

# THE BLUE-CHIP E-GAMING SOFTWARE COMPANY



CRYPTOLOGIC®

Q3 2005

CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005

CryptoLogic Inc. is a leading software and services provider to the worldwide Internet gaming market. Its leadership in regulatory compliance makes it one of very few companies with government-approved gaming software that has passed the world's highest regulatory tests for online gaming.

WagerLogic Limited, a wholly-owned subsidiary of CryptoLogic, is responsible for the licensing of its gaming software and services to an internationally-recognized blue chip customer base. In addition to a broad product portfolio of more than 100 casino games, multi-player bingo and player-to-player poker, WagerLogic offers integrated e-cash management and customer care services in multiple currencies and multiple languages for a total online gaming solution.

CryptoLogic's common shares trade on the Toronto Stock Exchange (symbol: CRY), the Nasdaq National Market (symbol: CRYP) and the Main Market on the London Stock Exchange (symbol: CRP).

All dollar amounts in this report are expressed in United States dollars, unless otherwise indicated.

Statements in this report which are not historical are forward-looking statements made pursuant to the safe harbour provisions of the Private Securities Litigation Reform Act of 1995. Investors are cautioned that all forward-looking statements involve risks and uncertainties, including, without limitation, risks associated with the Company's financial condition and prospects, legal risks associated with Internet gaming and risks of governmental legislation and regulation, risks associated with market acceptance of technological changes, dependence on licensees and key licensees, increased competition and other risks detailed in the Company's filings with securities regulatory authorities. When used herein, the words "may", "would," "could," "will," "intend," "plan," "anticipate," "believe," "seek," "propose," "estimate," "expect" and similar expressions are intended to identify forward-looking statements. Should one or more of these risks or uncertainties materialize, or should assumptions underlying forward-looking statements prove incorrect, actual results may vary materially from those projected in the forward-looking statements as intended, planned, anticipated, believed, estimated or expected. CryptoLogic does not intend, and does not assume any obligation, to update these forward-looking statements.

## Dear Fellow Shareholders:

CryptoLogic's record revenue, near record earnings and positive operating cash flow reflected strong organic growth from existing customers in our primary Internet casino and Internet poker markets, even in the traditionally soft summer season for Internet gaming and fast-changing times for the industry. We are delivering innovative games to selected blue-chip customers in the world's most lucrative markets for Internet gaming, and this diversified, disciplined strategy and our trusted reputation as a long-standing public company are producing excellent results.

Fiscal 2005 third quarter highlights included:

- Quarterly revenue grew 35% to a record \$21.0 million, and earnings rose 80% over Q3 2004 to a near record \$5.1 million or \$0.36 per diluted share. This exceeded analysts' average consensus of \$0.31 per diluted share;
- Internet poker fees derived from the company's WagerLogic licensing subsidiary grew 89% over Q3 2004, and were up 6% sequentially over Q2 2005. Poker software fees accounted for more than 30% of Q3 2005 revenue;
- The central Internet poker room shared by WagerLogic licensees now attracts more than 7,500 simultaneous online players – making it one of the most populated poker sites on the Internet;
- Internet casino revenue derived from WagerLogic rose 12% over Q3 2004, and was up 8% sequentially over Q2 2005. Fees from casino software represented 60% of total Q3 2005 revenue;
- The launch of seven new multi-line video slots featuring Marvel Super Heroes such as The Hulk, Daredevil and The X-Men, and the well-known, gem-matching game, Bejeweled, gained immediate popularity with players;
- The company secured its first patent in the UK, for both online and land-based gaming, for Millionaires Club™, one of the company's own innovations. Millionaires Club™ is one of the most popular progressive jackpot slots with a current jackpot in excess of \$1.3 million;
- Geographic diversification remained strong with licensees' revenue from international markets exceeding 65% of total revenue, up from over 60% in 2004;
- A 40% increase in the quarterly cash dividend to US\$0.07 per share to be payable on December 15, 2005 to shareholders of record as at December 8, 2005;
- In Q3 2005, CryptoLogic repurchased and cancelled 270,500 shares at an approximate average price of \$19.32 per share under its 2004/2005 Normal Course Issuer Bid. Subsequent to the quarter-end, the company bought back a further 222,800 shares at an approximate average price of \$16.49 per share, for a total of 493,300 shares (\$8.9 million) for 2005 year-to-date; and
- Subsequent to the quarter-end, Betfair confirmed continuation of its poker software agreement with WagerLogic until June 2006, with an option to extend until January 2007. Regardless of the timing of Betfair's departure, WagerLogic will receive fees from Betfair such that CryptoLogic's annual results for 2006 are not expected to be materially affected.

**Q3 Results: Record Revenue, Near Record Earnings (all financial figures expressed in US dollars)**

CryptoLogic achieved record revenue and excellent earnings momentum in the third quarter ended September 30, 2005. Revenue rose 35% to \$21.0 million (Q3 2004: \$15.6 million). EBITDA<sup>(1)</sup> for the quarter grew 67% to \$5.9 million (Q3 2004: \$3.6 million). EBITDA<sup>(1)</sup> margin for the quarter increased significantly to 28% as a percentage of revenue (Q3 2004: 23%). Earnings for the quarter rose 80% to \$5.1 million or \$0.36 per diluted share (Q3 2004: \$2.9 million or \$0.21 per diluted share).

