

**IP APPLICATIONS CORP.**

**Nine Months Ended September 30, 2007**

**MANAGEMENT DISCUSSION AND  
ANALYSIS**

**November 29, 2007**

This Management's Discussion and Analysis ("MD&A") dated November 23, 2007 is supplementary to, and should be read in conjunction with, the consolidated financial statements for the interim period ended September 30, 2007 and the Company's MD&A and annual audited financial statements for the year ended December 31, 2006. The Company's consolidated financial statements and the notes thereto have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") on a going concern basis and do not include any adjustments to the amounts and classifications that might be necessary should the Company be unable to continue business. The interim unaudited financial statements for the nine months ended September 30, 2007 have been reviewed by the Company's external auditors PricewaterhouseCoopers. All amounts are in Canadian dollars unless otherwise stated. Certain comparative amounts have been reclassified to conform to the current years' classifications.

## **FORWARD LOOKING STATEMENTS**

This discussion may contain forward-looking statements that are based upon current expectations, which involves risks and uncertainties associated with our business and the economic environment in which the business operates. These uncertainties may cause the Company's actual results to differ materially from those contemplated by the forward looking statements. Factors that might cause or contribute to such differences include, among others, competitive pressures, the growth rate of the Internet and telecommunications' concerns, constantly changing technology and market acceptance of the Company's products and services. Forward-looking statements contained in the MD&A represent the Company's expectations and intentions as of November 29, 2007. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## **BUSINESS OVERVIEW**

The Company delivers business process automation and customer care for companies in the rapidly expanding Software-as-a-Service ("SaaS") market. IP Applications' customers use the Company's data center and staff to run particular segments of their business operations. Customers focus on their product marketing and technology while IP Applications solves the end user satisfaction, subscriber management and payment processing issues for them.

IP Applications provides three major service products to its customers: secure and certified datacenter support for subscription management, provisioning, billing and payment processing; end-user customer care via inbound and outbound telephone, email and online chat; and automated provisioning and control of third party products and services such as hosted application software ("on-demand" or "software-as-a-service" products), internet access, security products and other internet content.

The Company markets its services directly to enterprise customers and through Internet Service Providers in Canada and the USA. Approximately one third of the company's customers by revenue use only its customer care services, one third use only its subscription management and payment processing services, and the remaining third use a combination of both.

Additional information related to the Company can be found at [www.SEDAR.com](http://www.SEDAR.com) and [www.ipapplications.com](http://www.ipapplications.com).

## 2007 THIRD QUARTER OVERVIEW

- Revenues of \$1.9M for the quarter ended September 30, 2007, represent a 22% decrease from the \$2.4M recognized for the three months ended September 30, 2006.
- Gross margin improved to 44.5% in the current quarter, as compared to 37.2% in the comparable quarter in 2006.
- Operating expenses decreased 25% to \$1.0M in the current quarter, as compared to \$1.4M for the three month period ended September 30, 2006.
- Net loss of \$197K for the quarter ended September 30, 2007, represents a 58% improvement on the net loss of \$472K incurred for the three months ended September 30, 2006.
- The company achieved positive EBITDA of \$6K for the nine months ended September 30, 2007 which represents a significant improvement over the EBITDA loss of \$284K incurred during the first nine months of 2006.
- The rapid appreciation of the C\$ during the year, relative to the US\$, continues to have a material impact on operating results. The Company incurred foreign exchange translation losses of \$43,071 during the current quarter and \$103,129 year-to-date. Our operational improvements over the past year have served to insulate the EBITDA from a greater negative impact due to foreign exchange fluctuations.

