

## **CONSTELLATION SOFTWARE INC.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following discussion and analysis should be read in conjunction with the unaudited consolidated interim financial statements for the three months ended March 31, 2007 and the accompanying notes, and with our consolidated annual financial statements and our annual MD&A for the year ended December 31, 2006. Certain information included herein is forward-looking and based upon assumptions and anticipated results that are subject to uncertainties. Should one or more of these uncertainties materialize or should the underlying assumptions prove incorrect, actual results may vary significantly from those expected. See "Forward-Looking Statements" and "Risks and Uncertainties". This MD&A and all information herein is current as at May 9, 2007 unless otherwise indicated.

Unless otherwise indicated, all dollar amounts are expressed in U.S. dollars. All references to "\$" are to U.S. dollars and all references to "C\$" are to Canadian dollars.

Additional information about the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).

#### **Forward Looking Statements**

Certain statements in this report may contain "forward looking" statements that involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company or industry to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Words such as "may", "will", "expect", "believe", "plan", "intend", "should", "anticipate" and other similar terminology are intended to identify forward looking statements. These statements reflect current assumptions and expectations regarding future events and operating performance and speak only as of the date of this MD&A, May 9, 2007. Forward looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. A number of factors could cause actual results to vary significantly from the results discussed in the forward looking statements, including, but not limited to, the factors discussed under "Risks and Uncertainties". Although the forward looking statements contained in this MD&A are based upon what management of the Company believes are reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this MD&A and the Company assumes no obligation to update any forward looking statements to reflect new events or circumstances. This report should be viewed in conjunction with the Company's other publicly available filings, copies of which can be obtained electronically on SEDAR at [www.sedar.com](http://www.sedar.com).

#### **Non-GAAP Measures**

This MD&A includes certain measures which have not been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") such as Adjusted EBITDA, Adjusted EBITDA margin, Adjusted net income and Adjusted net income margin.

The term "Adjusted EBITDA" refers to net income before deducting interest, taxes, depreciation, amortization, appreciation in common shares eligible for redemption, other expenses and foreign exchange, and before including gain on sale of short-term investments, marketable securities and other assets. The Company believes that Adjusted EBITDA is useful supplemental information as it provides an indication of the results generated by the Company's main business activities prior to taking into consideration how those activities are financed and taxed and also prior to taking into consideration asset depreciation and the other items listed above. "Adjusted EBITDA margin" refers to the percentage that Adjusted EBITDA for any period represents as a portion of total revenue for that period.

The term “Adjusted net income” means net income plus appreciation in common shares eligible for redemption and amortization of intangible assets. The Company believes that Adjusted net income is useful supplemental information as it provides an indication of the results generated by the Company’s main business activities prior to taking into consideration appreciation in common shares eligible for redemption (which are no longer included in net income for periods following the closing of our IPO) and prior to taking into consideration amortization of intangibles as these are non-cash expenses that do not necessarily reflect the economic value of our acquisitions. “Adjusted net income margin” refers to the percentage that Adjusted net income for any period represents as a portion of total revenue for that period.

Adjusted EBITDA and Adjusted net income are not recognized measures under Canadian GAAP and, accordingly, shareholders are cautioned that Adjusted EBITDA and Adjusted net income should not be construed as alternatives to net income determined in accordance with Canadian GAAP as an indicator of the financial performance of the Company or as a measure of the Company’s liquidity and cash flows. The Company’s method of calculating Adjusted EBITDA and Adjusted net income may differ from other issuers and, accordingly, Adjusted EBITDA and Adjusted net income may not be comparable to similar measures presented by other issuers. See “Results of Operations —Adjusted EBITDA” and “—Adjusted Net Income” for a reconciliation of Adjusted EBITDA and Adjusted net income to net income.

## **Overview**

We acquire, manage and build vertical market software (“VMS”) businesses. Generally, these businesses provide mission critical software solutions that address the specific needs of our customers in particular markets. Our focus on acquiring businesses with growth potential, managing them well and then building them has allowed us to generate significant cash flow and revenue growth during the past several years.

Our revenue consists primarily of software license fees, maintenance fees, and professional service fees. Software license revenue is comprised of license fees charged for the use of our software products generally licensed under single-year, multiple-year or perpetual arrangements in which the fair value of the license fee is separately determinable from maintenance and/or professional service fees. Maintenance revenue consists of fees charged for customer support on our software products post-delivery. Maintenance fee arrangements generally include ongoing customer support and rights to certain product updates “if and when available”. Professional service revenue consists of fees charged for product training, consulting and implementation services. Our customers typically purchase a combination of software, maintenance and professional services, although the types, mix and quantity of each solution varies by customer.

Cost of revenue consists primarily of the costs directly related to revenues including third party costs and internal costs related to the delivery of professional services and maintenance. Cost of revenue is generally expected to increase in the future as a result of increases in revenue.

Research and development expenses include personnel and related costs associated with our research and development efforts.

Sales and marketing expenses consist primarily of personnel and related costs associated with our sales and marketing functions, including advertising, commissions, trade shows and other promotional materials.

General and administration expenses include personnel and related costs associated with the administration of our business, rental of office space, legal and professional fees and insurance.

## Results of Operations

(In thousands of dollars, except percentages and per share amounts)

	Three months ended Mar. 31,		Period-Over-Period Change	
	<u>2007</u>	<u>2006</u>	\$	%
<b>Revenue</b>	<b>55,893</b>	<b>51,220</b>	<b>4,673</b>	<b>9.1%</b>
Cost of Revenue	21,516	20,338	1,178	5.8%
Gross Profit	34,377	30,882	3,495	11.3%
Expenses				
Research and development	8,910	8,192	718	8.8%
Sales and marketing	7,042	6,408	634	9.9%
General and administration	10,036	9,053	983	10.9%
Total Expenses (pre amortization)	25,988	23,653	2,335	9.9%
<b>Adjusted EBITDA</b>	<b>8,389</b>	<b>7,229</b>	<b>1,160</b>	<b>16.0%</b>
Depreciation	692	636	56	8.8%
Total Expenses	26,680	24,289	2,391	9.8%
<b>Income before the undernoted</b>	<b>7,697</b>	<b>6,593</b>	<b>1,104</b>	<b>16.7%</b>
Appreciation in common shares eligible for redemption	0	10,093	(10,093)	NA
Amortization of intangible assets	4,434	3,661	773	21.1%
Other expenses	0	884	(884)	NA
Gain on sale of short-term investments, marketable securities and other assets	(234)	(8)	(226)	NA
Interest expense (income)	(115)	(59)	(56)	94.9%
Foreign exchange loss	7	263	(256)	-97.3%
Income (loss) before income taxes	3,605	(8,241)	11,846	-143.7%
<b>Income taxes (recovery)</b>				
Current	1,157	710	447	63.0%
Future	(154)	(295)	141	-47.8%
	1,003	415	588	141.7%
<b>Net income (loss)</b>	<b>2,602</b>	<b>(8,656)</b>	<b>11,258</b>	<b>-130.1%</b>
<b>Adjusted net income</b>	<b>7,036</b>	<b>5,098</b>	<b>1,938</b>	<b>38.0%</b>
Weighted avg # of shares outstanding (000's)				
Basic	21,093	20,232		
Diluted	21,192	20,232		
<b>Net income (loss) per share</b>				
Basic	\$ 0.12	\$ (0.43)	\$ 0.55	NA
Diluted	\$ 0.12	\$ (0.43)	\$ 0.55	NA
<b>Adjusted EBITDA per share</b>				
Basic	\$ 0.40	\$ 0.36	\$ 0.04	11.3%
Diluted	\$ 0.40	\$ 0.36	\$ 0.04	10.8%
<b>Adjusted net income per share</b>				
Basic	\$ 0.33	\$ 0.25	\$ 0.08	32.4%
Diluted	\$ 0.33	\$ 0.25	\$ 0.08	31.8%

