

Consolidated Financial Statements of

**CONSTELLATION  
SOFTWARE INC.**

Years ended December 31, 2007 and 2006



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## **AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the consolidated balance sheets of Constellation Software Inc. as at December 31, 2007 and 2006 and the consolidated statements of operations, deficit, comprehensive income (loss) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style. Below the signature is a single horizontal line that tapers at both ends, serving as a decorative underline.

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

March 3, 2008

# CONSTELLATION SOFTWARE INC.

Consolidated Balance Sheets  
(In thousands of U.S. dollars)

December 31, 2007 and 2006

	2007	2006
<b>Assets</b>		
Current assets:		
Cash	\$ 19,796	\$ 25,807
Restricted cash (note 4)	750	858
Short-term investments and marketable securities available for sale (note 5)	1,217	3,320
Accounts receivable	47,177	32,655
Work in progress	10,839	13,189
Inventory	2,069	1,434
Prepaid expenses and other current assets	7,608	4,746
Investment tax credit receivable	661	41
Future income taxes (note 15)	1,096	1,153
	<u>91,213</u>	<u>83,203</u>
Property and equipment (note 8)	8,025	6,385
Future income taxes (note 15)	3,890	3,429
Notes receivable (note 6)	3,490	—
Share purchase warrants (note 6)	571	—
Investment tax credit receivable	1,551	547
Other long-term assets	871	38
Intangible assets (note 9)	128,942	66,085
Goodwill (note 10)	28,594	26,886
	<u>\$ 267,147</u>	<u>\$ 186,573</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Bank indebtedness (note 11)	\$ 19,342	\$ —
Accounts payable and accrued liabilities	43,892	37,024
Acquisition holdback payments	10,442	4,797
Deferred revenue	78,870	56,190
Income taxes payable	3,426	1,063
Future income taxes (note 15)	347	—
	<u>156,319</u>	<u>99,074</u>
Future income taxes (note 15)	21,238	8,048
Acquisition holdback payments	1,000	231
Other long-term liabilities	1,708	404
Shareholders' equity:		
Capital stock (note 12)	99,283	99,283
Shareholder loans (note 13)	(1,915)	(2,135)
Accumulated other comprehensive loss (note 23)	(3,237)	(3,152)
Deficit	(7,249)	(15,180)
	<u>86,882</u>	<u>78,816</u>
Commitments (note 20)		
Contingencies (note 21)		
Guarantees (note 22)		
	<u>\$ 267,147</u>	<u>\$ 186,573</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:



Director



Director

# CONSTELLATION SOFTWARE INC.

Consolidated Statements of Operations  
(In thousands of U.S. dollars, except per share amounts)

Years ended December 31, 2007 and 2006

	2007	2006
Revenue	\$ 243,023	\$ 210,759
Cost of revenue	92,113	81,970
	150,910	128,789
Research and development	36,965	32,821
Sales and marketing	28,666	25,942
General and administration	44,127	39,183
Depreciation	3,117	2,943
	112,875	100,889
Income before the undernoted	38,035	27,900
Appreciation in common shares eligible for redemption (note 12(d))	-	10,093
Amortization of intangible assets	22,364	17,090
Other expenses	14	1,970
Gain on sale of short-term investments, marketable securities and other assets	(1,369)	(286)
Interest income	(508)	(286)
Foreign exchange loss (gain)	2,466	(595)
Income (loss) before income taxes	15,068	(86)
Income taxes (recovery) (note 15):		
Current	4,273	1,421
Future	(315)	(271)
	3,958	1,150
<b>Net income (loss)</b>	<b>\$ 11,110</b>	<b>\$ (1,236)</b>
Income (loss) per share (note 16):		
Basic	\$ 0.53	\$ (0.06)
Diluted	0.52	(0.06)
Weighted average number of shares outstanding (in thousands) (note 16):		
Basic	21,110	20,810
Diluted	21,192	20,810
Number of shares outstanding at the end of the year (in thousands)	21,192	21,192

See accompanying notes to consolidated financial statements.

# CONSTELLATION SOFTWARE INC.

Consolidated Statements of Deficit  
(In thousands of U.S. dollars)

Years ended December 31, 2007 and 2006

	2007	2006
Deficit, beginning of year	\$ (15,180)	\$ (12,623)
Net income (loss)	11,110	(1,236)
Dividends	(3,179)	(1,381)
Refundable taxes and other	–	60
Deficit, end of year	\$ (7,249)	\$ (15,180)

Consolidated Statements of Comprehensive (Loss)  
(In thousands of U.S. dollars)

Years ended December 31, 2007 and 2006

	2007	2006
Net income (loss)	\$ 11,110	\$ (1,236)
Other comprehensive income (loss)	(85)	–
Comprehensive income (loss)	\$ 11,025	\$ (1,236)

See accompanying notes to consolidated financial statements.

# CONSTELLATION SOFTWARE INC.

Consolidated Statements of Cash Flows  
(In thousands of U.S. dollars)

Years ended December 31, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Net income (loss)	\$ 11,110	\$ (1,236)
Adjustments to reconcile net income to net cash flows from operations:		
Depreciation	3,117	2,943
Amortization of intangible assets	22,364	17,090
Accretion interest (note 6)	61	-
Appreciation in common shares eligible for redemption	-	10,093
Deferred compensation	-	400
Future income taxes	(315)	(271)
Gain on sale of short-term investments, marketable securities and other assets	(1,369)	(286)
Unrealized foreign exchange (gain) loss	2,300	(660)
Change in non-cash operating working capital (note 19)	(2,348)	556
Cash flows from operating activities	34,920	28,629
Cash flows from financing activities:		
Increase (decrease) in other long-term liabilities	521	(278)
Increase in bank indebtedness	19,342	-
Credit facility financing fees (note 11)	(549)	-
Dividends	(3,179)	(1,381)
Distributions to common shares eligible for redemption	-	(471)
Issue of common shares eligible for redemption, net of shareholder loans	-	3,806
Redemption of common shares eligible for redemption	-	(20)
Issuance of shareholder loans (note 13)	(447)	-
Repayment of shareholder loans (note 13)	667	2,975
Repurchase of phantom shares	-	(1,657)
Return of capital	-	(637)
Cash flows from financing activities	16,355	2,337
Cash flows from investing activities:		
Acquisition of businesses, net of cash acquired (note 7)	(52,290)	(19,331)
Investment in VCG Inc. (note 6)	(4,000)	-
Additions to short-term investments, marketable securities and other assets	(801)	(2,850)
Proceeds on sale of short-term investments, marketable securities and other assets	4,144	748
Decrease (increase) in restricted cash	108	(858)
Decrease in other assets	253	202
Property and equipment purchases	(2,997)	(2,255)
Cash flows used in investing activities	(55,583)	(24,344)
Effect of currency translation adjustment on cash and cash equivalents	(1,703)	900
Increase (decrease) in cash and cash equivalents	(6,011)	7,522
Cash, beginning of year	25,807	18,285
Cash, end of year	\$ 19,796	\$ 25,807
Supplemental cash flow information:		
Income taxes paid	\$ 2,649	\$ 2,230
Interest paid	517	251
Interest received	1,025	575