## SELECTED QUARTERLY INFORMATION

The table below details selected operating results for the past eight quarters (in \$ thousands, except per share figures)

Quarter Ended	Sep 30 2007	Jun 30 2007	Mar 31 2007	Dec 31 2006	Sep 30 2006	Jun 30 2006	Mar 31 2006	Dec 31 2005
Revenue	1,878	1,882	2,143	2,117	2,408	2,334	2,430	2,340
Direct Costs	1,043	1,080	1,145	1,263	1,512	1,457	1,341	1,478
Expenses	1,032	1,049	1,184	2,215	1,368	1,517	1,500	2,442
Net Loss	(197)	(247)	(186)	(1,361)	(472)	(640)	(411)	(1,580)
EBITDA (Loss) <sup>(1)</sup>	(7)	(12)	25	(307)	(49)	(221)	(14)	(489)
Net Loss per share - basic	(0.01)	(0.02)	(0.01)	(0.19)	(0.03)	(0.04)	(0.03)	(0.11)

(1) - The Company reports Earnings Before Interest, Taxes, Depreciation and Amortization – and other non-cash expense items (“EBITDA”), which is an approximate measure of operating results based on selected financial data from the Company’s income statement. EBITDA is not a measure that is governed and defined by generally accepted accounting principles. Readers are cautioned that EBITDA as calculated by the Company may not be comparable to similarly titled amounts reported by other companies. The disclosure of EBITDA is intended to add to and not replace the discussion of financial results or cash flow from operations.

## RESULTS OF OPERATIONS - QUARTER ENDED SEPTEMBER 30, 2007

At the conclusion of the 2006 fiscal year, the Company completed an amalgamation of its subsidiaries and review of its expense classifications. The expenses for the quarter ended September 30, 2006 now conform to the re-classified expense categories used in the current fiscal period.

	2007 September 30 (three months)	% of Revenue	2006 September 30 (three months)	% of Revenue
Revenue	<b>\$1,878,429</b>		<b>\$2,408,248</b>	
Direct costs	1,043,286	56%	1,511,976	63%
<b>Gross Margin</b>	<b>835,143</b>	44%	<b>896,272</b>	37%
Amortization	106,999	6%	317,710	13%
General & administrative	382,975	20%	382,522	16%
Interest accretion	77,277	4%	42,994	2%
Marketing & selling	81,189	4%	191,639	8%
Stock based compensation	31,417	2%	88,167	4%
Technical & development	352,399	19%	345,434	14%
<b>Operating Expenses</b>	<b>1,032,256</b>		<b>1,368,466</b>	
Net Loss	<b>\$(197,113)</b>		<b>\$(472,194)</b>	

## ***Revenue***

Revenues include fees for subscription management, provisioning, payment processing, customer care and third party products and services billed to clients. These fees are primarily recurring monthly and are earned on a per-end-user or per-minute basis. The Company also charges additional fees to clients for adding new end users and new services onto the Company's platform.

Revenues of \$1,878,429 for the three months ended September 30, 2007 represent a net decrease of \$529,819 (or 22%) over the corresponding period in the prior year. The loss of two large customers in 2006 and significant attrition in the volume usage and/or user base of three others in 2007 contributed \$598,963 to this net decline.

## ***Direct Costs***

Direct costs include expenses related to providing subscription management, provisioning, payment processing, customer care and third party products and services. The majority of these costs are proportionate to connection time for third-party connection services and customer care support to the customers' subscribers.

Direct costs of \$1,043,286 for the three months ended September 30, 2007 represent a decrease of \$468,690 (or 31%) over the corresponding quarter in the prior year. This decrease can be broken down by key component expenses: i) third-party service costs decreased by \$296,273; ii) technical support wages and related administrative costs in the Help Desk decreased by \$122,695; and iii) commissions paid to SourceNet decreased by \$49,722.

The reduction in dial-up usage due to attrition in the user base of key customers, and the loss of a significant technical support customer, have had a proportional effect on direct costs. Coupled with the realization of unit price savings negotiated with third party channel service providers during Q4 of 2006 and Q1 of 2007, gross margins improved to 44.5% in the current quarter versus 37.2% in Q3 of 2006.

## ***Operating Expenses***

*Amortization* - Amortization expense decreased \$210,711 (or 66%) during the quarter ended September 30, 2007 relative to the quarter ended September 30, 2006. Intangible assets were fully amortized by December 31, 2006 and this accounts for \$178,686 of the decrease.