CryptoLogic delivered excellent third quarter results despite the traditional softness of the summer season for online gaming. The company attributed this success to very strong organic growth from existing casino licensees and the benefits of launching innovative new games. Fuelled by poker software enhancements, tournament offerings and growing player volumes, Internet poker licensees also contributed record revenue levels in Q3 2005.

Increased earnings and improved margins in 2005 also reflect the early benefits of higher revenue as a result of investing in the company's business, including from its major investment program.

As announced a year ago, CryptoLogic has been implementing a \$12.5 million investment program to support the company's long term growth. As at Q3 2005, the company had invested approximately 84% (\$10.4 million) of this program, of which \$3.6 million were operating costs and \$6.8 million were capital expenditures (comprising \$3.1 million for the purchase of capital assets and \$3.7 million in capitalized software development related to the investment program). This investment program will be substantially completed this year as planned.

Going forward, we will continue to manage normal course expenditures in proportion to revenue generation, while also planning for incremental investments that may be necessary to position our company for a regulated UK market for online gaming, once the new rules and requirements are finalized.

Revenue for the nine months ended September 30, 2005 increased 34% to \$61.2 million (Q3 2004 YTD: \$45.8 million). EBITDA<sup>(1)</sup> for the first nine months in 2005 rose by 38% to \$17.3 million (Q3 2004 YTD: \$12.6 million). EBITDA<sup>(1)</sup> margin for the first nine months in 2005 remained strong at 28% as a percentage of revenue (Q3 2004 YTD: 28%). Earnings for the first nine months of 2005 increased by 49% to \$14.7 million or \$1.04 per diluted share (Q3 2004 YTD: \$9.9 million or \$0.73 per diluted share).

**Balance Sheet Strength: Positive Operating Cash Flow, No Debt**

CryptoLogic's financial strength remains evident from its healthy operating cash flow and strong balance sheet. At September 30, 2005, CryptoLogic had no debt, and total cash was \$92.1 million or \$6.49 per diluted share (comprising cash and cash equivalents, short term investments, and including security deposits of \$2.0 million). CryptoLogic's working capital was \$69.5 million or \$4.90 per diluted share.

Given CryptoLogic's continued earnings and cash generation, on November 1, the Board approved a 40% increase in its quarterly cash dividend to US\$0.07 per share, up from US\$0.05 per share. The increase will commence with the company's next quarterly dividend payable on December 15, 2005 to shareholders of record as at December 8, 2005.

Operating cash flow for the third quarter of 2005 rose significantly to \$14.2 million (Q3 2004: \$2.2 million). This increase was attributed largely to higher earnings and a significant reduction in security deposit requirements with payment processors.

**Geographic Diversification: A Major Presence in the UK and Europe**

CryptoLogic's strategic diversification across the world's key gaming markets continues to pay off. Revenue derived from licensees' international players accounted for more than 65% of Q3 2005 revenue, up from over 60% in 2004. The UK and Continental Europe continued to be the company's largest markets.

### **Product Innovation: Great Brands, Great Games, Great Entertainment**

CryptoLogic continues to reap the returns from its investment in extending its poker software and system scalability. This continued investment has contributed to poker licensees achieving record levels. Fees earned from Internet poker rose 89% over Q3 2004, and up 6% over Q2 05. Online poker fees exceeded 30% of total Q3 2005 revenue, and grew 143% on a year-to-date basis over the same 2004 period.

By delivering a broad choice of games at different speed and stake levels, and enabling online and offline tournament offerings – such as this year’s second annual Caribbean Poker Classic™ tournament in St. Kitts – CryptoLogic-developed software is helping customers increase player traffic to their Internet poker sites.

Internet casino continues to be a main revenue contributor for CryptoLogic, accounting for 60% of total Q3 2005 revenue. Online casino performed strongly, rising 12% over Q3 2004, and up 8% over Q2 2005. On a year-to-date basis, casino revenue increased 7% over Q3 2004 YTD. The launch of 20 new games released this year was a contributing factor and key to helping customers attract, retain and re-activate player interest.

CryptoLogic continues to bring the latest product innovation and exciting entertainment concepts to its Internet casino software. The company’s recently released seven-game pack offers high-impact video game play and multi-level jackpots, and are already among the most popular games with players. CryptoLogic is the exclusive developer of Marvel-branded casino slot games on the Internet, and the first to offer a play-for-real slot version of Bejeweled, the wildly popular, gem-matching game. The first ever Marvel-themed progressive jackpot video slots feature The Hulk, Daredevil, The X-Men, Blade and The Punisher – with exciting bonus sequences allowing players to battle villains, hunt vampires and smash tanks to win cash prizes in US dollars, Euros and Pounds Sterling.

### **Patenting Our Innovations**

CryptoLogic also received its first game patent in the UK for one of its most popular progressive jackpot slots, Millionaires Club™, and the game’s distinctive three-wheel bonus concept. The patent is pending in other major markets and will be applicable for both online and land-based gaming. The patenting of the company’s proprietary game innovations and technologies creates incremental revenue-generating opportunities and provides a competitive advantage for CryptoLogic.

