MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FIRST QUARTER ENDED SEPTEMBER 30, 2010

November 15, 2010

INTRODUCTION

The management’s discussion and analysis (“MD&A”) provides a detailed analysis of the financial condition and results of operations of Sangoma Technologies Corporation (hereinafter referred to as “Sangoma” or the “Corporation”). The MD&A compares the financial quarter September 30, 2010 financial results with those of the corresponding period of the previous year, and compares the first-quarter interim financial condition of the Corporation with its financial condition as at the most recently completed financial year-end of June 30, 2010. The MD&A should be read in conjunction with Sangoma’s financial statements and related notes for the quarter ended September 30, 2010 (“Financial Statements”), which have been prepared in accordance with generally accepted accounting principles in Canada. All amounts are in Canadian Dollars unless otherwise noted.

Additional information about Sangoma is available at www.sedar.com.

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements, including statements regarding the future success of our business, development strategies and future opportunities.

Forward-looking statements include, but are not limited to, statements concerning estimates of expected expenditures, statements relating to expected future production and cash flows, and other statements which are not historical facts. When used in this document, the words such as “could”, “plan”, “estimate”, “expect”, “intend”, “may”, “potential”, “should” and similar expressions indicate forward-looking statements.

Although Sangoma believes that its expectations reflected in these forward-looking statements are reasonable, such statements involve risks and uncertainties and no assurance can be given that actual results will be consistent with these forward-looking statements. Forward-looking statements are based on the opinions and estimates of management at the date that the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in forward-looking statements. Sangoma undertakes no obligation to update forward-looking statements if circumstances or management’s estimates or opinions should change except as required by law.

Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the
predictions, forecasts, projections and other events contemplated by the forward-looking statements will not occur. Although Sangoma believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct as these expectations are inherently subject to business, economic and competitive uncertainties and contingencies. Some of the risks and other factors which could cause results to differ materially from those expressed in the forward-looking statements contained in the management's discussion and analysis include, but are not limited to changes in exchange rate between the Canadian Dollar and other currencies, changes in technology, changes in the business climate, changes in the regulatory environment, the decline in the importance of the PSTN (see glossary below) and new competitive pressures. The forward-looking statements contained in the management's discussion and analysis are expressly qualified by this cautionary statement.

DESCRIPTION OF THE BUSINESS

Glossary of terms

Analog
Analog telephony is the telephone system that dates back to the original experiments by Alexander Graham Bell. The voice signal is picked up by a microphone and transmitted to the central office. Voice signals from the central office consist of voltages that drive a headset to produce sound. Analog means that the voice pressure signals are represented by voltages levels on the line.

API
Application Program Interface: An API is a purpose-built interface that allows third party software to interact with a particular application. A typical API is the user interface for Windows that allow programmers to write programs for Windows that use all its built-in utilities. APIs do not depend on revealing source code, in general. They are usually well documented and include sample programs that make development easy.

Codec
In the telephony context a codec is a mechanism of digitally encoding voice. On the PSTN a voice channel takes up 64kbps in a codec standard called G.711. Cell phones use a codec called GSM that compress the voice further so that a GSM call consumes about 24kbps. Other compressed codecs are used in VoIP to conserve bandwidth. These include standards such as G.729, G.723. Most audio codecs are lossy, in that some of the voice quality is degraded by the compression.

On the other hand, as bandwidth becomes cheaper, VoIP allows one to use other codecs that in fact use more bandwidth than the PSTN, the so-called broadband codecs that have DVD-like voice quality.

Digital telephony
In the modern PDSTN only the “last mile” line to the customer is still analog, all other internal parts of the network are digital. Digital in this case means that at the central office the analog signal from the subscriber’s telephone is sampled digitally, converting the line voltages to a series of numbers that can be easily transmitted error free over long distances. See T1, E1 below.
Gateway
In the telephony context this is typically a separate unit with its own case and power supply that provides VoIP-to-PSTN services for a VoIP network. Almost all gateway devices use SIP interfaces to the VoIP system over Ethernet and have analog or digital telephony interfaces that connect to the PSTN. VoIP gateways are available from many manufacturers including Audiocodes, Cisco, Grandstream, Patton Electronics and many others.

ISDN
Integrated Services Digital Network (ISDN) is a set of communications standards for simultaneous digital transmission of voice, video, data, and other network services over the traditional circuits of the public switched telephone network. Of the many variations of ISDN, Sangoma supports BRI (Basic Rate Interface) which is essentially an all-digital replacement for ordinary analog lines and PRI (Primary Rate Interface) which is used over T1 and E1 lines. BRI is very popular outside of North America. PRI is used worldwide.

