

407 *International*

407 INTERNATIONAL INC.

Consolidated Financial Statements

Years ended December 31, 2007 and 2006

AUDITORS' REPORT

To the Shareholders of
407 International Inc.

We have audited the consolidated balance sheets of 407 International Inc. as at December 31, 2007 and 2006 and the consolidated statements of operations, comprehensive income and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

(signed)
Deloitte & Touche LLP
Chartered Accountants
Licensed Public Accountants

(signed)
PricewaterhouseCoopers LLP
Chartered Accountants
Licensed Public Accountants

Toronto, Canada
January 31, 2008

407 INTERNATIONAL INC.
CONSOLIDATED BALANCE SHEETS
As at December 31, 2007 and 2006
(in thousands of dollars)

	2007	2006
Assets		
Current		
Cash and cash equivalents (note 18)	\$ 104,444	\$ 91,764
Short-term investments	-	11,391
Restricted cash (notes 7 and 12)	137,797	181,574
Accrued interest	-	4,278
Accounts receivable (note 13)	150,006	140,540
	<u>392,247</u>	<u>429,547</u>
Long-term restricted cash and investments (notes 7 and 12)	231,192	189,035
Property, plant and equipment (note 4)	2,256,666	2,231,987
Long-term investments (note 12 (b))	66,587	-
Intangible assets (note 5)	1,625,528	1,629,914
Other assets (note 6)	-	43,224
	<u>\$ 4,572,220</u>	<u>\$ 4,523,707</u>
Liabilities		
Current		
Accounts payable and accrued liabilities (note 13)	\$ 35,889	\$ 46,793
Accrued interest on long-term debt	59,267	61,889
Current portion of long-term debt (notes 7 and 12)	9,380	888,583
Current portion of obligation under capital leases (note 15)	1,547	3,281
	<u>106,083</u>	<u>1,000,546</u>
Long-term debt (notes 7 and 12)	4,594,147	3,588,125
Obligation under capital leases (note 15)	2,077	3,302
Deferred gains (note 3)	-	19,927
	<u>4,702,307</u>	<u>4,611,900</u>
Shareholders' deficiency		
Share capital (note 8)	775,000	775,000
Contributed surplus	29,568	29,568
Deficit	(955,489)	(892,761)
Accumulated other comprehensive income (note 9)	20,834	-
	<u>(130,087)</u>	<u>(88,193)</u>
	<u>\$ 4,572,220</u>	<u>\$ 4,523,707</u>
Commitments and contingencies (note 15)		

On Behalf of the Board:

(signed)

DAVID McFADDEN
Director

(signed)

PIERRE ANCTIL
Director

The accompanying notes are an integral part of these consolidated financial statements.

407 INTERNATIONAL INC.
CONSOLIDATED STATEMENTS OF OPERATIONS,
COMPREHENSIVE INCOME AND DEFICIT
Years ended December 31, 2007 and 2006
(in thousands of dollars, except per share amounts)

	<u>2007</u>	<u>2006</u>
Revenues (notes 15 and 17)	\$ 518,933	\$ 455,678
Operating expenses	111,284	103,009
Depreciation and amortization	68,617	62,274
	<u>179,901</u>	<u>165,283</u>
Income from operations	339,032	290,395
Interest and other expenses, net (note 7)	278,724	241,907
Net income	<u>\$ 60,308</u>	<u>\$ 48,488</u>
Other comprehensive loss - reclassification to income of gains and losses on cash flow hedges, net (note 9)	(2,306)	
Comprehensive income	<u>\$ 58,002</u>	
Net income per share basic and diluted (note 10)	<u>\$ 0.078</u>	<u>\$ 0.063</u>
Deficit, beginning of year, as previously reported	\$ (892,761)	\$ (796,249)
Transitional adjustment on adoption of new accounting policies (note 3)	(3,036)	-
Deficit, beginning of year, as restated	<u>(895,797)</u>	<u>(796,249)</u>
Net income	60,308	48,488
Dividends paid to shareholders	(120,000)	(145,000)
Deficit, end of year	<u>\$ (955,489)</u>	<u>\$ (892,761)</u>

The accompanying notes are an integral part of these consolidated financial statements.

407 INTERNATIONAL INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2007 and 2006
(in thousands of dollars)

	2007	2006
Operating activities		
Net income	\$ 60,308	\$ 48,488
Adjustments for:		
Depreciation on property, plant and equipment	64,231	55,980
Amortization of intangible assets	4,386	6,294
Accrued interest - non-current and other	83,170	60,616
Fair value adjustment - Senior Bond, Series 04-A2 (note 7)	(25,231)	(24,784)
Fair value adjustment - Asset-backed commercial paper "ABCP" (notes 7 and 12)	22,185	-
	209,049	146,594
Change in non-cash working capital items:		
Accounts receivable	(8,327)	(22,299)
Accounts payable and accrued liabilities	(8,439)	12,240
Accrued interest - current	(4,468)	2,341
	187,815	138,876
Investing activities		
Additions to property, plant and equipment, net	(89,950)	(96,891)
Short-term investments	11,386	15,984
Long-term investments	(67,973)	5,948
Restricted cash and investments	(14,996)	9,997
Non-trade receivables	(490)	6,130
	(162,023)	(58,832)
Financing activities		
Proceeds from issuance of long-term debt	999,688	729,386
Debt issue costs and other	(2,567)	(3,080)
Repayment of long-term debt	(886,613)	(631,263)
Repayment of obligation under capital leases	(3,620)	(3,625)
Dividends paid to shareholders	(120,000)	(145,000)
	(13,112)	(53,582)
Increase in cash and cash equivalents	12,680	26,462
Cash and cash equivalents, beginning of year	91,764	65,302
Cash and cash equivalents, end of year	\$ 104,444	\$ 91,764

The accompanying notes are an integral part of these consolidated financial statements.

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended December 31, 2007 and 2006
(in thousands of dollars, except per share amounts)

1. NATURE OF OPERATIONS

The principal business of 407 International Inc. (the "Company") is the ownership of 407 ETR Concession Company Limited ("407 ETR") and, through 407 ETR, the operation, maintenance and management of Highway 407 along with the construction of extensions and certain deferred interchanges, lane widenings and additional interchanges.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Company are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The significant accounting policies are as follows:

a) Principles of consolidation

The consolidated financial statements include the accounts of the Company consolidated with those of its wholly-owned subsidiaries, 407 ETR, Canadian Tolling Company International Inc. ("CanToll") and 4290607 Canada Inc. ("Canada Inc."). CanToll was incorporated in December 2001 to complete development and assume ownership of an integrated accounting, billing and customer relationship management system, as well as to purchase new transponders. CanToll also develops improvements to the roadside tolling system. Canada Inc. was incorporated in March 2005 as a holding company. All inter-company transactions and balances have been eliminated on consolidation.

b) Revenue recognition

The Company recognizes toll revenues, net of amounts deemed to be uncollectible, from both transponder and video customers' use of the highway on the date trips are taken.