## *Comparison of the first quarter ended March 31, 2007 and 2006*

### Revenue:

Total revenue for the first quarter of 2007 ended March 31, 2007 was \$55.9 million, an increase of 9.1%, or \$4.7 million, compared to \$51.2 million for the comparable period in 2006. The increase was driven entirely by acquired growth as our organic growth or growth from our existing businesses was estimated to be negative 1% in the quarter.

Software license revenue for the quarter ended March 31, 2007 decreased by 15.1%, or \$1.1 million to \$6.0 million, from \$7.1 million for the same period in 2006. Professional services and other services revenue for the quarter ended March 31, 2007 increased by 4.1%, or \$0.5 million to \$13.2 million, from \$12.7 million for the same period in 2006. Hardware and other revenues for the quarter ended March 31, 2007 increased by 1.3%, or \$0.1 million to \$4.1 million, from \$4.0 million for the same period in 2006. Maintenance revenues for the quarter ended March 31, 2007 increased by 18.9%, or \$5.2 million to \$32.6 million, from \$27.4 million for the same period in 2006. The following table displays the breakdown of our revenue according to revenue type:

### Revenue by Type

	Three months ended Mar. 31,			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	(\$000)		(% of total revenue)	
Licenses	6,045	7,117	10.8%	13.9%
Professional services and other:				
Services	13,179	12,659	23.6%	24.7%
Hardware and other	4,091	4,039	7.3%	7.9%
Maintenance	32,578	27,405	58.3%	53.5%
	<b>55,893</b>	<b>51,220</b>	<b>100.0%</b>	<b>100.0%</b>

We aggregate our business into two distinct segments for financial reporting purposes: (i) the public sector segment, which includes businesses focused on government and government-related customers, and (ii) the private sector segment, which includes businesses focused on commercial customers.

The following table displays our revenue by reporting segment and the percentage change for the quarter ended March 31, 2007 to the quarter ended March 31, 2006:

	Three months ended		Period-Over-Period	
	Mar. 31,		Change	
	2007	2006	\$	%
	(\$000, except percentages)			
<b>Public Sector</b>				
Licenses	3,384	4,252	(868)	-20.4%
Professional services and other:				
Services	9,391	8,377	1,014	12.1%
Hardware and other	2,969	2,670	299	11.2%
Maintenance	19,023	15,014	4,009	26.7%
	34,767	30,313	4,454	14.7%
<b>Private Sector</b>				
Licenses	2,661	2,865	(204)	-7.1%
Professional services and other:				
Services	3,788	4,282	(494)	-11.5%
Hardware and other	1,122	1,369	(247)	-18.0%
Maintenance	13,555	12,391	1,164	9.4%
	21,126	20,907	219	1.0%

#### Public Sector:

For the quarter ended March 31, 2007, total revenue in the public sector segment increased 14.7%, or \$4.5 million, to \$34.8 million, compared to \$30.3 million for the quarter ended March 31, 2006. The increases were driven primarily by maintenance and services revenues with license revenues actually declining 20%. Revenue growth from acquired businesses was significant in Q1 2007 as we have completed 12 acquisitions since the beginning of 2006 in our public sector segment. It is estimated that these acquisitions contributed approximately \$4.8 million to our Q1 2007 revenues. Our public sector experienced a very slight decline in organic revenue growth of \$0.3 million. The relatively flat organic growth is a combination of growth at our Empahsys and Harris operating groups offset by negative growth at our Trapeze and Justice operating groups. The decline at Trapeze is the result of lower license and professional services revenues due to the timing of bookings in our mobile computing and European business areas as well as some implementation slow downs in North America. These declines were partially offset by continued growth in maintenance revenues from clients completing installations and moving on to maintenance. At our Justice operating group the decline in revenues from organic sources is more a function of an unusually strong first quarter in 2006.

#### Private Sector:

For the quarter ended March 31, 2007, total revenue in the private sector segment increased 1.0%, or \$0.2 million, to \$21.1 million, compared to \$20.9 million for the quarter ended March 31, 2006. Decreases occurred on all revenue lines with the exception of maintenance revenues which increased \$1.2 million or 9.4%. Revenue growth from acquired businesses was only \$0.5 million in Q1 2007, as we have only completed one acquisition since the beginning of 2006 in this segment. Growth from organic sources in the private sector was actually negative 1.6% or in dollar terms it decreased by \$0.3 million as compared to Q1 2006. We continue to feel the effects of a slow down in our construction and building product related verticals (on the license and services revenue lines) with our Friedman and Homebuilder operating groups experiencing negative organic growth of approximately \$0.5 million in aggregate. This decline was partially offset by growth in our Jonas operating group driven from our private club vertical.

Gross Profit by Source:

The following table displays the breakdown of our gross profit by revenue source as a percentage of total revenue:

	Three months ended Mar. 31,			
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
			(\$000)	
Gross profit licenses	91.9%	94.2%	5,555	6,707
Gross profit services & maintenance	60.8%	58.7%	27,830	23,528
Gross profit hardware & other	24.2%	16.0%	992	647
Gross profit on total revenue	61.5%	60.3%	34,377	30,882

Gross profit increased for the quarter ended March 31, 2007 to \$34.4 million, or 61.5% of total revenue, from \$30.9 million, or 60.3% of total revenue, for the quarter ended March 31, 2006. The increase in gross margin dollars is attributable to the overall increase in total revenue while the increase in gross margin percentage can be attributed mainly to the increase in our margins on services and maintenance. Our services and maintenance revenue margins increased to 60.8% from 58.7% mainly due to a shift in revenue mix toward maintenance revenues which tend to have higher margins. Our hardware and other revenue margins expanded as we realized stronger margins on our hardware and forms businesses in Q1 2007 versus Q1 2006. Our license revenue margins decreased as the percentage of total third party licenses increased, relative to total license sales. Management is uncertain as to whether we can maintain this aggregate gross profit level in future periods as gross profit is often influenced by variables outside of our control. For example, it is difficult for us to predict the percentage of our sales that will come from low margin revenue sources such as hardware and other versus higher margin revenues such as license revenue.