IVR
Interactive Voice Response: IVR systems use the phone to navigate a menu, for example those used by banks to allow access to customer’s account information. IVR systems have typically been driven by dial tones as the buttons on your phone are pressed, but increasingly they are using voice recognition for navigation.

Open Source
Open Source software is distributed free subject to certain conditions. Open Source licenses usually stipulate that source code must always be distributed or made available, and any improvements in the code have to be donated back to the community. It is possible to have dual licensing: Open Source to the community and also a closed, commercial license of the same or similar software.

NetBorder
This is the trade name of a Sangoma SIP to PSTN gateway product. It includes several other functions in addition to the PSTN gateway function. The mass marketed version is known as NetBorder Express or NBE.

PSTN
Public Switched Telephone Network: This is the standard telephone network that has been in operation for many decades. A telephone or FAX or PBX or other telephony device is generally connected to an analog line at a wall plug, which is connected by “last mile” cabling to the central office. The analog signal from the device is converted to a digital signal at the Telco central office and is multiplexed, 24 simultaneous voice channels per line (in North America) onto a T1 for onward transmission. At the other end of the line the digital channel is reconverted to analog for transmission over the “last mile” to the receiving phone or other device.

Signalling
Call setup and tear down is remarkably complicated, involving such things as responding to the different tones as well as generating them, caller identification and handling the different features like hookflash and voicemail properly. There are different signalling mechanisms for different types of circuits. Analog circuits use tones such as out-of-order, busy, ringing as well as the dialling tones. T1 lines often use a data protocol called ISDN.
PRI, where packets of control data are exchanged on a separate data channel. ISDN PRI is a simplification of the general signalling protocol used internally by the telecommunications networks known as SS7.

In all cases signalling has to be exactly compatible with what the Telco expects, so interoperability and standards are important.

**SIP**
Session Initiation Protocol: SIP is the emerging standard signalling protocol for VoIP, though it has much broader applications. SIP is responsible for setting up and teardown of two party and multiparty calls, as well as a host of management features. To a great and increasing extent, VoIP calls are SIP based.

**T1, E1**
A T1 line is a circuit that carries 24 digital telephone calls simultaneously. At higher densities, 28 T1s are aggregated into a T3 line carrying 672 calls.

Larger offices can also connect to the central office via T1 directly, so as to have only one circuit for up to 24 calls.

T1 is standard in North America and Japan while E1 is the standard in the rest of the world. E1 carries 30 channels of digitized voice per line.

**Unified Communications**
Unified communications is a concept in which voice, email, messaging, video and any other type of communication are all considered forms of data that can be combined, manipulated and used in intelligent applications in a seamless way.

**VoIP**
Voice over IP: The transfer of voice traffic over the Internet Protocol (IP). IP is used universally for all networking including local area networks and private networks, not just the Internet. So VoIP is not necessarily voice over the Internet, but voice over general data networks.

**General**

Sangoma’s primary business is the manufacture of hardware and software that enables computing devices, mainly PC servers, to communicate with telephone networks and high speed Wide Area Networks. These products consist of hardware cards, software drivers, software applications and utilities. Figure 1 shows a typical Sangoma card, The A104 card. The A104 is capable of supporting up to 128 simultaneous telephone calls or providing up to 8Mbps of full duplex data bandwidth over T1 or E1 lines.
While Sangoma continues to invest in the development and certification of new products supporting voice and data transport, the Corporation is also developing products that are not tied to the existing telephony infrastructure.

**Wide Area Networks cards**

Mass market switches and routers are purpose built devices that have either no expandability or use proprietary hardware interfaces that support only the supplier’s hardware.

Where somewhat specialized functions are required, it is convenient to use standard PC-type hardware and readily available operating systems and toolkits to produce switches, routers and other connectivity devices in small and medium quantities. Sangoma’s WANPIPE® internal routing solutions support these systems with standard telephony interfaces such as T3, E3, T1, E1, BRI, ADSL and 56kbps DDS, or industry standard serial interfaces such as RS232, V.35 and X.21. Typical customers for this technology include companies from a vast array of industry segments, but a few examples would include clients who build switches and routers for rugged industrial environments, a number of companies building devices that interface to Air Traffic Control systems, firms who use the cards to monitor cell phone call data and large global telephony equipment manufacturers who use Sangoma cards for a specialized SS7 monitoring application.