See accompanying notes to consolidated financial statements.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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Constellation Software Inc. (the "Company"), through its subsidiaries, is engaged in the development, installation and customization of software relating to: public and para transit operators, school transportation and administration, utilities, local government, law enforcement, public housing, production homebuilders, private clubs, general construction, healthcare food services, and manufacturing, and in the provision of related professional services and support.

## 1. Significant accounting policies:

### (a) Basis of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All significant intercompany transactions and balances have been eliminated. During the year, the Company completed certain acquisitions as described in note 7 to these consolidated financial statements. The results of operations of these acquired companies have been included in these consolidated financial statements from the date of acquisition.

### (b) Revenue recognition:

The Company earns revenue from licencing its products and providing related services, including professional services, maintenance and hardware.

The Company recognizes product revenue when it has an executed licence agreement, the software product has been delivered, the amount of the fee to be paid by the customer is fixed and determinable, and collection of the related receivables is deemed probable.

Typically, software licence agreements are multiple element arrangements as they may also include maintenance and professional services. The Company evaluates these contracts to determine whether the professional services are essential to the functionality of the software. Revenue from arrangements that involve professional services that are not essential to the functionality of the software is allocated to each element based on their relative fair values and recognized when the above-noted revenue recognition criteria have been met for each element.

Revenue from the licence of software products involving significant implementation or customization essential to the functionality of the Company's product is recognized under the percentage-of-completion method using labour hours as a measure of progress toward completion. Provisions for estimated contract losses are recognized in the year the loss becomes probable and can be reasonably estimated.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 1. Significant accounting policies (continued):

Professional services revenue is recognized as such services are performed. Maintenance and warranty revenue is recognized ratably over the term of the related maintenance agreement, which is normally one year.

The timing of revenue recognition often differs from contract payment schedules, resulting in revenue that has been earned but not billed. These amounts are included in work in progress. Amounts billed in accordance with customer contracts, but not yet earned, are recorded as deferred revenue.

Revenue from hardware sales is recognized upon successful installation or delivery of the product.

### (c) Property and equipment:

Property and equipment are recorded at cost. Depreciation is calculated using the following methods and annual rates:

Asset	Basis	Rate
Computer hardware	Declining balance and straight line	25% - 33%
Computer software	Declining balance and straight line	25% - 100%
Furniture and equipment	Declining balance and straight line	20% - 30%
Leasehold improvements	Straight line	Shorter of the estimated useful life and the term of the lease

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### (d) Translation of foreign currency:

The Company's functional currency is the U.S. dollar. The Company translates transactions denominated in foreign currencies other than the U.S. dollar at the exchange rates in effect on the transaction dates. Monetary assets and liabilities of the Company denominated in foreign currencies are translated into U.S. dollars at the exchange rates prevailing at the balance sheet date. Non-monetary assets and liabilities are translated at historical exchange rates. Exchange gains and losses resulting from transactions denominated in currencies other than the U.S. dollar are included in the results of operations for the year.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 1. Significant accounting policies (continued):

### (e) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment.

The Company records an income tax expense or recovery based on the income earned or loss incurred in each tax jurisdiction and the substantively enacted tax rate applicable to that income or loss. In ordinary course of business, there are many transactions for which the ultimate tax outcome is uncertain. The final tax outcome of these matters may be different from the estimates originally made by management in determining the Company's income tax provisions. The Company recognizes a tax benefit when it is more-likely-than-not based on the Company's best estimate of the amount that will ultimately be paid. A change to those estimates could impact the income tax provision and net income.

### (f) Stock-based compensation:

One of the Company's subsidiaries issued stock appreciation rights under a Phantom Share Plan. The Company measured compensation cost in the amount by which the current fair value of the underlying stock exceeded the exercise price on the balance sheet date prior to exercise, forfeiture or expiration. During 2006, the Company repurchased all outstanding stock appreciation rights. (Note 14)

### (g) Research and development:

Research expenditures are expensed as incurred. Development costs are expensed in the year incurred unless management believes they meet the criteria set out under Canadian generally accepted accounting principles for deferral and amortization. To date, no development costs have been capitalized.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 1. Significant accounting policies (continued):

### (h) Investment tax credits:

Investment tax credits are accounted for as a reduction of the related expenditure for items of a current expense nature or as a reduction of property and equipment for items of a capital nature when the Company has reasonable assurance that the credit will be realized. As at December 31, 2007, investment tax credits receivable totalled \$2,212 (2006 - \$588) and for the year ended December 31, 2007 investment tax credits received totalled \$1,399 (2006 - \$158).

### (i) Investments:

Investments over which the Company does not have significant influence are classified as available-for-sale and are recorded at fair value.

### (j) Goodwill:

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the tangible and intangible assets acquired, less liabilities assumed, based on their fair values. When the Company enters into a business combination, the purchase method of accounting is used. Goodwill is assigned as of the date of the business combination to reporting units that are expected to benefit from the business combination.

Goodwill is not amortized but instead is tested for impairment annually or more frequently, if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit, including goodwill, is compared with its fair value. When the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of a reporting unit exceeds its fair value, in which case, the implied fair value of the reporting unit's goodwill, determined in the same manner as the value of goodwill is determined in a business combination, is compared with its carrying amount to measure the amount of the impairment loss, if any.