Operating Expenses:

The following table displays the breakdown of our operating expenses by category:

	Three months ended Mar. 31,		Period-Over-Period Change	
	<u>2007</u>	<u>2006</u>	\$	%
	(\$000, except percentages)			
Research and development	8,910	8,192	718	8.8%
Sales and marketing	7,042	6,408	634	9.9%
General and administration	10,036	9,053	983	10.9%
Depreciation	692	636	56	8.8%
	26,680	24,289	2,391	9.8%

Overall operating expenses for the quarter ended March 31, 2007 increased 9.8%, or \$2.4 million, to \$26.7 million, compared to \$24.3 million over the same period in 2006. As a percentage of total revenue, operating expenses remained relatively stable at 47.7% in Q1 2007 versus the quarter ended March 31, 2006. The growth in expenses is primarily due to the growth in the number of employees, as the vast majority of our operating expenses are headcount-related. Our average employee count associated with operating expenses grew 8% from approximately 649 in the quarter ended March 31, 2006 to approximately 700 in the quarter ended March 31, 2007. The increase in expenses was also due to the depreciation of the US dollar versus other currencies in which we transact business. While the Canadian dollar to US dollar was relatively unchanged year over year (the Canadian dollar actually decreased marginally), the Pound Sterling and Danish Krone strengthened 12% and 9% respectively, thus

increasing our cost on a US dollar basis. Finally general inflation and salary increases also contributed to the rise in expenses.

**Research and development** – Research and development expenses increased 8.8%, or \$0.7 million, to \$8.9 million for the quarter ended March 31, 2007 compared to \$8.2 million for the same period in 2006. As a percentage of total revenue, research and development expense decreased to 15.9% in 2007 from 16.0% in 2006. The absolute dollar increase from the prior year reflects the growth in personnel devoted to research and development (383 employees in 2007 as compared to 348 in 2006). This 10% increase in headcount was the key contributor to the growth in expenses.

We currently do not have any capitalized software development costs. All of our software development costs have been expensed as incurred unless they meet generally accepted accounting criteria for deferral and amortization. Software development costs incurred prior to the establishment of technological feasibility do not meet these criteria, and are expensed as incurred. Capitalized costs would be amortized over the estimated benefit period of the software developed. No costs were deferred in the first quarter of 2007 as most projects did not meet the criteria for deferral and, for those projects that met these criteria, the period between achieving technological feasibility and the completion of software development was minimal, and the associated costs immaterial.

**Sales and marketing** – Sales and marketing expenses increased 9.9%, or \$0.6 million to \$7.0 million, in the quarter ended March 31, 2007 compared to \$6.4 million for the same period in 2006. As a percentage of total revenue, sales and marketing expenses increased to 12.6% in the quarter ended March 31, 2007 from 12.5% for the same period in 2006. The increase in expenses during the quarter ended March 31, 2007 is partially attributable to our growth in headcount from both acquisitions and internal hiring. For the quarter ended March 31, 2007, we averaged 163 staff compared to 156 in the quarter ended March 31, 2006. The other key contributor to the growth in expenses was an increase in commission accruals due to the timing of bookings and other milestones that trigger the obligation on behalf of the Company.

**General and administration** – General and administration (“G&A”) expenses increased 10.9%, or \$1.0 million, to \$10.0 million in the quarter ended March 31, 2007 from \$9.1 million for the same period in 2006. As a percentage of total revenue, G&A expenses increased to 18.0% in 2007 from 17.7% in 2006. The dollar value increase was mainly attributable to increases in headcount in 2007 as compared to the same period in 2006. Average headcount in G&A grew 5% from 146 staff in Q1 2006 to 154 for Q1 2007. Further occupancy costs and other premises related expenses also increased in conjunction with our overall growth in headcount. Total headcount in our operations increased 9.5% from the first quarter of 2006, and we have added several new office locations with the 13 acquisitions we have closed since the beginning of 2006.

**Depreciation of Property and Equipment** – Depreciation of property and equipment for the quarter ended March 31, 2007 was \$0.7 million, compared to \$0.6 million for the same period in 2006, representing an increase of 8.8%. As a percentage of total revenue depreciation was 1.2% in Q1 2007 compared to 1.2% in Q1 2006. The overall dollar value increase in depreciation is consistent with our overall headcount growth.

Non-Operating Expenses:

The following table displays the breakdown of our non-operating expenses by category.

	Three months ended		Period-Over-Period	
	Mar. 31,		Change	
	2007	2006	\$	%
	(\$000, except percentages)			
Appreciation in common shares eligible for redemption	0	10,093	(10,093)	NA
Amortization of intangible assets	4,434	3,661	773	21.1%
Other expenses	0	884	(884)	NA
Gain on sale of short term investments, marketable securities and other assets	(234)	(8)	(226)	2825.0%
Interest expense (income)	(115)	(59)	(56)	94.9%
Foreign exchange loss	7	263	(256)	-97.3%
Income tax expense	1,003	415	588	141.7%
	5,095	15,249	(10,154)	-66.6%

**Appreciation in Common Shares eligible for redemption** – As highlighted in our prospectus dated May 11, 2006, with the completion of our initial public offering (“IPO”), the redemption rights on the common shares eligible for redemption were terminated, thus we incurred no charge in the first quarter of 2007 with respect to appreciation in common shares eligible for redemption. Further we do not expect to incur these charges on a go forward basis. The historical expense of \$10.1 million in Q1 2006 for appreciation in common shares eligible for redemption was a result of the rights of certain shareholders (contained in the shareholder agreements) to force the Company to redeem their common shares. In conjunction with pronouncements from the Canadian Institute of Chartered Accountants (“CICA”), we were required to classify all common shares subject to such shareholder agreements as a debt obligation of the Company. As such, each time our stock was re-valued, we were required to include a charge on our income statement for the related increase in this liability.

**Amortization of intangible assets** – Amortization of intangible assets was \$4.4 million for the quarter ended March 31, 2007 compared to \$3.7 million for the same period in 2006, representing an increase of 21.1%. This increase was attributable to the increase in our intangible asset balance (on a cost basis) over the twelve month period ended March 31, 2007 as a result of the significant number of acquisitions that we completed since the beginning of 2006.

**Other expenses** – Other expenses in the quarter ended March 31, 2007 was nil compared to other expenses of \$0.9 for the same period in 2006. As we have stated in the past, now that we have accrued all expenses with respect to the IPO and redeemed the previously outstanding phantom shares, we expect very little if any “Other expenses” in our income statements for future periods. The \$0.9 million expense in Q1 2006 is the combination of: (i) \$0.4 million expense, due to the increase in liability associated with our phantom shares from the increase in our share price (see discussion above in the appreciation of common shares eligible for redemption section) and (ii) \$0.5 million in one time costs associated with the IPO.