This business is the original market that Sangoma products addressed from conception and it is still a very important component of the Corporation’s business.

**Open Source Telephony (OST)**

Asterisk®

Asterisk is an Open Source telephony project based on the PC platform and was one of the first such OST products. It grew out of a small initiative in the late 1990s and has grown into a worldwide phenomenon. Over 12% of all new PBX installations in the US in 2008 were Asterisk-based. Asterisk is Open Source which means that it is free to use and modify, but it is owned and copyrighted by Digium, Inc. which also markets telephony cards similar to those provided by Sangoma.

In 2004 Sangoma began providing cards to this market and has been the most successful telephony card supplier in this space, except for Digium itself.

The original market for these products was to large numbers of small OEMs and integrators who hand built systems for themselves or clients. This has been changing into one of increasing scale and professionalism as the market consolidates.

Sangoma’s successes in this market has largely been with larger, more professional OEM packagers of the basic Asterisk product, where requirements for product quality, low system loads and voice quality have steered customers to the Sangoma product line. Thus the increasing consolidation in the market has worked to Sangoma’s advantage. The

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barriers to entry in the Asterisk market can be quite low (so several other companies have attempted to enter this market with generally modest success) and this market is a price sensitive one (so some entries from China are finding acceptance in the low end).

**Other Open Source Markets**
There exist several other OST projects apart from Asterisk. Such OST projects allow Sangoma to compete with other board suppliers on a level playing field compared to Asterisk, where Digium can be perceived to have somewhat of an advantage due to providing the software application as well as the hardware cards.

FreeSwitch™ is one such OST application that is generally considered architecturally superior to earlier solutions. It has begun to be used for switching and PBX applications commercially. Sangoma has supported the project virtually from its inception, and is currently involved in the development of the part of the system that provides connectivity to the PSTN. Sangoma’s involvement in FreeSwitch provides Sangoma a competitive advantage as compared to other PSTN card manufacturers for FreeSwitch. The Sangoma implementation for FreeSwitch does not include Open Source telephony control and signalling modules (those are provided as closed source modules that only work with Sangoma hardware), and that adds a considerable barrier to entry for competitors in this space.

There are many other such OST solutions and Sangoma endeavours to work with these organizations and interface to these products whenever practical. Some examples of solutions based upon their own OST application/appliance or upon integrating others’ OST products include YATE, Fonality, PBXnSIP, 3Cx, Elastix, etc. many of which we already support and cooperate with. These offerings are all potential opportunities for Sangoma to sell its hardware and software into, or alongside.

Figure 2 below illustrates typical Sangoma support for an OST project. The OST PSTN interface, being Open Source, is what we integrate with. It is essentially an API that Sangoma has been able to use to integrate our its low level driver, and hence Sangoma’s hardware, into the system. The PSTN connection can be analog, or digital T1, E1 or BRI.

![Figure 2: Sangoma support of OST applications](image-url)
Non OST Telephony projects

The success of OST offerings coupled with growth in the concept of VoIP has fuelled a movement away from the use of proprietary hardware to the use of PC platforms for telephony applications, not only for OST but also for the larger, more general market of commercial applications. Thus companies that had traditionally used their own hardware for PBX and call center applications now are making available software that can be run under Windows or Linux on virtually any PC server that has enough computing power. These PC-based telephony applications are all VoIP based and concentrate on Unified Communications features. Connection to the PSTN is generally intended to be provided by third party gateways.

As virtually all telephony is moving to the PC platform there is an opportunity to provide the same integrated PSTN connectivity for commercial, non-OST (i.e. “closed source”) telephony applications as we have done for the OST market. One of the more interesting applications in this market is the new version of Microsoft Office Communication Server (planned is to be released in late 2010), but there are many others that could prove very successful as well, including but not limited to applications by Avaya, Cisco, IBM and many others. All such solutions are potential opportunities for Sangoma.

For closed source applications, it is generally much more difficult to provide PSTN connectivity than with OST, because unless the developer provides a documented API it is not practical to integrate other programs.

So, in the case of closed source applications, Sangoma has had to find another standard interface, one that is supported by all commercial applications. Until a decade ago, such an interface did not exist. With the rise of VoIP, however, a standard has emerged for supporting VoIP traffic, and that standard is SIP. SIP is supported by all modern software-based telephony applications and it has the power and control required to allow a fully functioning PSTN support application to work properly. The opportunity for Sangoma therefore lies in being able to provide integrated Gateway functions (i.e. inside the PC that hosts the telephony application).