*General & administrative* – These costs include general office expenses, rent and occupancy fees, insurance, bad debt expense, regulatory costs, director's fees, consulting fees, professional fees and salaries paid to finance and administration staff of the Company.

Costs quarter over quarter have remained relatively stable. Reductions in bad debts recognized (\$16,080) and consulting fees (\$14,386) were offset with increases in foreign currency exchange loss (\$24,437) and convertible debenture interest (\$16,934).

*Marketing & selling* – These costs include travel, attendance and participation at trade shows, printed material, website maintenance and salaries and commissions paid to sales and marketing staff of the Company.

The net decrease in costs of \$110,450 (or 58%) during the three months ended September 30, 2007 relative to the corresponding period in the prior year, is almost exclusively a result of the substantial decline in headcount. There were the equivalent of five full-time sales and marketing personnel on staff in Q3 of 2006 who are no longer with the company in the current quarter.

*Operations & development* – Salaries related to operations and development personnel comprise the bulk of these costs. There was a net increase of \$6,965 (or 2%) for the quarter ended September 30, 2007. Though net head count was relatively stable quarter over quarter, salaries and benefits increased by approximately \$38K due in large part to the hiring of more senior personnel. This increase was offset by a reduction in consulting expense (\$6,744) and co-location costs \$(24,017).

*Stock based compensation* – These costs represent the expense associated with stock options granted to employees, directors and consultants. The amount recorded in a particular period is directly related to the number of options that have vested with recipients during that period. Stock-based compensation expense recognized during the quarter ended September 30, 2007 was \$31,417, a decrease of \$56,750 (or 64%) over the 2006 quarter due to the elimination of expense associated with the forfeiture of options stemming from the overall head count reduction in 2006, and the fact that a significant portion of outstanding options have vested fully as of September 30, 2007.

*Convertible debenture* - The Company increased the convertible debenture principal balance to \$960,130 in Q4 of 2006. It was determined that the fair value of the conversion-to-common shares option of the debt was \$227,193. This amount is being accreted on a straight-line basis over the term of the debt. Accretion expense recognized during the quarter ended September 30, 2007 was \$77,277, as compared to \$42,994 recognized for the quarter ended September 30, 2006, prior to the increase in principal by \$411,144 in Q4 of 2006.

## RESULTS OF OPERATIONS FOR THE NINE-MONTH PERIOD ENDED SEPTEMBER 30, 2007

	2007 September 30 (nine months)	% of Revenue	2006 September 30 (nine months)	% of Revenue
Revenue	\$5,903,741		\$7,166,308	
Direct costs	3,268,474	55%	4,278,261	60%
<b>Gross Margin</b>	<b>2,635,267</b>	45%	<b>2,888,047</b>	40%
Amortization	350,891	6%	947,597	13%
General & administrative	1,207,524	20%	1,284,203	18%
Interest accretion	231,831	4%	128,983	2%
Marketing & selling	296,805	5%	761,400	11%
Stock based compensation	128,582	2%	250,135	3%
Technical & development	1,049,646	18%	1,038,543	14%
<b>Operating Expenses</b>	<b>3,265,279</b>		<b>4,410,861</b>	
Net Loss	\$ (630,012)		\$ (1,522,814)	

### ***Revenue***

Revenues include fees for subscription management, provisioning, payment processing, customer care and third party products and services. These fees are primarily recurring monthly and are earned on a per-end-user or per minute basis. The Company also charges additional fees to clients for adding new end-users and new services onto the Company's platform.

Revenues of \$5,903,741 for the nine-months ended September 30, 2007 represent a decrease of \$1,262,567 (or 18%) over the corresponding period in the prior year. Though we experienced net growth in new and existing customers aggregating to \$883,325, the decline in revenue from lost customers and those experiencing a deteriorating user base, amounted to \$2,159,277.

This decrease was augmented by declines in the value of the US dollar relative to the CDN dollar. Further, given that the percentage of US dollar based revenue increased to 84% (of total revenue) during the nine months ended September 30, 2007 from 81% for the same period in 2006, the impact of exchange rate fluctuations on revenue have been substantial. For every 1% decline in the exchange rate the Company's total US dollar denominated revenue for the nine months ended September 30, 2007 would have experienced a decline of approximately \$50,000.