**Gain on sale of short-term investments, marketable securities and other assets** - Gains for the quarter ended March 31, 2007 were \$0.2 million compared to \$8,000 in Q1 2006. The gains recorded in Q1 2007 are a result of liquidating a portion of our investment in certain marketable securities. We expect to realize gains or losses on an infrequent basis as our strategic goal is to buy VMS businesses in their entirety and hold them indefinitely. However, occasionally we will acquire an ownership interest that is less than 100% of a publicly traded VMS business and subsequently sell these shares if we cannot acquire a controlling stake, generating either gains or losses. As of March 31, 2007, we had three investments that would have the potential to create such gains or losses. In the future, we may liquidate

these holdings if we feel we have a better use for the capital, if our outlook for the business changes, or if the market price exceeds our expectations of value.

**Interest (income)** – Interest income was \$0.12 million for the quarter ended March 31, 2007 compared to \$0.06 million in the previous year, representing an increase of 94.9%. The increase was primarily a result of higher average cash balances and higher interest rates. We maintain excess cash in various bank accounts or low yield, low risk, short term debt instruments. We have in place a \$20 million operating line of credit that can be used for either acquisitions or general working capital purposes. As of March 31, 2007, we had borrowings of \$2.4 million against this line. Occasionally we issue letters of credit, which reduce our borrowing capacity under this facility. As of March 31, 2007, we had letters of credit outstanding of \$4.6 million. Aside from the aforementioned obligations and computer equipment related leases we had no other significant interest bearing debt outstanding at March 31, 2007.

**Foreign exchange loss (gain)** – Most of our businesses are organized geographically, so that most of our expenses are incurred in the same currency as our revenue, which mitigates some of our exposure to currency fluctuations. For the quarter ended March 31, 2007, our foreign exchange loss was \$7,000 compared to a \$0.3 million loss for Q1 2006. The change in the foreign exchange impact was the result of significant fluctuations in exchange rates between the US dollar (our reporting currency) and the major currencies in which we deal (Canadian Dollar, British Pound, Danish Krone, Euro, and Australian Dollar).

**Income taxes** – We operate globally and we calculate our tax provision in each of the jurisdictions in which we conduct business. Our tax rate is, therefore, affected by the realization and anticipated relative profitability of our operations in those various jurisdictions, as well as different tax rates that apply and our ability to utilize tax losses. For the quarter ended March 31, 2007, the provision for income taxes was \$1.0 million, compared to \$0.4 million in 2006. The increase in the tax provision for the first quarter of 2007 compared to 2006 is mainly attributable to an increase in taxable income.

#### Net income (loss)

Net income for the quarter ended March 31, 2007 was \$2.6 million compared to net loss of \$8.7 million for the same period in 2006. On a per share basis this translated into a net income per diluted share of \$0.12 versus a net loss per diluted share of \$0.43 in 2006. Net income was positively impacted by the growth in our operations and operating income, however, the majority of the change is attributable to no longer incurring the costs associated with our common shares eligible for redemption.

#### Cash and Cash Equivalents

Our cash and cash equivalents position decreased to \$9.8 million at March 31, 2007, from \$25.8 million at December 31, 2006 representing a decrease of 62%. See “Liquidity and Capital Resources”.

#### Adjusted EBITDA:

For the quarter ended March 31, 2007, Adjusted EBITDA increased by \$1.2 million to \$8.4 million compared to \$7.2 million in 2006, representing an increase of 16.0%. Adjusted EBITDA margin was 15.0% in the first quarter of 2007, compared to 14.1% of total revenue for the same period in 2006. See “Non-GAAP Measures” for a description of Adjusted EBITDA and Adjusted EBITDA margin.

The following table reconciles Adjusted EBITDA to net income:

	Three months ended	
	Mar. 31,	
	<u>2007</u>	<u>2006</u>
	(\$000, except percentages)	
<b>Total revenue</b>	<u>55,893</u>	<u>51,220</u>
<b>Net income (loss)</b>	2,602	(8,656)
<b>Add back:</b>		
Income tax expense	1,003	415
Foreign exchange loss	7	263
Interest expense (income)	(115)	(59)
Gain on sale of short-term investments, marketable securities and other assets	(234)	(8)
Other expenses	0	884
Appreciation in common shares eligible for redemption	0	10,093
Amortization of intangible assets	4,434	3,661
Depreciation	692	636
Adjusted EBITDA	8,389	7,229
Adjusted EBITDA margin	15.0%	14.1%

Adjusted net income:

For the three months ended March 31, 2007, Adjusted net income increased by \$1.9 million to \$7.0 million compared to \$5.1 million for the same period in 2006, representing an increase of 38.0%. Adjusted net income margin was 12.6% in first quarter of 2007, compared to 10.0% of total revenue for the same period in 2006. See “Non-GAAP Measures” for a description of Adjusted net income and Adjusted net income margin.

The following table reconciles Adjusted net income to net income:

	Three months ended	
	Mar. 31,	
	<u>2007</u>	<u>2006</u>
	(\$000, except percentages)	
<b>Total revenue</b>	<u>55,893</u>	<u>51,220</u>
<b>Net income (loss)</b>	2,602	(8,656)
<b>Add back:</b>		
Appreciation in common shares eligible for redemption	0	10,093
Amortization of intangible assets	4,434	3,661
Adjusted net income	7,036	5,098
Adjusted net income margin	12.6%	10.0%

## Quarterly Results

	Quarter Ended							
	June 30, 2005	Sep. 30, 2005	Dec. 31, 2005	Mar. 31, 2006	June 30, 2006	Sep. 30, 2006	Dec. 31, 2006	Mar. 31, 2007
	(\$000, except per share amounts)							
Revenue	40,700	42,648	44,551	51,220	52,211	53,809	53,519	55,893
Net Income (loss)	(3,456)	2,075	815	(8,656)	1,301	2,287	3,831	2,602
Net Income (loss) per share								
Basic	(0.17)	0.10	0.04	(0.43)	0.06	0.11	0.18	0.12
Diluted	(0.17)	0.10	0.04	(0.43)	0.06	0.11	0.18	0.12

We do not generally experience significant seasonality in our operating results from quarter to quarter. However, our quarterly results may fluctuate as a result of the various acquisitions which may be completed by the Company in any given quarter. We may experience variations in our net income on a quarterly basis depending upon the timing of certain one-time expenditures or gains such as: loss (gain) on the sale of short-term investments, marketable securities and other assets, and appreciation in Common Shares eligible for redemption. As noted above, we do not expect to incur any further charges for appreciation in Common Shares eligible for redemption.

## Liquidity and Capital Resources

At March 31, 2007, cash and cash equivalents totalled \$9.8 million, compared to \$25.8 million at December 31, 2006.