Sangoma has been investing heavily in R&D to address this market, and has now launched Gateway products accordingly. These relatively new products, including Net Border Express obtained via Sangoma’s acquisition of Paraxip, are starting to generate revenue for us.

Sangoma’s product offering, including the software Gateway (Net Border Express or otherwise) and the hardware cards, allows us to support SIP interfaces and therefore acts as a built-in gateway for closed source packages as shown in Figure 3.
An internal, largely software-based gateway has several advantages over an external, standalone gateway including:

a) An obvious cost saving as the internal gateway uses the host’s spare CPU power, casing, power supply, memory, storage, operating system etc., all of which have to be built into an external gateway.

b) Particularly for OEMs, configuration of the gateway plus debugging and control interfaces can be seamlessly integrated with the management system for the telephony application itself, such that it becomes one seamless product. Because there are a large number of external gateways available, it is very difficult to achieve that kind of close coupling with an external device.

c) If an external gateway is purchased by the customer, and there usually is no revenue stream to the OEM from that purchase. An integrated, internal gateway becomes a normal part of the OEM’s offering, with attendant sales, maintenance contracts etc.

d) For the customer, an integrated PC package means that there is no finger pointing if there are technical issues, no additional power or cooling requirements, no extra rack space for an external gateway, no requirement for a separate maintenance contract or gateway management course and lower initial and ongoing costs.

e) Remote management is far simpler for a well-integrated OEM package than for a system that includes a third party gateway.
Call Progress Analysis

This is a new product acquired as part of the Paraxip acquisition which has since been improved and enhanced. CPA is a software product, running under Windows or Linux, that is able to examine digitized telephone traffic and report whether a call has been answered by a human or answering machine/voicemail or has some other type of response such as an out of order message. CPA is a product that is purely VoIP-based. As such, it is a product that does not depend on the PSTN for its implementation, although most sales to date have also included gateways.

CPA is used in outbound call centers which are typically controlled by automatic diallers working from lists. Calls are only connected to agents once the call has been answered and verified to be a person (not an answering machine, etc.). Accurate CPA can have a very significant effect on the efficiency of the agents and hence the profitability of a call center. In addition, new regulations are coming into effect worldwide to reduce nuisance calls to subscribers, and these impose strict limits on the accuracy of determination of a human respondent as well as the time taken to make that determination.

Sangoma’s CPA is based on a proprietary artificial intelligence model that is the subject of a patent application. It is currently considered the most accurate system available, having an accuracy of approximately 95% while most competing systems have an accuracy of about 80%. Customers of CPA include many large companies and Fortune 500 firms. CPA is sold largely through recommendations by partners, the most important at this time being Genesys, a major supplier of call center applications. Work continues on streamlining the implementation of CPA, to simplify the task performed by these partners, and we are actively seeking new partners in the call center business to help market and implement the product.

Transcoding

Sangoma’s D100 and D500 cards were released in mid-August 2010.

Transcoding means the translation of voice traffic encoding from one Codec to another, usually to save bandwidth, in which the ‘translation’ is a compression task. A standard digital voice channel consumes 64kbps in each direction, while one that is compressed using another Codec may only consume 8kbps. Especially in the “last mile” scenario where the link may have an upstream bandwidth of 700kbps or less, VoIP compression is very important, particularly if the link is shared with normal Internet traffic.

Transcoding to different Codecs can be done on a PC, but the number of sessions that a single PC can handle is severely limited. Also, many of the codecs are patented so that significant license fees are required for software-based transcoding.

Sangoma’s transcoding cards can handle 480 simultaneous compression sessions on the D100 series and 2400 sessions on the D500 series.

The product is expected to be of interest to SIP-based telephony providers of all types, as well as call centers and PBX manufacturers. Transcoding is another new area of business for Sangoma that is not dependent at all on the PSTN.
OVERALL PERFORMANCE

Financial

Sales for the first quarter of fiscal 2011 ended September 30, 2010 were a disappointing $2.51 million as compared with $3.12 million for the quarter ended September 30, 2009, a decrease of 19%. This decline in revenue was dominated by the North American market where sales decreased 45% versus the same quarter last year. North America generally (and the United States specifically) have experienced more dramatic and longer lasting effects of the world recession, and Sangoma’s sales into these markets have suffered as a result. Further, Sangoma’s tight control over marketing and sales activity for the past year or so during the downturn, and a lack of or delay in new product launches, has also had a pronounced effect. Sangoma is taking immediate action in an attempt to correct this issue with a well-considered series of new activities in these areas, under new leadership. Sales outside of North America grew by 28% over the same quarter last year, due primarily to efforts to add/motivate/incent new channel partners and because some of these international markets have recovered more quickly from the recession. While the company believes second quarter revenue may show improvement over the first quarter of fiscal 2011, it is unclear if the quarter ended September 30, 2010 may be reflective of future results. Sangoma will closely monitor the corrective action described above, but does not issue guidance because the size and timing of future orders is uncertain.

