

# CONSTELLATION SOFTWARE INC.

## MANAGEMENT'S DISCUSSION AND ANALYSIS ("MD&A")

The following discussion and analysis should be read in conjunction with the unaudited consolidated interim financial statements for the three and nine month periods ended September 30, 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".

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, November 7, 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 is 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 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 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" and products sold on a subscription basis. 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 and by product.

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		Period-Over-Period		Nine months ended		Period-Over-Period	
	Sep. 30,		Change		Sep. 30,		Change	
	2007	2006	\$	%	2007	2006	\$	%
<b>Revenue</b>	<b>60,574</b>	<b>53,809</b>	<b>6,765</b>	<b>12.6%</b>	<b>176,955</b>	<b>157,240</b>	<b>19,715</b>	<b>12.5%</b>
Cost of Revenue	22,368	21,060	1,308	6.2%	66,904	61,674	5,230	8.5%
Gross Profit	38,206	32,749	5,457	16.7%	110,051	95,566	14,485	15.2%
Expenses								
Research and development	9,127	8,489	638	7.5%	26,899	24,877	2,022	8.1%
Sales and marketing	6,727	6,488	239	3.7%	21,093	19,634	1,459	7.4%
General and administration	10,994	9,848	1,146	11.6%	31,440	28,603	2,837	9.9%
Total Expenses (pre amortization)	26,848	24,825	2,023	8.1%	79,432	73,114	6,318	8.6%
<b>Adjusted EBITDA</b>	<b>11,358</b>	<b>7,924</b>	<b>3,434</b>	<b>43.3%</b>	<b>30,619</b>	<b>22,452</b>	<b>8,167</b>	<b>36.4%</b>
Depreciation	863	793	70	8.8%	2,411	2,156	255	11.8%
Total Expenses	27,711	25,618	2,093	8.2%	81,843	75,270	6,573	8.7%
<b>Income before the undernoted</b>	<b>10,495</b>	<b>7,131</b>	<b>3,364</b>	<b>47.2%</b>	<b>28,208</b>	<b>20,296</b>	<b>7,912</b>	<b>39.0%</b>
Appreciation in common shares eligible for redemption	0	0	0	NA	0	10,093	(10,093)	-100.0%
Amortization of intangible assets	5,302	4,489	813	18.1%	14,945	11,947	2,998	25.1%
Other expenses	70	0	70	NA	70	1,970	(1,900)	-96.4%
Gain on sale of short-term investments, marketable securities and other assets	0	0	0	NA	(1,354)	(8)	(1,346)	16825.0%
Interest income	(249)	(3)	(246)	8200.0%	(398)	(87)	(311)	357.5%
Foreign exchange loss (gain)	690	(185)	875	NA	2,042	(111)	2,153	NA
Income (loss) before income taxes	4,682	2,830	1,852	65.4%	12,903	(3,508)	16,411	NA
<b>Income taxes (recovery)</b>								
Current	1,471	(184)	1,655	NA	4,050	1,816	2,234	123.0%
Future	(115)	727	(842)	NA	(617)	(256)	(361)	141.0%
	1,356	543	813	149.7%	3,433	1,560	1,873	120.1%
<b>Net income (loss)</b>	<b>3,326</b>	<b>2,287</b>	<b>1,039</b>	<b>45.4%</b>	<b>9,470</b>	<b>(5,068)</b>	<b>14,538</b>	<b>NA</b>
<b>Adjusted net income</b>	<b>8,628</b>	<b>6,776</b>	<b>1,852</b>	<b>27.3%</b>	<b>24,415</b>	<b>16,972</b>	<b>7,443</b>	<b>43.9%</b>
Weighted avg # of shares outstanding (000's)								
Basic	21,119	21,039			21,107	20,726		
Diluted	21,192	21,192			21,192	21,021		
<b>Net income (loss) per share</b>								
Basic	\$ 0.16	\$ 0.11	\$ 0.05	45.5%	\$ 0.45	\$ (0.24)	\$ 0.69	NA
Diluted	\$ 0.16	\$ 0.11	\$ 0.05	45.5%	\$ 0.45	\$ (0.24)	\$ 0.69	NA
<b>Adjusted EBITDA per share</b>								
Basic	\$ 0.54	\$ 0.38	\$ 0.16	42.1%	\$ 1.45	\$ 1.08	\$ 0.37	34.3%
Diluted	\$ 0.54	\$ 0.37	\$ 0.17	45.9%	\$ 1.44	\$ 1.07	\$ 0.37	34.6%
<b>Adjusted net income per share</b>								
Basic	\$ 0.41	\$ 0.32	\$ 0.09	28.1%	\$ 1.16	\$ 0.82	\$ 0.34	41.5%
Diluted	\$ 0.41	\$ 0.32	\$ 0.09	28.1%	\$ 1.15	\$ 0.81	\$ 0.34	42.0%

### *Comparison of the third quarter and nine months ended September 30, 2007 and 2006*

#### Revenue:

Total revenue for the third quarter of 2007 ended September 30, was \$60.6 million, an increase of 12.6%, or \$6.8 million, compared to \$53.8 million for the comparable period in 2006. For the first nine months of 2007 total revenues were \$177.0 million, an increase of 12.5%, or \$19.7 million, compared to \$157.2 million for the comparable period in 2006. The increase for both the third quarter and nine month periods compared to the same periods in the prior year, were almost entirely attributable to growth from acquisitions, as organic growth from our existing businesses was estimated at approximately 1% for the third quarter and 0% for the first nine months. The remaining 12% growth for the third quarter and 13% for the first nine months is due to acquisitions completed since the beginning of 2006.

Software license revenue for the quarter ended September 30, 2007 increased by 3.1%, or \$0.2 million to \$7.1 million, from \$6.9 million for the same period in 2006. During the nine months ended

September 30, 2007, license revenue decreased by 4.1% or \$0.9 million to \$20.4 million, from \$21.3 million for the same period in 2006. Professional services and other services revenue for the quarter ended September 30, 2007 increased by 6.2%, or \$0.8 million to \$14.4 million, from \$13.6 million for the same period in 2006. During the nine months ended September 30, 2007, services revenue increased by 6.1% or \$2.4 million to \$42.2 million, from \$39.8 million for the same period in 2006. Hardware and other revenue for the quarter ended September 30, 2007 decreased by 26.8%, or \$1.1 million to \$3.0 million, from \$4.1 million for the same period in 2006. During the nine months ended September 30, 2007, hardware and other revenue decreased by 2.5% or \$0.3 million to \$11.1 million, from \$11.4 million for the same period in 2006. Maintenance revenues for the quarter ended September 30, 2007 increased by 23.3%, or \$6.8 million to \$36.1 million, from \$29.3 million for the same period in 2006. During the nine months ended September 30, 2007, maintenance revenue increased by 21.7% or \$18.4 million to \$103.2 million, from \$84.8 million for the same period in 2006. The following table displays the breakdown of our revenue according to revenue type:

	Three months ended Sep. 30,				Nine months ended Sep. 30,			
	2007 (\$000)	2006	2007 (% of total revenue)	2006	2007 (\$000)	2006	2007 (% of total revenue)	2006
Licenses	7,079	6,867	11.7%	12.8%	20,417	21,298	11.5%	13.5%
Professional services and other:								
Services	14,395	13,553	23.8%	25.2%	42,211	39,775	23.9%	25.3%
Hardware and other	3,006	4,109	5.0%	7.6%	11,089	11,369	6.3%	7.2%
Maintenance	36,094	29,280	59.6%	54.4%	103,238	84,798	58.3%	53.9%
	60,574	53,809	100.0%	100.0%	176,955	157,240	100.0%	100.0%

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 three and nine months ended September 30, 2007 compared to the same periods in 2006:

	Three months ended Sep. 30,		Period-Over-Period Change		Nine months ended Sep. 30,		Period-Over-Period Change	
	2007 (\$000, except percentages)	2006	\$	%	2007 (\$000, except percentages)	2006	\$	%
<b>Public Sector</b>								
Licenses	4,643	4,509	134	3.0%	12,583	13,261	(678)	-5.1%
Professional services and other:								
Services	10,924	9,941	983	9.9%	31,482	27,503	3,979	14.5%
Hardware and other	2,063	2,749	(686)	-25.0%	7,950	7,597	353	4.6%
Maintenance	21,831	16,474	5,357	32.5%	61,552	46,895	14,657	31.3%
	39,461	33,673	5,788	17.2%	113,567	95,256	18,311	19.2%
<b>Private Sector</b>								
Licenses	2,436	2,358	78	3.3%	7,833	8,036	(203)	-2.5%
Professional services and other:								
Services	3,471	3,613	(142)	-3.9%	10,729	12,273	(1,544)	-12.6%
Hardware and other	944	1,359	(415)	-30.5%	3,140	3,773	(633)	-16.8%
Maintenance	14,262	12,806	1,456	11.4%	41,686	37,902	3,784	10.0%
	21,113	20,136	977	4.9%	63,388	61,984	1,404	2.3%

## Public Sector

For the quarter ended September 30, 2007, total revenue in the public sector segment increased 17.2%, or \$5.8 million, to \$39.5 million, compared to \$33.7 million for the quarter ended September 30, 2006. For the nine months ended September 30, 2007 total revenue increased by 19.2% or \$18.3 million, to \$113.6 million, compared to \$95.3 million for the comparable period in 2006. The increases for both the three and nine month periods were significant in maintenance and professional services revenue. License fees increased by 3.0% in the third quarter but decreased by 5.1% for the first nine months over the comparable periods in 2006. Revenue growth from acquired businesses was significant for both the three and nine month periods as we completed 15 acquisitions since the beginning of 2006 in our public

sector segment. It is estimated that these acquisitions contributed approximately \$5.5 million to our Q3 2007 revenues and \$17.4 million to our revenues in the nine months ended September 30, 2007. The remaining \$0.3 million of revenue growth for Q3 and \$0.9 million of revenue growth for the first nine months of 2006 in this sector was generated from organic sources. The organic growth was driven by the following:

- **Trapeze operating group** (decrease of approximately \$0.7 million for Q3 and \$1.4 million for the first nine months). Trapeze experienced declines in license and services revenues in both the quarter and year to date results, primarily due to the timing of bookings in our mobile computing and European businesses, offset in part by strong growth in maintenance revenues in both the quarter and year to date results of 2007.
- **Harris operating group** (increase of approximately \$0.4 million for Q3 and \$1.9 million for the first nine months). Harris' organic growth continues to be driven by upgrades under our software for life program and continued sales to new name customers.
- **Emphasys operating group** (increase of approximately \$0.5 million for Q3 and \$0.6 million for the first nine months). The Emphasys organic growth primarily results from continued sales back to our existing clients and sales to new name customers.

#### **Private Sector:**

For the quarter ended September 30, 2007, total revenue in the private sector segment increased 4.9%, or \$1.0 million, to \$21.1 million, compared to \$20.1 million for the quarter ended September 30, 2006. For the nine months ended September 30, 2007, total revenue increased by 2.3% or \$1.4 million, to \$63.4 million, compared to \$62.0 million for the comparable period in 2006. Strong growth in maintenance revenue was offset by a decline in both professional services and hardware revenue. Revenue growth from acquired businesses was not as strong as in the public sector as we have only completed three acquisitions since the beginning of 2006 in our private sector segment. It is estimated that these acquisitions contributed approximately \$0.9 million of revenue growth to our Q3 2007 revenues and \$2.0 million of revenue growth to our revenues in the nine months ended September 30, 2007. Revenues increased organically by \$0.1 million in Q3 2007 and declined by \$0.6 million in the first nine months of 2007. The organic revenue decline was driven by the following:

- **Jonas operating group** (increase of approximately \$0.8 million for Q3 and \$1.7 million for the first nine months of 2007). The Jonas organic growth in 2007 continues to be driven by maintenance revenues as we continue to capture both market share and customer share in the private club and construction verticals.
- **Homebuilder operating group** (decrease of approximately \$0.5 million for Q3 and \$1.4 million for the first nine months of 2007). Our Homebuilder operating group continues to feel the effects of the housing slowdown in the U.S. The decline was most apparent in licenses and professional services as many of our clients and prospective clients have delayed purchasing decisions.
- **Friedman operating group** (decrease of approximately \$0.1 million for Q3 and \$0.8 million for the first nine months of 2007). Friedman (like Homebuilders) is feeling the effects of the building products and housing starts slow down. The decline at Friedman is the result of lower services as our maintenance revenues have increased period over period.

Gross Profit by Source:

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

	Three months ended Sep. 30,				Nine months ended Sep. 30,			
	2007	2006	2007	2006	2007	2006	2007	2006
	(\$000)				(\$000)			
Gross profit licenses	89.7%	91.8%	6,351	6,305	90.9%	92.7%	18,567	19,741
Gross profit services & maintenance	62.1%	60.2%	31,377	25,795	61.5%	59.7%	89,397	74,409
Gross profit hardware & other	15.9%	15.8%	478	649	18.8%	12.5%	2,087	1,416
Gross profit on total revenue	63.1%	60.9%	38,206	32,749	62.2%	60.8%	110,051	95,566

Gross profit increased for the quarter ended September 30, 2007 to \$38.2 million, or 63.1% of total revenue, from \$32.7 million, or 60.9% of total revenue, for the quarter ended September 30, 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 to the revenue mix as we experienced a greater increase in our higher margin maintenance revenue in the quarter. For the first nine months of 2007, our gross profit increased to \$110.1 million or 62.2% of total revenue, from \$95.6 million or 60.8% of total revenue for the comparable period in 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 to the revenue mix as we experienced a greater increase in our higher margin maintenance revenue in the first nine months. Our licenses, services and maintenance revenue margins experienced minimal change vs. 2006 in both the three and nine month periods. Our hardware and other revenue margins continued to strengthen in the nine months ended September 30, 2007 as we realized stronger margins in our hardware and forms businesses. Management believes there could be significant fluctuations in gross profit margins for future periods if we experience a significant shift in our revenue mix.