Total assets increased \$19.8 million, from \$186.6 million at December 31, 2006 to \$206.4 million at March 31, 2007. While most asset categories increased, the majority of the increase can be explained by increases in: a) intangible assets and goodwill of \$17.8 million due to the 3 acquisitions completed in the first quarter of 2007, b) accounts receivable of \$10.0 million which is driven by growth in the business and increases in receivables due to acquisitions, and c) prepaid expenses and other current assets of \$5.7 million the vast majority of which was acquired in the PG Govern acquisition. These increases were partially offset by the decrease in cash and restricted cash of \$16.9 million (as explained below).

Current liabilities increased by \$17.7 million from \$99.1 million as of December 31, 2006, to \$116.8 million at March 31, 2007. From an individual category perspective the increases were driven by: a) deferred revenue up \$13.2 million, consistent with the growth in our maintenance revenues and the acquired deferred revenue, b) acquisition holdback payments up \$3.9 million, representing the holdbacks on Q1 2007 acquisitions offset by holdbacks paid in the quarter, c) income taxes payable up \$2.9 million from taxes accrued in Q1 2007 and acquired taxes payable from PG Govern. These were offset by a decrease in our accounts payable and accrued liabilities of \$4.8 million, driven by the payout of the 2006 bonus in Q1 2007 offset by increases from acquired accounts payable and accrued liabilities.

### Net Changes in Cash Flow

	Three months ended March 31, 2007 (in millions of \$)
Net cash used in operating activities	\$(1.6)
Net cash used in financing activities	(0.6)
Net cash used in investing activities	(13.8)
Effect of exchange rate changes on cash and cash equivalents	0.0
<b>Net decrease in cash and cash equivalents</b>	<b>(\$16.0)</b>

The net cash flow from operating activities was \$(1.6) million for the three months ended March 31, 2007. In the first quarter of 2007, we generated free cash flow profits of approximately \$7.3 million, however, this was offset by a net increase in our working capital of \$8.9 million most of which can be attributed to the payment of the 2006 employee bonuses.

The net cash used in financing activities in the first quarter of 2007 was due to the payment of our annual dividend of \$0.15 per share for cash usage of \$3.2 million, the issuance of shareholder loans of \$0.4 million, and the repayment of long term debt of \$0.2 million. This was offset by borrowings on our line of credit generating cash of \$2.4 million and the repayment of shareholder loans of \$0.8 million.

The net cash used in investing activities was due primarily to acquisitions completed in the quarter for an aggregate of \$14.6 million (including payments for holdbacks on prior acquisitions). We also invested about \$0.5 million in property and equipment. These amounts were partially offset by cash generated from the sale of marketable securities and the application of our restricted cash to fund acquisitions.

We believe we have more than sufficient cash and cash equivalents to continue to operate for the foreseeable future. Generally our VMS businesses operate with negative working capital as a result of the collection of maintenance payments and other revenues in advance of the performance of the related services. As such, management anticipates that it can continue to grow the business organically without any additional funding, however, if we continue to acquire VMS businesses we may need additional external funding depending on the size of the acquisitions and the timing of when we acquire them.

### **Capital Resources and Commitments**

We obtained a credit facility in 2004 that is collateralized by substantially all of our assets including the assets of certain of our Canadian and US subsidiaries. Certain other subsidiaries also guarantee this facility. In the fourth quarter of 2006, we amended the agreement to increase the maximum borrowing under the facility to \$20 million from \$10 million. The facility is available for our working capital needs and other general corporate purposes and for the needs of our subsidiaries. As of March 31, 2007, we had drawn \$2.4 million on this facility.

Commitments include operating leases for office equipment and facilities, letters of credit, bank guarantees, and performance bonds that are routinely issued on our behalf by financial institutions in connection with facility leases and contracts with public sector customers. Also, occasionally we structure some of our acquisitions with “earn out” payments based on the future performance of the acquired VMS business. Aside from the aforementioned, we do not have any other business arrangements, derivative financial instruments, or any equity interests in unconsolidated companies (aside from our shareholdings in publicly traded companies included in our short term investments) that would have a significant effect on our assets and liabilities as at March 31, 2007.

### **Foreign Currency Exposure**

We operate internationally and have foreign currency risks related to our revenue and operating expenses denominated in currencies other than the US dollar. Consequently, we believe movements in the foreign currencies in which we transact could significantly affect future net earnings. Currently, we do not use hedging techniques to mitigate such currency risks. We cannot predict the effect of foreign exchange losses in the future; however, if significant foreign exchange losses are experienced, they could have a material adverse effect on our business, results of operations, and financial condition.

### **Off-Balance Sheet Arrangements**

As a general practice, we have not entered into off-balance sheet financing arrangements. Except for operating leases, bank guarantees, letters of credit and other low probability and/or unmeasurable

contingent liabilities (not accrued in accordance with Canadian GAAP), all of our commitments are reflected on our balance sheet.

### **Transactions with Related Parties**

Aside from our Key Employee Loan Program (“KELP”), we had no material related party transactions during the first quarter of 2007. The outstanding balance of loans granted under the KELP as of March 31, 2007 was \$1.8 million as compared to \$2.1 million as of December 31, 2006.

### **Proposed Transactions**

We seek potential acquisition targets on an ongoing basis and may complete several acquisitions in any given fiscal year.

### **Critical Accounting Estimates**

Details of the critical accounting estimates are available in the management’s discussion and analysis for the year ended December 31, 2006 (as contained in the Company’s annual report for 2006).

### **Changes in Accounting Policies**

On January 1, 2007, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants Handbook (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*. The prospective adoption of these new standards resulted in changes in the accounting and presentation for financial instruments as well as the recognition of certain transition adjustments that have been recorded in opening accumulated other comprehensive income. As required by the implementation of these new standards, the comparative Interim Consolidated financial Statements have not been restated.

### **Share Capital**

As at May 9, 2006, there were 21,191,530 total shares outstanding comprised of 16,903,530 common shares and 4,288,000 class A non-voting shares.

### **Outlook**

Although we anticipate that our annual revenue and Adjusted EBITDA will vary from year to year, management’s objective is to grow each of our annual revenue and Adjusted EBITDA at an average rate, in the five year period commencing January 1, 2006 and ending December 31, 2010, of approximately 20% per annum. While the mix of organic growth and growth from acquisitions will change from year to year, we anticipate that approximately two thirds of our growth will be attributable to acquisitions over this five year period (vs. the approximate 50/50 split estimated at the time of the IPO). Further a shift toward more acquired growth could lead to slightly increased Adjusted EBITDA margins. The foregoing objectives are based on various assumptions of management, including, without limitation, that (i) there will be a sufficient number of reasonably-priced acquisitions available, (ii) we will continue to declare modest dividends, and (iii) we will not issue any additional equity. See “Forward-Looking Statements” and “Risks and Uncertainties”.

### **Risks and Uncertainties**

The risks and uncertainties affecting the Company are described in the Company’s Annual Information Form for the year ended December 31, 2006. Additional risks and uncertainties not presently known to us or that we currently consider immaterial also may impair our business and operations and

cause the price of the common shares to decline. If any of the noted risks actually occur, our business may be harmed and the financial condition and results of operation may suffer significantly. In that event, the trading price of the common shares could decline, and shareholders may lose all or part of their investment.