Gross margins for the quarter were 73%, 3% lower than those of the quarter ended September 30, 2009. Expenses for the quarter ended September 30, 2010 were 16% higher than those of the comparable quarter last year at $1.72 million but were fairly consistent with the run-rate from recent quarters. Net income was $0.05 million ($0.00 per share fully diluted) compared to net income of $0.56 million ($0.02 per share fully diluted) for the quarter ended September 30, 2009. EBITDA for the quarter ended September 30, 2010 was $0.53 million as compared to $1.18 million for the quarter ended September 30, 2009, a decrease of 55%.

On September 30, 2010 Sangoma had working capital of $10.66 million, as compared to $10.92 million on September 30, 2010. Working capital on September 30, 2010 included $7.61 million in cash and equivalents.
Operational

Sangoma has earned a reputation for quality, innovation and responsiveness as the supplier of key network connectivity components to the high growth PC-based telephony and data transport markets. Sangoma’s move into the commercial, non-OST space continues to show promise, with the introduction of our Gateway products, including NetBorder 3.0 released during the quarter. Several other applications are using our Gateway products for PSTN connections, and we expect this to grow in the future.

Sangoma’s traditional OST business is well positioned to benefit from Digium’s Asterisk project beginning to face a credible challenge from other OST offerings, including products such as FreeSwitch (supported by Barracuda Networks), which is increasingly being used for larger switching applications as well as for PBXs. Sangoma is heavily involved in the development and maintenance of the PSTN interface portion of FreeSwitch, giving the Corporation a significant competitive advantage in this market.

Sangoma has recently released its D100 and D500 transcoding cards that provide hardware-based compression for voice streams. Target markets for this technology include any organization concerned with VoIP including SIP trunking providers, call center operators, Telcos and cell phone operators. Transcoding is an entirely new application for Sangoma so that all revenues are accretive to our other WAN and PSTN-based income.

Sangoma’s Call Progress Analysis software is being deployed mainly through partnership with Genesys, a major call center application provider. There are other partners for this technology that will be assisting us to reach new ranges of customers in the coming quarters. CPA is also significant in that it is based entirely on VoIP and is therefore not PSTN-based.

Sangoma continues to provide data transport cards to the router, air traffic control and telephony equipment industries, and this market segment continues to be a significant source of revenue.

Sangoma’s opportunity is to aggressively exploit new markets while maintaining and nurturing our existing lines of business.

Innovation

Sangoma invests in Research and Development to produce products and improved versions of existing offerings. Sangoma has two teams of engineers, one based in Markham and the other in Montreal.

The Montreal teams primary focus is on enhancements to the NetBorder™ application, adding features, field testing and making it more specification-compliant. This work continues and in the quarter, version 3.0 of the product was released, which includes secure VoIP communications through traffic encryption, SNMP support for remote management and monitoring, support of Sangoma’s FXS (switch side) analog ports, silence suppression and comfort noise generation to save bandwidth, automatic board discovery for simplified upgrades and management and an enhanced web based management system with contextual help menus. The Montreal group has also improved the CPA product and worked on porting the system to Linux.

The Markham hardware group has developed new, lower cost and higher quality voice cards for release later this year. The group developed the D100 and D500 series of voice transcoding cards that were released this quarter and for which new marketing programs commence in November.
Other activities included modifications to existing hardware to make it compatible with the latest versions of fast servers from Dell, HP and IBM.

During the quarter, the Markham software team developed new Gateway functionality that will be released shortly as our SS7 Media Gateway and a new contribution to the open source community in the form of a FreeTDM API (furthering our standing and thought leadership in OST).