Various fees and charges are also included in revenues, net of amounts deemed to be uncollectible. Account and other fees are recognized when billed, lease fees for transponders are recognized over the term of the lease and late charges are recognized once the account is delinquent and the late charges are applied to the account.

c) Cash and cash equivalents

Cash and cash equivalents include short-term highly liquid interest-bearing investments with maturities of three months or less from the date of acquisition. Cash and cash equivalents are designated as held-for-trading and are carried at fair value.

d) Short-term investments

Short-term investments include highly liquid interest-bearing investments with maturities within twelve months. Short-term investments are designated as held-for-trading and are carried at fair value.

e) Restricted cash and investments

Restricted cash includes highly liquid interest-bearing investments with maturities of 10 years or less. Restricted investments are interest-bearing investments with maturities of 10 years or less. Restricted cash and investments are designated as held-for-trading and are carried at fair value. Pursuant to the Indenture (see note 7 – LONG TERM DEBT, Capital Markets Platform), the current portion is expected to become unrestricted within the next 12 months.

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(in thousands of dollars, except per share amounts)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

f) Long-term investments

Long-term investments include interest-bearing investments with maturities of 10 years or less. Long-term investments are designated as held-for-trading and are carried at fair value.

g) Property, plant and equipment

Property, plant and equipment are recorded at cost net of accumulated depreciation and amortization and net of any residual values or impairment loss. An impairment loss is recognized when the asset is no longer recoverable from its future estimated undiscounted cash flows and its carrying value exceeds its fair value.

Prior to October 1, 2006, depreciation and amortization charges were recorded using methods and rates determined to amortize the cost of the property, plant and equipment over their estimated useful lives as follows:

Toll Highway - Bridge Structures, Storm Sewer Culverts and Concrete Pavement - Asphalt Pavement - Tolling Civil and Electrical, Barriers and Guide Rails, Signage, Landscaping and Fencing	99 years projected Vehicle Kilometers Traveled ("VKT's") 53 years projected VKT's 50 - 99 years straight-line
Toll Equipment	5 - 10 years straight-line
Transponders	6 years straight-line
Operations Centre	30 years straight-line
Office Equipment	5 years straight-line
Motor Vehicles	3 years straight-line
Snow Clearing Equipment Under Capital Lease	10 years straight-line
Computer Equipment Under Capital Lease	5 years straight-line

The Company revised its estimates of the useful lives of certain highway and toll equipment assets based on recent experience from the use of these assets and additional information made available, effective October 1, 2006.

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended December 31, 2007 and 2006
(in thousands of dollars, except per share amounts)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

On a prospective basis from October 1, 2006, depreciation and amortization charges were recorded using methods and rates determined to amortize the cost of the property, plant and equipment over their revised estimated useful lives as follows:

Toll Highway - Bridge Structures, Storm Sewer Culverts, Grading, Granular, Asphalt & Concrete Pavement (Base) and Drainage.	50 - 99 years projected VKT's
- Large Galvanized Steel Drainage, Bridge Bearings and Joints.	25 - 30 years projected VKT's
- Asphalt & Concrete Pavement (Top Coat)	8 - 15 years projected VKT's
- Tolling Civil and Electrical, Barriers and Guide Rails, Signage, Landscaping, Fencing and Utilities Relocation	50 - 99 years straight-line
- Highway Tools, Cameras and Inspection Stations	5 - 15 years straight-line
Toll Equipment	4 - 35 years straight-line
Transponders	6 years straight-line
Operations Centre	30 years straight-line
Office Equipment	5 years straight-line
Motor Vehicles	3 years straight-line
Snow Clearing Equipment and Motor Vehicles Under Capital Lease	2 - 10 years straight-line
Computer Equipment Under Capital Lease	5 years straight-line

Effective April 1, 2007, the Company prospectively revised its estimate of the useful lives for the bridge deck components of the Bridge Structures from 50 years projected VKTs to a range of 72-90 years projected VKTs based on additional information recently made available to the Company. Accordingly, the new useful life for the Bridge Structures, Storm Sewer Culverts, Grading, Granular, Asphalt & Concrete Pavement (Base) and Drainage category has changed to 60-99 years projected VKTs. Depreciation expense in 2007 was lower (before additions) by approximately \$800 due to the change in useful lives.

h) Leases

Leases are classified as capital or operating depending on the terms and conditions of the contracts. The costs of assets acquired under capital leases are amortized on a straight-line basis over their estimated useful lives. Obligations recorded under capital leases are reduced by lease payments net of imputed interest. Operating leases are expensed on a straight-line basis.

i) Interest capitalization

Interest expense of debt attributable to the construction of Property, plant and equipment is capitalized during the construction or development period as part of the cost of the related asset.

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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2. SIGNIFICANT ACCOUNTING POLICIES (continued)

j) Intangible assets and concession rights

Intangible assets are recorded at cost less accumulated amortization and net of any impairment loss. An impairment loss is recognized when the assets carrying value is no longer recoverable from its future estimated undiscounted cash flows and exceeds its fair value.

Concession rights are amortized on a usage basis using projected revenues over 99 years to reflect the duration of the Highway 407 Concession and Ground Lease Agreement ("Concession Agreement") with the Province of Ontario (the "Province"). Effective October 1, 2006, the Company revised projected revenues in order to accommodate recent traffic trends and changes to toll rates which have contributed to higher current and projected revenues.

A license and related intellectual property relating to roadside maintenance of the tolling system are amortized over their terms and useful lives of five years on a straight-line basis.

k) Real return bonds ("RRBs")

Prior to January 1, 2007, the Company followed the retrospective interest rate method of accounting for interest expense relating to RRBs. Under this method, the amortized cost is calculated as the present value of estimated future cash flows using an effective yield, which is the yield that equates all past actual and current estimated future cash flow streams to the initial debt. Upon transition to CICA Section 3855, Financial Instruments – Recognition and Measurement on January 1, 2007, the Company began accounting for RRBs using the amortized cost method.

l) Deferred financing costs

Prior to January 1, 2007, deferred financing costs, which were included in other assets, were amortized on a straight-line basis over the term of the related debt. The amortization of these costs is included as part of Interest and other expenses, net. Upon transition to CICA Section 3855, Financial Instruments – Recognition and Measurement on January 1, 2007, the Company nets any transaction costs against the proceeds from long-term debt instruments classified as Other Liabilities ("OL") and amortizes these costs over the expected life of the instrument using the effective interest method. The amortization amounts are included as interest expense of the related long-term debt instrument and recognized in Interest and other expenses, net.

m) Derivative financial instruments and hedging

Prior to January 1, 2007, the Company used interest rate hedging agreements to manage its interest risk exposure. The Company also issued inflation derivative instruments. Derivative financial instruments that did not qualify for hedge accounting under Accounting Guideline 13 ("AcG 13") were recorded at fair value with changes in the fair value recognized as part of Interest and other expenses, net.

n) Income taxes

The Company follows the liability method of accounting for Income taxes. Under this method, future income tax assets and liabilities reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts employed for income tax purposes and the benefit of losses available to be carried forward to future years for income tax purposes.