### **Betfair Poker Continues in 2006**

As announced in August, Betfair, one of WagerLogic’s poker licensees, plans to bring its poker software in-house. Uniquely positioned as a technology-driven betting organization, Betfair’s long term strategy is to own and operate all of its core products. Betfair will continue its exclusive agreement with WagerLogic until June 2006, with an option to extend until January 2007. Regardless of the timing of Betfair’s departure, WagerLogic will receive fees from Betfair such that CryptoLogic's annual results for 2006 are not expected to be materially affected. Excluding Betfair, poker revenue from other WagerLogic licensees was up approximately 100% on a year-to-date basis over the same period in 2004.

### **Executive, Director Appointments**

In August, CryptoLogic appointed Stephen Taylor as Chief Financial Officer. Mr. Taylor is a Chartered Accountant, having qualified in the top one percent in Canada and has held senior positions at two of the country’s large accounting firms. He brings more than two decades of experience in financial and business management, public markets, and mergers and acquisitions.

In September, Nigel Simon was appointed as a Non-Executive Director of CryptoLogic’s Board of Directors. Mr. Simon, a veteran British business executive, has more than 25 years of broad senior management and strategic experience in leading and managing international businesses, including senior roles at a multi-billion-dollar FTSE 50 and NYSE-listed global organization based in the UK. He brings particular expertise in strategy, marketing, regulatory issues, sales, banking, corporate governance and mergers and acquisitions.

**Outlook**

CryptoLogic's disciplined execution and focused investments are proving successful in generating strong revenue, profitability and healthy cash flow. The company's diversified strategy – in its customers, products and markets – and proven record of performance and transparency as a long-established public company continue to set it apart in the global Internet gaming industry.

CryptoLogic will remain clearly focused on working with a core group of major international customers to achieve the highest returns in the lucrative Internet casino and Internet poker sectors. Management expects fourth quarter revenue to range from \$22.2-\$22.6 million, with earnings of \$5.4-\$5.6 million or \$0.39-\$0.40 per diluted share.

While CryptoLogic continues to seek new substantial licensees that meet its rigorous criteria, the company is experiencing significant organic growth from its customers. In today's fast-paced environment where players demand more choice and value, CryptoLogic will continue to develop innovative new games and expand its back-office offering with sophisticated business intelligence, data mining and marketing support tools to help customers effectively compete for player attention and drive incremental revenue in the world's major Internet casino and poker markets – both of which continue to grow.

Respectfully,

A handwritten signature in cursive script that reads "Lewis Rose".

Lewis Rose  
President and CEO  
November 3, 2005

## MANAGEMENT'S DISCUSSION AND ANALYSIS

CryptoLogic Inc. and our subsidiaries are referred collectively as "CryptoLogic", "the Company", "we", "us" and "our" throughout Management's Discussion and Analysis ("MD&A"), unless otherwise specified. The following MD&A should be read in conjunction with the unaudited consolidated interim financial statements of CryptoLogic, including the notes thereto, for the three and nine months ended September 30, 2005 and September 30, 2004, and the audited consolidated financial statements and the MD&A for the year ended December 31, 2004 as set out in our 2004 Annual Report. Except where otherwise indicated, the reader may assume that economic and industry factors are substantially unchanged from the 2004 year-end MD&A. This MD&A is dated November 3, 2005. Additional information relating to CryptoLogic, including our Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com) or EDGAR at [www.sec.gov](http://www.sec.gov).

All currency amounts are in US dollars, unless otherwise indicated.

### BUSINESS OVERVIEW

CryptoLogic is a world leading and long-standing publicly traded online gaming software developer and supplier serving the global Internet gaming market. WagerLogic Limited ("WagerLogic"), a wholly-owned subsidiary of CryptoLogic, provides software licensing, e-cash management and customer support services for our Internet gaming software to an internationally-recognized blue-chip client base ("licensees" or "customers") around the world who operate under government authority where their Internet businesses are domiciled.

### OVERVIEW OF RESULTS

In the third quarter of 2005, CryptoLogic delivered strong performance in both our primary Internet casino and Internet poker markets through excellent organic growth from a core group of blue-chip international customers, supported by strategic investments in key areas of our business.

New casino games continued to help licensees attract, re-energize and retain players, which contributed to a 12% increase in fees from Internet casino over Q3 2004. Online casino revenue remains a major cash generator, and accounted for 60% of total Q3 2005 revenue. WagerLogic's poker licensees continued to perform strongly, fuelled by ongoing poker enhancements and tournament offerings, which provide one of the broadest range of game options, stake and speed levels to attract a wide range of players. Fees from Internet poker for Q3 2005 grew 89% over Q3 2004.