## **Controls and Procedures**

### ***Evaluation of disclosure controls and procedures:***

Management is responsible for establishing and maintaining disclosure controls and procedures as defined under Multilateral Instrument 52-109. At March 31, 2007, the President and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective and that material information relating to the Company, including its subsidiaries, was made known to them and was recorded, processed, summarized and reported within the time periods specified under applicable securities legislation.

### ***Internal controls over financial reporting:***

Management is responsible for the design of its internal controls over financial reporting (“ICOFR”) as defined under Multilateral Instrument 52-109. At December 31, 2006, the President and Chief Financial Officer concluded that the design of these internal controls and procedures was effective in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with Canadian GAAP. The President and CFO have evaluated whether there were changes to internal controls over financial reporting during the interim period ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting. No such changes were identified.

## **NOTICE TO READER OF THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

The consolidated financial statements of Constellation Software Inc. (the “Company”) and the accompanying consolidated balance sheet and consolidated statement of deficit as at March 31, 2007, the interim consolidated statement of operations and consolidated statement of cash flows for the three month period ended March 31, 2007, are the responsibility of the Company’s management. These consolidated financial statements have been reviewed on behalf of the shareholders by the independent external auditors of the Company, KPMG LLP.

The interim consolidated financial statements have been prepared by management and include the selection of appropriate accounting principles, judgments and estimates necessary to prepare these financial statements in accordance with accounting principles generally accepted in Canada.

Mark Leonard  
President  
Toronto, Canada  
May 9, 2007

Barry Symons  
Chief Financial Officer  
Toronto, Canada  
May 9, 2007

# CONSTELLATION SOFTWARE INC.

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

	March 31, 2007	December 31, 2006
	(Unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 9,808	\$ 25,807
Restricted cash	—	858
Short-term investments and marketable securities - available for sale (note 3)	3,587	3,320
Accounts receivable	42,673	32,655
Work in progress	13,168	13,189
Inventory	1,594	1,434
Prepaid expenses and other current assets	10,521	4,787
Future income taxes	1,914	1,153
	<u>83,265</u>	<u>83,203</u>
Property and equipment	8,855	6,385
Future income taxes (note 9)	2,600	3,429
Other long-term assets	895	585
Goodwill	28,752	26,886
Intangible assets (note 5)	81,991	66,085
	<u>\$ 206,358</u>	<u>\$ 186,573</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Bank indebtedness (note 6)	\$ 2,422	\$ —
Accounts payable and accrued liabilities	32,262	37,024
Acquisition holdback payments	8,716	4,797
Deferred revenue	69,405	56,190
Income taxes payable	3,965	1,063
	<u>116,770</u>	<u>99,074</u>
Future income taxes (note 9)	8,985	8,048
Acquisition holdback payments	231	231
Other long-term liabilities	956	404
Shareholders' equity:		
Capital stock (note 7)	99,283	99,283
Shareholder loans (note 8)	(1,790)	(2,135)
Accumulated other comprehensive income (note 13)	(2,320)	(3,152)
Deficit	(15,757)	(15,180)
	<u>79,416</u>	<u>78,816</u>
Subsequent event (note 15)		
	<u>\$ 206,358</u>	<u>\$ 186,573</u>

See accompanying notes to interim consolidated financial statements.

# CONSTELLATION SOFTWARE INC.

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

	Three months ended March 31,	
	2007	2006
	(Unaudited)	
Revenue	\$ 55,893	\$ 51,220
Cost of revenue	21,516	20,338
	34,377	30,882
Research and development	8,910	8,192
Sales and marketing	7,042	6,408
General and administration	10,036	9,053
Depreciation	692	636
	26,680	24,289
Income before the undernoted	7,697	6,593
Appreciation in common shares eligible for redemption (note 7(d))	–	10,093
Amortization of intangible assets	4,434	3,661
Other expenses	–	884
Gain on sale of short-term investments, marketable securities and other assets	(234)	(8)
Interest expense (income)	(115)	(59)
Foreign exchange loss	7	263
Income (loss) before income taxes	3,605	(8,241)
Income taxes (recovery) (note 9):		
Current	1,157	710
Future	(154)	(295)
	1,003	415
<b>Net income (loss)</b>	<b>\$ 2,602</b>	<b>\$ (8,656)</b>
Income (loss) per share (note 10):		
Basic	\$ 0.12	\$ (0.43)
Diluted	0.12	(0.43)
Weighted average number of shares outstanding:		
Outstanding (in thousands) (note 10):		
Basic	21,093	20,232
Diluted	21,192	20,232
Outstanding at the end of the period	21,192	21,036

See accompanying notes to interim consolidated financial statements.

# CONSTELLATION SOFTWARE INC.

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

	Three months ended March 31,	
	2007	2006
	(Unaudited)	
Deficit, beginning of period	\$ (15,180)	\$ (12,623)
Net income (loss)	2,602	(8,656)
Dividends (note 7(c))	(3,179)	(1,381)
Refundable taxes and other	—	60
<b>Deficit, end of period</b>	<b>\$ (15,757)</b>	<b>\$ (22,600)</b>

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

	Three months ended March 31,	
	2007	2006
	(Unaudited)	
Net income (loss)	\$ 2,602	\$ (8,656)
Other comprehensive income (note 13)	832	—
<b>Comprehensive income (loss)</b>	<b>\$ 3,434</b>	<b>\$ (8,656)</b>

See accompanying notes to interim consolidated financial statements.

# CONSTELLATION SOFTWARE INC.

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

	Three months ended March 31,	
	2007	2006
	(Unaudited)	
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 2,602	\$ (8,656)
Adjustments to reconcile net income to net cash flows from operations:		
Depreciation	692	636
Amortization of intangible assets	4,434	3,661
Loss on appreciation of common shares eligible for redemption	—	10,093
Deferred compensation	—	400
Future income taxes	(154)	(295)
Gain on sale of short-term investments, marketable securities and other assets	(234)	(8)
Unrealized exchange loss (gain)	(16)	243
Change in non-cash operating working capital (note 12)	(8,922)	(6,971)
Cash flows from (used) in operating activities	(1,598)	(897)
<b>Cash flows from financing activities:</b>		
Increase (decrease) in long-term liabilities	(230)	4
Increase in bank indebtedness	2,422	1,100
Dividends	(3,179)	(1,381)
Distributions to common shares eligible for redemption	—	(471)
Issue of common shares eligible for redemption, net of shareholder loans	—	2,899
Redemption of common shares eligible for redemption	—	(14)
Issuance of shareholder loans	(447)	—
Repayment of shareholder loans	792	1,910
Return of capital	—	(637)
Cash flows from (used in) financing activities	(642)	3,410
<b>Cash flows from investing activities:</b>		
Acquisition of businesses, net of cash acquired (note 4)	(14,617)	(3,433)
Reduction (increase) to short-term investments, marketable securities and other assets	801	(1,156)
Decrease in restricted cash	858	—
Decrease (increase) in other assets	(310)	19
Property and equipment purchased	(517)	(687)
Cash flows from (used) in investing activities	(13,785)	(5,257)
Effect of currency translation adjustment on cash and cash equivalents	26	(193)
Increase (decrease) in cash and cash equivalents	(15,999)	(2,937)
Cash and cash equivalents, beginning of period	25,807	18,285
Cash and cash equivalents, end of period	\$ 9,808	\$ 15,348

See accompanying notes to interim consolidated financial statements.