Operating Expenses:

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

	Three months ended		Period-Over-Period		Nine months ended		Period-Over-Period	
	2007	2006	\$	%	2007	2006	\$	%
	(\$000, except percentages)				(\$000, except percentages)			
Research and development	9,127	8,489	638	7.5%	26,899	24,877	2,022	8.1%
Sales and marketing	6,727	6,488	239	3.7%	21,093	19,634	1,459	7.4%
General and administration	10,994	9,848	1,146	11.6%	31,440	28,603	2,837	9.9%
Depreciation	863	793	70	8.8%	2,411	2,156	255	11.8%
	27,711	25,618	2,093	8.2%	81,843	75,270	6,573	8.7%

Overall operating expenses for the quarter ended September 30, 2007 increased 8.2%, or \$2.1 million, to \$27.7 million, compared to \$25.6 million over the same period in 2006. As a percentage of total revenue, operating expenses decreased from 47.6% in the quarter ended September 30, 2006 to 45.7% in the quarter ended September 30, 2007. During the nine months ended September 30, 2007, operating expenses increased 8.7%, or \$6.6 million, to \$81.8 million, compared to \$75.3 million over the same period in 2006. As a percentage of total revenue, operating expenses decreased from 47.9% in the nine months ended September 30, 2006 to 46.3% in the nine months ended September 30, 2007. 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 10.3% from 679 in the quarter ended September 30, 2006 to 749 in the quarter ended September 30, 2007. During the nine months ended September 30, 2007, headcount associated with operating expenses was up 9.4% to an average headcount of 727 compared to an average of 664 during the same period in 2006. Offsetting the increase associated with higher headcount, was a lower bonus accrual and tight expense controls throughout the group. The lower bonus accrual was driven by our lower period over period revenue growth rates in 2007 vs. 2006. Strengthening of the Canadian dollar vs. the US dollar contributes to the growth in operating expenses (as we estimate that approximately one

third of our total expenses, including costs of goods sold, are originated in Canadian dollars). The average exchange rate for the Canadian dollar changed significantly in the periods being measured, as evidenced by a 7% increase in Q3 2007 vs. Q3 2006 and a 3% increase for the comparable nine month periods.

**Research and development** – Research and development expenses increased 7.5%, or \$0.6 million, to \$9.1 million for the quarter ended September 30, 2007 compared to \$8.5 million for the same period in 2006. As a percentage of total revenue, research and development expense decreased to 15.1% in Q3 2007 from 15.8% in Q3 2006. During the nine months ended September 30, 2007, research and development expense increased 8.1%, or \$2.0 million, to \$26.9 million, compared to \$24.9 million over the same period in 2006. As a percentage of total revenue, research and development decreased from 15.8% in the nine months ended September 30, 2006 to 15.2% in the nine months ended September 30, 2007. The absolute dollar increase from the same three and nine month periods of the prior year reflects the growth in personnel devoted to research and development (419 in Q3 2007 vs. 380 in Q3 2006 and 404 during the nine months ended September 30, 2007 vs. 364 for the same period in 2006).

We currently do not have any capitalized software development costs. All of our software development costs are expensed as incurred unless they meet Canadian 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 third quarter or first nine months 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 3.7%, or \$0.2 million to \$6.7 million, in the quarter ended September 30, 2007 compared to \$6.5 million for the same period in 2006. As a percentage of total revenue, sales and marketing expenses decreased to 11.1% in the quarter ended September 30, 2007 from 12.1% for the same period in 2006. For the nine months ended September 30, 2007, sales and marketing expenses increased 7.4%, or \$1.5 million, to \$21.1 million, compared to \$19.6 million over the same period in 2006. As a percentage of total revenue, sales and marketing expenses decreased from 12.5% in the nine months ended September 30, 2006 to 11.9% in the nine months ended September 30, 2007. The increase in expenses during the quarter and nine months ended September 30, 2007 is largely attributable to our growth in headcount from both acquisitions and internal hiring. For Q3 2007, we averaged 172 staff compared to 153 in the same period in 2006 (166 vs. 154 for the comparable nine month periods).

**General and administration** – General and administration (“G&A”) expenses increased 11.6%, or \$1.1 million, to \$11.0 million in the quarter ended September 30, 2007 from \$9.8 million for the same period in 2006. As a percentage of total revenue, G&A expenses decreased to 18.1% in Q3 2007 from 18.3% in Q3 2006. For the nine months ended September 30, 2007, G&A increased 9.9%, or \$2.8 million, to \$31.4 million, compared to \$28.6 million over the same period in 2006. As a percentage of total revenue, G&A decreased from 18.2% in the nine months ended September 30, 2006 to 17.8% in the nine months ended September 30, 2007. The dollar value increase was mainly attributable to increases in headcount in 2007 as compared to the same period in 2006. Average headcount for G&A employees grew 8.2% from 146 staff in Q3 2006 to 158 for Q3 2007. For the nine months ended September 30, 2007, average headcount grew 6.8% to 156 staff from 146 staff over the same period in 2006.

**Depreciation of property and equipment** – Depreciation of property and equipment for the quarter and nine months ended September 30, 2007 did not change materially. As a percentage of total revenue, depreciation was 1.4% in Q3 2007 compared to 1.5% in Q3 2006. For the nine month periods the percentages were 1.4% in 2007 vs. 1.4% in 2006.

### Non-Operating Expenses:

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

	Three months ended		Period-Over-Period		Nine months ended		Period-Over-Period	
	Sep. 30,		Change		Sep. 30,		Change	
	2007	2006	\$	%	2007	2006	\$	%
	(\$000, except percentages)				(\$000, except percentages)			
Appreciation in common shares eligible for redemption	0	0	0	NA	0	10,093	(10,093)	NA
Amortization of intangible assets	5,302	4,489	813	18.1%	14,945	11,947	2,998	25.1%
Other expenses	70	0	70	NA	70	1,970	(1,900)	NA
Gain on sale of short term investments, marketable securities and other assets	0	0	0	NA	(1,354)	(8)	(1,346)	16825.0%
Interest income	(249)	(3)	(246)	8200.0%	(398)	(87)	(311)	357.5%
Foreign exchange loss (gain)	690	(185)	875	-473.0%	2,042	(111)	2,153	-1939.6%
Income tax expense	1,356	543	813	149.7%	3,433	1,560	1,873	120.1%
	7,169	4,844	2,325	48.0%	18,738	25,364	(6,626)	-26.1%

**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 third quarter or first nine months of 2007 with respect to appreciation in common shares eligible for redemption. Further we do not expect to incur these charges in the future. 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 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 \$5.3 million for the quarter ended September 30, 2007 compared to \$4.5 million for the same period in 2006, representing an increase of 18.1%. For the nine months ended September 30, 2007, amortization of intangibles increased 25.1%, to \$14.9 million, compared to \$11.9 million over the same period in 2006. Both the three and nine month increases are attributable to the increases in our intangible asset balance (on a cost basis) over the twelve month period ended September 30, 2007 as a result of the acquisitions that we completed during this period.