The Company has tested goodwill for impairment at December 31, 2007 and 2006, and determined that no impairment in the carrying value of these assets existed.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 1. Significant accounting policies (continued):

### (k) Intangible assets:

Intangible assets acquired individually or as part of a group of other assets are initially recognized and measured at cost. The cost of a group of intangible assets acquired in a transaction, including those acquired in a business combination that meet the specified criteria for recognition apart from goodwill, is allocated to the individual assets acquired based on their relative fair values.

Intangible assets with finite useful lives are amortized on a straight-line basis over their useful lives. The estimated useful lives of intangible assets, which are reviewed annually, are as follows:

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Technology assets	4 to 12 years
Non-compete agreements	5 years
Customer assets	3 to 12 years
Trademarks	15 years
Backlog	1 year
Contract related assets	2 years

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### (l) Long-lived assets:

Long-lived assets, which comprise property and equipment and intangible assets, are amortized over their useful lives. The Company reviews long-lived assets for impairment annually or more frequently, if events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the undiscounted future cash flows expected to result from the use and eventual disposition of a group of assets is less than its carrying amount, it is considered to be impaired. An impairment loss is measured as the amount by which the carrying amount of the group of assets exceeds its fair value. At December 31, 2007 and 2006, no such impairment had occurred.

### (m) Guarantees:

The Company is required to disclose significant information about certain types of guarantees that it has provided, including certain types of indemnities and indirect guarantees of indebtedness to others, without regard to the likelihood of whether it will have to make any payments under the guarantees.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 1. Significant accounting policies (continued):

### (n) Common shares eligible for redemption:

Prior to its initial public offering in May 2006, the Company had certain shares issued and outstanding whereby the shareholders had the right to sell the shares to the Company in accordance with the provisions of the respective shareholder agreements. Historically, these shares were presented as a liability on the Company's balance sheet. The liability was measured at each balance sheet date at its estimated redemption amount. Appreciation and depreciation resulting from the remeasurement of the liability were recognized in the Company's statement of operations. The redemption features of these shares were eliminated with the completion of the initial public offering and are no longer presented as a liability on the Company's consolidated balance sheet (note 12(c)).

### (o) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

Accounts receivable are stated after evaluation as to their collectibility, and an appropriate allowance for doubtful accounts is provided where considered necessary.

In connection with revenue recognition and work in progress, the Company is required to make ongoing estimates of the amount of revenue and costs of long-term projects to customize and install software. The Company makes these assessments by measuring labour costs incurred to date and estimating the labour costs to be incurred over the life of the project.

The Company is required to make ongoing estimates of the results of future operations as part of its assessment of the recoverability of goodwill, intangible assets, property and equipment and future income tax assets. Significant changes in the assumptions with respect to future business plans and cash flows could result in impairment of goodwill, intangible assets, property and equipment, and future tax assets.

By their nature, these estimates are subject to measurement uncertainty and actual results could differ from these estimates.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 2. Changes in accounting policies:

Effective January 1, 2007, the Company adopted retrospectively without adjustment of prior years the recommendations of CICA Handbook Section 1530, Comprehensive Income; Section 3855, Financial Instruments - Recognition and Measurement; Section 3861, Financial Instruments - Disclosure and Presentation; Section 3865, Hedges; and Section 3251, Equity. These sections provide standards for recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives, and describe when and how hedge accounting may be applied.

Section 1530 provides standards for the reporting and presentation of comprehensive income, which represents the change in equity from transactions and other events and circumstances from non-owner sources. Other comprehensive income is defined by revenue, expenses, gains and losses that are recognized in comprehensive income, but excluded from net income, in conformity with generally accepted accounting principles.

Under the new standards, all financial assets are classified as held for trading, held-to-maturity investments, loans and receivables or available-for-sale categories. Also, all financial liabilities must be classified as held for trading or other financial liabilities. The financial instruments are measured at their fair values, except for held-to-maturity investments, loans and receivables and other financial liabilities, which are measured at amortized cost using the effective interest method. The change in the fair value of a financial asset or financial liability classified as held for trading is included in operations in the period in which it arises, and the change in the fair value of available-for-sale financial assets is recognized in other comprehensive income until the financial asset is derecognized and any cumulative gain or loss is then recognized in operations.

As a result of the implementation of the standards, the Company has classified cash as held for trading. Short-term investments and marketable securities have been classified as available-for-sale. Accounts receivable has been classified as loans and receivables. Bank indebtedness, accounts payable and certain accrued liabilities have been classified as other financial liabilities. The Company has not classified any financial asset as held-to-maturity. The remeasurement on adoption to fair value resulted in an increase in short-term investments and marketable securities of \$1,154 and a corresponding increase in accumulated other comprehensive income (note 23).

All derivatives, including embedded derivatives, that must be separately accounted for, are measured at fair value with change in fair value recorded in the consolidated statement of operations unless they are effective cash flow hedges. As part of the process of implementing these new standards, all contracts signed after January 1, 2003, were reviewed to identify

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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embedded derivatives requiring separation from the host contract. No material embedded derivatives requiring separation were identified

### 3. Changes in accounting policies not yet adopted:

The following accounting pronouncements have been released but have not yet been adopted by the Company.

#### (a) Capital disclosures:

In October 2006, the Accounting Standards Board (AcSB) issued Section 1535, Capital Disclosures, which establishes standards for disclosing information about an entity's capital and how it is managed. This standard requires disclosure of: an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically January 1, 2008 for the Company. The Company does not expect the adoption of this standard to have a material impact on its financial statements.

#### (b) Financial instruments - disclosures:

In October 2006, the CICA issued Section 3862, Financial Instruments - Disclosures and Section 3863, Financial Instruments - Presentation, which supersedes Sections 3861, Financial Instruments - Presentations and Disclosures. Section 3862 places an increased emphasis on disclosures about the risks associated with both recognized and unrecognized financial instruments and how these risks are managed.

Section 3862 requires disclosures, by class of financial instrument that enables users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net income and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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### 3. Changes in accounting policies not yet adopted (continued):

This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically on January 1, 2008 for the Company. The Company does not expect the adoption of this standard to have a material impact on its financial statements.