### ***Direct Costs***

Direct costs include expenses related to providing subscription management, provisioning, payment processing, customer care and third party products and services. The majority of these costs are proportionate to connection time for third-party connection services and customer care support to the customers' subscribers.

Direct costs of \$3,268,474 for the nine-months ended September 30, 2007 represent a decrease of \$1,009,787 (or 24%) over the corresponding period in the prior year. This decrease can be broken down by key component expenses: i) third-party service costs decreased by \$563,552; ii) technical support wages and related administrative costs in the Help Desk decreased by \$310,623; and iii) commissions paid to SourceNet decreased by \$135,612.

This decrease is primarily and proportionately related to the net decline in operating activity stemming from lost or attriting customers. Additionally, the positive impact of cost saving measures initiated in late 2006 have contributed to the reduction in direct costs.

### ***Operating Expenses***

*Amortization* – Amortization expense decreased \$596,706 (or 63%) during the nine months ended September 30, 2007 relative to the period ended September 30, 2006. Intangible assets associated with the acquisitions made in 2004 and 2005 were fully amortized by December 31, 2006 and this accounts for \$536,056 of the decrease.

*General & administrative* – These costs include general office expenses, rent and occupancy fees, insurance, bad debt expense, regulatory costs, director's fees, consulting fees, professional fees and salaries paid to finance and administration staff of the Company.

The net decrease of \$76,679 (or 6%) during the nine-months ended September 30, 2007 relative to the corresponding period in the prior year, can primarily be attributed to increases in foreign exchange loss (\$28,138) and debenture interest (\$46,889) offset by decreases in bad debt expense (\$20,033), rent and occupancy (\$38,429), salaries and benefits (\$40,059) and general administrative expenses (\$48,685).

*Marketing & Selling* – These costs include travel, attendance and participation at trade shows, printed materials, website maintenance and salaries and commissions paid to sales and marketing staff of the Company.

The decrease in costs of \$464,595 (or 61%) during the nine-month period ended September 30, 2007 relative to the September 2006 period, stems from a combination of a \$14,180 reduction in general marketing expenses and a decrease of \$450,415 in salaries and commissions. There were the equivalent of five full-time sales and marketing personnel on staff during the first nine months of 2006, who were no longer with the company by early 2007.

*Operations & Development* – Salaries related to operations and development personnel comprise the bulk of these costs. There was a net increase of \$11,103 (or 1%) for the nine months ended September 2007, relative to the comparative period in 2006. Though the headcount actually declined period over period, more senior personnel was hired resulting in increased salaries and benefits (\$164,480). This increase was mitigated by reduced consulting expenses (\$69,053) and co-location costs (\$82,523).

*Stock-based compensation* – These costs represent the compensation expense associated with stock options granted to employees, directors and consultants. The amount recorded in a particular period is directly related to the number of options that have vested with recipients during the period in question. Stock-based compensation expense recognized during the period was \$128,582, a decrease of \$121,553 (or 49%) over the September 2006 period due to the elimination of expense associated with the forfeiture of options stemming from the overall head count reduction in 2006, and the fact a significant portion of the outstanding options have vested fully as of September 30, 2007.

*Convertible Debenture* – The Company increased the convertible debenture principal balance to \$960,130 in Q4 of 2006. It was determined that the fair value of the conversion-to-common shares option of the debt was \$227,193. This amount is being accreted on a straight-line basis over the term of the debt. Accretion expense recognized during the nine months ended September 30, 2007 was \$231,831, as compared to \$128,983 recognized for the quarter ended September 30, 2006, prior to the increase in principal by \$411,144 in Q4 of 2006.

## **LIQUIDITY AND CAPITAL RESOURCES**

For additional detail, see the Consolidated Statements of Cash Flows for the period ended September 30, 2007.