**Other expenses** – Other expenses in the quarter ended September 30, 2007 were \$70,000 compared to other expense of \$0 for the same period in 2006. The current quarter expense included \$0.3 million relating to the terminated secondary offering of common shares. This amount was offset by a \$230,000 gain on the sale of a patent. As we have stated in the past, now that we have accrued all expenses with respect to the IPO and redeemed the phantom shares, we expect very little if any “Other expenses” in our statements of operations for future periods. On a nine month basis, the \$2.0 million in other expenses for 2006 relates to the one time costs associated with the IPO (\$1.6 million) and our phantom share plan that existed prior to our IPO (\$0.4 million).

**Gain on sale of short-term investments, marketable securities and other assets** - Gains for the quarter and nine months ended September 30, 2007 were \$0 million and \$1.4 million compared to a gain of \$0 million for Q3 2006 and a gain of \$0 million for the first nine months of 2006. The gains for the first nine months of 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 September 30, 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 businesses changes, or if the market price exceeds our expectations of value.

**Interest income** – Net interest income was \$249,000 for the quarter ended September 30, 2007 compared to \$3,000 for the same period in the previous year. For the first nine months of the year net interest income was \$398,000 compared to \$87,000 in the comparable period for 2006, representing an increase of 358%. At the end of the second quarter, we completed an investment in VCG Inc. which will generate approximately \$0.1 million per quarter in interest income. Our excess cash balances (to the extent that we have excess cash) will also generate interest income. These sources of interest income will be offset by periodic borrowings on our line of credit to fund acquisitions. As a result, we expect interest income / expense to fluctuate significantly in the future depending upon the timing of acquisitions and the amount we borrow against our line of credit to complete them.

**Foreign exchange loss (gain)** – Most of our businesses are organized geographically so that many of our expenses are incurred in the same currency as our revenues, which mitigates some of our exposure to currency fluctuations. For the quarter ended September 30, 2007, our foreign exchange loss was \$0.7 million compared to a gain of \$0.2 million for Q3 2006. For the nine months ended September 30, 2007, the loss was \$2.0 million vs. a gain of \$0.1 million during the same period in 2006. The significant foreign exchange loss in Q3 2007 is mainly attributable to a 7% increase in the quarter-end closing rate for the Canadian dollar vs. the US dollar at September 30, 2007 vs. June 30, 2007. As we generally run our business with negative working capital and we had a reasonable amount of our net liabilities denominated in Canadian dollars, when we re-valued Canadian dollar net liabilities to US dollars (our functional currency) at quarter end, we had to record a significant foreign exchange loss in the quarter.

**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 September 30, 2007, the provision for income taxes was \$1.4 million, compared to \$0.5 million in 2006. For the nine months ended September 30, 2007, the provision for income taxes was \$3.4 million, compared to \$1.6 million in 2006. The increase in the tax provision for both the third quarter and first nine months of 2007 compared to 2006 is mainly attributable to an increase in taxable income.

#### Net Income (Loss)

Net income for the quarter ended September 30, 2007 was \$3.3 million compared to net income of \$2.3 million for the same period in 2006. On a per share basis this translated into a net income per diluted share of \$0.16 in Q3 2007 vs. a net income per diluted share of \$0.11 in Q3 2006. Net income in Q3 2007 was positively impacted by the growth in our operations and operating income, offset by the increase in amortization of intangibles and the foreign exchange loss. For the first nine months of 2007, net income was \$9.5 million or \$0.45 per diluted share compared to a loss of \$5.1 million or \$0.24 per share in the first nine months of 2006. The net loss for the first nine months of 2006 was a result of the charges for appreciation in common shares eligible for redemption.

#### Adjusted EBITDA:

For Q3 2007, Adjusted EBITDA increased by \$3.4 million to \$11.4 million compared to \$7.9 million in Q3 2006, representing an increase of 43.3%. Adjusted EBITDA margin was 18.8% in the third quarter of 2007, compared to 14.7% of total revenue for the same period in 2006. For the first nine months of 2007, Adjusted EBITDA increased by \$8.2 million to \$30.6 million compared to \$22.5 million during the same period in 2006, representing an increase of 36.4%. Adjusted EBITDA margin was 17.3% in the first nine months of 2007, compared to 14.3% 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 (loss):

	Three months ended Sep. 30,		Nine months ended Sep. 30,	
	2007	2006	2007	2006
	(\$000, except percentages)		(\$000, except percentages)	
<b>Total revenue</b>	<u>60,574</u>	<u>53,809</u>	<u>176,955</u>	<u>157,240</u>
<b>Net income (loss)</b>	3,326	2,287	9,470	(5,068)
<b>Add back:</b>				
Income tax expense	1,356	543	3,433	1,560
Foreign exchange loss (gain)	690	(185)	2,042	(111)
Interest income	(249)	(3)	(398)	(87)
Gain on sale of short-term investments, marketable securities and other assets	0	0	(1,354)	(8)
Other expenses	70	0	70	1,970
Appreciation in common shares eligible for redemption	0	0	0	10,093
Amortization of intangible assets	5,302	4,489	14,945	11,947
Depreciation	863	793	2,411	2,156
Adjusted EBITDA	11,358	7,924	30,619	22,452
Adjusted EBITDA margin	18.8%	14.7%	17.3%	14.3%

Adjusted net income:

For Q3 2007, Adjusted net income increased by \$1.9 million to \$8.6 million compared to \$6.8 million in 2006, representing an increase of 27.3%. Adjusted net income margin was 14.2% in the third quarter of 2007, compared to 12.6% of total revenue for the same period in 2006. For the first nine months of 2007, Adjusted net income increased by \$7.4 million to \$24.4 million compared to \$17.0 million during the same period in 2006, representing an increase of 43.9%. Adjusted net income margin was 13.8% in the first nine months of 2007, compared to 10.8% 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 Sep. 30,		Nine months ended Sep. 30,	
	2007	2006	2007	2006
	(\$000, except percentages)		(\$000, except percentages)	
<b>Total revenue</b>	<u>60,574</u>	<u>53,809</u>	<u>176,955</u>	<u>157,240</u>
<b>Net income (loss)</b>	3,326	2,287	9,470	(5,068)
<b>Add back:</b>				
Appreciation in common shares eligible for redemption	0	0	0	10,093
Amortization of intangible assets	5,302	4,489	14,945	11,947
Adjusted net income	8,628	6,776	24,415	16,972
Adjusted net income margin	14.2%	12.6%	13.8%	10.8%