(c) Financial instruments - presentation:

In October 2006, the AcSB approved Section 3863, Financial Instruments - Presentation, which replaces Section 3861, Financial Instruments - Disclosure and Presentation. The existing requirements on presentation of financial instruments have been carried forward unchanged to Section 3863, Financial Instruments - Presentation.

This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically January 1, 2008 for the Company. The Company does not expect the adoption of this standard to have a material impact on its financial statements.

(d) International Financial Reporting Standards:

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards ("IFRS") over a transition period expected to end in 2011. The impact on the transition to IFRS on the Company's financial statements is not yet determinable.

(e) Goodwill and Intangible Assets:

In 2008, the CICA issued Handbook Section 3064 ("CICA 3064"), "Goodwill and Intangible Assets". CICA 3064 replaces Section 3062 "Goodwill and Intangible Assets", and Section 3450, "Research and Development Costs". It establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This new standard is effective for the Company's interim and annual consolidated financial statements commencing January 1, 2009. The Company is currently assessing the impact of the new standard.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 4. Restricted cash:

At December 31, 2007, the Company has \$750 held in accordance with an escrow agreement between the Company and the selling parties of Varsity Logistics Inc. a company acquired in October, 2007. The funds relate to the holdback amount which is payable in the second quarter of 2008 subject to no claims under the representations and warranties of the agreement.

At December 31, 2006, the Company had \$858 held in accordance with an escrow agreement between the Company and the selling parties of PG Govern QC Inc. and PG Govern Inc., an acquisition target. The acquisition was completed on March 1, 2007 (note 7) and these funds were applied against the purchase price.

## 5. Short-term investments and marketable securities available for sale:

At December 31, 2007, the Company held investments in three (2006 - three) public companies listed in the U.K. and U.S., all of which develop and sell software solutions.

	2007		2006	
	Cost	Market value	Cost	Market value
Common shares	\$ 1,303	\$ 1,217	\$ 3,320	\$ 4,474

## 6. Notes receivable:

On June 18, 2007, the Company entered into an agreement with VCG Inc. (subsequently VCG LLC) to purchase \$4,000 of senior subordinated secured notes. These notes bear interest at 12% per annum payable annually in arrears and mature on June 18, 2012, at which time the principal sum of \$4,000 is due. In conjunction with these notes, the Company received 1,120,183 share purchase warrants (the "Warrants") having the right to purchase Preferred Series C-1 shares convertible into 8% of the fully diluted equity interest of VCG Inc. as of June 18, 2007, subject to the terms of the Warrants. The exercise price for the Warrants is \$0.00007 per share. The Warrants can be exercised at the option of the holder anytime until the expiration date of June 18, 2017.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## **6. Notes receivable (continued):**

The Warrant component of this instrument constitutes a derivative, and thus under Canadian GAAP must be valued separately from the value of the notes. The Company allocated the total consideration paid to the notes and warrants using the residual method. The fair value of the Warrants was determined using the Black-Scholes option-pricing model. On June 18, 2007 the following assumptions were used to value the Warrants: risk-free interest rate of 4.53%, volatility of 89%, share price of \$0.51, expected life of 10 years and zero dividend yield. This resulted in the allocation of \$571 to the Warrants and \$3,429 to the notes receivable. At December 31, 2007 the assumptions were updated as follows: risk-free interest rate of 3.99%, volatility of 89%, share price of \$0.51, expected life of 10 years and zero dividend yield. The revised assumptions resulted in no change in the fair value of the derivative.

The note component is recorded at amortized cost with an effective interest rate of 14.86%. For the year ended December 31, 2007, the Company recorded interest income related to carrying value accretion of \$61 (2006 - nil).

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 7. Business acquisitions:

### 2007

#### (a) PG Govern QC Inc. ("PG"):

On March 1, 2007, the Company acquired the assets and shares of PG for net cash consideration of \$13,112 on closing plus a holdback of \$2,228 resulting in total consideration of \$15,340. The holdback is expected to be paid in the first quarter of 2008, subject to no claims under the representations and warranties of the agreement. The acquisition has been accounted for by the purchase method with the results of operations included in these consolidated financial statements from the date of acquisition. The following table summarizes the fair value of the assets acquired and liabilities assumed at the date of acquisition:

Assets acquired:	
Current assets	\$ 8,115
Property and equipment	1,030
Other long-term assets	2,212
Technology assets	16,694
Customer assets	4,346
Backlog	767
	<u>33,164</u>
Liabilities assumed:	
Current liabilities	8,441
Deferred revenue	7,068
Future income tax liability	1,533
Other long-term liabilities	782
	<u>17,824</u>
<u>Total purchase price consideration</u>	<u>\$ 15,340</u>

This acquisition has been allocated to the Public Sector.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 7. Business acquisitions (continued):

### (b) Computrition Inc. ("Computrition"):

On November 30, 2007, the Company acquired the assets and shares of Computrition for net cash consideration of \$12,618 on closing plus a cash holdback of \$2,000 resulting in total consideration of \$14,618. Half of the holdback is payable in the third quarter of 2008 and the remaining half in the fourth quarter of 2009, subject to no claims under the representations and warranties of the agreement. The acquisition has been accounted for by the purchase method with the results of operations included in these consolidated financial statements from the date of acquisition. The following table summarizes the preliminary estimate of the fair value of the assets acquired and liabilities assumed at the date of acquisition:

---

Assets acquired:	
Current assets	\$ 4,283
Property and equipment	131
Intangibles	23,320
	<hr/> 27,734
Liabilities assumed:	
Current liabilities	1,377
Deferred revenue	6,856
Future income tax liability	4,883
	<hr/> 13,116
Total purchase price consideration	<hr/> \$ 14,618

The Company has determined that it acquired technology, customer relationships and backlog. The Company is in the process of determining the fair value of the intangible assets acquired.