Future income tax assets and liabilities are measured using the substantively enacted tax rates expected to apply to taxable income in the years in which the related temporary differences are expected to

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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2. SIGNIFICANT ACCOUNTING POLICIES (continued)

reverse. The effect on future income tax assets and liabilities of a change in tax rates is recognized in the year of substantive enactment. If, on the basis of available evidence, it is more likely than not that all or a portion of any future income tax assets will not be realized, the net future income tax assets are reduced by a valuation allowance.

o) Light-vehicle benefits program (the “Benefits Program”)

The 407 ETR Benefits Program has been designed to reward eligible frequent customers with free weekend kilometres on the Highway in conjunction with discounts on gas purchases. When benefits are earned by such customers, the Company defers the revenues relating to the future free kilometres and records an expense for the gas, thereby establishing a liability for future redemption. The deferred revenue is determined by multiplying the estimated number of revenue kilometres displaced by the estimated price per kilometre. The expense for gas is determined by multiplying the number of litres offered by the Company’s estimated cost per litre based on expected future redemption patterns. The actual revenue and cost redemptions are charged against the liability for the Benefits Program, which is included in accounts payable and accrued liabilities.

p) Use of estimates

The preparation of the consolidated financial statements of the Company in conformity with GAAP requires management of the Company and its subsidiaries (“Management”) to make estimates and assumptions, particularly as they relate to the valuation allowance on future tax assets, useful lives of property, plant and equipment, projected revenues for the amortization of concession rights, the fair valuation of ABCP, the Benefits Program displaced kilometres and expected gas take-up rates and the provision for overdue accounts that affect the reported amounts and disclosures during the reporting period. Actual results could differ materially from these estimates.

The Company provides for doubtful accounts based principally on historical collection rates and Management’s expectation of success rates in plate denial. In February 2000, 407 ETR voluntarily suspended its enforcement right of vehicle permit denials under the Highway 407 Act, 1998. In August 2003, 407 ETR began notifying a limited number of customers with overdue accounts that it had requested the Registrar of Motor Vehicles (the “Registrar”) to not renew or issue their vehicle permits until their outstanding amounts are paid. Following a unanimous decision of the Ontario Superior Court of Justice, Divisional Court on November 7, 2005, the Registrar began collection of overdue accounts through the enforcement of vehicle permit denials on November 24, 2005. Given the limited volume of accounts and limited history of the Registrar collecting overdue accounts through vehicle permit denials, the Company’s provision for overdue accounts could materially change and may result in significant changes to accounts receivable balances as 407 ETR gains experience with the vehicle permit denial collection process.

3. CHANGES IN ACCOUNTING POLICIES AND CRITICAL ESTIMATES

i) As required by the Canadian Institute of Chartered Accountants (“CICA”), on January 1, 2007, the Company adopted CICA Handbook Section 1530, *Comprehensive Income*; Section 3251, *Equity*; Section 3855, *Financial Instruments – Recognition and Measurement*; Section 3861, *Financial Instruments – Disclosure and Presentation* and Section 3865, *Hedges*. The prospective adoption of these new standards resulted in changes in the accounting and presentation for financial instruments and hedging relationships as well as the recognition of certain transition adjustments that have been recorded in opening deficit or opening accumulated other comprehensive income as described below. As required by the implementation of these new standards, the comparative Consolidated Financial Statements have not been restated. The principal changes in the accounting for financial instruments and hedging relationships due to the adoption of these accounting standards are described below.

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended December 31, 2007 and 2006
(in thousands of dollars, except per share amounts)

3. CHANGES IN ACCOUNTING POLICIES AND CRITICAL ESTIMATES (continued)

(a) Section 1530, Comprehensive Income

The Company's comprehensive income is composed of net income and other comprehensive loss ("OCL"). OCL includes the effective portion of the change in fair value of designated cash flow hedges less any amounts reclassified to interest and other expenses, net in the period that the underlying hedged item is also recorded in interest and other expenses, net.

(b) Section 3251, Equity

Accumulated other comprehensive income ("AOCI") is included on the consolidated balance sheet as a separate component of shareholders' deficiency, and includes the effective portion of gains and losses on derivative instruments designated as cash flow hedges.

**(c) Section 3855, Financial Instruments – Recognition and Measurement and
Section 3861, Financial Instruments – Disclosure and Presentation**

Financial Assets and Financial Liabilities

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the Company's designation of such instruments. The standards require that all financial assets be classified either as held-for-trading ("HFT"), available-for-sale ("AFS"), held-to-maturity ("HTM"), or loans and receivables. The standards require that all financial assets, including all derivatives, be measured at fair value with the exception of loans and receivables, debt securities classified as HTM, and AFS financial assets that do not have quoted market prices in an active market. Settlement date accounting continues to be used for all financial assets, except changes in fair value between the trade date and settlement date are reflected in interest and other expenses, net for HFT financial assets, while changes in fair value between trade date and settlement date are reflected in OCL for AFS financial assets.

Classification of financial instruments

The following is a summary of the accounting model the Company has elected to apply to each of its significant categories of financial instruments outstanding as of January 1, 2007:

Cash and cash equivalents	Designated as held-for-trading
Short-term investments	Designated as held-for-trading
Long-term investments	Designated as held-for-trading
Restricted cash and investments – current and long-term	Designated as held-for-trading
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Long-term debt (excluding Senior Bonds, Series 04-A2)	Other liabilities
Senior Bonds, Series 04-A2	Held-for-trading

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended December 31, 2007 and 2006
(in thousands of dollars, except per share amounts)

3. CHANGES IN ACCOUNTING POLICIES AND CRITICAL ESTIMATES (continued)

Held-for-trading

HFT financial assets are financial assets typically acquired for resale prior to maturity. They are measured at fair value at the balance sheet date. Interest earned, interest accrued, gains and losses realized on disposal and unrealized gains and losses from market fluctuations are included in interest and other expenses, net.

Financial liabilities designated at fair value ("FVO") are those non-derivative financial liabilities that the Company elects to designate on initial recognition as instruments that it will measure at fair value through interest and other expenses, net. These are accounted for in the same manner as HFT financial assets. The Company has not designated any non-derivative financial liabilities as FVO.

Held-to-maturity

HTM financial assets are non-derivative financial assets with fixed or determinable payments and a fixed maturity, other than loans and receivables that an entity has the positive intention and ability to hold to maturity. These financial assets are measured at amortized cost.

Available-for-sale

AFS financial assets are those non-derivative financial assets that are designated as AFS, or that are not classified as loans and receivables, HTM investments or HFT. AFS financial assets are carried at fair value with unrealized gains and losses included in AOCI until realized when the cumulative gain or loss is transferred to interest and other expenses, net. The Company has not designated any financial assets as AFS.

Loans and receivables

Loans and receivables are accounted for at amortized cost.

Other liabilities

OL are recorded at amortized cost and include all liabilities, other than derivatives or liabilities to which the FVO has been applied.

Derivatives

Derivatives are carried at fair value and are reported as assets where they have a positive fair value and as liabilities where they have a negative fair value. The change in fair value during the period is recorded as interest and other expenses, net. At December 31, 2007 and December 31, 2006, the only derivative outstanding is Senior Bond, Series 04-A2, which is included in long-term debt.

Embedded derivatives

Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for as derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivative are the same as those of a free standing derivative; and the combined instrument or contract is not measured at fair value with changes in fair value recognized in interest and other expenses, net. These embedded derivatives are measured at fair value with changes therein recognized in interest and other expenses, net. The Company selected January 1, 2003 as the transition date for embedded derivatives, as such only contracts or financial instruments entered into or modified after the transition date were examined for embedded derivatives. As at December 31, 2007 and December 31, 2006, the Company does not have any outstanding contracts or financial instruments with embedded derivatives that require bifurcation.

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended December 31, 2007 and 2006
(in thousands of dollars, except per share amounts)

3. CHANGES IN ACCOUNTING POLICIES AND CRITICAL ESTIMATES (continued)

Transaction Costs

Transaction costs related to HFT financial assets, HFT financial liabilities and FVO financial liabilities are expensed to interest and other expenses, net as incurred. Transaction costs related to AFS financial assets, HTM financial assets, OL and loans and receivables are netted against the carrying value of the asset or liability and are then amortized over the expected life of the instrument using the effective interest method.

