	<u>\$ 1,263,507</u>
(Loss) Earnings per share		
Basic	\$ (0.27)	\$ 0.11
Diluted	(0.27)	0.08
Retained earnings (deficit), beginning of year	\$ 561,057	\$ (675,779)
Excess of consideration paid over ascribed value for shares repurchased	-	(26,671)
Net (loss) earnings	<u>(4,990,841)</u>	<u>1,263,507</u>
(Deficit) retained earnings, end of year	<u>\$ (4,429,784)</u>	<u>\$ 561,057</u>

Consolidated Statements of Cash Flows

(expressed in Canadian dollars)
Years Ended February 28

2007

2006

Cash flows provided by (used in)

Operating activities

Net (loss) earnings	\$	(4,990,841)	\$	1,263,507
Items not affecting cash:				
Stock-based compensation		272,874		20,353
Amortization of property and equipment		887,783		653,972
Impairment of intangibles and other assets		6,211,465		-
Non-controlling interest in results of subsidiary		-		(4,762)
Future income taxes		-		670,500
Net changes in non-cash operating items				
Accounts receivable		159,033		327,956
Inventory		(205,250)		-
Prepays		13,072		(107,503)
Accounts payable and accrued liabilities		(976,240)		986,836
Allowance for bad debts		807,500		-
Deferred revenue		367,311		(49,163)
Deferred contract costs		35,226		123,524
		<u>2,581,933</u>		<u>3,885,220</u>

Investing activities

Deferred start up cost		(1,253,151)		(1,926,420)
Capitalized development cost		(398,685)		(752,189)
Acquisition of property and equipment		(362,644)		(688,096)
Restricted cash		(1,100,903)		-
Acquisition of Riptide Technologies Inc., net of acquisition costs incurred		-		(683,827)
		<u>(3,115,383)</u>		<u>(4,050,532)</u>

Financing activities

Issuance of common shares		8,893,388		28,125
Loan payable		(1,000,000)		1,000,000
Capital lease payments		(294,889)		(173,998)
Software license obligation		(109,616)		(106,136)
Share issue costs		-		(936,987)
Repurchase of common shares		-		(42,600)
		<u>7,488,883</u>		<u>(231,596)</u>

Increase (decrease) in cash and cash equivalents		6,955,433		(396,908)
Cash and cash equivalents, beginning of year		<u>2,498,268</u>		<u>2,895,176</u>
Cash and cash equivalents, end of year	\$	<u>9,453,701</u>	\$	<u>2,498,268</u>

Forward- looking Statements

This news release contains forward-looking statements concerning ESI Entertainment Systems Inc, which statements can be identified by the use of forward-looking terminology such as “expect”, “proposed”, “may”, “plan”, “intend”, “will”, “would” or the negative thereof or any other variations thereon or comparable terminology referring to future events or results. Forward-looking statements are statements about the future and are inherently uncertain, and the actual events or results could be materially different than those anticipated in those forward-looking statements as a result of numerous factors discussed more fully in the Company’s Final Prospectus dated March 22, 2006 and elsewhere. These risks include risks related to revenue growth, operating results, industry growth, changes in regulation and legislation, products, technology, financing, competition, personnel and other factors affecting the Company and its business, any of which could cause actual events or results to vary materially from ESI’s anticipated future results. Forward-looking statements are based on beliefs, opinions and expectations of ESI’s management at the time they are made, and ESI does not assume any obligation to update its forward-looking statements if those beliefs, opinions or expectations, or other circumstances should change. The Toronto Stock Exchange does not accept responsibility for this press release.

About ESI Entertainment Systems Inc.

ESI Entertainment Systems Inc. (“ESI”) (TSX: ESY) provides products and services to the international gaming and e-commerce industries through its three principal subsidiaries, Citadel Commerce Corp., ESI Integrity Inc. and PlayLine Inc. ESI's products and services, which primarily consist of payment processing, transaction monitoring and turnkey gaming platforms, are deployed in the on-line and land based gaming and e-commerce markets.

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