This acquisition has been allocated to the Private Sector.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 7. Business acquisitions (continued):

(c) Other acquisitions:

During 2007, the Company made thirteen other acquisitions for aggregate net cash consideration of \$22,366 plus cash holdbacks of \$6,785 resulting in total consideration of \$29,151. The holdbacks are payable over a one-year period and are adjusted for any claims under the representations and warranties of the agreements. The acquisitions have been accounted for using the purchase method with the results of operations included in these consolidated financial statements from the date of each acquisition. The following table summarizes the aggregate preliminary estimated fair value of the assets acquired and liabilities assumed at the date of each acquisition:

---

Assets acquired:	
Current assets	\$ 11,255
Property and equipment	639
Technology assets	15,790
Customer assets	5,314
Goodwill	1,678
Intangibles	18,164
	<hr/>
	52,840
Liabilities assumed:	
Current liabilities	4,495
Deferred revenue	12,561
Future income tax liability	6,633
	<hr/>
	23,689
Total purchase price consideration	<hr/>
	\$ 29,151

On November 30, 2007, the Company acquired the assets and shares of Systems & Software, Inc. The Company has determined that it acquired technology, customer relationships and backlog, and is in the process of determining the fair value of the intangible assets acquired.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 7. Business acquisitions (continued):

### 2006

#### (e) Advanced Utility Systems Corporation:

On June 14, 2006, the Company acquired the assets and shares of Advanced Utility Systems Corporation for net cash consideration of \$10,063 on closing plus a cash holdback of \$1,631 resulting in total consideration of \$11,694. On June 14, 2007, the Company paid the holdback of \$1,696, which represented the entire amount owing as there were no claims under the representations and warranties of the agreement. The acquisition has been accounted for by the purchase method with the results of operations included in these consolidated financial statements from the date of acquisition. The following table summarizes the fair value of the assets acquired and liabilities assumed at the date of acquisition:

---

Assets acquired:	
Current assets	\$ 2,173
Property and equipment	371
Technology assets	9,468
Customer assets	750
Goodwill	2,956
	<hr/>
	15,718
Liabilities assumed:	
Current liabilities	1,481
Deferred revenue	1,815
Future income tax liability	634
Other long-term liabilities	94
	<hr/>
	4,024
	<hr/>
Total purchase price consideration	\$ 11,694

Goodwill has been allocated to the Public segment.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 7. Business acquisitions (continued):

### (f) Other acquisitions:

During 2006, the Company made nine other acquisitions for aggregate net initial cash consideration of \$7,741 plus cash holdbacks of \$2,725 resulting in total consideration of \$10,466. The holdbacks are payable over a one-year period subject to no claims under the representations and warranties of the agreements. Holdbacks of \$1,886 were paid during 2007. The acquisitions have been accounted for using the purchase method with the results of operations included in these consolidated financial statements from the date of each acquisition. The following table summarizes the aggregate fair value of the assets acquired and liabilities assumed at the date of each acquisition:

---

Assets acquired:	
Current assets	\$ 1,821
Property and equipment	256
Technology assets	13,227
Customer assets	1,369
Goodwill	210
	<hr/> 16,883
Liabilities assumed:	
Current liabilities	1,288
Deferred revenue	5,129
	<hr/> 6,417
<hr/> Total purchase price consideration	<hr/> \$ 10,466

Goodwill has been allocated to the Public Sector.

### (g) 2005 Holdbacks:

During the year ended December 31, 2007, holdbacks of \$612 relating to acquisitions made in 2005 came due and were paid.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 8. Property and equipment:

2007	Cost	Accumulated depreciation	Net book value
Computer hardware	\$ 12,189	\$ 8,606	\$ 3,583
Computer software	4,360	3,297	1,063
Furniture and equipment	5,211	3,464	1,747
Leasehold improvements	2,646	1,014	1,632
	\$ 24,406	\$ 16,381	\$ 8,025

  

2006	Cost	Accumulated depreciation	Net book value
Computer hardware	\$ 9,716	\$ 7,108	\$ 2,608
Computer software	3,634	2,646	988
Furniture and equipment	4,262	2,681	1,581
Leasehold improvements	1,838	630	1,208
	\$ 19,450	\$ 13,065	\$ 6,385

## 9. Intangible assets:

2007	Cost	Accumulated amortization	Net book value
Technology assets	\$ 121,574	\$ 49,708	\$ 71,866
Non-compete agreements	1,680	1,589	91
Customer assets	23,807	8,632	15,175
Trademarks	133	93	40
Backlog	767	639	128
Contract related assets	549	–	549
Other	41,484	391	41,093
	\$ 189,994	\$ 61,052	\$ 128,942

Note: "Other" includes Intangible Assets, Customer Assets, and Backlog relating to certain acquisition preliminary purchase price allocations. The allocations will be finalized in 2008.

2006	Cost	Accumulated amortization	Net book value
Technology assets	\$ 88,989	\$ 32,226	\$ 56,763
Non-compete agreements	1,880	1,374	506
Customer assets	13,771	5,006	8,765
Trademarks	133	82	51
	\$ 104,773	\$ 38,688	\$ 66,085

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 10. Goodwill:

	2007	2006
Opening balance	\$ 26,886	\$ 23,720
Additions due to acquisitions during the year	1,678	3,166
Adjustments relating to prior period acquisitions	30	—
Ending balance	\$ 28,594	\$ 26,886

## 11. Credit facilities:

The Company has an operating line-of-credit with a Canadian charter bank in the amount of \$50,000 (2006 - \$20,000). The line-of-credit bears a variable interest rate and is due in full November 16, 2010. It is secured by a general security agreement covering the majority of the assets of the company and its subsidiaries, and is subject to various debt covenants. As at December 31, 2007, \$19,342 (2006 - nil) had been drawn from this credit facility, and letters of credit totalling \$7,186 (2006 - \$250) were issued, which limits the borrowing capacity on a dollar-for-dollar basis. Interest expense paid on the line-of-credit for the year ended December 31, 2007 totalled \$262 (2006-\$121).