Effective interest method

The Company uses the effective interest method of amortization for transaction costs or fees, premiums or discounts earned or incurred for financial instruments.

Determination of fair value

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, the fair values of financial instruments that are quoted in active markets are based on bid prices for financial assets held and offer prices for financial liabilities. When independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparisons with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. For certain derivatives, fair values may be determined in whole or in part from valuation techniques using non-observable market data or transaction prices. A number of factors such as bid-offer spread, credit profile and model uncertainty are taken into account, as appropriate, when values are calculated using valuation techniques.

(d) Section 3865, Hedges

Section 3865 specifies the criteria that must be satisfied in order for hedge accounting to be applied and the accounting for each of the permitted hedging strategies; fair value hedges and cash flow hedges. Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item.

The Company does not have any outstanding hedging contracts as at December 31, 2007 and December 31, 2006.

Cash flow hedges

Prior to January 1, 2007, the Company entered into, and terminated cash flow hedging relationships to hedge cash flows relating to certain senior and junior bonds. As these hedging relationships continue to qualify for hedge accounting under the new standard, the gains and losses were recorded in AOCI and amounts will be reclassified from AOCI to interest and other expenses, net during the periods when the variability in the cash flows of the senior and junior bonds affect interest and other expenses, net.

Upon transition to the new standards on January 1, 2007, the Company reclassified \$19,927 of deferred gains to AOCI (\$23,140) and deficit (\$3,213 loss).

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years ended December 31, 2007 and 2006
(in thousands of dollars, except per share amounts)

3. CHANGES IN ACCOUNTING POLICIES AND CRITICAL ESTIMATES (continued)

Transitional adjustment

As required, these standards have been applied as an adjustment to opening deficit and AOCI. Prior period balances have not been restated. The impact of adopting these standards as at January 1, 2007 was as follows:

	As at December 31 2006	Adjustment upon adoption of new standards	As at January 1 2007
Assets			
Cash and cash equivalents ¹	\$ 91,764	\$ 809	\$ 92,573
Short-term investments ¹	11,391	177	11,568
Restricted cash - current ¹	181,574	1,326	182,900
Accrued interest ¹	4,278	(4,278)	-
Restricted cash - long-term ¹	189,035	1,889	190,924
Deferred financing costs (note 6)	43,224	(43,224)	-
Impact on total assets	\$ 521,266	\$ (43,301)	\$ 477,965
Liabilities and shareholders' deficiency			
Accounts payable and accrued liabilities	\$ 108,682	\$ (61,889)	\$ 46,793
Accrued interest on long-term debt	-	61,889	61,889
Current portion of long-term debt	888,583	(1,775)	886,808
Long-term debt	3,588,125	(41,703)	3,546,422
Deferred gains	19,927	(19,927)	-
Impact on total liabilities	4,605,317	(63,405)	4,541,912
Shareholders' deficiency			
Deficit	(892,761)	(3,036)	(895,797)
Accumulated other comprehensive income (note 9)	-	23,140	23,140
Impact on shareholders' deficiency	(892,761)	20,104	(872,657)
Impact on liabilities and shareholders' deficiency	\$ 3,712,556	\$ (43,301)	\$ 3,669,255

¹ The fair values of cash and cash equivalents, short-term investments, and restricted cash include accrued interest. Upon transition to the new standards on January 1, 2007, the Company reclassified \$4,278 of accrued interest to cash and cash equivalents (\$809), short-term investments (\$177), restricted cash - current (\$1,326), restricted cash - long-term (\$1,889) and deficit (\$77 loss).

ii) Future Changes in accounting policies:

The CICA issued three new accounting standards: section 1535, Capital Disclosures, section 3862, Financial Instruments-Disclosures, and section 3863, Financial Instruments-Presentation. Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate objectives, policies and processes for managing capital. Sections 3862 and 3863 will replace section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing disclosure requirements while carrying forward its presentation requirements. These new sections will place increased emphasis on disclosure about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The mandatory effective date is for annual and interim periods in fiscal years beginning on or after October 1, 2007. The Company will begin application of these sections effective January 1, 2008.

407 INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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4. PROPERTY, PLANT AND EQUIPMENT

	As at December 31, 2007		As at December 31, 2006	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Toll highway	\$ 2,231,970	\$ 108,974	\$ 2,162,017	\$ 86,731
Toll equipment	266,944	178,754	257,042	149,406
Transponders	32,700	18,300	31,154	16,926
Operations centre	24,277	4,693	23,671	3,878
Office equipment	18,657	14,792	17,330	12,668
Motor vehicles	1,376	830	855	737
Snow clearing equipment and motor vehicles under capital lease	2,869	1,015	2,398	742
Computer equipment under capital lease	23,310	18,079	23,043	14,435
	<u>\$ 2,602,103</u>	<u>\$ 345,437</u>	<u>\$ 2,517,510</u>	<u>\$ 285,523</u>
Net book value		<u>\$ 2,256,666</u>		<u>\$ 2,231,987</u>

Certain property, plant and equipment has been retired and as a result, the cost has been reduced by \$4,801 (2006 - \$3,511) and accumulated depreciation by \$4,383 (2006 - \$3,351).

As at December 31, 2007, Toll highway and Toll equipment costs include amounts not being depreciated of \$10,551 (2006 - \$36,405) as they relate to projects under design and construction such as the Highway 407E/Highway 403W/QEW South ramp, and, Highway 407 lane expansion between Highway 404 and Regional Road 30, as well as certain computer system development included in Toll equipment.

5. INTANGIBLE ASSETS

	As at December 31, 2007		As at December 31, 2006	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Concession rights	\$ 1,676,139	\$ 53,524	\$ 1,676,139	\$ 50,036
Other intangible assets	5,163	2,250	7,953	4,142
	<u>\$ 1,681,302</u>	<u>\$ 55,774</u>	<u>\$ 1,684,092</u>	<u>\$ 54,178</u>
Net book value		<u>\$ 1,625,528</u>		<u>\$ 1,629,914</u>

During the year, certain intangible assets have been retired and as a result, the cost and accumulated amortization have been reduced by \$2,790 (2006 - \$Nil)

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6. OTHER ASSETS

	As at December 31, 2007		As at December 31, 2006	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Deferred financing costs	\$ -	\$ -	\$ 69,592	\$ 26,368
Net book value		<u>\$ -</u>		<u>\$ 43,224</u>

Upon transition to CICA Section 3855, Financial Instruments – Recognition and Measurement on January 1, 2007, the Company reclassified \$43,224 of deferred financing costs to long-term debt (\$41,703), current portion of long-term debt (\$1,775) and deficit (\$254 gain).