## Quarterly Results

	Quarter Ended							
	Dec. 31, 2005	Mar. 31, 2006	June 30, 2006	Sep. 30, 2006	Dec. 31, 2006	Mar. 31, 2007	Jun. 30, 2007	Sep. 30, 2007
	(\$000, except per share amounts)							
Revenue	44,551	51,220	52,211	53,809	53,519	55,893	60,487	60,574
Net Income (loss)	815	(8,656)	1,301	2,287	3,831	2,602	3,542	3,326
Net Income (loss) per share								
Basic	0.04	(0.43)	0.06	0.11	0.18	0.12	0.17	0.16
Diluted	0.04	(0.43)	0.06	0.11	0.18	0.12	0.17	0.16

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 appreciation in Common Shares eligible for redemption charges on a go forward basis.

## Liquidity and Capital Resources

Our cash and cash equivalents position (net of borrowings on our line of credit) at September 30, 2007 decreased to \$17.3 million, from \$25.8 million at December 31, 2006 representing a decrease of 26%.

Total assets increased \$24.2 million, from \$186.6 million at December 31, 2006 to \$210.7 million at September 30, 2007. While most asset categories increased, the majority of the increase can be explained by increases in: a) intangible assets and goodwill of \$15.1 million due to the 8 acquisitions completed in the first nine months of 2007, b) accounts receivable of \$7.0 million which is driven by growth in the business and increases in receivables due to acquisitions, c) prepaid expenses and other current assets of \$5.0 million the majority of which was acquired in the PG Govern acquisition, d) other long-term assets of \$1.5 million, the majority of which was also acquired in the PG Govern acquisition, and e) the \$4 million investment in VCG Inc. These increases were partially offset by the decrease in cash of \$6.8 million (as explained below) and restricted cash of \$0.9 million.

Current liabilities increased by \$15.3 million from \$99.1 million as of December 31, 2006, to \$114.4 million at September 30, 2007. From an individual category perspective the increases were driven by: a) deferred revenue up \$10.4 million, consistent with the growth in our maintenance revenues and the acquired deferred revenue, b) acquisition holdback payments up \$1.6 million, representing the holdbacks on 2007 acquisitions offset by holdbacks paid in the first nine months of 2007, c) income taxes payable up \$4.0 million from taxes accrued in the first nine months of 2007, and d) borrowings on our line of credit which are up \$1.7 million since December 31, 2006. These were offset by a decrease in our accounts payable and accrued liabilities of \$2.5 million, driven by the payout of the 2006 employee bonuses in the first half of 2007, offset by increases from acquired accounts payable and accrued liabilities and additional bonus accruals for the 2007 fiscal year.

**Net Changes in Cash Flow****Nine months ended  
September 30, 2007**  
(in millions of \$)

Net cash provided by operating activities	\$20.1
Net cash used in financing activities	(1.1)
Net cash used in investing activities	(24.1)
Effect of exchange rate changes on cash and cash equivalents	(1.7)
<b>Net decrease in cash and cash equivalents</b>	<b>(\$6.8)</b>

The net cash flow from operating activities was \$20.1 million for the nine months ended September 30, 2007. In the first nine months of 2007, we generated free cash flow profits of approximately \$26.9 million, however, this was offset by a net increase in our working capital of \$6.8 million most of which can be attributed to the payment of the 2006 employee bonuses. The bonuses were paid in the first quarter however the funds withheld to buy shares were only forwarded to the purchasing agent as the shares were purchased. As at September 30, 2007, all shares required for the 2006 bonus plan have been purchased.

The net cash used in financing activities in the first nine months of 2007 was due to the payment of our annual dividend of \$0.15 per share for cash usage of \$3.2 million, and the issuance of shareholder loans of \$0.4 million. Borrowings on our line of credit generated cash of \$1.7 million and the repayment of shareholder loans a further \$0.7 million.

The net cash used in investing activities was due primarily to acquisitions completed in the first nine months of 2007 for an aggregate of \$25.9 million (including payments for holdbacks relating to prior acquisitions and the investment in VCG Inc.). We also invested approximately \$1.8 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. If we continue to acquire VMS businesses we may need additional external funding depending upon the size and timing of the acquisitions.

**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 U.S. 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 September 30, 2007, we had drawn \$1.7 million on this facility and issued a letter of credit for C\$5.0 million which limits our borrowing capacity dollar for dollar.

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 and our investment in VCG Inc.) that would have a significant effect on our assets and liabilities as at September 30, 2007.

## **Foreign Currency Exposure**

We operate internationally and have foreign currency risks related to our revenue, operating expenses, assets and liabilities denominated in currencies other than the U.S. 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 un-measurable 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 third quarter of 2007. The outstanding balance of loans granted under the KELP as of September 30, 2007 was \$1.9 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 and Recent Accounting Pronouncements**

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.

On January 1, 2007, the Company also adopted CICA Handbook Section 1506, “Accounting changes”, which requires that voluntary changes in accounting policy are made only if the changes result in financial statements that provide more reliable and more relevant information. It also requires prior period errors to be corrected retrospectively. The adoption of this standard did not impact the Company’s consolidated financial statements.

In December 2006, the CICA issued Section 3862, “Financial Instruments, Disclosures”, and Section 3863, “Financial Instruments, Presentation”. These standards provide additional guidance on disclosing risks related to recognized and unrecognized financial instruments and how those risks are managed. The standards are effective for 2008. The Company is currently evaluating the impact of adopting these standards on its consolidated financial statements.

## **Share Capital**

As at November 7, 2007, 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. 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 September 30, 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 September 30, 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 September 30, 2007, the interim consolidated statement of operations and consolidated statement of cash flows for the three and nine month periods ended September 30, 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  
November 7, 2007