Sales and Marketing

Sangoma has a dual sales path to customers: Direct to large OEMs and two tier distribution to others. Two tier distribution involves Sangoma selling to a distributor, the distributor selling to resellers, and resellers selling to end users. Utilizing regional distributors to cultivate their own network of resellers supported by Sangoma sales and marketing efforts has proven very successful. The impact of lower margins from a two tier distribution model is offset by the net new growth of sales which distributors bring to Sangoma as well as reducing the cost of handling relatively small orders.

Sangoma participated as an exhibitor, provided a speaker for or attended as an active participant in a few trade shows of various types during the quarter.

Sangoma presents at general trade shows and concentrates our efforts on specialized seminars run by our distribution channel and other partners. These are more cost effective and bring us closer to our OEMs, distributors, resellers, and customers.

Customers tend to be long term successful participants in their given markets and to have longer term focus. It is important to reach these potential customers in the early days of any project to secure ‘design wins’ and to have sales and marketing programs that will ensure close intercompany collaboration during development and sales development cycles that may last as long as three years.

Sangoma’s OST buyers are often smaller resellers which are well serviced through online resellers and distributors. Distribution channels require frequent attention to keep the Sangoma products top of mind in a crowded product marketplace. Sangoma has implemented several incentive programs with distributors and is defining marketing programs for each region. The development and support effort that the Markham software group have donated to OST projects help not only to support our own sales into these projects, but have kept Sangoma’s brand and name prominent in the OST community.

Sangoma continues to invest in electronic marketing strategies as these are particularly cost effective advertising vectors. Electronic marketing also is able to provide quantitative measures of program effectiveness. Sophisticated web presence, social media and blogging are increasingly important and Sangoma has virtually abandoned traditional print media. The Sangoma partner portal is continuing to develop as a place where approved application partners, distributors and resellers of Sangoma can get access to product information, online pricing/purchasing, co-marketing material, sales tools and other privileged partner information. Sangoma’s marketing team is putting together programs to further leverage this partner community and adopt a more “partner focused” marketing approach, especially in our international markets.
RESULTS OF OPERATIONS

The following table is a summary of selected unaudited quarterly consolidated financial information of the Corporation for each of the eight most recently completed quarters ended September 30, 2010 ($000’s except per share data):

Sales and Net Income by Quarter

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<td>Net Sales</td>
<td>$ 2,595</td>
<td>$ 2,759</td>
<td>$ 3,170</td>
<td>$ 3,123</td>
<td>$ 2,968</td>
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<tr>
<td>non-diluted basis</td>
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<td>$0.024</td>
<td>$0.000</td>
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<td>fully diluted basis</td>
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<td>$0.022</td>
<td>$0.000</td>
<td>$0.019</td>
<td>$0.013</td>
<td>$0.014</td>
<td>$0.040</td>
<td>$0.002</td>
</tr>
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Sales

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Cost of Sales and Gross Profit

The cost of sales for the quarter ended September 30, 2010 was $0.69 million (27% of sales, gross profit margin of 73%), as compared to $0.75 million (24% of sales, gross profit margin of 76%) for the quarter ended September 30, 2009. Gross profit for the quarter ended September 30, 2010 was $1.82 million, as compared to $2.37 million for the quarter ended September 30, 2009.
a decrease of 23%.

Sangoma expects the gross margin percentage to decline slightly, as sales to new larger OEM customers have lower margins.

**Expenses**

**Administration Expenses**
Administration expenses were $0.66 million for the quarter ended September 30, 2010, an increase of 44% over those for the first quarter ended September 30, 2009 ($0.46 million) but fairly consistent with recent run-rate for the past few quarters in this area. This increase reflects the addition of staff back in 2009 to handle the ramp in business and the introduction of a bonus program to strengthen employee retention/satisfaction.

**Development Costs**
Continuous product development is crucial to maintaining Sangoma’s competitive position in the fast-moving data communications and voice market. All development costs are amortized on a straight-line basis over three years (see Note 2 to the Notes to Consolidated Financial Statements). Actual cash expenditure on development was $0.61 million for the quarter ended September 30, 2010, as compared to $0.40 million for the quarter ended September 30, 2009, an increase of 52%. The increase is largely due to additional development staff to bring new products to market and is fairly consistent with recent run-rate for the past few quarters in this area.

Sangoma is entitled to investment tax credits of $0.09 million for the quarter ended September 30, 2010 ($0.09 million in the quarter ended September 30, 2009) which reduced the net deferred development costs to $2.38 million ($1.17 million for the quarter ended September 30, 2009), an increase of 103%.