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

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## 1. Basis of presentation:

The accompanying unaudited condensed interim consolidated financial statements (the "Interim Financial Statements") include the accounts of the Company and its subsidiaries, all of which are wholly owned. All significant inter-company transactions and balances have been eliminated. During the three months ended March 31, 2007, the Company completed certain acquisitions as described in note 4 to the Interim Financial Statements. The results of operations of these acquired companies have been included in these Interim Financial Statements from the date of acquisition.

These Interim Financial Statements are expressed in U.S. dollars and are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and reflect all adjustments consisting only of normal adjustments, which in the opinion of management, are necessary for a fair presentation of the results of the interim periods presented. These Interim Financial Statements are based upon accounting policies and methods of their application that are consistent with those used and described in the Company's annual consolidated financial statements. The Interim Financial Statements do not include all of the financial statement disclosures included in the annual financial statements prepared in accordance with Canadian GAAP and therefore, should be read in conjunction with the consolidated financial statements and notes included in the 2006 Annual Report.

## 2. Changes in accounting policies:

On January 1, 2007, the Company adopted the recommendations of The Canadian Institute of Chartered Accountants' Handbook ("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 apply to fiscal years beginning on or after October 1, 2006 and 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 revenues, expenses, gains and losses that are recognized in comprehensive income, but excluded from net income, in conformity with generally accepted accounting principles.

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

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## 2. Changes in accounting policies (continued):

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. All financial instruments are recorded on the consolidated balance sheet at fair value. After initial recognition, the financial instruments should be measured at their fair values, except for held-to maturity investments, loans and receivables and other financial liabilities, which should be measured at amortized cost. The effective interest related to the financial liabilities and the gain or loss arising from a change in the fair value of a financial asset or financial liability classified as held for trading is included in net income for the period in which it arises. If a financial asset is classified as available-for-sale, the gain or loss should be recognized in other comprehensive income until the financial asset is derecognized and any cumulative gain or loss is then recognized in net income.

As a result of the implementation of this standard, the Company has classified cash and cash equivalents 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 receivable. 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 to fair value resulted in an increase in short-term investments and marketable securities of \$1,154 and a corresponding increase in other comprehensive income.

## 3. Short-term investments and marketable securities:

At March 31, 2007, the Company held investments in two U.K. listed public companies and a U.S. listed public company, all of which develop and sell software solutions.

	March 31, 2007		December 31, 2006	
	Cost	Market value	Cost	Market value
Common shares	\$ 2,755	\$ 3,587	\$ 3,320	\$ 4,474

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# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

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## 4. 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 \$4,280. The acquisition has been accounted for by the purchase method with the results of operations included in the Interim Financial Statements from the date of acquisition. The following table summarizes the preliminary estimated fair value of the assets acquired and liabilities assumed at the date of acquisition:

---

Assets acquired:	
Current assets	\$ 13,484
Property and equipment	2,628
Goodwill	1,866
Technology assets	16,694
Customer assets	2,373
	<hr/>
	37,045
Liabilities assumed:	
Current liabilities	17,727
Future income tax liability	1,144
Other long-term liabilities	782
	<hr/>
	19,653
	<hr/>
Total purchase price consideration	<hr/>
	\$ 17,392

Goodwill has been allocated to the Public segment.

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

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## 4. Business acquisitions (continued):

### (b) Other acquisitions:

During the three months ended March 31, 2007, the Company made two other acquisitions for aggregate net initial cash consideration of \$705 plus holdbacks of \$150. The holdbacks are payable over a one-year period subject to no claims under the representations and warranties of the agreement. The acquisitions have been accounted for using the purchase method with the results of operations included in these Interim 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	\$ 79
Property and equipment	17
Technology assets	1,062
Customer assets	208
	<hr/> 1,366
Liabilities assumed:	
Current liabilities	511
	<hr/>
Total purchase price consideration	<hr/> \$ 855 <hr/>

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

## 4. Business acquisitions (continued):

2006:

Other acquisitions:

During the three months ended March 31, 2006, the Company made three acquisitions for aggregate net initial cash consideration of \$3,775 plus holdbacks of \$1,000. The holdbacks are payable over a one-year period subject to no claims under the representations and warranties of the agreement. (Holdbacks of \$200 and \$800 were paid in 2006 and during the three months ended March 31, 2007, respectively.) The acquisitions have been accounted for using the purchase method with the results of operations included in these Interim Financial Statements from the date of each acquisition. The following table summarizes the aggregate estimated fair value of the assets acquired and liabilities assumed at the date of each acquisition:

Assets acquired:			
Current assets		\$	926
Property and equipment			150
Technology assets			5,793
Customer assets			96
			<u>6,965</u>
Liabilities assumed:			
Current liabilities			2,190
			<u>\$ 4,775</u>

## 5. Intangible assets:

			March 31, 2007	December 31, 2006
	Cost	Accumulated amortization	Net book value	Net book value
Technology assets	\$ 106,749	\$ 36,001	\$ 70,748	\$ 56,763
Non-compete agreements	1,680	1,427	253	506
Customer assets	16,552	5,610	10,942	8,765
Trademarks	133	85	48	51
	<u>\$ 125,114</u>	<u>\$ 43,123</u>	<u>\$ 81,991</u>	<u>\$ 66,085</u>

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

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## 5. Intangible assets (continued):

Amortization expense related to intangible assets for the three months ended March 31, 2007 was \$4,434 (March 31, 2006 - \$3,661).

## 6. Credit facilities:

The Company has an operating line-of-credit with a major bank in the amount of \$20,000. The line-of-credit bears a variable interest rate and is payable in 24 equal monthly instalments following the date of termination. It is secured by a general security agreement and is subject to various standard debt covenants. As at March 31, 2007, \$2,422 (December 31, 2006 - nil) had been drawn from this credit facility, and letters of credit totalling \$4,576 (December 31, 2006 - 250) were issued which limit the borrowing capacity on a dollar-for-dollar basis.