Cash received from (used for) :	<b>2007 September 30 (nine months ended)</b>	<b>2006 September 30 (nine months ended)</b>
Operating Activities	(415,454)	(708,170)
Investing Activities	(40,473)	203,100
Financing Activities	164,790	290,843

As at September 30, 2007, the Company had cash and short term investments totaling \$40,000, down from \$70,193 as at December 31, 2006. The \$40,000 is restricted as it has been pledged as collateral for a line of credit with a chartered bank. As at September 30, 2007, the Company was indebted to this bank in the amount of \$220,944, up slightly from \$213,095 owed at June 30, 2007.

***Operating Activities:***

For the nine months ended September 30, 2007, the Company's negative cash flow from operating activities was \$(415,454) as compared to a negative cash flow of \$(708,170) for the corresponding period in 2006. The bulk of this significant cash flow improvement of \$292,718 results from the \$289,581 improvement in EBITDA.

***Investing Activities:***

For the nine months ended September 30, 2007, the Company used cash of \$40,000 to pledge as collateral against a new line of credit. In the comparable period of 2006, the Company generated cash of \$300,000 from the release of cash collateral pledged against the previous line of credit set up in 2005. Expenditures during the nine months ended September 30, 2007 incurred for capital equipment purchases were \$473, as compared to \$96,900 in the same period of 2006.

***Financing Activities:***

The Company traditionally financed its cash requirements through the issuance of common shares, debt instrument or capital lease.

During the nine months ended September 30, 2007, the Company raised \$40,000 from the exercise of warrants, received \$250,000 from a bridge loan and made capital lease payments totaling \$221,174. During the corresponding period in 2006, the Company raised gross proceeds of \$100,000 from a private placement, received \$411,144 from a convertible debenture issue and made capital lease payments totaling \$257,213.

In March 2007, the Company concluded a banking arrangement with a Canadian chartered bank, whereby credit facilities aggregating to \$720,000 were obtained. This facility consists of a \$320,000 standby letter of credit and a \$400,000 revolving line of credit.

Subsequent to September 30, 2007, the Company concluded a private placement whereby the demand loan of \$250,000 was converted to equity and the Company received further cash proceeds of \$982,590.

***Financial Condition:***

As at September 30, 2007, the Company had current assets of \$926,704 and current liabilities of \$1,472,008 for a working capital deficiency of \$545,304 as compared to a deficiency of \$635,643 at December 31, 2006. This improvement in working capital of \$90,339 can primarily be explained by significant reductions in capital lease obligations, accounts payable and unearned revenue balances, offset by increases in bank indebtedness and the demand loan.

The Company continues to exhibit positive signs of stability and recovery on the income statement. Cash burn from operations has been effectively reduced to almost nil over the past year and if not for the rapid depreciation of the US\$, the Company had expected to complete the 2007 fiscal year with a positive year-to-date EBITDA.

With the close of the private placement and debt settlement agreement with the Pender Group on November 7, 2007, the balance sheet has been dramatically transformed. Bank indebtedness, convertible debentures and the demand loan have all been extinguished and the Company expects to exit the fiscal year with a strong working capital position and cash resources of at least \$500,000.

### OUTSTANDING SHARE DATA

For additional detail, see Note 9 to the financial statements for the period ended September 30, 2007.

		<b>Number Outstanding September 30 2007</b>	<b>Number Outstanding December 31 2006</b>
Common Shares issued		15,186,624	15,086,624
Options to purchase Common Shares	(1)	1,855,500	1,929,900
Warrants to purchase Common Shares		1,550,000	4,855,149
		<b>18,592,124</b>	<b>21,871,673</b>

(1) Note: On November 29, 2007, the Company issued a news release which contained the following disclosure regarding new option grants and amendments to the existing Stock Option Plan:

“The Company announces that under the existing fixed Stock Option Plan (“Plan”), it has granted an Officer and a Director options to purchase 151,000 common shares of the Company and granted employees options to purchase an additional 600,000 common shares. All options are priced at \$0.18 per share, are exercisable for a period of 5 years and vest over a period of not less than 18 months. This grant is subject to regulatory approval.