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7. LONG-TERM DEBT

	<u>As at December 31, 2007</u>	<u>As at December 31, 2006</u>
Senior Bonds:		
\$400,000, Series 99-A1, 6.05%, maturing July 27, 2009	\$ 397,853	\$ 399,832
\$400,000, Series 99-A2, 6.47%, maturing July 27, 2029	388,934	398,775
\$300,000, Series 99-A3, 6.75%, maturing July 27, 2039	287,517	295,376
\$208,300, Series 99-A4, 5.328%, maturing December 1, 2016	233,157	217,794
\$208,300, Series 99-A5, 5.328%, maturing December 1, 2021	233,207	218,768
\$208,300, Series 99-A6, 5.328%, maturing December 1, 2026	233,227	219,317
\$208,300, Series 99-A7, 5.328%, maturing December 1, 2031	233,237	219,370
\$325,000, Series 00-A2, 5.29%, maturing December 1, 2039	370,696	372,786
\$430,000, Series 00-A3, 6.90%, maturing on December 17, 2007	-	430,754
\$340,000, Series 04-A3, 5.96%, maturing December 3, 2035	337,847	339,778
\$100,000, Series 06-A1, 3-month CDOR plus 0.12%, maturing February 11, 2008	99,976	100,000
\$150,000, Series 06-A2, 3-month CDOR plus 0.05%, maturing November 23, 2007	-	150,000
\$75,000, Series 07-A1, 3-month CDOR plus 0.05%, maturing May 26, 2008	74,925	-
\$625,000, Series 07-A2, 4.90%, maturing October 4, 2010	622,735	-
Other Senior Bond:		
\$162,274, Series 04-A2, 3.276%, maturing July 27, 2039	149,100	168,718
Junior Bond:		
\$165,000, Series 00-B1, 7.00%, maturing July 26, 2010, extendible to July 26, 2040, at an increased annual rate of 7.125%	163,889	164,917
Subordinated Bonds:		
\$300,000, Series 00-C1, 9.00%, maturing August 15, 2007	-	300,056
\$480,000, Series 06-D1, 5.75%, maturing February 14, 2036	476,777	479,404
\$300,000, Series 07-D1, 3-month CDOR plus 0.15%, maturing May 26, 2008	299,742	-
Other Debt	708	1,063
	<u>4,603,527</u>	<u>4,476,708</u>
Less: Current Portion	9,380	888,583
	<u>\$ 4,594,147</u>	<u>\$ 3,588,125</u>

Long-term debt repayments for the next five years are as follows:

Year:	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Amount:	\$484,381	\$409,818	\$799,926	\$10,417	\$10,937

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7. LONG-TERM DEBT (continued)

Interest and Other Expenses, Net

	2007	2006
Interest expense	\$ 264,685	\$ 250,398
Non-cash interest expense:		
Inflation component of RRBs and Senior Bond, Series 04-A2	42,379	21,134
Fair value adjustment, Senior Bond, Series 04-A2	(25,231)	(24,784)
Fair value adjustment, ABCP [note 12(b)]	22,185	-
Interest income	(25,407)	(19,639)
Reclassification of gains and losses on cash flow hedges (note 9)	(2,306)	-
Other interest and expenses	2,419	14,798
	\$ 278,724	\$ 241,907

Total interest expense on long-term debt amounted to \$281,833 (2006 - \$246,748), net of capitalized interest of \$1,766 (2006 - \$2,066).

Capital Markets Platform

The Company, along with its financial advisors, developed a financing plan referred to as the Capital Markets Platform, capable of accommodating a variety of corporate debt instruments. All indebtedness incurred under the Capital Markets Platform is secured under a Master Trust Indenture ("Indenture") which establishes a common security and a set of common covenants given by the Company for the benefit of all its lenders. The security comprises a leasehold mortgage on 407 ETR's leasehold interest in the Highway, a security interest in all real and personal property of the Company, a security interest in all real and personal property of 407 ETR related to the Highway and a security interest in all real and personal property of CanToll and Canada Inc. Such security interest includes the following:

- (i) a specific assignment of each of the Company's and 407 ETR's interest in and rights under all Project Agreements and other material agreements;
- (ii) an assignment of revenues and a security interest in all funds and accounts that are required to be maintained pursuant to the Indenture and any Supplemental Indenture; and
- (iii) a pledge of, or a security interest in, the shares of 407 ETR, CanToll and Canada Inc. owned by the Company.

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7. LONG-TERM DEBT (continued)

Restricted cash and investments

Pursuant to the Indenture, the Company established the following cash and investment reserves:

	<u>As at December 31, 2007</u>	<u>As at December 31, 2006</u>
Current		
Debt service funds	\$ 59,219	\$ 58,990
Debt service reserve fund	-	34,130
Operating and maintenance reserve and renewal and replacement funds	78,578	87,000
Other reserves	-	1,454
	<u>\$ 137,797</u>	<u>\$ 181,574</u>
Long-term		
Debt service funds	\$ 2,135	\$ -
Debt service reserve funds	221,635	189,035
Operating and maintenance reserve and renewal and replacement funds	7,422	-
	<u>\$ 231,192</u>	<u>\$ 189,035</u>

Pursuant to the Indenture, the Company is required to maintain a minimum cash balance of \$10,000 to fund working capital requirements; this amount is included as Cash and cash equivalents.

Senior Bonds

The Company issued Series 99-A1, 99-A2 and 99-A3 in July 1999, Series 00-A3 in March 2000, Series 04-A1 in November 2004, Series 04-A3 in December 2004, Series 06-A1 in February 2006, Series 06-A2 in November 2006, Series 07-A1 in May 2007 and Series 07-A2 in October 2007, with interest payable semi-annually except for Series 99-A3, where interest is payable commencing January 27, 2005 and Series 06-A1, Series 06-A2 and Series 07-A1, where interest is payable quarterly. These bonds are all repayable at maturity except for Series 99-A3, which are repayable in fixed semi-annual scheduled installments of interest and principal of \$11,224, commencing January 27, 2005. These bonds are redeemable in whole or in part, at the option of the Company, except for Series 04-A1, Series 06-A1, Series 06-A2 and Series 07-A1. Series 06-A2 and Series 07-A1 are redeemable in whole, at the option of the Company. Interest on Series 04-A3 was paid from a prepaid interest reserve for the first two years, and from operations thereafter.

On January 25, 2008, the Company announced the intention to redeem \$75,000 Senior Bonds, Series 07-A1, in whole, on February 26, 2008 for \$75,000 and accrued interest of \$913. Also on January 25, 2008, the Company issued \$250,000, 4.50%, Senior Bonds, Series 08-A1 with interest payable semi-annually. The maturity date is January 25, 2011. The Series 08-A1 bonds are repayable at maturity and are redeemable, in whole or in part, at the option of the Company. The net proceeds from Series 08-A1 bonds will primarily be used to fund a series reserve of \$15,268, to repay \$100,000 Senior Bonds, Series 06-A1, due February 11, 2008, to repay \$75,000 Senior Bonds, Series 07-A1, on February 26, 2008 and for general corporate purposes.

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7. LONG-TERM DEBT (continued)

Real Return Bonds (“RRBs”)

The Company issued RRBs Series 99-A4, 99-A5, 99-A6 and 99-A7 in August 1999 with semi-annual interest payments originally commencing December 1, 2004. During 2002, the Company increased the face value of each series of bonds by \$45,800 to a total of \$208,300 for each bond series and deferred the first semi-annual interest payment to December 1, 2009. The Company issued amortizing RRB Series 00-A2 in February 2000.

The cash interest and principal payable on Series 99-A4 to 99-A7 RRBs, is adjusted based on the Consumer Price Index (“CPI”) at the time of measurement divided by the CPI at the time of issue. In addition to reserves established at the time of issuance of the Series 99-A4 to 99-A7 RRBs, the Company is required to fund a series excess inflation reserve should the principal outstanding multiplied by the difference between the CPI at the time of measurement divided by the CPI at the time of issue exceed a pre-established threshold level. The RRBs are repayable at maturity except for Series 00-A2, which is repayable in semi-annual scheduled installments of interest and principal of \$10,244, adjusted based on the CPI at the time of measurement divided by the CPI at the time of issue, commencing June 1, 2005.