Revenue rose 35% for Q3 2005 to a record \$21.0 million (Q3 2004: \$15.6 million) and was up 34% to \$61.2 million for the first nine months of 2005 (Q3 2004 YTD: \$45.8 million). EBITDA<sup>(1)</sup> increased 67% for Q3 2005 to \$5.9 million (Q3 2004: \$3.6 million), and 38% to \$17.3 million on a year-to-date basis (Q3 2004 YTD: \$12.6 million). EBITDA<sup>(1)</sup> margin rose considerably to 28% as a percentage of revenue for Q3 2005 (Q3 2004: 23%) and was 28% for the first nine months of 2005 (Q3 2004 YTD: 28%). Furthermore, earnings rose 80% to \$5.1 million or \$0.36 per diluted share (Q3 2004: \$2.9 million or \$0.21 per diluted share), and grew by 49% to \$14.7 million or \$1.04 per diluted share in the first nine months of 2005 (Q3 2004 YTD: \$9.9 million or \$0.73 per diluted share).

CryptoLogic's balance sheet strength continued to be reflected with no debt, and cash, cash equivalents and short term investments of \$92.1 million (including \$2.0 million in security deposits) at quarter-end. Working capital was \$69.5 million.

The early returns of CryptoLogic's major investment program, which is aimed at driving long term growth, contributed to excellent third quarter performance. Since the program's implementation a year ago, approximately 84%, or \$10.4 million of this program, has been invested.

## RESULTS OF OPERATIONS

### Revenue

Revenue reached record levels in Q3 2005, up 35% to \$21.0 million (Q3 2004: \$15.6 million), and up 34% on a year-to-date basis to \$61.2 million (Q3 2004 YTD: \$45.8 million). CryptoLogic generated strong third quarter revenue in 2005 in what is one of the two seasonally slowest quarters of the year for Internet gaming. Strong top-line results were fuelled by licensees' strengthening market position and growth in both the major Internet poker and Internet casino markets. CryptoLogic continued to derive near term incremental returns from our major investment program, which is aimed at key areas of our business: our casino and poker software offerings, system infrastructure and scalability, and back-office and customer care improvements.

Ongoing enhancements to WagerLogic's poker software that extend the choice of games, stakes and tournament opportunities for players have contributed to the continued growth of existing poker licensees. During the quarter, Internet poker fees rose 89% over Q3 2004, and up 6% sequentially over Q2 2005. Poker software fees exceeded 30% of Q3 2005 revenue, and grew 143% on a year-to-date basis over the same 2004 period. We expect poker licensees to continue this strong positive momentum as they benefit from our broad poker offering and the greater liquidity of being part of WagerLogic's central poker room, which now attracts more than 7,500 live players simultaneously online.

Internet casino software fees rose 12% over Q3 2004, and up 8% sequentially over Q2 2005. Casino remained a large contributor to our business, and represented 60% of total Q3 2005 revenue. On a year-to-date basis, online casino software revenue increased 7% over the same 2004 period.

In the third quarter when summer seasonality is usually a factor, online casino licensees enjoyed excellent growth, which was attributed to the incremental returns derived from new casino games added this year. Our innovative new offerings have included a multi-line version of Millionaires Club™, a hugely popular progressive Internet slot game that is contributing meaningful revenue. Most recently, we introduced the Internet's first casino games based on well-known Marvel comic characters – The Hulk, Daredevil, The X-Men, Blade and The Punisher – and the first online play-for-real slot version of Bejeweled, one of the most popular titles online. By delivering a comprehensive casino portfolio and ongoing roll out of market-targeted games – 20 in the past few months – we expect our licensees to continue to strengthen their market position in this competitive and highly demanding market segment.

The enhancement of our back-office solutions is intended to aid customers in attracting, retaining and re-activating players. We have recently introduced sophisticated business intelligence, data warehousing and marketing tools, which are helping customers better understand, respond and serve their players.

CryptoLogic continued to be well-diversified in the key global markets for online gaming. Licensees' revenue derived from international players accounted for more than 65% of overall Q3 2005 revenue, up from over 60% in fiscal 2004. The UK and Continental Europe represented the vast majority, and together accounted for more than 60% of total Q3 2005 revenue.

### Operating Costs

Operating costs comprise software development and support costs that include all personnel and compensation costs, licensee support, customer service costs and compliance-related expenditures. Operating costs were \$12.8 million in Q3 2005 or 61% of revenue (Q3 2004: \$10.4 million or 66%). For the nine months ended September 30, 2005, operating costs were \$38.0 million or 62% of revenue (Q3 2004 YTD: \$28.6 million or 63%).

Increased costs were in line with CryptoLogic's investments directed at new casino games, enhancement of our poker offering, an expanding system infrastructure to support growing player traffic and volumes, and improvement of our customer care and back-office processing and support services. Operating costs also rose with increased processing fees associated with growing financial transaction volumes.

Last year's third quarter operating costs were higher as a percentage of revenue due to higher expenditures related to CryptoLogic initiating a major investment program in Q3 2004 without the commensurate revenue benefits. This investment program is above and beyond our normal course expenditures, and aimed at significantly upgrading our gaming platform and system and service infrastructure. Over the last five quarters, approximately 84%, or \$10.4 million of this \$12.5 million program, has been invested as follows: \$3.6 million in operating costs and \$6.8 million in capital expenditures (comprising \$3.1 million for purchases of capital assets and \$3.7 million in capitalized software development associated with the program). CryptoLogic continues to benefit from these investments as evidenced by strong top-line performance and improved margins. Our major investment program will be substantially completed in 2005 as planned.