## 7. 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.

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

	Common shares		Class A non-voting		Total	
	Number	Amount	Number	Amount	Number	Amount
Balance, December 31, 2006	16,903,530	\$ 84,762	4,288,000	\$ 14,521	21,191,530	\$ 99,283
Issuance of shares	-	-	-	-	-	-
Repurchased for cancellation	-	-	-	-	-	-
Balance, March 31, 2007	16,903,530	\$ 84,762	4,288,000	\$ 14,521	21,191,530	\$ 99,283

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

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## 7. Capital stock (continued):

(c) During the three months ended March 31, 2007, a distribution to shareholders of U.S. \$0.15 per share (2006 - \$0.12) was declared and paid by the Company.

(d) Share structure prior to the Initial Public Offering ("IPO"):

At March 31, 2006, prior to the IPO in May 2006, the Company had issued and outstanding 1,732,102 Series 1 and 2,491,856 Series 3 common shares eligible for redemption (all of which were converted to common shares as part of the IPO). The holders of these shares had the right to sell their shares back to the Company on an annual basis, subject to certain restrictions, at their fair value as determined by the Company's Board of Directors. Accordingly, these shares were presented as a liability on the Company's consolidated balance sheets. For the three months ended March 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 IPO and are no longer presented as a liability on the Company's consolidated balance sheets. Accordingly, the Company will no longer record an appreciation charge in future periods.

## 8. Shareholder loans:

Share purchase loans receivable of \$1,790 (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.

## 9. Income taxes:

The Company operates in various tax jurisdictions, and accordingly, the Company's income is subject to varying rates of tax. Losses incurred in one jurisdiction cannot be used to offset income taxes payable in another. The Company's ability to use income tax losses and future income tax deductions is dependent upon the profitable operations of the Company in the tax jurisdictions in which such losses or deductions arise. As of March 31, 2007, the Company had total net deferred tax assets of \$4,514 (2006 - \$4,582) and total deferred tax liabilities of \$8,985 (2006 - \$8,048).

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

## 9. Income taxes (continued):

In assessing the valuation 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.

## 10. Net income (loss) per share:

	Three months ended March 31,	
	2007	2006
Numerator:		
Net income (loss)	\$ 2,602	\$ (8,656)
Denominator:		
Weighted average number of shares:		
Basic	21,093	20,232
Effect of dilutive securities:		
Shares secured by shareholder loans	99	—
Diluted	21,192	20,232
Net income (loss) per share:		
Basic	0.12	(0.43)
Diluted	0.12	(0.43)

At March 31, 2006, common shares secured by shareholder loans totalled 511. 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 Interim Consolidated Financial Statements (continued)  
(In thousands of U.S. dollars, except per share amounts)

Three months ended March 31, 2007 and 2006  
(Unaudited)

## 11. Segmented information:

The Company has a number of operating subsidiaries, which have been aggregated into two reportable segments in accordance with Section 1701 of the CICA Handbook. 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.

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

### (a) Reportable segments:

Three months ended March 31, 2007	Public Sector	Private Sector	Other	Total
Revenue	\$ 34,767	\$ 21,126	\$ –	\$ 55,893
Cost of revenue	14,504	7,012	–	21,516
	20,263	14,114	–	34,377
Research and development	5,580	3,330	–	8,910
Sales and marketing	4,450	2,592	–	7,042
General and administration	6,055	3,981	–	10,036
Depreciation	460	232	–	692
	16,545	10,135	–	26,680
Income before the undernoted	3,718	3,979	–	7,697
Amortization of intangible assets	2,766	1,668	–	4,434
Interest income	(79)	(25)	(11)	(115)
Gain on sale of short-term investments, marketable securities and other assets	–	–	(234)	(234)
Foreign exchange loss (gain)	(151)	56	102	7
Inter-company expenses (income)	432	438	(870)	–
Income before income taxes	750	1,842	1,013	3,605
Income taxes (recovery):				
Current	558	628	(29)	1,157
Future	44	(198)	–	(154)
	602	430	(29)	1,003
Net income	\$ 148	\$ 1,412	\$ 1,042	\$ 2,602
Other selected information:				
Property and equipment purchased	\$ 341	\$ 147	\$ 29	\$ 517

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

## 11. Segmented information (continued):

Three months ended March 31, 2006	Public Sector	Private Sector	Other	Total
Revenue	\$ 30,313	\$ 20,907	\$ —	\$ 51,220
Cost of revenue	12,850	7,488	—	20,338
	17,463	13,419	—	30,882
Research and development	5,126	3,066	—	8,192
Sales and marketing	3,484	2,924	—	6,408
General and administration	5,451	3,602	—	9,053
Depreciation	327	309	—	636
	14,388	9,901	—	24,289
Income before the undernoted	3,075	3,518	—	6,593
Appreciation in common shares eligible for redemption	—	—	10,093	10,093
Amortization of intangible assets	2,026	1,635	—	3,661
Other expenses	—	426	458	884
Interest income	(20)	(19)	(20)	(59)
Gain on sale of short-term investments, marketable securities and other assets	—	—	(8)	(8)
Foreign exchange loss	230	20	13	263
Inter-company expenses (income)	313	167	(480)	—
Income (loss) before income taxes	526	1,289	(10,056)	(8,241)
Income taxes (recovery):				
Current	267	543	(100)	710
Future	(35)	(260)	—	(295)
	232	283	(100)	415
Net income (loss)	\$ 294	\$ 1,006	\$ (9,956)	\$ (8,656)
Other selected information:				
Property and equipment purchased	\$ 250	\$ 373	\$ 64	\$ 687

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

## 11. 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.

	Three months ended March 31,			
	2007		2006	
Canada	\$ 5,356	10%	\$ 5,495	11%
United States	42,155	75%	37,710	73%
Other	8,382	15%	8,015	16%
Total	\$ 55,893	100%	\$ 51,220	100%

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

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

	Three months ended March 31,	
	2007	2006
Increase in accounts receivable	\$ (1,865)	\$ (1,342)
Decrease (increase) in work in progress	21	(1,394)
Decrease (increase) in inventory	(160)	(534)
Decrease (increase) in prepaid expenses and other current assets	(324)	(275)
Increase (decrease) in accounts payable, accrued liabilities, and income taxes payable	(12,313)	(9,112)
Increase in deferred revenue	5,719	5,686
	\$ (8,922)	\$ (6,971)

The above table excludes initial non-cash working capital acquired via acquisition. For non-cash working capital related to acquisitions, the table only reflects changes between the acquisition date and the amounts at March 31, 2007 and 2006.

# CONSTELLATION SOFTWARE INC.

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

Three months ended March 31, 2007 and 2006  
(Unaudited)

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## 13. Accumulated other comprehensive income:

Accumulated other comprehensive income 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	1,154
Net unrealized gain on available-for-sale financial assets	(322)
<u>Balance, March 31, 2007</u>	<u>\$ (2,320)</u>

## 14. Comparative figures:

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

## 15. Subsequent event:

On April 16, 2007, the Company purchased Grampian Software Holdings Limited, incorporated under the laws of Scotland, for cash consideration of \$1,291 (£650 GBP) on closing plus a holdback of \$695 (£350 GBP).