## 12. Capital stock:

- (a) The authorized share capital of the Company consists of an unlimited number of common shares and an unlimited number of Class A non-voting shares. The rights and privileges of the existing Class A non-voting shares entitle the holders of such shares to distributions, if and when declared by the Board of Directors. The holders of the Class A non-voting shares are entitled to convert such shares, at any time into common shares, on a one-for-one basis.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 12. Capital stock (continued):

(b) The issued share capital of the Company is as follows:

	Common shares		Class A non-voting		Series 1, 2 and 3 common shares		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Balance, December 31, 2005	–	–	8,304,554	\$ 28,123	8,507,562	\$ 29,097	16,812,116	\$ 57,220
Return of capital	–	–	–	–	–	(637)	–	(637)
Reorganization of share capital:								
Conversion of Series 1, 2 and 3 common shares	8,507,562	\$ 28,460	–	–	(8,507,562)	(28,460)	–	–
Conversion of Series 1 common shares eligible for redemption	1,732,102	16,888	–	–	–	–	1,732,102	16,888
Conversion of Series 3 common shares eligible for redemption	2,647,312	25,812	–	–	–	–	2,647,312	25,812
Conversion of shares as part of IPO	4,016,554	13,602	(4,016,554)	(13,602)	–	–	–	–
Balance, December 31, 2007 and 2006	16,903,530	\$ 84,762	4,288,000	\$ 14,521	–	\$ –	21,191,530	\$ 99,283

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 12. Capital stock (continued):

### (c) Reorganization of share capital:

On May 11, 2006, the Company filed a prospectus to qualify the distribution of 5,176,472 common shares of the Company to be sold by two of the Company's significant shareholders at a price of Cdn. \$17.00 per share. The Company did not receive any of the proceeds relating to the common shares sold by these shareholders. The initial public offering of 4,705,883 common shares was completed on May 18, 2006 and an additional 470,589 common shares were sold by the selling shareholders on June 16, 2006 pursuant to the exercise by the underwriters of their over-allotment option.

Concurrently with the above-noted transaction, the Company completed a reorganization of its share capital and amended its Articles of Incorporation to remove the Series 1 and Series 2 common shares and re-designate the Series 3 common shares as common shares and amend the provisions of the common shares and the Class A non-voting shares. Accordingly, all the issued and outstanding Series 1 and Series 2 common shares were converted into an equivalent number of Series 3 common shares, which were subsequently re-designated as 8,507,562 "common shares".

Certain holders of the Series 1 and Series 3 common shares had the right to sell to the Company a specified number of these shares on an annual basis in accordance with the terms of the shareholder agreements. Accordingly, these shares were presented as a liability on the Company's balance sheet. Under these shareholder agreements, upon the completion of an initial public offering, the redemption rights terminated and, therefore, these shares no longer represent a liability to the Company and the Company reduced the liability for common shares eligible for redemption with a corresponding increase to share capital in the amount of \$26,502 (note 12(d)).

The costs related to the initial public offering and reorganization of approximately \$1,600 were charged to the statement of operations during the year ended December 31, 2006.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 12. Capital stock (continued):

(d) Series 1 and Series 3 common shares eligible for redemption:

For the year ended December 31, 2006, the Company recorded \$10,093 as a charge for the appreciation in common shares eligible for redemption, representing the remeasurement of the liability. The redemption features of these shares have been eliminated with the completion of the initial public offering and are no longer presented as a liability on the Company's consolidated balance sheet (note 12(c)). Accordingly, the Company recorded no appreciation charge for the year ended December 31, 2007.

	2006	
	Number	Amount
Common shares eligible for redemption:		
Series 1:		
Opening balance	1,685,344	\$ 401
Issued during the year	46,758	456
Return of capital	-	(202)
Converted on reorganization (1)	(1,732,102)	(655)
	-	-
Series 3:		
Opening balance	2,242,978	11,867
Issued during the year	406,667	3,965
Purchased for cancellation	(2,333)	(20)
Return of capital	-	(269)
Converted on reorganization (1)	(2,647,312)	(15,543)
	-	-
Premium on common shares eligible for redemption:		
Series 1	1,732,102	16,233
Series 3	2,647,312	10,269
Reclass to share capital (1)	(4,379,414)	(26,502)
	-	-
<b>Total shares outstanding</b>	<b>-</b>	<b>-</b>

(1) The aggregate of these amounts, 4,379,414 shares with an ascribed value of \$42,700, were converted to common shares.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 13. Shareholder loans:

Share purchase loans receivable of \$1,915 (2006 - \$2,135) under the Company's share purchase plan are included as a reduction of shareholders' equity. Interest rates on these loans range from 5.0% to 6.5% depending on the year the loan was advanced. The balances outstanding are secured by the shares for which they were used to purchase.

The following table summarizes the shareholder loan activity for the year:

---

Balance at December 31, 2006	\$ 2,135
Issuance of shareholder loans	447
Repayment of shareholder loans	(767)
Interest	100
<hr/>	
Balance, December 31, 2007	\$ 1,915

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## 14. Deferred compensation:

During 2000, the Company created a Phantom Share Plan under which 512,505 phantom shares of the Company's common stock were granted to employees of a subsidiary company. The exercise price per phantom share was Cdn. \$0.01. The shares vested immediately and the greater of 20% of the shares held or 500 shares could be redeemed by the holder per year.

During the second quarter of 2006, the Company redeemed the remaining 169,953 shares at a price of \$9.75 per share, for a total of \$1,657.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 15. Income taxes:

The income tax effects of temporary differences that give rise to significant components of future income tax assets and liabilities at December 31, 2007 are as follows:

	2007	2006
Future income tax assets:		
Non-capital income tax loss carryforwards	\$ 6,492	\$ 5,918
Scientific research and experiment development expenditure pool carryforward	573	582
Deferred compensation	—	—
Deferred revenue	4,458	2,410
Reserves	855	1,049
Property and equipment	213	323
Intangible assets	573	416
Stock issuance costs	351	413
Corporate minimum tax and foreign tax credits	1,427	779
Other, including capital loss carryforwards	785	881
	<u>15,727</u>	<u>12,771</u>
Less valuation allowance	7,419	6,150
	8,308	6,621
Future income tax liabilities:		
Intangible assets	(22,404)	(9,357)
Property and equipment	(1,351)	(504)
Scientific research and experiment development investment tax credits	(168)	(113)
Other, including foreign exchange gains	(984)	(113)
	<u>(24,908)</u>	<u>(10,087)</u>
<b>Net future income taxes</b>	<b>\$ (16,599)</b>	<b>\$ (3,466)</b>
Current future income tax asset	\$ 1,096	\$ 1,153
Long-term future income tax asset	3,890	3,429
Current future income tax liability	(347)	-
Long-term future income tax liability	(21,238)	(8,048)
<b>Net future income taxes</b>	<b>\$ (16,599)</b>	<b>\$ (3,466)</b>

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 15. Income taxes (continued):

In assessing the realizability of future income tax assets, management considers whether it is more likely than not that some portion or all of the future income tax assets will be realized. The ultimate realization of future income tax assets is dependent upon the generation of future taxable income during the years in which the temporary differences are deductible. Management considers the scheduled reversals of future income tax liabilities, the character of the income tax assets, and tax planning strategies in making this assessment. To the extent that management believes that the realization of the future income tax assets does not meet the more likely than not realization criterion, a valuation allowance is recorded against the future tax assets.