Going forward, we will continue to manage normal course expenditures in proportion to revenue generation, while also planning for incremental investments that may be necessary to position our company for a regulated UK market for online gaming, once the new rules and requirements are finalized.

### General and Administrative Costs

General and administrative (G&A) expenses were \$2.2 million for the quarter (Q3 2004: \$1.6 million). For the first nine months of 2005, G&A expenses were \$5.7 million (Q3 2004 YTD: \$4.3 million). The rise in G&A costs reflected higher costs associated with a growing organization and increased facilities and infrastructure expenditures. Given our larger company, G&A expenses will rise modestly, although will be expected to remain fairly consistent as a percentage of revenue.

### Finance Costs

Finance costs include bank charges and fees for bank drafts. These costs were fairly consistent at \$0.1 million for Q3 2005 and Q3 2004, and similarly on a year-to-date basis at \$0.3 million for both 2004 and 2005.

### EBITDA<sup>(1)</sup>

EBITDA<sup>(1)</sup> improved significantly by 67% for Q3 2005 to \$5.9 million (Q3 2004: \$3.6 million), and up 38% on a year-to-date basis to \$17.3 million (Q3 2004 YTD: \$12.6 million). EBITDA<sup>(1)</sup> margin increased significantly to 28% for Q3 2005 (Q3 2004: 23%) as a percentage of revenue, and was 28% on a year-to-date basis in 2005 (Q3 2004 YTD: 28%). Improved margins in Q3 2005 reflected the early benefits of higher revenue from ongoing and major investment plans. EBITDA<sup>(1)</sup> is expected to remain at solid levels as major investments are substantially completed in 2005, and normal course expenditures are managed in proportion to revenue generation.

(1) Management believes that EBITDA (earnings before interest, taxes, and amortization) is a useful supplemental measure of performance. However, EBITDA is not a recognized earnings measure under generally accepted accounting principles (GAAP) and does not have a standardized meaning. Therefore, EBITDA may not be comparable to similar measures presented by other companies.

EBITDA is reconciled to earnings as follows:

(In thousands of US dollars)	For the three months ended September 30,		For the nine months ended September 30,	
	2005	2004	2005	2004
Earnings	\$5,127	\$2,856	\$14,705	\$9,874
Income taxes	747	525	2,361	2,176
Interest income	(967)	(361)	(2,478)	(867)
Amortization	1,042	548	2,741	1,415
EBITDA	\$5,949	\$3,568	\$17,329	\$12,598

### Amortization

Amortization expense during the quarter rose to \$1.0 million (Q3 2004: \$0.5 million), and to \$2.7 million in the first nine months of 2005 (Q3 2004 YTD: \$1.4 million). The increase reflected higher investments in computer equipment, leasehold improvements, software and licenses to support our growing organization and the Company's major investment program.

## Interest Income

Interest income rose to \$1.0 million in the third quarter (Q3 2004: \$0.4 million), and \$2.5 million in the first nine months of 2005 (Q3 2004 YTD: \$0.9 million). The increase was a result of a higher cash position and better interest yield.

## Provision for Income Taxes

Income taxes for the quarter were \$0.7 million (Q3 2004: \$0.5 million), and \$2.4 million for the first nine months of 2005 (Q3 2004 YTD: \$2.2 million), which reflected a taxable income mix that was lower in certain markets. The change in future income taxes arose from the fluctuation in foreign exchange rates during the third quarter of 2005.

## Earnings

Earnings for the third quarter rose 80% to \$5.1 million or \$0.36 per diluted share (Q3 2004: \$2.9 million or \$0.21 per diluted share). On a year-to-date basis in 2005, earnings increased by 49% to \$14.7 million or \$1.04 per diluted share (Q3 2004 YTD: \$9.9 million or \$0.73 per diluted share).

## Summary of Quarterly Results

	Fiscal 2005			Fiscal 2004				Fiscal 2003
	Q3 05	Q2 05	Q1 05	Q4 04	Q3 04	Q2 04	Q1 04	Q4 03
<i>(In thousands of US dollars, except per share data)</i>								
Revenue	\$21,049	\$19,923	\$20,274	\$17,949	\$15,616	\$14,925	\$15,224	\$13,540
Interest income	967	874	637	426	361	262	244	160
Earnings	5,127	4,739	4,839	3,794	2,856	3,197	3,821	3,033
Earnings per share								
Basic	0.37	0.34	0.36	0.29	0.22	0.25	0.30	0.25
Diluted	0.36	0.33	0.34	0.27	0.21	0.23	0.28	0.23
Basic weighted average number of shares (000's)	13,681	13,736	13,573	13,185	13,076	12,979	12,641	12,280
Diluted weighted average number of shares (000's)	14,063	14,361	14,184	13,871	13,642	13,734	13,419	12,972

Typically, our first and fourth quarters (during the winter and fall seasons) are our strongest periods, and revenue in the middle two quarters can slow down as Internet usage moderates in the summer months when players tend to be outdoors. The sequential increase in Q3 2005 over Q2 2005 was due to continued high growth in Internet poker fees as well as strong online casino revenue attributed to the popularity of new games, which helped offset the usual summer softness expected in the more developed casino segment during this period.