John Billowits  
Chief Financial Officer  
Toronto, Canada  
November 7, 2007

# CONSTELLATION SOFTWARE INC.

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

	September 30, 2007	December 31, 2006
	(Unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 18,977	\$ 25,807
Restricted cash	—	858
Short-term investments and marketable securities - available for sale (note 3)	1,366	3,320
Accounts receivable	39,623	32,655
Work in progress	13,398	13,189
Inventory	2,061	1,434
Prepaid expenses and other current assets	9,813	4,787
Future income taxes (note 10)	911	1,153
	<u>86,149</u>	<u>83,203</u>
Property and equipment	7,079	6,385
Future income taxes (note 10)	3,320	3,429
Notes receivable (note 15)	3,461	—
Share purchase warrants (note 15)	571	—
Other long-term assets	2,092	585
Goodwill	30,130	26,886
Intangible assets (note 5)	77,937	66,085
	<u>\$ 210,739</u>	<u>\$ 186,573</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Bank indebtedness (note 6)	\$ 1,712	\$ —
Accounts payable and accrued liabilities	34,540	37,024
Acquisition holdback payments	6,378	4,797
Deferred revenue	66,618	56,190
Income taxes payable	5,109	1,063
Future income taxes (note 10)	37	—
	<u>114,394</u>	<u>99,074</u>
Future income taxes (note 10)	9,501	8,048
Acquisition holdback payments	231	231
Other long-term liabilities	1,287	404
Shareholders' equity:		
Capital stock (note 7)	99,283	99,283
Shareholder loans (note 8)	(1,887)	(2,135)
Accumulated other comprehensive loss (note 14)	(3,181)	(3,152)
Deficit	(8,889)	(15,180)
	<u>85,326</u>	<u>78,816</u>
Subsequent event (note 16)		
	<u>\$ 210,739</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 September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
	(Unaudited)		(Unaudited)	
Revenue	\$ 60,574	\$ 53,809	\$ 176,955	\$ 157,240
Cost of revenue	22,368	21,060	66,904	61,674
	38,206	32,749	110,051	95,566
Research and development	9,127	8,489	26,899	24,877
Sales and marketing	6,727	6,488	21,093	19,634
General and administration	10,994	9,848	31,440	28,603
Depreciation	863	793	2,411	2,156
	27,711	25,618	81,843	75,270
Income before the undernoted	10,495	7,131	28,208	20,296
Appreciation in common shares eligible for redemption (note 7(d))	—	—	—	10,093
Amortization of intangible assets	5,302	4,489	14,945	11,947
Other expenses	70	—	70	1,970
Gain on sale of short-term investments, marketable securities and other assets	—	—	(1,354)	(8)
Interest income	(249)	(3)	(398)	(87)
Foreign exchange loss (gain)	690	(185)	2,042	(111)
Income (loss) before income taxes	4,682	2,830	12,903	(3,508)
Income taxes (recovery) (note 10):				
Current	1,471	(184)	4,050	1,816
Future	(115)	727	(617)	(256)
	1,356	543	3,433	1,560
Net income (loss)	\$ 3,326	\$ 2,287	\$ 9,470	\$ (5,068)
Income (loss) per share (note 11):				
Basic	\$ 0.16	\$ 0.11	\$ 0.45	\$ (0.24)
Diluted	0.16	0.11	0.45	(0.24)
Weighted average number of shares outstanding (in thousands) (note 11):				
Basic	21,119	21,039	21,107	20,726
Diluted	21,192	21,192	21,192	20,726
Outstanding at the end of the period	21,192	21,192	21,192	21,192

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 September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
	(Unaudited)		(Unaudited)	
Deficit, beginning of period	\$ (12,215)	\$ (21,299)	\$ (15,180)	\$ (12,623)
Net income (loss)	3,326	2,287	9,470	(5,068)
Dividends (note 7(c))	–	–	(3,179)	(1,381)
Refundable taxes and other	–	–	–	60
<b>Deficit, end of period</b>	<b>\$ (8,889)</b>	<b>\$ (19,012)</b>	<b>\$ (8,889)</b>	<b>\$ (19,012)</b>

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

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
	(Unaudited)		(Unaudited)	
Net income (loss)	\$ 3,326	\$ 2,287	\$ 9,470	\$ (5,068)
Other comprehensive income (loss)	(116)	–	(30)	–
<b>Comprehensive income (loss)</b>	<b>\$ 3,210</b>	<b>\$ 2,287</b>	<b>\$ 9,440</b>	<b>\$ (5,068)</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 September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
	(Unaudited)		(Unaudited)	
Cash flows from operating activities:				
Net income (loss)	\$ 3,326	\$ 2,287	\$ 9,470	\$ (5,068)
Adjustments to reconcile net income to net cash flows from operations:				
Depreciation	863	793	2,411	2,156
Amortization of intangible assets	5,302	4,489	14,945	11,947
Loss on common shares eligible for redemption	—	—	—	10,093
Deferred compensation	—	—	—	400
Future income taxes	(115)	727	(617)	(256)
Gain on sale of short-term investments, marketable securities and other assets	—	—	(1,354)	(8)
Unrealized exchange loss (gain)	713	(241)	1,996	(480)
Change in non-cash operating working capital (note 13)	5,439	3,546	(6,760)	(3,276)
Cash flows from operating activities	15,528	11,601	20,091	15,508
Cash flows from financing activities:				
Increase (decrease) in long-term liabilities	310	(819)	101	(802)
Increase in bank indebtedness	(1,881)	(2,600)	1,712	—
Dividends	—	—	(3,179)	(1,381)
Distributions to common shares eligible for redemption	—	—	—	(471)
Issue of common shares eligible for redemption, net of shareholder loans	—	—	—	3,805
Redemption of common shares eligible for redemption	—	—	—	(20)
Issuance of shareholder loans	—	—	(447)	—
Repayment of shareholder loans	(65)	262	695	2,474
Repurchase of phantom shares (note 9)	—	—	—	(1,657)
Return of capital	—	—	—	(637)
Cash flows from financing activities	(1,636)	(3,157)	(1,118)	1,311
Cash flows from investing activities:				
Acquisition of businesses, net of cash acquired (note 4)	(3,103)	(1,298)	(21,918)	(15,025)
Reduction (increase) to short-term investments, marketable securities and other assets	(869)	(831)	3,082	(2,309)
Decrease in restricted cash	—	—	858	—
Decrease (increase) in other assets	(25)	(31)	(4,249)	130
Property and equipment purchased	(544)	(483)	(1,829)	(1,992)
Cash flows (used in) investing activities	(4,541)	(2,643)	(24,056)	(19,196)
Effect of currency translation adjustment on cash and cash equivalents	(998)	198	(1,747)	640
Increase (decrease) in cash and cash equivalents	8,353	5,999	(6,830)	(1,737)
Cash and cash equivalents, beginning of period	10,624	10,549	25,807	18,285
Cash and cash equivalents, end of period	\$ 18,977	\$ 16,548	\$ 18,977	\$ 16,548

See accompanying notes to interim consolidated financial statements.

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 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 and nine months ended September 30, 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 dates 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 revenue, 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  
(In thousands of U.S. dollars, except per share amounts)

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 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 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 other comprehensive income.

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

At September 30, 2007, the Company held investments in a U.K. listed public company and two U.S. listed public companies, all of which develop and sell software solutions.