At December 31, 2007, the inflation compensation component of all RRBs was \$229,052 (2006 - \$197,468), of which the Company recorded \$216,716 (2006 - \$192,492) as additional long-term debt.

Other Senior Bond

In December 2004, the Company issued Series 04-A2. Commencing January 27, 2005, the Company is obligated to make semi-annual cash payments (consisting of principal and interest) determined by the product of \$13,000 and the percentage increase, if any, in CPI from December 3, 2004 until the payment date. As required by GAAP, the Company accounts for the Series 04-A2 bond as a derivative financial instrument and reports Series 04-A2 at its fair value. Given that the market for this financial instrument is not active, the Company establishes fair value by using valuation techniques, including reference to the current fair value of another instrument that is similar, and discounted cash flow analysis. The fair value of Senior Bond, Series 04-A2 as at December 31, 2007 was \$149,100 (2006 - \$168,718). The Senior Bond, Series 04-A2 is redeemable, in whole or in part, at the option of the Company.

Junior Bond

The Company issued Series 00-B1 in July 2000 with interest payable semi-annually. At the end of the initial maturity term on July 26, 2010, bondholders have the option to extend the maturity date to July 26, 2040, bearing interest at an increased annual rate of 7.125%. These bonds are repayable at maturity and are redeemable, in whole or in part, at the option of the Company, after the initial maturity term.

Subordinated Bonds

The Company issued Series 00-C1 in May 2000, Series 06-D1 in February 2006, and Series 07-D1 in May 2007 with interest payable semi-annually, except for Series 07-D1, where interest is payable quarterly. On June 15, 2007, the Company redeemed all \$300,000 of Series 00-C1 with proceeds from Series 07-D1 and other available cash. The Company paid \$301,950 plus accrued interest of \$8,877 to the Series 00-C1 bondholders. Upon the redemption of Series 00-C1, the Master Security Agreement was terminated and the Subordinated Bond Pledge Security was fully released. Series 06-D1 is redeemable, in whole or in part, at the option of the Company. Series 07-D1 is redeemable in whole, at the option of the Company.

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7. LONG-TERM DEBT (continued)

On January 29, 2008, the Company issued \$300,000, 5.00%, Subordinated Bonds, Series 08-D1 with interest payable semi-annually. The maturity date is January 31, 2011. The Series 08-D1 bonds are repayable at maturity and are redeemable, in whole or in part, at the option of the Company. The net proceeds from Series 08-D1 bonds, together with other available funds, will be used to repay \$300,000 Subordinated Bonds, Series 07-D1, on May 26, 2008.

Senior Reserves Credit Facility

On August 27, 2007, the Company entered into a credit agreement with respect to a revolving credit facility with a Canadian chartered bank in the aggregate principal amount of up to \$125,000 for deposit to the Company's reserve accounts under the Indenture in the event certain investments are no longer "Qualified Investments" as defined in the Indenture. The obligations under the credit facility rank pari passu with the senior debt of the Company. The Company issued to the Canadian chartered bank a \$200,000 Series 2007-A-2 senior pledged bond resulting in the indebtedness arising from the credit facility being secured under the Indenture.

The credit facility bears interest at floating rates based, at the option of the Company, on the prime rate for Canadian dollar loans, and the interbank bid rate for Canadian dollar bankers' acceptances, plus 0.50%. The Company is also obligated to pay a commitment fee of 0.15% to the bank, calculated on the undrawn portion of the credit facility.

The Company may draw on this credit facility until the maturity date. The maturity date is August 25, 2008. The Company may also repay a portion or all of the obligations owing under the credit facility at any time during the term. As at December 31, 2007, the Company has not drawn under the credit facility.

Other Debt

Other debt represents amounts owing to a municipality for the acquisition of lands for the purpose of a particular highway interchange. The principal repayment of this obligation is based on a fixed amount of \$177 semi-annually until July 1, 2009. Interest at the prime rate plus 3% is charged on overdue amounts.

8. SHARE CAPITAL

	As at December 31, 2007		As at December 31, 2006	
	Number of Shares	Amount	Number of Shares	Amount
Common Shares				
Authorized - Unlimited				
Issued and Outstanding	775,000,003	\$ 775,000	775,000,003	\$ 775,000

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9. ACCUMULATED OTHER COMPREHENSIVE INCOME

	<u>2007</u>	<u>2006</u>
Balance, beginning of year	\$ -	\$ -
Transitional adjustment on adoption of new accounting policies (note 3)	23,140	-
Other comprehensive loss	(2,306)	-
Balance, end of year	<u>\$ 20,834</u>	<u>\$ -</u>

AOCI includes gains and losses on cash flow hedges (net of income taxes, tax benefit of non-capital tax losses and valuation allowance). These amounts will be reclassified to interest and other expenses, net, over periods up to 31 years of which approximately \$1,199 will be reclassified during the next 12 months.

10. NET INCOME PER SHARE, BASIC AND DILUTED

The weighted daily average number of shares outstanding was 775,000,003 in 2007 and 2006 used in determining basic and diluted net income per share. The Company has no dilutive securities currently outstanding.

Net income per share has been determined by dividing the consolidated net income for the year by the weighted daily average number of shares outstanding.

11. INCOME TAXES

The Income tax expense differs from taxes computed at the statutory rates as a result of the following:

	<u>2007</u>	<u>2006</u>
Income tax expense at statutory rates - 36.12% (2006 - 36.12%)	\$ 21,768	\$ 17,514
Reduction (increase) in future Income tax recovery (expense) resulting from:		
(Increase) reduction in statutory rates and other	24,917	5,709
Decrease in valuation allowance	<u>(46,685)</u>	<u>(23,223)</u>
Income tax expense	<u>\$ -</u>	<u>\$ -</u>

As at December 31, 2007, the Company has non-capital tax losses of \$390,092, available to offset future taxable income expiring in the following years:

Year:	<u>2010</u>	<u>2014</u>	<u>2015</u>	<u>2026</u>	<u>2027</u>
Amount:	\$6,827	\$199,813	\$75,662	\$107,418	\$372

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11. INCOME TAXES (continued)

Temporary differences and tax losses give rise to future income tax assets (liabilities) as follows:

	<u>As at December 31, 2007</u>	<u>As at December 31, 2006</u>
Future income tax liabilities:		
Property, plant and equipment and intangible assets	\$ (36,142)	\$ (49,417)
Deferred financing costs and others	-	(12,751)
	<u>(36,142)</u>	<u>(62,168)</u>
Future income tax assets:		
Long-term debt, accrued liabilities and others	3,748	17,917
Restricted and long-term investments	3,716	-
Deferred gains	-	6,688
Tax losses carried over	127,901	183,471
Valuation allowance	(99,223)	(145,908)
	<u>36,142</u>	<u>62,168</u>
Future income tax assets and liabilities	<u>\$ -</u>	<u>\$ -</u>

12. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of Cash and cash equivalents, Restricted cash and investments, Short-term Investments, Accounts receivable, Long-term investments, Accounts payable and accrued liabilities, Long-term debt, capital lease liability, and derivative financial instruments.

a) Fair value of financial instruments

The estimated fair values of the Company's financial instruments are as follows:

Short-term financial assets and liabilities

Short-term financial assets and liabilities are amounts that are expected to be settled within one year. The carrying amounts in the consolidated balance sheets approximate fair value because of the short-term nature of these instruments.