## LIQUIDITY AND CAPITAL RESOURCES

In the quarter, CryptoLogic continued to report a strong financial position. As at September 30, 2005, the Company had no debt, and a total cash position of \$92.1 million or \$6.49 per diluted share, which comprised cash and cash equivalents, short term investments, and included \$2.0 million of security deposits. Working capital was \$69.5 million or \$4.90 per diluted share.

Operating cash flow in Q3 2005 increased significantly to \$14.2 million (Q3 2004: \$2.2 million), compared with \$23.4 million on a year-to-date basis (Q3 2004 YTD: \$9.9 million). This increase was largely due to higher earnings, a significant decline in security deposits required as collateral to payment processors, and changes in working capital requirements.

Under the 2004/2005 Normal Course Issuer Bid, which expired on September 22, 2005, we repurchased and cancelled 270,500 shares at an approximate average price of \$19.32 per share in Q3 2005. On September 26 2005, the Board of Directors announced the renewal of its Normal Course Issuer Bid, which authorizes the Company to purchase up to 1.34 million common shares from September 28, 2005 to September 27, 2006. Subsequent to the quarter-end, the Company bought back a further 222,800 shares at an approximate average price of \$16.49 under our current 2005/2006 bid. For 2005 year-to-date, we have repurchased a total of 493,300 shares (\$8.9 million).

CryptoLogic currently has 13.3 million common shares and 1.2 million stock options outstanding.

## **CRITICAL ACCOUNTING POLICIES, CHANGES IN ACCOUNTING POLICIES AND OFF-BALANCE SHEET ARRANGEMENTS**

These items are substantially unchanged as discussed in the Company's MD&A for the year ended December 31, 2004 as contained in our 2004 Annual Report.

## **RISKS AND UNCERTAINTIES**

The primary risks and uncertainties that affect and may affect us and our business, financial condition and results of operations are substantially unchanged from those discussed in the Company's MD&A for the year ended December 31, 2004 as contained in our 2004 Annual Report.

## **OUTLOOK**

While the global online gaming market continues to promise vast growth potential, competition is intensifying for players and market position. In Internet casino, we will continue to deliver an array of new and engaging games to help our customers refresh their offerings to players, and foster player loyalty. In Internet poker, we will continue to enhance our poker solution to build on the strong liquidity and wide choice of games, stake levels and tournaments we provide today. We have also enhanced our back-office solution with sophisticated new relationship management tools and reporting options, which are aimed at helping customers better understand and serve their players and foster player loyalty.

As announced in August, Betfair, one of our poker licensees, plans to establish its own internally-operated Internet poker room in keeping with its core strength as a technology-driven betting company. Betfair will remain in the WagerLogic central poker room until June 2006, with an option to extend to January 2007. Regardless of when Betfair leaves, WagerLogic will receive fees from Betfair such that CryptoLogic's annual results for 2006 are not expected to be materially affected. Betfair's departure may affect the liquidity of the central poker room next year, although the continued substantial organic growth of our other customers is expected to be an offsetting factor. Other WagerLogic customers, which are primarily gaming and/or casino companies, continue to benefit from the greater liquidity, outsourced technical expertise and an ever-expanding product offering developed by CryptoLogic.

CryptoLogic has achieved increasing returns – as evidenced by strong Q3 results – by executing a strategy of customer, product and market diversification. We remain committed to this disciplined approach to drive the organic growth of a core group of high quality international brand-name customers that target the major Internet casino and Internet poker sectors.

**CRYPTOLOGIC INC.**  
**CONSOLIDATED BALANCE SHEETS**  
*(In thousands of US dollars)*

	As at September 30, 2005 (unaudited)	As at December 31, 2004
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$77,133	\$43,182
Security deposits	2,000	7,000
Short term investments	12,963	35,782
Accounts receivable and other	7,764	6,487
Prepaid expenses	4,830	1,754
	<b>104,690</b>	<b>94,205</b>
User funds on deposit	23,716	18,908
Capital assets	16,400	9,227
Intangible assets	85	106
Goodwill	1,776	1,776
	<b>\$146,667</b>	<b>\$124,222</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities	\$32,612	\$30,056
Income taxes payable	2,589	1,331
	<b>35,201</b>	<b>31,387</b>
<b>User funds held on deposit</b>	<b>23,716</b>	<b>18,908</b>
<b>Future income taxes</b>	<b>2,094</b>	<b>1,840</b>
	<b>61,011</b>	<b>52,135</b>
<b>Shareholders' equity:</b>		
Share capital	25,456	20,380
Stock options	1,674	1,114
Retained earnings	58,526	50,593
	<b>85,656</b>	<b>72,087</b>
	<b>\$146,667</b>	<b>\$124,222</b>

**CRYPTOLOGIC INC.**  
**CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**  
*(In thousands of US dollars)*  
*(Unaudited)*

	For the three months ended September 30,		For the nine months ended September 30,	
	2005	2004	2005	2004
Retained earnings, beginning of period	\$58,800	\$45,000	\$50,593	\$38,758
Earnings	5,127	2,856	14,705	9,874
Excess of purchase price of treasury shares over stated value	(4,722)	--	(4,722)	--
Dividends paid	(679)	(393)	(2,050)	(1,169)
Retained earnings, end of period	<b>\$58,526</b>	<b>\$47,463</b>	<b>\$58,526</b>	<b>\$47,463</b>