Total income tax expense varies from the amounts that would be computed by applying the statutory income tax rate to income before income taxes for the following reasons:

	2007	2006
Statutory income tax rate	36.12%	36.12%
Income tax expense (recovery) on income (loss) before income taxes	\$ 5,443	\$ (30)
Increase (decrease) in income taxes resulting from:		
Change in the future statutory tax rates	166	(57)
Change in the valuation allowance for future tax assets	1,269	2,083
Non-deductible loss on common shares eligible for redemption	—	3,645
Permanent differences	1,504	268
Adjustment to future tax assets, including foreign exchange	(1,830)	(1,946)
Foreign tax rate differential	(2,650)	(2,002)
Other	56	(811)
	\$ 3,958	\$ 1,150

As at December 31, 2007, the Company has non-capital income tax losses of \$ 7,675 available to reduce future years' income for Canadian income tax purposes. Canadian losses expire as follows: \$370 in 2014; \$3903 in 2026 and the balance in 2027. In addition, the Company has income tax credits of \$894 available to offset future Ontario income taxes otherwise payable, which expire as follows: \$118 in 2012; \$204 in 2013; \$130 in 2014; \$134 in 2015; \$174 in 2026 and the balance in 2027.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 15. Income taxes (continued):

The Company also has approximately \$4,834 and \$ 7,650 of tax losses available to reduce future years' income for tax purposes in the United States, and the rest of the world, respectively. The U.S. losses expire as follows: \$911 in 2019; \$1,288 in 2020; \$680 in 2021; \$19 in 2023; \$1,049 in 2024; \$530 in 2025; \$249 in 2026 and the balance in 2027; the majority of the rest of the losses can be carried forward indefinitely.

## 16. Income (loss) per share:

	2007	2006
Numerator:		
Net income (loss)	\$ 11,110	\$ (1,236)
Denominator:		
Weighted average number of shares:		
Basic	21,110	20,810
Effect of dilutive securities:		
Shares secured by shareholder loans	82	—
Diluted	\$ 21,192	\$ 20,810
Income (loss) per share:		
Basic	\$ 0.53	\$ (0.06)
Diluted	0.52	(0.06)

At December 31, 2006, common shares secured by shareholder loans totalled 255. These shares were not included in the calculation of diluted net income (loss) per share because to do so would have been anti-dilutive.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 17. Financial instruments:

### (a) Foreign exchange risk management:

The Company operates internationally, giving rise to exposure to market risks from changes in foreign exchange rates. The Company currently does not use derivative instruments to hedge its exposure to those risks.

### (b) Credit risk:

Financial instruments potentially exposing the Company to a concentration of credit risk principally consist of cash, short-term investments, accounts receivable and notes receivable.

The Company manages credit risk related to cash by maintaining bank accounts with Schedule I banks.

The Company manages its credit risk related to short-term investments by only investing in securities which are traded on active markets.

The Company manages credit risk related to accounts receivable by maintaining reserves for potential credit losses and returns, but historically has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area.

The Company manages credit risk related to notes receivable by monitoring the results of the business to which the note relates, and maintaining security over the assets of the business.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 17. Financial instruments (continued):

### (c) Fair values of financial instruments:

The carrying values of cash, restricted cash, accounts receivable, bank indebtedness, accounts payable, holdbacks, and accrued liabilities approximate their fair values due to the short-term nature of these instruments.

The fair values of short-term investments, which are publicly traded, are determined by the quoted market values for each investment (note 5).

Warrants which are not traded are valued using fair valuation techniques and adjusted by the Company after considering the fair value of the underlying security and the strike price of the warrants. As at December 31, 2007, there was no change in the value of the warrants.

## 18. Segmented information:

The Company has a number of operating subsidiaries, which have been aggregated into two reportable segments in accordance with CICA Handbook Section 1701. The Company's Public Sector segment develops and distributes software solutions to government and government-related customers. The Company's Private Sector segment develops and distributes software solutions to commercial customers.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 18. Segmented information (continued):

The accounting policies of the segments are the same as those described in the significant accounting policies (note 1). The Company evaluates performance of the Public Sector businesses and the Private Sector businesses based on several factors, of which the primary financial measures are revenue and earnings (loss) from operations. The Company defines earnings (loss) from operations as earnings (loss) prior to: appreciation of common shares eligible for redemption, amortization of intangible assets, other expenses, gain on sale of short-term investments, marketable securities and other assets, interest income, foreign exchange gains and losses, inter-company expenses and income taxes.