The development costs amortized during the quarter ended September 30, 2010 were $0.31 million ($0.18 million for the quarter ended September 30, 2009), reflecting the ramp in new product development and the commencement of amortization of the software development tools purchased in the quarter ended June 30, 2010.

**Amortization - property, plant and equipment**
Amortization of property, plant and equipment increased to $0.04 million for the quarter ended September 30, 2010 from $0.03 million in the quarter ended September 30, 2009. The increase was due to equipment purchases during fiscal 2010 and leasehold improvements associated with the change in the location of the Markham office.

**Amortization - intangibles**
Intangible assets include copyright to software and patent rights acquired as part of the Paraxip purchase. This expense is a non-cash item.

**Foreign Exchange**
Sangoma experiences foreign exchange losses or gains based on the rate of change of the Canadian/US Dollar exchange rate largely due to the fact that the foreign exchange rate can fluctuate between the time a receivable is created (at the point of a sale transaction) and the time a client actually pays, and because much of the Corporation’s cash is held in US dollars. For the quarter ended September 30, 2010, the foreign exchange loss was
$0.15 million as compared to a foreign exchange loss of $0.37 million for the quarter ended September 30, 2009.

Stock Based Compensation
No stock based compensation was awarded during the quarters ended September 30, 2010 or September 30, 2009.

Selling and Marketing Expenses
Selling and marketing expenses were $0.48 million for the quarter ended September 30, 2010 as compared with $0.37 million for the quarter ended September 30, 2009, an increase of 30%, and consistent with or below the run-rate for the past few quarters in this area. Sangoma has begun to target marketing and promotion activity towards supporting the recently introduced new products.

Investment income
Investment income was negligible for the quarters ended September 30, 2010 as interest rates remain at historical lows.

Total Expenses
Total expenses were $1.72 million for the quarter ended September 30, 2010 as compared to $1.49 million for the quarter ended September 30, 2009, an increase of 16% and consistent with our spending run-rate for the past few quarters. Management believes that the focus should be on re-building revenue back above $3 million per quarter immediately (and then beyond that level in the mid-term) not on reducing costs to drive short term profit. Continuing to invest in our people, research and development, and sales and marketing will be what drives revenue growth, if done in the right manner.

Net Earnings
Income before income taxes was $0.10 million for the quarter ended September 30, 2010, as compared to income before income taxes for the quarter ended September 30, 2009 in the amount of $0.88 million, a decrease of 88%. After taking into account current and future income taxes, the net income was $0.05 million ($0.00 per share fully diluted) for quarter ended September 30, 2010 as compared to net income after tax of $0.56 million ($0.02 per share fully diluted) for the quarter ended September 30, 2009.

LIQUIDITY
The Corporation completed the financial quarter ended September 30, 2010 with current assets of $11.98 million and current liabilities of $1.32 million, resulting in working capital of $10.66 million, as compared to $10.92 million at June 30, 2010.

Cash and equivalents at September 30, 2010 were $7.61 million as compared to $7.74 million at June 30, 2010.

The average collection period for receivables is approximately 50 days, based on the first quarter sales and accounts receivable at September 30, 2010, slightly lower than the 54 at the end of the fiscal year 2010.
Inventory levels were $1.91 million on September 30, 2010, 14% higher than on June 30, 2010. The turnover rate was approximately 1.5 times per year for the quarter ended September 30, 2010 as compared to 2.0 times per year during the year ended June 30, 2010. The increase in inventory in the quarter resulted from the prebuild of modules for new products and some additional finished goods to speed up customer order fill times.

The Corporation continues to be profitable with positive cash flow from operations. There are no existing or anticipated defaults or arrears on lease payments, or interest. Management of the Corporation believes that the current working capital and funds generated from operations will be sufficient to meet the operating and planned capital expenditures of the Corporation for the foreseeable future.

Cash flow from operations before non-cash working capital balances was positive $0.49 million for quarter ended September 30, 2010 as compared to positive $0.87 million in the quarter ended September 30, 2009. After taking into account non-cash working capital balances related to operations, cash flow from operations was positive $0.51 million as compared to positive $0.97 million for the quarter ended September 30, 2009.

CAPITAL RESOURCES

There are no planned commitments for unusual capital expenditures at this time, nor are there any sources of financing that have been arranged but not yet used.

OFF-BALANCE SHEET ARRANGEMENTS

There are no material off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations or financial condition of Sangoma.

TRANSACTIONS WITH RELATED PARTIES

The corporation is not party to any material transactions with related parties.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

Sangoma has determined the estimated fair value of its financial assets and liabilities based on generally accepted valuation methods.