**CRYPTOLOGIC INC.**  
**CONSOLIDATED STATEMENTS OF EARNINGS**  
*(In thousands of US dollars, except per share information)*  
*(Unaudited)*

	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2005</b>	2004	<b>2005</b>	2004
Revenue	<b>\$21,049</b>	\$15,616	<b>\$61,246</b>	\$45,765
Expenses				
Operating costs	<b>12,797</b>	10,382	<b>37,950</b>	28,626
General and administrative	<b>2,179</b>	1,564	<b>5,654</b>	4,255
Finance	<b>124</b>	102	<b>313</b>	286
Amortization	<b>1,042</b>	548	<b>2,741</b>	1,415
	<b>16,142</b>	12,596	<b>46,658</b>	34,582
Earnings before undernoted	<b>4,907</b>	3,020	<b>14,588</b>	11,183
Interest income	<b>967</b>	361	<b>2,478</b>	867
Earnings before income taxes	<b>5,874</b>	3,381	<b>17,066</b>	12,050
Income taxes:				
Current	<b>243</b>	31	<b>2,107</b>	780
Future	<b>504</b>	494	<b>254</b>	1,396
	<b>747</b>	525	<b>2,361</b>	2,176
<b>Earnings</b>	<b>\$5,127</b>	\$2,856	<b>\$14,705</b>	\$9,874
Earnings per common share				
Basic	<b>\$0.37</b>	\$0.22	<b>\$1.08</b>	\$0.77
Diluted	<b>\$0.36</b>	\$0.21	<b>\$1.04</b>	\$0.73
Weighted average number of shares ('000s)				
Basic	<b>13,681</b>	13,076	<b>13,664</b>	12,899
Diluted	<b>14,063</b>	13,642	<b>14,187</b>	13,562

**CRYPTOLOGIC INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(In thousands of US dollars)*  
*(Unaudited)*

	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2005</b>	2004	<b>2005</b>	2004
<b>Cash provided by (used in):</b>				
Operating activities:				
Earnings	<b>\$5,127</b>	\$2,856	<b>\$14,705</b>	\$9,874
Adjustments to reconcile earnings to cash provided by (used in) operating activities:				
Amortization	<b>1,042</b>	548	<b>2,741</b>	1,415
Future income taxes	<b>504</b>	494	<b>254</b>	1,396
Stock options	<b>440</b>	326	<b>1,285</b>	863
Changes in operating assets and liabilities:				
Security deposits	<b>5,000</b>	--	<b>5,000</b>	(450)
Accounts receivable and other	<b>(859)</b>	(3,608)	<b>(1,277)</b>	(4,970)
Prepaid expenses	<b>2,353</b>	(80)	<b>(3,076)</b>	(633)
Accounts payable and accrued liabilities	<b>1,096</b>	2,385	<b>2,556</b>	2,365
Income taxes payable	<b>(465)</b>	(701)	<b>1,258</b>	87
	<b>14,238</b>	2,220	<b>23,446</b>	9,947
Financing activities:				
Issue of capital stock	<b>420</b>	271	<b>4,854</b>	6,163
Dividends paid	<b>(679)</b>	(393)	<b>(2,050)</b>	(1,169)
Repurchase of common shares	<b>(5,225)</b>	--	<b>(5,225)</b>	--
	<b>(5,484)</b>	(122)	<b>(2,421)</b>	4,994
Investing activities:				
Purchase of capital assets	<b>(4,683)</b>	(2,210)	<b>(9,891)</b>	(5,547)
Purchase of intangible assets	--	--	<b>(2)</b>	(89)
Short term investments	<b>(10,963)</b>	1,683	<b>22,819</b>	(28,875)
	<b>(15,646)</b>	(527)	<b>12,926</b>	(34,511)
Increase (decrease) in cash and cash equivalents	<b>(6,892)</b>	1,571	<b>33,951</b>	(19,570)
Cash and cash equivalents, beginning of period	<b>84,025</b>	22,869	<b>43,182</b>	44,010
Cash and cash equivalents, end of period	<b>\$77,133</b>	\$24,440	<b>\$77,133</b>	\$24,440
Supplemental cash flow information:				
Non cash portion of options exercised	<b>\$137</b>	\$8	<b>\$725</b>	\$477

## NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

**As at September 30, 2005**

*(All figures are in thousands of US dollars, except per share disclosure and where otherwise indicated)  
(Unaudited)*

These consolidated interim financial statements of CryptoLogic Inc. (the “Company”) have been prepared in accordance with Canadian generally accepted accounting principles using the same accounting policies as were used for the audited consolidated financial statements for the year ended December 31, 2004. These consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2004, as set out in the 2004 Annual Report.

### 1. Stock Option Plan

In accordance with the guidelines of the Canadian Institute of Chartered Accountants, the Company has expensed the costs of all stock option grants issued on or after January 1, 2003. The fair value of the options granted in 2004 and 2005 was made using the Black-Scholes option pricing model under the following weighted assumptions:

	<u>2005</u>	<u>2004</u>
Dividend yield	0.75%	0.75%
Risk-free rate	3.25%	2.75%
Expected volatility	50.0%	50.0%
Expected life of options in years	5.0	5.0

The estimated fair value of options is recorded over the vesting period of the options. The costs of stock options of \$440 in Q3 2005 (\$326 in Q3 2004), and \$1,285 YTD 2005 (\$863 YTD 2004) are included in operating costs. Consideration paid by employees on the exercise of stock options is recorded as share capital.