The Directors have resolved to amend the Plan to increase the total number of options reserved for issuance to 3,810,389 from 2,624,935 and to grant Officers and Directors options to purchase 587,000 common shares of the Company. These options are priced at \$0.18 per share and may not be exercised until shareholder approval of the amendment to the Plan is obtained at the next AGM. Further, the Company intends to re-price 270,000 options previously granted to employees (non-insiders). Of these, 172,000 options with an exercise price of \$0.33 per share and 98,000 options with an exercise price of \$0.55 per share will be re-priced to \$0.18 per share. This re-pricing is subject to regulatory and shareholder approval and the re-priced options may not be exercised until such approvals are obtained.”

## **OFF BALANCE SHEET ARRANGEMENTS**

The company has not engaged in off-balance sheet arrangements.

## **DISCLOSURE CONTROLS AND PROCEDURES**

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, on a timely basis so that the appropriate decisions can be made regarding public disclosure.

The Chief Executive Officer and Chief Financial Officer of the Company have conducted an evaluation of the disclosure controls and procedures as required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators. They concluded that at September 30, 2007, the Company's disclosure controls and procedures were effective to provide reasonable assurance that material information regarding required disclosures was made known to them on a timely basis.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

Management is responsible for designing such internal controls over financial reporting, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

No changes were made in the Company's internal control over financial reporting during the interim period ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **RISKS AND UNCERTAINTIES**

The Company has incurred significant losses in recent years and has a working capital deficit of \$545,304 as at September 30, 2007. It is expected that operating results will continue to moderately fluctuate into the foreseeable future due to a variety of factors, including but not limited to:

- While management is of the opinion that sufficient working capital will be obtained from operations or external financing to meet the Company's liabilities and commitments in the near term, there is a risk that additional financing may not be available on a timely basis or on terms acceptable to the Company. If the Company is unable to obtain additional funds when needed, its ability to continue to operate and grow the business could be impeded;
- the Company's business could be adversely affected by changes in general economic conditions and specific market conditions in the telecommunications and Internet industries;
- the Company obtains approximately 84% of its monthly revenue in US dollars. Significant variations in exchange rates may have an adverse impact on operating results;

- the Company's business could be adversely affected if the Company's current and future competitors will be able to develop infrastructure expertise comparable or superior to those developed and offered by the Company or if they may adapt more quickly than the Company to new technologies, third party offerings, evolving industry standards or customer requirements;
- the timing and magnitude of operating expenses, capital expenditures and expenses related to the expansion of sales, development, operations and acquisitions;
- the Company's business could be adversely affected if key customer contracts are not renewed upon expiry;
- the Company's business could be adversely affected if key customers experience financial difficulties resulting in collection delays and/or loss of business;
- the Company's business could be adversely affected if key suppliers of third-party services experience financial and/or technical difficulties resulting in service disruptions to the Company's customers; Further, if the Company is denied access to premises, electricity supply or communications services due to circumstances beyond its control and it is unable to secure replacement services on a timely basis, it could incur indefinite delays in providing services to its customers;
- the Company's product lines and customer base are not broadly diversified and the Company derives the majority of its revenue from sales of a narrow range of services and capabilities to a small number of customers. The Company's business and operating results would be adversely affected by factors within this range of products and customers that could not be offset with diversification;
- competition within the Company's markets may reduce its ability to win new contracts, reduce sales and reduce margins on sales made;
- the Company's future success will depend on its ability to maintain its existing products and services and to develop new products and services that attain market acceptance;
- the Company depends on the recruitment and retention of qualified personnel. If it cannot attract and retain staff, it could hamper its ability to provide products and services under existing contracts and to new contracts;
- the Company's business could be adversely affected if it fails to manage its growth effectively;
- third parties may claim that the Company infringes their proprietary rights; and
- the Company may not be able to protect its proprietary information.

Any of the foregoing factors could have a material adverse effect on the Company's business, results of operations or financial condition. Although the Company is beginning to exhibit signs of operational stability, this pattern is not necessarily indicative of future operating results.