Long-term restricted cash and investments and long-term investments

The fair values were reported in the consolidated financial statements using quotations provided by financial institutions, except for ABCP, which management determined by using valuation techniques.

Long-term debt

The fair value of the Long-term debt as at December 31, 2007 was \$5,137,634 (2006 - \$5,199,429). The fair value was determined using quotations provided by financial institutions.

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12. FINANCIAL INSTRUMENTS (continued)

Obligations under Capital Lease

The carrying amount in the consolidated balance sheets approximates the fair value of the capital lease liability.

Derivative financial instruments

The Company accounts for the Series 04-A2 bond as a derivative financial instrument. The fair value of Series 04-A2 bond was as reported in the consolidated financial statements using a valuation technique.

b) ABCP

As at December 31, 2007, the Company held \$158,967 principal amount of non-bank sponsored ABCP. DBRS Limited ("DBRS") placed \$147,943 principal amount of these ABCP (the "Montreal Proposal ABCP") "Under Review with Developing Implications" following the August 16, 2007 announcement that a group representing banks, asset providers and major investors had agreed in principle to a long-term proposal and interim agreement to convert the Montreal Proposal ABCP into term floating-rate notes ("FRNs") maturing no earlier than the scheduled termination dates of the underlying assets.

The maturity dates of the Montreal Proposal ABCP range from August 13, 2007 to December 3, 2007. At the dates at which the Company acquired the investments, the non-bank sponsored ABCP was rated R-1 (High) by DBRS, the highest credit rating for commercial paper, since the ABCP is issued by conduits that are set up as special purpose entities holding tranches of securities rated AAA.

On September 6, 2007, the Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper (the "Committee") consisting of a panel of major Montreal Proposal ABCP investors was formed. The Committee subsequently retained Goodmans LLP and JP Morgan as legal and financial advisors, respectively, to oversee the proposed restructuring process. On October 16, 2007, the Chairman of the Committee announced the proposed successful restructuring of Skeena Capital Trust, the first of 22 conduits, and an agreed upon extension of the standstill agreement until December 14, 2007, at which time the Committee expected to have proposals to restructure all of the remaining conduits. On December 20, 2007, the Company received \$1,154 upon the closing of the restructuring of \$1,171 principal amount of Skeena Capital Trust. On December 23, 2007, the Chairman of the Committee announced the framework of the proposed restructuring of 20 of the remaining 21 conduits (the "Framework Agreement") and further extended the standstill agreement until January 31, 2008. The Framework Agreement will (i) extend the maturity of the Montreal Proposal ABCP to provide for a maturity similar to that of the underlying assets; (ii) pool certain series of Montreal Proposal ABCP which are supported in whole or in part by underlying synthetic assets; (iii) mitigate the margin call obligations of the existing conduits with margin call risk and create a structure to address margin calls if they occur; and (iv) support the liquidity needs of those Montreal Proposal ABCP holders requiring it.

The Montreal Proposal ABCP last traded in the active market on or about August 13, 2007 and there are currently no market quotations available for the Montreal Proposal ABCP. The Montreal Proposal ABCP continue to be rated R-1 (High, Under Review with Developing Implications) by DBRS, except for one conduit, which was rated R-4 by DBRS on October 17, 2007.

There is currently no certainty regarding the outcome of the proposed restructuring and therefore there is a significant amount of uncertainty in estimating the amount and timing of cash flows associated with the Montreal Proposal ABCP. The Company estimates the fair values of the Montreal Proposal ABCP using a valuation technique which incorporates a probability weighted approach applied to discounted future cash flows considering the best available data regarding market conditions for such investments as at December 31, 2007. In determining the fair values of the Montreal Proposal ABCP, the Company assumes the Montreal Proposal ABCP will be converted to FRNs and in accordance with the key

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12. FINANCIAL INSTRUMENTS (continued)

elements of the Framework Agreement. In addition, the Company assumes the restructured notes will include traditional securitized assets (\$1,020 principal amount) with average maturity of 7 years having interest commensurate with AAA rated notes. The Company assumes the restructured pooled synthetic notes (\$136,809 principal amount) will include collateralized debt obligations ("CDOs") with average maturity of 7 years having interest commensurate with AAA rated notes. These pooled synthetic notes will be bifurcated into senior and subordinated notes, the significant majority of which are expected to be ranked senior. Furthermore, in determining the fair value of the Montreal Proposal ABCP, the Company assumes that returns on the pooled synthetic notes will be reduced by the cost of a margin facility estimated to be 1.00%. The Company assumes that all US non-prime residential mortgage-backed CDOs will be restructured as ineligible notes (\$10,114 principal amount) with average maturity of 7 years bearing interest commensurate with the rating of the underlying assets ranging from BB to AAA. In determining the fair values, the Company also included factors taking into consideration current market conditions surrounding the Montreal Proposal ABCP such as liquidity and transparency. The Company has estimated the restructuring costs applicable to all restructured notes based upon the recent experience of Skeena Capital Trust. Such restructuring cost are expected to further diminish returns on the Montreal Proposal ABCP. Based on these assumptions, the Company recorded a reduction in fair value of \$22,185, which is included in interest and other expenses, net. As at December 31, 2007, the fair value of the Company's Montreal Proposal ABCP was \$125,758, of which \$59,171 was classified as long-term restricted cash and investments and \$66,587 was classified as long-term investments, and the fair value of the other non-bank ABCP (\$11,024 principal amount) was \$11,000 based on a quotation provided by a financial institution.

Since the fair value of the Montreal Proposal ABCP is determined using a probability-weighted approach employing the foregoing assumptions and is based on the Company's assessment of market conditions as at December 31, 2007, the fair value reported may change materially in subsequent periods. In addition, the fair value estimate is dependent upon the likelihood, nature and timing of future restructuring under the terms of the Montreal Proposal and the December 2007 Restructuring Proposal. The fair value of the Montreal Proposal ABCP could range from \$120,000 to \$142,000 based on alternative assumptions that are reasonably possible. The Company believes the outcome of the proposed restructuring will not have a material impact to the Company's financial condition.

c) Concentration of credit risk

The Company's financial assets that are exposed to credit risk consist primarily of Cash and cash equivalents, Short-term investments, Accounts receivable, Restricted cash and investments, Long-term investments and interest rate derivative instruments. Concentrations of credit risk with respect to Accounts receivable are limited due to the large number of customers comprising the Company's client base. The Company is exposed to credit loss in the event of non-performance by counterparties to interest rate derivative instruments that have a positive fair value as well as Cash and cash equivalents, Short-term investments, Restricted cash and investments and Long-term investments but does not anticipate non-performance by these counterparties. The Company manages this risk by dealing with highly reputable organizations having a satisfactory credit rating from an independent rating agency.