Short-term financial instruments

Cash and equivalents, accounts receivable, investment tax credits, accounts payable and accrued liabilities and term loan are short-term financial instruments whose fair value approximates their carrying amount on the balance sheet due to their near-term maturities. The Corporation does not otherwise rely on financial instruments to satisfy its capital requirements.
NEW ACCOUNTING POLICIES (NOT YET ADOPTED)

International Financial Reporting Standards

In February 2009, the CICA Accounting Standards Board ("AcSB") confirmed that the changeover to International Financial Reporting Standards ("IFRS") from Canadian Generally Accepted Accounting Principles ("GAAP") will be required for both interim and annual financial statements for all publicly traded companies, effective for fiscal years beginning on or after January 1, 2011. For the Corporation, these new standards will be effective for the interim and annual financial statements commencing on July 1, 2011, with retrospective presentation of the comparative fiscal 2011 results. The Company’s first financial statements to be reported under IFRS will be for the quarter ending September 30, 2011, with restatement of comparative periods.

The Corporation has commenced its IFRS conversion project. The project will have primary phases as follows:

1. Scoping and diagnostic phase. This phase involves a high-level assessment to identify and rank, as to high, medium and low priority, key areas that may be impacted by the transition to IFRS. This phase also includes creation of a formalized project plan including key milestones and timelines, resources required, education and training requirements is currently in process.

2. Impact analysis, evaluation and design phase. In this phase, each area identified from the scoping and diagnostic phase will be addressed by performing an in depth analysis of Canadian GAAP/IFRS differences, evaluation and selection of available accounting policies, quantification of impacts and development of draft IFRS financial statement contents. This phase also includes the identification of operational impacts such as information technology, process and internal control changes.

3. Implementation and review phase – This phase will integrate our new accounting policies and resulting operational impacts into the Corporation’s underlying information systems, business processes and internal controls.

The Company has completed the scoping and diagnostic component of phase one of the project and is currently working on phase two of the project, with potential areas of impact being assessed with consideration to complexity, scope of operational impact, potential magnitude of impact, expected changes to IFRS standards and other matters. Based on IFRS standards currently in effect, the key potential areas of impact are functional currency, specifically which functional currency is most appropriate under IFRS; and impairment of assets, specifically under IFRS the Corporation must recognize impairment when the carrying value of an asset or cash generating unit ("CGU") exceeds its recoverable amount. These areas should not be regarded as a complete list of changes that will result from the transition to IFRS, as both Canadian GAAP and IFRS continue to change, and may therefore impact this ongoing assessment.

The Corporation anticipates the completion of phase two of the project during mid-fiscal 2011. The Corporation has the appropriate resources committed to meet all milestones through to completion of its conversion to IFRS.
Business combinations

In January 2010, the CICA issued Handbook Section 1582, "Business combinations," which replaces the existing standards. This section establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This standard is equivalent to the International Financial Reporting Standards on business combinations. This standard is applied prospectively to business combinations with acquisition dates on or after January 1, 2011. Earlier adoption is permitted. Management is currently evaluating the impact of adopting this standard on the Corporation’s consolidated financial statements.

Non-controlling interests

In January 2010, the CICA issued Handbook Section 1602, "Non-controlling interests," which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This standard is equivalent to the International Financial Reporting Standards on consolidated and separate financial statements. This standard is effective for 2011. Earlier adoption is permitted. Management is currently evaluating the impact of adopting this standard on the Corporation’s consolidated financial statements.

Consolidated financial statements

In January 2010, the CICA issued Handbook Section 1601, "Consolidated financial statements," which replaces the existing standards. This section establishes the standards for preparing consolidated financial statements and is effective for 2011. Earlier adoption is permitted. Management is currently evaluating the impact of adopting this standard on the Corporation’s consolidated financial statements.

OUTSTANDING SHARE DATA

As at the date hereof, there are 30,342,809 issued and outstanding common shares of Sangoma and 1,283,950 outstanding options to acquire common shares. Each option converts to one common share.

Under the terms of their respective employment agreements, Mr. Wignall, CEO, and Mr. Moore, CFO, are to be granted options to acquire common shares of Sangoma, representing 6% and 2% of the number of shares on a fully diluted basis as at the dates of their agreements.

ADDITIONAL INFORMATION

All relevant information relating to the Corporation is filed electronically on SEDAR at www.sedar.com.