Had compensation expense been determined based on the fair value of the employee stock option awards for 2002 grants at the grant dates in accordance with the new recommendations, the Company’s earnings and earnings per common share would have been changed to the following pro forma amounts:

	Three months ended September 30,				Nine months ended September 30,			
	2005		2004		2005		2004	
	As reported (‘000)	Pro forma (‘000)	As reported (‘000)	Pro forma (‘000)	As reported (‘000)	Pro forma (‘000)	As reported (‘000)	Pro forma (‘000)
Earnings	\$5,127	\$4,993	\$2,856	\$2,718	\$14,705	\$14,309	\$9,874	\$9,428
Earnings per share:								
Basic	\$0.37	\$0.37	\$0.22	\$0.21	\$1.08	\$1.05	\$0.77	\$0.73
Diluted	\$0.36	\$0.36	\$0.21	\$0.20	\$1.04	\$1.01	\$0.73	\$0.70

## 2. Share Capital

### *Authorized:*

Unlimited common shares

### *Issued and Outstanding:*

	Common Shares		Series F Warrants		Total
	Issued	Stated Value	Issued	Stated Value	Stated Value
	('000)		('000)		('000)
Balance, December 31, 2003	12,300	\$11,078	30	\$272	\$11,350
Exercise of stock options	1,011	9,030	--	--	9,030
Balance, December 31, 2004	13,311	\$20,108	30	\$272	\$20,380
Balance, December 31, 2004	13,311	\$20,108	30	\$272	\$20,380
Share repurchase	(271)	(503)	--	--	(503)
Exercise of stock options	486	5,153	--	--	5,153
Exercise of Series F warrants	23	630	(23)	(204)	426
Balance, September 30, 2005	13,549	\$25,388	7	\$68	\$25,456

## 3. Normal Course Issuer Bid

In September 2004, the Board of Directors approved a share repurchase plan, under a Normal Course Issuer Bid, to repurchase and cancel up to 1,250,000 of the Company's outstanding common shares for the period commencing September 23, 2004 and ending September 22, 2005. Under this plan, the Company had repurchased and cancelled 270,500 common shares during the three months ended September 30, 2005 for total cost, including transaction cost, of \$5.2 million.

In September 2005, the Board of Directors approved the renewal of the share repurchase plan, under a Normal Course Issuer Bid, to repurchase and cancel up to 1,340,000 of the Company's outstanding common shares for the period commencing September 28, 2005 and ending September 27, 2006. As at September 30, 2005, the Company had not repurchased any shares from the renewed Normal Course Issuer Bid.

## 4. Comparative Figures

Certain of the prior period's figures have been reclassified for consistency with the current period's presentation.

## **CRYPTOLOGIC INC. CORPORATE DIRECTORY**

### **DIRECTORS**

Robert Stikeman, *Chairman*  
Randall Abramson  
Stephen H. Freedhoff  
Edward L. Greenspan  
Lewis N. Rose  
Nigel T. Simon

### **LEGAL COUNSEL**

Stikeman, Graham, Keeley & Spiegel LLP  
Toronto, Canada

### **AUDITORS**

KPMG LLP Chartered Accountants  
Toronto, Canada

### **BANKER**

Bank of Montreal  
Toronto, Canada

### **COMMON SHARES LISTED**

TSX Symbol: CRY  
Nasdaq Symbol: CRYP  
LSE Symbol: CRP

### **TRANSFER AGENTS**

Equity Transfer Services Inc.  
Toronto, Canada  
416-361-0930

Continental Stock  
Transfer & Trust Company  
New York, USA  
212-509-4000

### **OFFICERS**

Lewis N. Rose, *President and CEO*  
Stephen B. Taylor, *Chief Financial Officer*  
Michael Starzynski, *Chief Technology Officer*  
Serguei Bourenkov, *Vice President, Research &  
System Architecture*  
Jennifer L. Cua, *Vice President, Finance & Treasurer*  
Andrew Goetsch, *Vice President, Poker Software  
Development*  
Marilyn Shabot, *Vice President, Human Resources*

### **INVESTOR RELATIONS**

Nancy Chan-Palmateer, *Director, Communications*  
Telephone: 416-545-1455  
Facsimile: 416-545-1454  
E-mail: [investor.relations@cryptologic.com](mailto:investor.relations@cryptologic.com)

### **CORPORATE GOVERNANCE**

A comprehensive discussion of CryptoLogic's corporate governance information is provided in the Company's Management Information Circular, available on the SEDAR website at [www.sedar.com](http://www.sedar.com), or by request.

### **HEAD OFFICE**

CryptoLogic Inc.  
55 St. Clair Avenue West, 3<sup>rd</sup> Floor  
Toronto, Ontario, Canada M4V 2Y7

### **WEB SITE**

[www.cryptologic.com](http://www.cryptologic.com)