	September 30, 2007		December 31, 2006	
	Cost	Market value	Cost	Market value
	(Unaudited)			
Common shares	\$ 1,396	\$ 1,366	\$ 3,320	\$ 4,474

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 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 holdback is payable in the fourth quarter of 2007 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 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	\$ 11,089
Property and equipment	1,030
Other long-term assets	1,290
Goodwill	2,481
Technology assets	16,694
Customer assets	2,373
	<hr/> 34,957
Liabilities assumed:	
Current liabilities	15,639
Future income taxes	1,144
Other long-term liabilities	782
	<hr/> 17,565
<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  
(In thousands of U.S. dollars, except per share amounts)

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 4. Business acquisitions (continued):

### (b) Other acquisitions:

During the nine months ended September 30, 2007, the Company made seven other acquisitions for aggregate net initial cash consideration of \$5,078 plus holdbacks of \$1,042. The holdbacks are payable over a one-year period and are adjusted for any 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	\$ 2,289
Property and equipment	246
Goodwill	721
Technology assets	6,777
Customer assets	944
	<hr/> 10,977
Liabilities assumed:	
Current liabilities	3,605
Future income taxes	1,252
	<hr/> 4,857
<hr/> Total purchase price consideration	<hr/> \$ 6,120

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 4. Business acquisitions (continued):

2006:

### (c) Advanced Utility Systems Corporation:

On June 14, 2006, the Company acquired Advanced Utility Systems Corporation for net cash consideration of \$10,063 on closing plus a holdback of \$1,631. 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 using the purchase method with the results of operations included in these Interim 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 the acquisition:

---

Assets acquired:	
Current assets	\$ 2,131
Property and equipment	371
Goodwill	2,998
Technology assets	9,468
Customer assets	750
	<hr/> 15,718
Liabilities assumed:	
Current liabilities	3,296
Future income taxes	634
Other long-term liabilities	94
	<hr/> 4,024
<hr/> Total purchase price consideration	<hr/> \$ 11,694

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 4. Business acquisitions (continued):

### (d) Other acquisitions:

During the nine months ended September 30, 2006, the Company made four other acquisitions for aggregate net initial cash consideration of \$4,911 plus holdbacks of \$2,250. The holdbacks are payable over a one-year period and are adjusted for any claims under the representations and warranties of the agreement. Holdbacks of \$1,520 were paid during the nine months ended September 30, 2007. 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 fair value of the assets acquired and liabilities assumed at the date of each acquisition:

Assets acquired:	
Current assets	\$ 1,476
Property and equipment	180
Technology assets	8,380
Customer assets	696
	<hr/>
	10,732
Liabilities assumed:	
Current liabilities	3,571
	<hr/>
Total purchase price consideration	\$ 7,161

### (e) 2005 Holdbacks:

During the nine months ended September 30, 2007 holdbacks of \$512 relating to acquisitions made in 2005 came due and were paid. (Three months ended September 30, 2007 – nil).

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 5. Intangible assets:

			September 30, 2007	December 31, 2006
	Cost	Accumulated amortization	Net book value	Net book value
Technology assets	\$ 112,469	\$ 44,895	\$ 67,574	\$ 56,763
Non-compete agreements	1,680	1,535	145	506
Customer assets	17,288	7,113	10,175	8,765
Trademarks	133	90	43	51
	<u>\$ 131,570</u>	<u>\$ 53,633</u>	<u>\$ 77,937</u>	<u>\$ 66,085</u>

Amortization expense related to intangible assets for the three months and nine months ended September 30, 2007 was \$5,302 and \$14,945 (three months and nine months ended September 30, 2006 - \$4,489 and \$11,947), respectively.

## 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 September 30, 2007, \$1,712 (December 31, 2006 - nil) had been drawn from this credit facility, and letters of credit totalling \$5,036 (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.

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 7. Capital stock (continued):

(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, September 30, 2007	16,903,530	\$ 84,762	4,288,000	\$ 14,521	21,191,530	\$ 99,283

(c) During the nine months ended September 30, 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 values 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 nine months ended September 30, 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 no longer records an appreciation charge.

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 8. Shareholder loans:

Share purchase loans receivable of \$1,887 (December 31, 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 period:

Balance, December 31, 2006	\$ (2,135)
Issuance of shareholder loans	(447)
Repayment of shareholder loans	809
Interest	(114)
Balance, September 30, 2007	\$ (1,887)

## 9. 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.

## 10. 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 at September 30, 2007, the Company had total net future tax assets of \$4,231 (December 31, 2006 - \$4,582) and total future tax liabilities of \$9,538 (December 31, 2006 - \$8,048).

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 10. 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 periods 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.

## 11. Income (loss) per share:

	Three months ended September 30, 2007		September 30, 2006		Nine months ended September 30, 2007		September 30, 2006	
	(Unaudited)		(Unaudited)		(Unaudited)		(Unaudited)	
Numerator:								
Net income (loss)	\$	3,326	\$	2,287	\$	9,470	\$	(5,068)
Denominator:								
Weighted average number of shares:								
Basic		21,119		21,039		21,107		20,726
Effect of dilutive securities:								
Shares secured by shareholder loans		73		153		85		—
Diluted		21,192		21,192		21,192		20,726
Income (loss) per share:								
Basic	\$	0.16	\$	0.11	\$	0.45	\$	(0.24)
Diluted		0.16		0.11		0.45		(0.24)

For the nine months ended September 30, 2006, common shares secured by shareholder loans totalled 295. These shares were not included in the calculation of diluted income (loss) per share because to do so would have been anti-dilutive.

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 12. 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 September 30, 2007	Public Sector	Private Sector	Other	Total
Revenue	\$ 39,461	\$ 21,113	\$ —	\$ 60,574
Cost of revenue	15,564	6,804	—	22,368
	23,897	14,309	—	38,206
Research and development	5,685	3,442	—	9,127
Sales and marketing	4,345	2,382	—	6,727
General and administration	6,780	4,214	—	10,994
Depreciation	630	233	—	863
	17,440	10,271	—	27,711
Income before the undernoted	6,457	4,038	—	10,495
Amortization of intangible assets	3,684	1,618	—	5,302
Other expenses	—	(230)	300	70
Interest income	(76)	(16)	(157)	(249)
Gain on sale of short-term investments, marketable securities and other assets	—	—	—	—
Foreign exchange loss (gain)	172	593	(75)	690
Inter-company expenses (income)	298	805	(1,103)	—
Income before income taxes	2,379	1,268	1,035	4,682
Income taxes (recovery):				
Current	614	738	119	1,471
Future	(107)	(8)	—	(115)
	507	730	119	1,356
Net income	\$ 1,872	\$ 538	\$ 916	\$ 3,326
Other selected information:				
Property and equipment purchased	\$ 339	\$ 187	\$ 20	\$ 546

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 12. Segmented information (continued):