### (a) Reportable segments:

2007	Public Sector	Private Sector	Other	Total
Revenue	\$ 156,804	\$ 86,219	\$ —	\$ 243,023
Cost of revenue	63,899	28,214	—	92,113
	92,905	58,005	—	150,910
Research and development	23,205	13,760	—	36,965
Sales and marketing	18,401	10,265	—	28,666
General and administration	27,246	16,881	—	44,127
Depreciation	2,145	972	—	3,117
	70,997	41,878	—	112,875
Income before the undernoted	21,908	16,127	—	38,035
Amortization of intangible assets	14,973	7,391	—	22,364
Other expenses	—	(230)	244	14
(Gain) loss on sale of short-term investments, marketable securities and other assets	38	3	(1,410)	(1,369)
Interest (income) expense	(230)	(73)	(205)	(508)
Foreign exchange (gain) loss	416	1,400	650	2,466
Inter-company expenses (income)	1,497	2,755	(4,252)	—
Income (loss) before income taxes	5,214	4,881	4,973	15,068
Income taxes (recovery):				
Current	2,093	2,108	72	4,273
Future	(55)	(260)	—	(315)
	2,038	1,848	72	3,958
Net income (loss)	\$ 3,176	\$ 3,033	\$ 4,901	\$ 11,110
Other selected information:				
Goodwill acquired	\$ 133	\$ 1,545	\$ —	\$ 1,678
Property and equipment purchased	2,218	692	87	2,997
Total assets	166,820	92,586	7,741	267,147

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 18. Segmented information (continued):

2006	Public Sector	Private Sector	Other	Total
Revenue	\$ 128,922	\$ 81,837	\$ —	\$ 210,759
Cost of revenue	53,575	28,395	—	81,970
	75,347	53,442	—	128,789
Research and development	20,610	12,211	—	32,821
Sales and marketing	15,025	10,917	—	25,942
General and administration	24,313	14,870	—	39,183
Depreciation	1,754	1,189	—	2,943
	61,702	39,187	—	100,889
Income before the undernoted	13,645	14,255	—	27,900
Appreciation in common shares eligible for redemption	—	—	10,093	10,093
Amortization of intangible assets	10,435	6,655	—	17,090
Other expenses	1	450	1,519	1,970
(Gain) loss on sale of short-term investments, marketable securities and other assets	(3)	—	(283)	(286)
Interest (income) expense	(131)	(51)	(104)	(286)
Foreign exchange (gain) loss	(226)	(150)	(219)	(595)
Inter-company expenses (income)	2,158	958	(3,116)	—
Income (loss) before income taxes	1,411	6,393	(7,890)	(86)
Income taxes (recovery):				
Current	469	1,123	(171)	1,421
Future	(399)	309	(181)	(271)
	70	1,432	(352)	1,150
<b>Net income (loss)</b>	<b>\$ 1,341</b>	<b>\$ 4,961</b>	<b>\$ (7,538)</b>	<b>\$ (1,236)</b>
Other selected information:				
Goodwill acquired	\$ 3,166	\$ —	\$ —	\$ 3,166
Property and equipment purchased	1,390	782	83	2,255
Total assets	115,153	56,080	15,340	186,573

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

## 18. Segmented information (continued):

(b) Geographic information:

The Company's external revenue by geographic region is based on the region in which the revenue is transacted. The property and equipment and goodwill and other intangible assets are based on the geographic region in which the Company operates:

2007	Canada	USA	Other	Total
Revenue	\$ 40,610	\$ 167,441	\$ 34,972	\$ 243,023
Property and equipment	3,759	3,452	814	8,025
Goodwill and other intangible assets	72,821	65,100	19,615	157,536

2006	Canada	USA	Other	Total
Revenue	\$ 24,441	\$ 154,993	\$ 31,325	\$ 210,759
Property and equipment	2,927	3,039	419	6,385
Goodwill and other intangible assets	46,879	24,617	21,475	92,971

As at and for the years ended December 31, 2007 and 2006, no single customer accounted for more than 10% of the Company's total accounts receivable and total revenues.

## 19. Change in non-cash operating working capital:

	2007	2006
Decrease (increase) in accounts receivable	\$ 2,118	\$ (1,785)
Decrease (increase) in work in progress	2,329	(1,350)
Decrease (increase) in work in inventory	(626)	(315)
Decrease (increase) in prepaid expenses and other current assets	2,135	(909)
Increase (decrease) in accounts payable and accrued liabilities excluding holdbacks from acquisitions	(6,075)	822
Increase (decrease) in deferred revenue	(3,805)	4,306
Increase (decrease) income taxes payable	1,576	(213)
	\$ (2,348)	\$ 556

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 20. Commitments:

The Company and its subsidiaries lease premises and certain equipment and automobiles under operating leases. The annual minimum lease commitments are as follows:

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2008	\$ 6,780
2009	4,903
2010	3,700
2011	2,503
2012	2,179
Thereafter	4,059
	<hr/>
	\$ 24,124

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## 21. Contingencies:

There exist certain claims and potential claims against the Company, none of which is expected to have a material adverse effect on the consolidated financial position of the Company.

## 22. Guarantees:

(a) In the ordinary course of business the Company and its subsidiaries have provided performance bonds and other guarantees for the completion of certain customer contracts. Guarantees for which the Company is contractually obligated to make payments in the event of a default by a third party or due to its inability to meet certain performance-based obligations total approximately \$3,189 (2006 - \$5,545). The Company has not experienced a loss to date and future losses are not anticipated; therefore, no liability has been recorded in the consolidated financial statements.

(b) As at December 31, 2007, in the normal course of business, the Company and its subsidiaries have outstanding letters of credit totalling \$7,186 (2006 - \$250).

(c) In the normal course of business, some of the Company's subsidiaries entered into lease agreements for facilities. As the joint lessees, the subsidiaries agree to indemnify the lessor for liabilities that may arise from the use of the leased facility. The maximum amount potentially payable under the foregoing indemnity cannot be reasonably estimated. The subsidiaries have liability insurance that relates to the indemnification described above.

# CONSTELLATION SOFTWARE INC.

Notes to Consolidated Financial Statements (continued)

(In thousands of U.S. dollars, except per share amounts and as otherwise indicated)

Years ended December 31, 2007 and 2006

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## 22. Guarantees (continued):

(d) The Company and its subsidiaries have provided routine indemnification to some of its customers against liability if the Company's product infringes on a third party's intellectual property rights. The maximum exposure from the indemnifications cannot be reasonably estimated.

## 23. Accumulated other comprehensive loss:

Accumulated other comprehensive loss consists of the following:

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Foreign currency translation account	\$ (3,152)
Mark-to-market adjustment of available-for-sale investments on January 1, 2007 (note 2)	1,154
Net unrealized loss on available-for-sale investments during the year	(96)
Transfer of gain upon derecognition of available-for-sale investments	(1,143)
<hr/> Balance, December 31, 2007	<hr/> \$ (3,237)

## 24. Comparative figures:

Certain comparative figures have been reclassified to conform to the current year's presentation.