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13. RELATED PARTY TRANSACTIONS

The Company entered into the following transactions with related parties:

Related Party	Relationship	Classification in the Company's consolidated financial statements	Nature of transaction with the related party	2007	2006
SNC-Lavalin Engineers & Constructors	Subsidiary of shareholder	Property, plant and equipment	Payment for design costs	\$ 2,113	\$ 2,305
SNC-Lavalin Engineers & Constructors	Subsidiary of shareholder	Operating expenses	Payment for administration costs	\$ 430	\$ 372
CINTRA	Parent of shareholder	Operating expenses	Payment for administration costs	\$ 568	\$ 1,089
Expertech Network Inst.	Subsidiary of shareholder	Property, plant and equipment	Payment for construction costs	\$ 24	\$ 1
Expertech Network Inst.	Subsidiary of shareholder	Operating expenses	Payment for administration costs	\$ 2	\$ 10
SLF Joint Venture	Joint venture between shareholder and parent of shareholder	Property, plant and equipment	Reimbursement of construction costs	\$ -	\$ (526)
CINTRA	Parent of shareholder	Operating expenses	Reimbursement of administration costs	\$ (83)	\$ (571)
Grupo Ferrovial	Parent of shareholder	Operating expenses	Reimbursement of administration costs	\$ -	\$ (7)
MCI	Shareholder	Operating expenses	Reimbursement of administration costs	\$ -	\$ (1)
Macquarie North America Ltd.	Subsidiary of shareholder	Operating expenses	Payment for professional fees	\$ 106	\$ -

The transactions with related parties were measured at the exchange amounts, which is the consideration agreed to by the parties.

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13. RELATED PARTY TRANSACTIONS (continued)

Amounts owed to (by) related parties were as follows:

Related Party	Relationship	Classification in the Company's consolidated financial statements	As at December 31, 2007	As at December 31, 2006
SNC-Lavalin Engineers & Constructors	Subsidiary of Subsidiary of shareholder	Accounts payable and accrued liabilities	\$ 179	\$ 165
CINTRA	Parent of shareholder	Accounts payable and accrued liabilities	\$ 95	\$ 205
CINTRA	Parent of shareholder	Accounts Receivable	\$ (32)	\$ (315)
MICI	Shareholder	Accounts Receivable	\$ (25)	\$ (25)
Grupo Ferrovial	Parent of shareholder	Accounts Receivable	\$ (4)	\$ (5)
Macquarie North America Ltd.	Subsidiary of shareholder	Accounts payable and accrued liabilities	\$ 106	\$ -

14. EMPLOYEE BENEFITS

The Company has a Deferred Profit Sharing Plan, which is a defined contribution plan, to which the Company contributed \$594 during 2007 (2006 - \$527).

15. COMMITMENTS AND CONTINGENCIES

Claims and Contingencies

2006 Settlement Agreement

Following the provincial election on October 2, 2003, a number of disputes had developed between the Province and 407 ETR or the Company. All of the disputes between the Province and 407 ETR or the Company were settled by agreement dated March 31, 2006 (the "2006 Settlement Agreement").

Pursuant to the 2006 Settlement Agreement, 407 ETR commenced to extend benefits of at least \$40 million over four years to approximately 100,000 light vehicle customers by way of a multi-tier frequent user program.

Other Claims and Contingencies

From time to time, in the ordinary course of business, the Company is a defendant or party to a number of pending or threatened legal actions and proceedings. It is not possible to determine the ultimate outcome of such matters; however, based on current knowledge, Management believes that liabilities, if any, arising from pending litigation will not have a material adverse effect on the financial position or results of operations of the Company.

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15. COMMITMENTS AND CONTINGENCIES (continued)

Lease Commitments

The Company has entered into operating and capital leases for the use of Snow Clearing and Computer Equipment, as well as vehicles. The Snow Clearing and Computer Equipment, and certain vehicle leases are classified as capital leases. The leases expire on various dates, at which time the Company has the right, but not the obligation, to purchase the equipment.

Minimum lease payments for capital leases in aggregate and for the next five years are as follows:

	Obligations under capital leases
2008	\$ 1,718
2009	1,526
2010	455
2011	112
2012	82
Thereafter	32
Total minimum lease payments	3,925
Interest included in minimum payments at rates varying between 5.30% and 8.26%	(301)
Present value of net minimum lease payments	3,624
Less: current portion	(1,547)
Long-term portion	\$ 2,077

Future Commitments and Significant Operating Agreements

The Company entered into an agreement with a supplier to provide expert technical support for its maintenance function of the tolling system requiring annual fixed payments of \$654, expiring on December 31, 2012. In addition, the agreement licensed certain technology, provided training and special tools to transition maintenance of certain toll equipment to the Company and required the supplier to develop certain new electronic toll system products requiring milestone payments.

The Company has future commitments comprised of a service agreement and associated operating lease for certain highway maintenance services requiring monthly payments, expiring on April 30, 2013.

The Company entered into an agreement with a supplier to provide enterprise software and services for its integrated automation system requiring monthly payments, expiring on August 31, 2009.

Payments under these agreements for the next five years are as follows:

Year:	2008	2009	2010	2011	2012
Amount:	\$11,751	\$10,881	\$8,166	\$6,462	\$6,571

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16. GUARANTEES

In the normal course of business, the Company, including certain of its subsidiaries, enters into agreements that may involve providing certain guarantees or indemnifications to third parties and others. These include, but are not limited to:

(a) Director/officer indemnification agreements

The Company entered into indemnification agreements with current and former directors and officers to indemnify them, to the extent permitted by law, against any and all charges, costs, expenses, amounts paid in settlement and damages incurred by the directors and officers as a result of any lawsuit, or any judicial, administrative, or investigative proceeding in which the directors and officers are sued as a result of their service. These indemnification claims will be subject to any statutory or other legal limitation period. The nature of the indemnification agreements prevents Management from making a reasonable estimate of the maximum potential amount the Company could be required to pay counterparties. The Company has purchased directors' and officers' liability insurance.

(b) Other indemnification agreements

The Company provides indemnification agreements to counterparties in transactions such as purchase contracts, service agreements, design-build agreements, and licensing agreements. These indemnification agreements require the Company to compensate the counterparties for costs incurred as a result of litigation claims that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnification agreements will vary based on the contract. The nature of the indemnification agreements prevents Management from making a reasonable estimate of the maximum potential amount the Company may be required to pay to counterparties because such limits are not set out in the agreements with these counterparties. Management attempts to limit its liability in respect of indemnifications provided to third parties in its contractual agreements.

17. REVENUE FROM OPERATING LEASES

The Company charges customers a lease fee for transponders to be used on Highway 407. Revenue from operating leases in 2007 totalled \$18,029 (2006 - \$15,803).

18. SUPPLEMENTARY CASH FLOW INFORMATION

	<u>As at December 31, 2007</u>	<u>As at December 31, 2006</u>
Cash and cash equivalents consist of:		
Cash	\$ 9,224	\$ 8,186
Bankers' Acceptances	95,220	47,859
Commercial Paper	-	32,027
Bonds	-	3,692
	<u>\$ 104,444</u>	<u>\$ 91,764</u>

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18. SUPPLEMENTARY CASH FLOW INFORMATION (continued)

	<u>2007</u>	<u>2006</u>
Interest paid	<u>\$ 226,234</u>	<u>\$ 212,991</u>
Income taxes paid	<u>\$ -</u>	<u>\$ 1,735</u>
Property, plant and equipment acquired by capital lease	<u>\$ 661</u>	<u>\$ 4,474</u>
Change in accrued property, plant and equipment included in accounts payable and accrued liabilities	<u>\$ (555)</u>	<u>\$ 10,502</u>

19. COMPARATIVE FIGURES

The 2006 consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2007 consolidated financial statements, primarily as a result of adopting CICA Sections 1530, 3251, 3855, 3861 and 3865.