Nine months ended September 30, 2007	Public Sector	Private Sector	Other	Total
Revenue	\$ 113,567	\$ 63,388	\$ —	\$ 176,955
Cost of revenue	46,005	20,899	—	66,904
	67,562	42,489	—	110,051
Research and development	16,983	9,916	—	26,899
Sales and marketing	13,822	7,271	—	21,093
General and administration	19,443	11,997	—	31,440
Depreciation	1,713	698	—	2,411
	51,961	29,882	—	81,843
Income before the undernoted	15,601	12,607	—	28,208
Amortization of intangible assets	10,014	4,931	—	14,945
Other expenses	—	(230)	300	70
Interest income	(175)	(56)	(167)	(398)
Gain on sale of short-term investments, marketable securities and other assets	—	—	(1,354)	(1,354)
Foreign exchange loss (gain)	353	1,032	657	2,042
Inter-company expenses (income)	1,204	1,934	(3,138)	—
Income before income taxes	4,205	4,996	3,702	12,903
Income taxes (recovery):				
Current	1,827	2,111	112	4,050
Future	(311)	(306)	—	(617)
	1,516	1,805	112	3,433
Net income	\$ 2,689	\$ 3,191	\$ 3,590	\$ 9,470
Other selected information:				
Property and equipment purchased	\$ 1,162	\$ 581	\$ 88	\$ 1,831

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 12. Segmented information (continued):

Three months ended September 30, 2006	Public Sector	Private Sector	Other	Total
Revenue	\$ 33,673	\$ 20,136	\$ —	\$ 53,809
Cost of revenue	14,068	6,992	—	21,060
	19,605	13,144	—	32,749
Research and development	5,440	3,049	—	8,489
Sales and marketing	3,809	2,679	—	6,488
General and administration	6,208	3,640	—	9,848
Depreciation	515	278	—	793
	15,972	9,646	—	25,618
Income before the undernoted	3,633	3,948	—	7,131
Appreciation on common shares eligible for redemption	—	—	—	—
Amortization of intangible assets	2,858	1,631	—	4,489
Other expenses	—	—	—	—
Interest income	(12)	(12)	21	3
Gain on sale of short-term investments, marketable securities and other assets	—	—	—	—
Foreign exchange loss (gain)	(54)	7	(138)	(185)
Inter-company expenses (income)	1,069	425	(1,494)	—
Income (loss) before income taxes	(228)	1,447	1,611	2,830
Income taxes (recovery):				
Current	305	159	(648)	(184)
Future	(32)	566	193	727
	273	725	(455)	543
Income (loss) for the period	\$ (501)	\$ 722	\$ 2,066	\$ 2,287
Other selected information:				
Property and equipment purchased	\$ 420	\$ 60	\$ 3	\$ 483

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 12. Segmented information (continued):

Nine months ended September 30, 2006	Public Sector	Private Sector	Other	Total
Revenue	\$ 95,256	\$ 61,984	\$ —	\$ 157,240
Cost of revenue	40,126	21,548	—	61,674
	55,130	40,436	—	95,566
Research and development	15,583	9,294	—	24,877
Sales and marketing	11,251	8,383	—	19,634
General and administration	17,298	11,305	—	28,603
Depreciation	1,259	897	—	2,156
	45,391	29,879	—	75,270
Income before the undernoted	9,739	10,557	—	20,296
Appreciation on common shares eligible for redemption	—	—	10,093	10,093
Amortization of intangible assets	7,055	4,892	—	11,947
Other expenses	1	450	1,519	1,970
Interest income	(38)	(45)	(4)	(87)
Gain on sale of short-term investments, marketable securities and other assets	—	—	(8)	(8)
Foreign exchange loss (gain)	(33)	209	(287)	(111)
Inter-company expenses (income)	1,722	811	(2,533)	—
Income (loss) before income taxes	1,032	4,240	(8,780)	(3,508)
Income taxes (recovery):				
Current	1,121	1,655	(960)	1,816
Future	(472)	216	—	(256)
	649	1,871	(960)	1,560
Income (loss) for the period	\$ 383	\$ 2,369	\$ (7,820)	\$ (5,068)
Other selected information:				
Property and equipment purchased	\$ 1,261	\$ 658	\$ 73	\$ 1,992

### (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 September 30,				Nine months ended September 30,			
	2007		2006		2007		2006	
Canada	\$ 11,617	19%	\$ 5,958	11%	\$ 28,182	16%	\$ 17,905	11%
United States	41,198	68%	40,410	75%	123,891	70%	116,060	74%
Other	7,759	13%	7,441	14%	24,882	14%	23,275	15%
Total	\$ 60,574	100%	\$ 53,809	100%	\$ 176,955	100%	\$ 157,240	100%

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## 12. Segmented information (continued):

As at September 30, 2007 and December 31, 2006 and for the nine months ended September 30, 2007 and 2006, no single customer accounted for more than 10% of the Company's total accounts receivable and total revenue, respectively.

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

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	2007	2006
	(Unaudited)		(Unaudited)	
Decrease (increase) in accounts receivable	\$ 2,416	\$ (3,426)	\$ 173	\$ (1,626)
Decrease (increase) in work in progress	(975)	429	(230)	(1,954)
Decrease (increase) in inventory	(334)	(454)	(622)	(1,676)
Decrease (increase) in prepaid expenses and other current assets	1,131	22	405	(453)
Increase (decrease) in accounts payable, accrued liabilities, and income taxes payable	3,349	3,495	(7,653)	(1,074)
Increase (decrease) in deferred revenue	(148)	3,480	1,167	3,507
	\$ 5,439	\$ 3,546	\$ (6,760)	\$ (3,276)

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 September 30, 2007 and 2006.

# CONSTELLATION SOFTWARE INC.

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

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## 14. Accumulated other comprehensive loss:

Accumulated other comprehensive loss consists of the following:

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 gain on available-for-sale financial assets during the period	79
Reclassification adjustment for gains and losses included in net income	(1,104)
<hr/>	
Balance, September 30, 2007	\$ (3,181)

## 15. Notes receivable:

Notes receivable from VCG Inc.:

On June 18, 2007, the Company entered into an agreement with VCG Inc. 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.

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 for the notes using the residual method. The fair value of the Warrants was determined using the Black-Scholes option-pricing model. 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. The fair value of the notes was determined by subtracting the fair value of the Warrants from the total face value of the notes. The allocation based on fair value of the Warrants and the residual portion allocated to the notes resulted in the allocation of \$571 to the Warrants and \$3,429 to the notes receivable.

# CONSTELLATION SOFTWARE INC.

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

Three months and nine months ended September 30, 2007 and 2006  
(Unaudited)

## **15. Note receivable (continued)**

The note component is recorded at amortized cost with an effective interest rate of 14.86%. Each reporting period, the Company is required to accrete the carrying value of the notes receivable, such that at maturity the carrying value of the notes receivable will equal the face value of \$4,000. For the three and nine months ended September 30, 2007, the Company recorded interest income of \$29 and \$32 (2006 - nil), respectively.

## **16. Subsequent event:**

On October 5, 2007, a subsidiary of the Company merged with Varsity Logistics Inc., incorporated under the laws of the State of California, for cash consideration of \$5,250 on closing plus a holdback of \$750.